CA RAVI AGARWAL PRESENTS

CA FINAL (NEW) MAY 2021 ONWARDS

FINANCIAL REPORTING COMPILER 2.0

MAIN HIGHLIGHTS

- Full Coverage of ICAI Study Mat
- Additional ICAI SM Dec 2020 Q's
- Includes New Illustrations
- All Past Papers
- All MTPs
- All RTPs (including Nov 2020)

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CHAPTER-1
FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

Questions from STUDY MATERIAL

Illustrations

1. Entity A sells goods to Mr. X on November, 20X1 and received payments on January 31, 20X2. The entity follows December 31, 20X1 as its annual closing of financial statements. State how this business transaction should be accounted.

Answer:

The goods have been sold off in the month of November, 20X1 and the payment has been received in the year 20X2 whereas the Entity A follows calendar year annual closing. Now, assuming that all recognition criteria (risk and rewards) has been met while selling off the goods in the month of November, 20X1, Entity A will recognize the sale in the Income statement with corresponding effect in accounts receivables for the year ending December 31, 20X1. This is called accrual accounting where the transaction is being recorded in the same year when it meets other recognition criteria and not when actual cash has been received/ paid.

Now, it is clear to understand that had this sale not been shown in the financial statement ending December 31, 20X1, the sale would have been understated by the same amount. Hence it has been recorded in the same period when the transaction has taken place and met recognition criteria as per applicable accounting standards.

2. Entity A is having inventory amounting Rs.100,000 in total with the details as below:

Spare parts	**Rs.30,000**
Finished goods	**Rs.25,000**
Work in progress	**Rs.40,000**
Tools	**Rs.5,000**
TOTAL	**Rs.1,00,000**

Materiality limit has been assessed Rs.30,000 based on the management estimation pertaining to annual profit basis. What should be the presentation requirement under the "Materiality" criteria?

Answer:

Entity A has estimated its materiality limit of Rs.30,000 which suggests that everything which is more than this amount will be required to present separately, subject to its nature (nature means the components of inventory in this example). Hence, Entity needs to show Inventory as below by way of notes to account – 5

Work in progress	Rs.40,000
Spare parts	Rs.30,000
Finished goods & tools	Rs.30,000
TOTAL	Rs.1,00,000

Since, Work in progress and Spare parts are more than materiality limits, hence, they have been shown separately based on its defined separate nature whereas finished goods & tools have amount lower than materiality limits and same has been clubbed together.

3. A legal case has been filed against A Ltd. However, expected outcome at the year-end cannot be evaluated. What would be relevant information and what would be reliable in it?

Answer:

It may be inappropriate for the entity to recognize the full amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

4. An asset has been sold from A Ltd. to Mr. X and immediately after this transaction, Mr. X has leased out the same to A Ltd. What would be the correct form to record the transaction using concept of "substance over form"?

Answer:

The asset has been actually transferred to pass on legal title of the asset to Mr. X and convert that into a lease asset. Hence, in substance, the economic benefit is still being enjoyed by A Ltd. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction).

Questions

1. There should be a balance between the qualitative information provided in the financial statements and its objective. Comment

Answer:

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

PAST EXAMINATION, MTPs, RTPs QUESTIONS

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

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

Find out:
(i) Financial capital maintenance at Historical Cost
(ii) Financial capital maintenance at Current Purchasing Power
(iii) Physical Capital Maintenance
[MAY 2019 - 5 MARKS]
Answer:

Financial Capital Maintenance at historical costs

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

Financial Capital Maintenance at current purchasing power

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

Physical Capital Maintenance

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

2. Explain Financial capital maintenance and Physical capital maintenance as per the Framework and differentiate it.
[MTP - MARCH 2018 - 4 MARKS]
Answer:
A. Financial Capital maintenance
Under this concept, a profit is earned only if the financial amount of the net assets at the end of the period exceeds the financial amount of net assets at the beginning of the period, after excluding any distribution to, and contribution from, owners during the period.
B. Physical Capital maintenance
Under this concept, a profit is earned only if the physical productive or operating capability of the entity at the the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

Major differences between Physical Capital & Financial Capital

:- The physical capital maintenance concept requires the adoption of the current cost basis as measurement whereas financial capital maintenance concept does not require the use of a particular basis of measurement.

:- Financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit.

Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

CHAPTER-2 IND AS ON PRESENTATION OF ITEMS IN THE FINANCIAL STATEMENTS

UNIT 1: INDAS 1: PRESENTATION OF FINANCIAL STATEMENTS

Questions from STUDY MATERIAL

Illustrations

1. An entity prepares its financial statements that contain an explicit and unreserved statement of compliance with Ind AS. However, the auditor's report on those financial statements contains a qualification because of disagreement on application of one Accounting Standard. In such case, is it acceptable for the entity to make an explicit and unreserved statement of compliance with Ind AS?

Answer:

Yes, it is possible for an entity to make an unreserved and explicit statement of compliance with Ind AS, even though the auditor's report contains a qualification because of disagreement on application of Accounting Standard(s), as the preparation of financial statements is the responsibility of the entity's management and not the auditors. In case the management has a bona fide reason to believe that it has complied with all Ind AS, it can make an explicit and unreserved statement of compliance with Ind AS.

2. Entity XYZ is a large manufacturer of plastic products for the local market. On 1st April, 20X6 the newly elected government unexpectedly abolished all import tariffs, including the 40 per cent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency Rs. appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products. Before 20X6 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ went into losses. As at 31st March, 20X7, entity XYZ's equity was Rs.1,000. During the second quarter of financial year ended 31 March 20X7, the management restructured entity's operations. That restructuring helped reduce losses for the third and fourth quarters to Rs.400 and Rs.380, respectively. During the year ended 31st March, 20X7, entity XYZ reported a loss of Rs.4,000. In January 20X7, the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15th March, 20X7, the government announced that it would reintroduce limited plastic import tariffs at 10 percent in 20X8. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term. Management of the entity XYZ undertook a going concern assessment at 31st March, 20X7. Management projects / forecasts that imposition of a 10 per cent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31st March, 20X7 annual financial statements?

Answer:

Going concern is a general feature to be considered while preparing the financial statements. As per Ind AS 1, when preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. An entity is required to disclose the facts, if the financial statements are not prepared on a going concern basis. Along with the reason, as to why the financial statements are not prepared on a going concern basis. While assessing the going concern assumption, an entity is required to take into consideration all factors covering atleast but not limited to 12 months from the end of reporting period. On the basis of Ind AS 1 and the facts and circumstances of this case, the following disclosure is appropriate:

Extracts from the notes to entity XYZ's 31st March, 20X7 financial statements

Note 1: Basis of preparation

On the basis of management's assessment at 31 March 20X7, the financial statements have been prepared on the going concern basis. However, management's assessment assumes that the government will reintroduce limited plastic import tariffs and that the currency exchange rate will remain constant. On 15 March 20X7, the government announced that limited import tariffs will be imposed in 20X8. However, the government emphasised that the tariff would not be as protective as the 40 percent tariff in effect before 20X7. Provided that Rs. does not strengthen, management projects / forecasts that a 10 percent tariff on all plastic products would result in entity XYZ returning to profitability. As at 31st March, 20X7 entity XYZ had net assets of Rs.1,000. If import tariffs are not imposed and currency exchange rates remain unchanged, entity XYZ's liabilities could exceed its assets by the end of financial year 20X7-20X8. On the basis of their assessment of these factors, management believes that entity XYZ is a going concern.

3. Is offsetting of revenue against expenses, permissible in case of a company acting as an agent and having sub-agents, where commission is paid to sub-agents from the commission received as an agent?

Answer:

On the basis of the guidance regarding offsetting, net presentation in the given case would not be appropriate, as it would not reflect substance of the transaction and would detract from the ability of users to understand the transaction. Accordingly, the commission received by the company as an agent is the gross revenue of the company. The amount of commission paid by it to the sub-agent should be considered as an expense and should not be offset against commission earned by it.

4. A retail chain acquired a competitor in March, 20X1 and accounted for the business combination under Ind AS 103 on a provisional basis in its 31st March, 20X1 annual financial statements. The business combination accounting was finalized in 20X1-20X2 and the provisional fair values were updated. As a result, the 20X0-20X1 comparatives were adjusted in the 20X1-20X2 annual financial statements. Does the restatement require an opening statement of financial position (that is, an additional statement of financial position) as of 1st April, 20X0?

Answer:

An additional statement of financial position is not required, because the acquisition had no impact on the entity's financial position at 1st April, 20X0.

5. X Ltd. provides you the following information:
Raw material stock holding period : 3 months
Work-in-progress holding period : 1 month
Finished goods holding period : 5 months
Debtors collection period : 5 months
You are requested to compute the operating cycle of X Ltd.

Answer:
The operating cycle of X Ltd. will be computed as under:
Raw material stock holding period + Work-in-progress holding period + finished goods holding period + Debtors collection period = 3 + 1 + 5 + 5 = 14 months.

6. Inventory or trade receivables of X Ltd. are normally realized in 15 months. How should X Ltd. classify such inventory / trade receivables: current or non-current if these are expected to be realized within 15 months?
Answer:
These should be classified as current.

7. B Ltd. produces aircrafts. The length of time between first purchasing raw materials to make the aircrafts and the date the company completes the production and delivery is 9 months. The company receives payment for the aircrafts 7 months after the delivery.
(a) What is the length of operating cycle?
(b) How should it treat its inventory and debtors?
Answer:
(a) The length of the operating cycle will be 16 months.
(b) Assuming the inventory and debtors will be realised within normal operating cycle, i.e., 16 months, both the inventory as well as debtors should be classified as current.

8. On 1st April, 20X3, Charming Ltd issued 100,000 Rs.10 bonds for Rs.1,000,000. On 1st April, each year interest at the fixed rate of 8 percent 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 Rs.10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements?
Answer:
Charming Ltd must present Rs.80,000 accrued interest and Rs.1,00,000 current portion of the noncurrent bond (i.e. the portion repayable on 1st April, 20X4) as current liabilities. The Rs.9,00,000 due later than 12 months after the end of the reporting period is presented as a non –current liability.

9. X Ltd provides you the following information:
Raw material stock holding period : 3 months
Work-in-progress holding period : 1 month
Finished goods holding period : 5 months
Debtors collection period : 5 months
The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?
Answer:
In this case, the operating cycle of X Ltd. is 14 months. Since the trade payables are expected to be settled within the operating cycle i.e. 12.5 months, they should be classified as a current.

10. Entity A has two different businesses, real estate and manufacturing of passenger vehicles. With respect to the real estate business, the entity constructs residential apartments for customers and the normal operating cycle is three to four years. With respect to the business of manufacture of passenger vehicles, normal operating cycle is 15 months. Under such circumstance where an entity has different operating cycles for different types of businesses, how classification into current and non-current be made?
Answer:

As per paragraph 66(a) of Ind AS 1, an asset should be classified as current if an entity expects to realize the same, or intends to sell or consume it in its normal operating cycle. Similarly, as per paragraph 69(a) of Ind AS 1, a liability should be classified as current if an entity expects to settle the liability in its normal operating cycle. In this situation, where businesses have different operating cycles, classification of asset/liability as current/non- current would be in relation to the normal operating cycle that is relevant to that particular asset / liability. It is advisable to disclose the normal operating cycles relevant to different types of businesses for better understanding.

11. An entity has placed certain deposits with various parties. How the following deposits should be classified, i.e., current or non-current?
(a) Electricity Deposit
(b) Tender Deposit/Earnest Money Deposit [EMD]
(c) GST Deposit paid under dispute or GST payment under dispute.
Answer:
(a) Electricity Deposit - At all points of time, the deposit is recoverable on demand, when the connection is not required. However, practically, such electric connection is required as long as the entity exists. Hence, from a commercial reality perspective, an entity does not expect to realize the asset within twelve months from the end of the reporting period. Hence, electricity deposit should be classified as a non-current asset.

(b) Tender Deposit/Earnest Money Deposit [EMD] -Generally, tender deposit / EMD are paid for participation in various bids. They normally become recoverable if the entity does not win the bid. Bid dates are known at the time of tendering the deposit. But until the date of the actual bid, one is not in a position to know if the entity is winning the bid or otherwise. Accordingly, depending on the terms of the deposit if entity expects to realize the deposit within a period of twelve months, it should be classified as current otherwise non-current.

(c) GST Deposit paid under dispute or GST payment under dispute -Classification of GST deposits paid to the Government authorities in the event of any legal dispute, which is under protest would depend on the facts of the case and the expectation of the entity to realize the same within a period of twelve months. In the case the entity expects these to be realised within 12 months, it should classify such amounts paid as current else these should be classified as non-current.

12. Paragraph 69(a) of Ind AS 1 states "An entity shall classify a liability as current when it expects to settle the liability in its normal operating cycle". An entity develops tools for customers and this normally takes a period of around 2 years for completion. The material is supplied by the customer and hence the entity only renders a service. For this, the entity receives payment upfront and credits the amount so received to "Income Received in Advance". How should this "Income Received in Advance" be classified, i.e., current or non - current?

Answer:

Ind AS 1 provides —"Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period." In accordance with the above, income received in advance would be classified as current liability since it is a part of the working capital, which the entity expects to earn within its normal operating cycle.

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

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

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

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

(d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation? [RTP - NOV 2019]

Answer:

(a) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liability for at least twelve months after the reporting period, the loan should be classified as non -current.

(b) Yes, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period, since assessment is required to be made based on terms of the existing loan facility. As at the end of the reporting period, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence the loan is to be classified as current.

(c) Yes, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this case, loan has to be repaid within a period of 9 months from the end of the reporting period, therefore, it will be classified as current liability.

(d) Yes, the answer will be different and the loan should be classified as current. This is because, as per paragraph 73 of Ind AS 1, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

14. In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments 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 on demand. 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.

(a) As on March 31, 20X2, how should the entity classify the loan?
(b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 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 will the loan classification as on March 31, 20X2 be different from (a) above?
[MTP - MARCH 2018 - 6 MARKS]
Answer:
(a) Paragraph 75 of Ind AS 1, inter alia, provides, ―An entity classifies the liability as non –current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.‖ In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 20X2, the loan will be classified as current.

(b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on June 30, 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.

15. OMN Ltd has a subsidiary MN Ltd. OMN Ltd provides a loan to MN Ltd at 8% interest to be paid annually. The loan is required to be paid whenever demanded back by OMN Ltd. How should the loan be classified in the financial statements of OMN Ltd? Will it be any different for MN Ltd?
Answer:
The demand feature might be primarily a form of protection or a tax-driven feature of the loan. Both parties might expect and intend that the loan will remain outstanding for the foreseeable future. If so, the instrument is, in substance, long-term in nature, and accordingly, OMN Ltd would classify the loan as a non-current asset.

However, OMN Ltd would classify the loan as a current asset if both the parties intend that it will be repaid within 12 months of the reporting period. MN Ltd would classify the loan as current because it does not have the right to defer repayment for more than 12 months, regardless of the intentions of both the parties.
The classification of the instrument could affect initial recognition and subsequent measurement. This might require the entity's management to exercise judgement, which could require disclosure under judgements and estimates.

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

(₹ in crores)

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

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

Answer:

A Limited

Consolidated Balance Sheet as at 31st March 20X1

(₹ in crores)

Particulars	Note	31st March, 20X1	31st March, 20X0
ASSETS			
Non-current assets			
(a) Property, plant and equipment	1	3,590	3,460
(b) Investment property		3,100	3,100
Total non-current assets		**6,690**	**6,560**
Current assets			
(a) Inventory	2	1,680	1,780
(b) Financial assets			
(i) Trade and other receivables	3	2,100	1,735
(ii) Cash and cash equivalents	4	320	200
Total current assets		**4,100**	**3,715**
Total assets		**10,790**	**10,275**
EQUITY & LIABILITIES			
Equity attributable to owners of the parent			
Share capital		1,130	1,050
Other Equity	5	2,825	2,350
Non-controlling interests		**830**	**540**
Total equity		**4,785**	**3,940**
LIABILITIES			
Non-current liabilities			
(a) Financial Liabilities			
Borrowings - Long-term debt	6	2,800	3,385
(b) Provisions			
Long-term provisions (environmental restoration)		765	640
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) Other short-term provisions		35	25
Total current liabilities		**2,440**	**2,310**
Total liabilities		**6,005**	**6,335**
Total equity and liabilities		**10,790**	**10,275**

Working Notes:

Notes	Particulars	Basis	Calculation ₹ crores	Amount ₹ crores
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 comparative year.

Questions

1. An entity manufactures passenger vehicles. The time between purchasing of underlying raw materials to manufacture the passenger vehicles and the date the entity completes the production and delivers to its customers is 11 months. Customers settle the dues after a period of 8 months from the date of sale.

(a) Will the inventory and the trade receivables be current in nature?

(b) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different?

Answer:

Inventory and debtors need to be classified in accordance with the requirement of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same, or intends to sell or consume it in its normal operating cycle.

(a) In this case, time lag between the purchase of inventory and its realisation into cash is 19 months [11 months + 8 months]. Both inventory and the debtors would be classified as current if the entity expects to realise these assets in its normal operating cycle.

(b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and its realise ion 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.

2. In December 2XX1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 2XX5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 2XX2, failing which the loan becomes payable on demand. As on March 24, 2XX2, the entity has not been able to get the promoter‘s contribution. On

March 25, 2XX2, the entity approached the bank and obtained a grace period upto June 30, 2XX2 to get the promoter‘s contribution.
The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31.
(a) As on March 31, 2XX2, how should the entity classify the loan?
(b) Assume that in anticipation that it may not be able to get the promoter‘s contribution by due date, in February 2XX2, the entity approached the bank and got the compliance date extended upto June 30, 2XX2 for getting promoter‘s contribution. In this case will the loan classification as on March 31, 2XX2 be different from (a) above?

Answer:
(a) Ind AS 1, inter alia, provides, ―An entity classifies the l iability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.‖ In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 2XX2, the loan will be classified as current.

(b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on June 30, 2XX2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 2XX2, the loan will retain its classification as non-current.

3. Company A has taken a long term loan from Company B. In the month of December 20X1, there has been a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on March 31, 20X2. In the month of May 20X2, the Company started negotiation with the Company B for not to demand payment as a consequence of the breach. The financial statements were approved for

the issue in the month of June 20X2. In the month of July 20X2, both the companies agreed that the payment will not be demanded immediately as a consequence of breach of material provision.

Advise on the classification of the liability as current / non-current. [Also asked in RTP MAY 2018]
Answer:
As per para 74 of Ind AS 1 —Presentation of Financial Statements‖, where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after

the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.
An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.
In the given case, Company B (the lender) agreed for not to demand payment but only after the reporting date and the financial statements were approved for issuance. The financial statements were approved for issuance in the month of June 20X2 and both companies

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

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

[MTP - MARCH 2018 - 4 MARKS]

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

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

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

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

Answer:

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

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

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

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

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

6. A Company presents financial results for three years (i.e one for current year and two comparative years) internally for the purpose of management information every year in addition to the general purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purpose. During current year, management thought why not they should present third year statement of profit and loss also in the general purpose financial statements. I t will save time and will be available easily whenever management needs this in future. With reference to above background, answer the following:
(i) Can management present the third statement of profit and loss as additional comparative in the general purpose financial statements?
(ii) If management present third statement of profit and loss in the general purpose financial statement as comparative, is it necessary that this statement should be compliant of Ind AS?
(iii) Can management present third statement of profit and loss only as additional comparative in the general purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?
Answer:
(i) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

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

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

7. A Company while preparing the financial statements for Financial Year (FY) 20X1 -20X2, erroneously booked excess revenue of Rs.10 Crore. The total revenue reported in FY 20X1-20X2 was Rs.80 Crore. However, while preparing the financial statements for 20X2-20X3, it discovered that excess revenue was booked in FY 20X1-20X2 which it now wants to correct in the financial statements. However, management of the Company is not sure whether it need to present the third balance sheet as additional comparative . With regard to the above background, answer the following:
(i) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?
(ii) The Company wants to correct the error during FY 20X2-20X3 by giving impact in the figures of current year only. Is the contention of management correct?
Answer:
(i) No, as per Para 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:
(a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
(b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.
(ii) No, management need to correct the previous year figures to correct the error but need not to furnish third balance sheet at the beginning of preceding period. (Refer Para 40A of Ind AS 1)

8. XYZ Limited (the _Company‘) is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e, March 31, 20X2.
In addition to above there are following items/transactions which took place during financial year 20X1-20X2.

S. No.	Items/transactions
(1)	The Company has some trade receivables which are due after 15 months from the date of balance sheet. So the Company expects that the payment will be received within the period of operating cycle.
(2)	The Company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the Company does not expect that it will be able to pay these payable within the operating cycle because the nature of business is such that generally projects gets delayed and payments from customers also gets delayed.
(3)	The Company was awarded a contract of ₹ 100 Crore on March 31, 20X2. As per the terms of the contract, the Company made a security deposit of 5% of the contract value with the customer, of ₹ 5 crore on March 31, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract.
(4)	The Company has also given certain contracts to third parties and have received security deposits from them of ₹ 2 Crore on March 31, 20X2 which are repayable on completion of the contract but if contract is cancelled before the contract term of 18 months, then it becomes payable immediately. However, the Company does not expect the cancellation of the contract.

Considering the above items/transactions answer the following:
(i) The Company wants to present the trade receivable as current despite the fact that these are receivables in 15 months‘ time. Does the decision of presenting the same as current is correct?

(ii) The Company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the Company. Does the decision of presenting the same as non-current is correct?
(iii) Can the security deposit of Rs.5 Crore made by the Company with the customers be presented as current?
(iv) Can the security deposit of Rs.2 Crore taken by the Company from contractors be presented as non-current?
Answer:
(i) Yes, but additionally the Company also need to disclose amounts that are receivable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)

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

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

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

PAST EXAMINATION, MTPs, RTPs QUESTIONS

1. Mike Ltd. has undertaken following various transactions in the financial year ended 31.03.2018

(a)	Re-measurement of defined benefit plans	1,54,200
(b)	Current service cost	1,05,000
(c)	Changes in revaluation surplus	75,000
(d)	Gains and losses arising from translating the monetary assets in foreign currency	45,000
(e)	Gains and losses arising from translating the financial statements of a foreign operation	39,000
(f)	Gains and losses arising from investments in equity instruments designated at fair value through other comprehensive income	60,000
(g)	Income tax expenses	21,000
(h)	Share based payments cost	2,01,000

Identify and present the transactions in the financial statements as per Ind AS 1.
[MAY 2019 - 4 MARKS]
Answer:
Items impacting the Statement of Profit and Loss for the year ended 31st March, 2018 (Rs.)

Current service cost	1,05,000
Gains and losses arising from translating the monetary assets in foreign currency	45,000
Income tax expenses	21,000
Share based payments cost	2,01,000

Items impacting the other comprehensive income for the year ended 31st March, 2018 (Rs.)

Remeasurement of defined benefit plans	1,54,200
Changes in revaluation surplus	75,000
Gains and losses arising from translating the financial statements of a foreign operation	39,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	60,000

2. Following are the Financial Statements of Abraham Ltd.:

Balance Sheet

Particulars	***Note No.***	***As at 31st March, 2019 (₹ in lakh)***
EQUITY AND LIABILITIES:		
Shareholders' funds		
Share capital (shares of ₹ 10 each)		*1,000*
Reserves and surplus	*1*	*2,400*
Non-current liabilities		
Long term borrowings	*2*	*5,700*
Deferred tax liabilities	*3*	*400*
Current liabilities		
Trade payables		*300*
Short-term provisions		*300*
Other current liabilities	*4*	*200*
Total		***10,300***
ASSETS		
Non-current assets		
Fixed assets		*5,000*
Deferred tax assets	*3*	*700*
Current assets		
Inventories		*1,500*
Trade receivables	*5*	*1,100*
Cash and bank balances		*2,000*
Total		***10,300***

Statement of Profit & Loss

Particular	Note No.	Year ended 31st March, 2019 (₹ in lakh)
Revenue from operations		6,000
Expenses:		
Employee benefit expense		1,200
Operating costs		3,199
Depreciation		450
Total expenses		4,849
Profit before tax		1,151
Tax expense		201
Profit after tax		950

Notes to Accounts:

Note 1: Reserves and surplus (₹ in lakh)

Capital reserve		500
Surplus from P & L		
Opening balance	550	
Additions	950	1,500
Reserve for foreseeable loss		400
Total		2,400

Note 2: Long-term borrowings

Term loan from bank	5,700
Total	5,700

Note 3: Deferred tax

Deferred tax asset	700
Deferred tax liability	400
Total	300

Note 4: Other current liabilities

Unclaimed dividends	10
Billing in advance	150
Other current liabilities	40
Total	200

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:
(i) Share capital comprises of 100 lakh shares of Rs. 10 each.
(ii) Term Loan from bank for Rs. 5,700 lakh also includes interest accrued and due of Rs. 700 lakh as on the reporting date.
(iii) Reserve for foreseeable loss is created against a service contract due within 6 months.
(iv) Inventory should be valued at cost Rs. 1,500 lakh, NRV as on date is Rs. 1,200 lakh.
(v) A dividend of 10 % was declared by the Board of directors of the company.
(vi) Accrued Interest income of Rs. 300 lakh is not booked in the books of the company.

(vii) Deferred taxes related to taxes on income are levied by the same governing tax laws.
Identify and report the errors and misstatements in the above extracts and prepare corrected Balance Sheet and Statement of Profit & Loss and where required the relevant notes to the accounts with explanations thereof.
[NOV 2019 - 12 MARKS/MTP OCT 2020]

Answer:
Following adjustments / rectifications are required to be done
1. Reserve for foreseeable loss for Rs. 400 lakh, due within 6 months, should be a part of provisions. Hence it needs to be regrouped. If it was also part of previous year's comparatives, a note should be added in the notes to account on the regrouping done this year.
2. Interest accrued and due of Rs. 700 lakh on term loan will be a part of current liabilities. Thus, it should be shown under the heading "Other Current Liabilities".
3. As per Ind AS 2, inventories are measured at the lower of cost and net realizable value. The amount of any write down of inventories to net realizable value is recognized as an expense in the period the write-down occurs. Hence, the inventories should be valued at Rs. 1,200 lakh and write down of Rs. 300 lakh (Rs. 1,500 lakh – Rs. 1,200 lakh) will be added to the operating cost of the entity.
4. In the absence of the declaration date of dividend in the question, it is presumed that the dividend is declared after the reporting date. Hence, no adjustment for the same is made in the financial year 2018-2019. However, a note will be given separately in this regard (not forming part of item of financial statements).
5. Accrued income will be shown in the Statement of Profit and Loss as 'Other Income' and as 'Other Current Asset' in the Balance Sheet.
6. Since the deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws, these shall be set off, in accordance with Ind AS 12. The net DTA of Rs. 300 lakh will be shown in the balance sheet.
7. As per Division II of Schedule III to the Companies Act, 2013, the Statement of Profit and Loss should present the Earnings per Equity Share.
8. In Ind AS, Assets are not presented in the Balance sheet as 'Fixed Asset', rather they are classified under various categories of Non-current assets. Here, it is assumed as 'Property, Plant and Equipment'.
9. The presentation of the notes to 'Trade Receivables' will be modified as per the requirements of Division II of Schedule III.

Balance Sheet of Abraham Ltd.
For the year ended 31st March, 2019

	Note No.	(₹ in lakh)
ASSETS		
Non-current assets		
Property, plant and equipment		5,000
Deferred tax assets	1	300
Current assets		
Inventories		1,200
Financial assets		
Trade receivables	2	1,100
Cash and cash equivalents		2,000
Others financial asset (accrued interest)		300
TOTAL		9,900
EQUITY AND LIABILITIES		
Equity		
Equity share capital	3	1,000
Other equity	4	2,000
Non-current liabilities		
Financial liabilities		
Long-term borrowings	5	5,000
Current liabilities		
Financial liabilities		
Trade payables		300
Others	6	710
Short-term provisions (300 + 400)	7	700
Other current liabilities	8	190
TOTAL		9,900

Statement of Profit and Loss of Abraham Ltd.
For the year ended 31st March, 2019

	Note No.	(₹ in lakh)
Revenue from operations		6,000
Other income		300
Total income		6,300
Expenses		
Operating costs	9	3,199
Change in inventories cost		300
Employee benefits expense		1,200
Depreciation		450
Total expenses		5,149
Profit before tax		1,151
Tax expense		(201)
Profit for the period		950
Earnings per equity share		
Basic		9.5
Diluted		9.5
Number of equity shares (face value of ₹ 10 each)		100 lakh

Statement of Changes in Equity of Abraham Ltd.

For the year ended 31st March, 2019

3. Equity Share Capital *(₹ in lakh)*

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
1,000	0	1,000

4. Other Equity *(₹ in lakh)*

Particulars	Reserves & Surplus		Total
	Capital reserve	Retained Earnings	
Balance at the beginning of the year	500*	550	1,050
Total comprehensive income for the year		950	950
Balance at the end of the year	500	1,500	2,000

***Note:** Capital reserve given in the Note 1 of the question is assumed to be brought forward from the previous year. However, alternatively, if it may be assumed as created during the year.

1. Deferred Tax *(₹ in lakh)*

Deferred Tax Asset	700
Deferred Tax Liability	400
	300

2. Trade Receivables *(₹ in lakh)*

Trade receivables considered good		1,065
Trade receivables which have significant increase in credit risk	40	
Less: Provision for doubtful debts	(5)	35
Total		1,100

5. Long Term Borrowings *(₹ in lakh)*

Term Loan from Bank (5,700 - 700)	5,000
Total	5,000

6. Other Financial Liabilities *(₹ in lakh)*

Unclaimed dividends	10
Interest on term loan	700
Total	710

7. Short-term provisions *(₹ in lakh)*

Provisions	300
Foreseeable loss against a service contract	400
Total	700

8. Other Current Liabilities *(₹ in lakh)*

Billing in Advance	150
Other	40
Total	190

9. Dividends not recognised at the end of the reporting period

At year end, the directors have recommended the payment of dividend of 10% ie ₹ 1 per equity share. This proposed dividend is subject to the approval of shareholders in the ensuing annual general meeting.

3. 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 - AUGUST 2018 - 16 MARKS]
[RTP - MAY 2018 (SAME QUESTION WITH AMOUNTS DOUBLED)]
Answer:
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 AS 22. 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. Para 14 to AS 29 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 para 27 of AS 29, 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 AS 20.

Revised extracts of the financial statements

Balance Sheet **(INR in Million)**

	Note No.	***As at 31st March, 2018***
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
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

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

8. 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 2019 to 31 May 2019 totalled ` 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 period from 1 June 2019 to 31 March 2020 totalled ` 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.

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.

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UNIT 2: INDIAN ACCOUNTING STANDARD 34: INTERIM FINANCIAL REPORTING

Questions from STUDY MATERIAL

Illustrations

1. Company A has reported ` 60,000 as pre tax profit in first quarter and expects a loss of ` 15,000 each in the subsequent quarter` It has a corporate tax slab of 20 percent on the first ` 20,000 of annual earnings and 40 per cent on all additional earnings. Calculate the amount of tax to be shown in each quarter.

Answer:

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

Expected total Income = ₹ 15,000 [60,000 - (15,000 x 3)]

Expected tax as per slabs = 15,000 x 20% = ₹ 3,000

Average Annual Income tax rate = 3,000 / 15,000 = 20%

	Q1	Q2	Q3	Q4
Profit / (Loss) before tax	60,000	(15,000)	(15,000)	(15,000)
Tax charge / (credit)	12,000	(3,000)	(3,000)	(3,000)

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

Answer:

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

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

` 3,000* x 40 / 100 = ` 1,200 lakhs.

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

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

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

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

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

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

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

Particulars	Amounts (in crore)
Sales	70
Employees benefits expenses	25
Administrative and other expenses	12
Finance cost	4

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

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

Answer:

Result of the first quarter ending 30 June

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

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

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

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

Presuming that there are no quarterly / seasonal variation, calculate the allocation of fixed production overheads for all the four quarters as per Ind AS 34 read with Ind AS 2.

Answer:

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

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

Quarters	Allocations
First Quarter	➢ Actual fixed production overheads = ₹ 2,500 ➢ Fixed production overheads based on the allocation rate of ₹ 5 per unit allocated to actual production = ₹ 5 x 400 = ₹ 2,000 ➢ Unallocated fixed production overheads to be charged as expense as per Ind AS 2 and consequently as per Ind AS 34 = ₹ 500
Second Quarter	➢ Actual fixed production overheads on year-to-date basis = ₹ 5,000 ➢ Fixed production overheads to be absorbed on year-to-date basis = 1,000 x ₹ 5 = ₹ 5,000 ➢ Earlier, ₹ 500 was not allocated to production in the 1st quarter. To give effect to the entire ₹ 5,000 to be allocated in the second quarter, as per Ind AS 34, ₹ 500 are reversed by way of a credit to the statement of profit and loss of the 2nd quarter.
Third Quarter	➢ Actual production overheads on year-to-date basis = ₹ 7,500 ➢ Fixed production overheads to be allocated on year-to-date basis = 1,500 x 5 = ₹ 7,500 ➢ There is no under or over recovery of allocated overheads. Hence, no further action is reuired.
Fourth Quarter	➢ Actual fixed production overheads on year-to-date basis = ₹ 10,000

	➢ Fixed production overheads to be allocated on year-to-date basis 1,900 x 5 = ₹ 9,500 ➢ ₹ 500, i.e., [₹ 2,500 – (₹ 5 x 400)] unallocated fixed production overheads in the 4th quarter, are to 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. ➢ Unallocated productions overheads for the year ₹ 500 (i.e ₹ 10,000 – ₹ 9,500) are expensed in the Statement of profit and loss as per Ind AS 2.

The cumulative result of all the quarters would also result in unallocated overheads of ` 500, thus, meeting the requirements of Ind AS 34 that the quarterly results should not affect the measurement of the annual results.

5. ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of ` 20,00,000 for the third quarter of 20X1.
Following adjustments are made while computing the net profit:
(i) Bad debts of ` 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.
(ii) Additional depreciation of ` 4,50,000 resulting from the change in the method of depreciation.
(iii) Exceptional loss of ` 28,000 incurred during the third quarter. 50% of exceptional loss have been deferred to next quarter.
(iv) ` 5,00,000 expenditure on account of administrative expenses pertaining to the third quarter is deferred on the argument that the fourth quarter will have more sales; therefore fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.
Ascertain the correct net profit to be shown in the Interim Financial Report of third quarter to be presented to the Board of Directors

Answers:

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 inter imreporting period should be recognized in the same period. Accordingly, ` 50,000 should be deducted from ` 20,00,000.

(ii) Recognizing additional depreciation of ` 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 ` 28,000 incurred during the third quarter should be recognized in the same quarter. Hence ` 14,000 which was deferred should be deducted from the profits of third quarter only.

(iv) As per Ind AS 34 the income and expense should be recognized when they are earned and incurred respectively. As per para 39 of Ind AS 34, the costs should be anticipated or deferred only when:

(i) it is appropriate to anticipate or defer that type of cost at the end of the financial year,

and
(ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the treatment done relating to deferment of ` 5,00,000 is not correct as expenditures are uniform throughout all quarters. Thus considering the above, the correct net profits to be shown in Interim Financial Report of the third quarter shall be ` 14,36,000 (` 20,00,000 -` 50,000 - ` 14,000 - ` 5,00,000).

Questions

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

Answer:

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

Expected Total Income = 15,000 x 4 = ₹ 60,000				
Expected Tax as per slabs = 20,000 x 20% + 40,000 x 40% = ₹ 20,000				
Average Annual Income tax rate = 20,000/60,000 x 100 = 33.33%				
				Amt (₹)
	Q1	Q2	Q3	Q4
Profit before tax	15,000	15,000	15,000	15,000
Tax expense	5,000	5,000	5,000	5,000

2. Narayan Ltd. provides you the following information and asks you to calculate the tax expense for each quarter, 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 Rs. 8,00,000)

Estimated Income of Quarter I is Rs. 7,00,000, Quarter II is Rs. 8,00,000, Quarter III (including Estimated Capital Gains of Rs. 8,00,000) is Rs. 12,00,000 and Quarter IV is Rs. 6,00,000.

Tax Rates:

On Capital Gains		**12%**
On Other Income:	**First Rs. 5,00,000**	**30%**
Balance Income		**40%**

Answer:

As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. If different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries) to the extent practicable, a separate rate is applied to each individual category of interim period pre-tax income.

	₹
Estimated annual income exclusive of estimated capital gain (33,00,000 – 8,00,000) (A)	25,00,000
Tax expense on other income:	
30% on ₹ 5,00,000	1,50,000
40% on remaining ₹ 20,00,000	8,00,000
(B)	9,50,000
Weighted average annual income tax rate = $\frac{B}{A} = \frac{9,50,000}{25,00,000} = 38\%$	

Tax expense to be recognized in each of the quarterly reports

		₹
Quarter I - ₹ 7,00,000 x 38%		2,66,000
Quarter II - ₹ 8,00,000 x 38%		3,04,000
Quarter III - ₹ (12,00,000 - 8,00,000) x 38%	1,52,000	
₹ 8,00,000 x 12%	96,000	2,48,000
Quarter IV - ₹ 6,00,000 x 38%		2,28,000
		10,46,000

3. An entity reports quarterly, earns Rs. 1,50,000 pre-tax profit in the first quarter but expects to incur losses of Rs. 50,000 in each of the three remaining quarters. The entity operates in a jurisdiction in which its estimated average annual income tax rate is 30%. The management believes that since the entity has zero income for the year, its income tax expense for the year will be zero. State whether the management's views are correct or not? If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.
[ALSO ASKED IN RTP - NOV 2019]
Answer:
As illustrated in para 30 (c) of Ind AS 34 'Interim financial reporting', income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Accordingly, the management's contention that since the net income for the year will be zero no income tax expense shall be charged quarterly in the interim financial report, is not correct. The following table shows the correct income tax expense to be reported each quarter in accordance with Ind AS 34:

Period	Pre-tax earnings (in ₹)	Effective tax rate	Tax expense (in ₹)
First Quarter	1,50,000	30%	45,000
Second Quarter	(50,000)	30%	(15,000)
Third Quarter	(50,000)	30%	(15,000)
Fourth Quarter	(50,000)	30%	(15,000)
Annual	0		0

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

PAST EXAMINATION, MTPs, RTPs QUESTIONS

1. Navya Limited manufacturer of ceramic tiles has shown a net profit of Rs. 15,00,000 for the first quarter of 2018-2019. Following adjustments were made while computing the net profit:
(i) Bad debts of Rs. 1,64,000 incurred during the quarter. 75% of the bad debts have been deferred for the next three quarters (25% for each quarter).
(ii) Sales promotion expenses of Rs. 5,00,000 incurred in the first quarter and 90% expenses deferred to the next three quarters (30% for each quarter) on the basis that the sales in these quarters will be high in comparison to first quarter.
(iii) Additional depreciation of Rs. 3,50,000 resulting from the change in the method of depreciation has been taken into consideration.
(iv) Extra-ordinary loss of Rs. 1,36,000 incurred during the quarter has been fully recognized in this quarter.
Discuss the treatment required under Ind AS 34 and ascertain the correct net profit to be shown in the Interim Financial report of first quarter to be presented to the Board of Directors.

[NOV 2018 - 5 MARKS]
Answer:
As per Ind AS 34, Interim Financial Reporting, the quarterly net profit should be adjusted and restated as follows:
(i) Bad debts of Rs. 1,64,000 have been incurred during current quarter. Out of this, the company has deferred 75% i.e. Rs. 1,23,000 to the next 3 quarters. This treatment is not correct as the expenses incurred during an interim reporting period should be recognised in the same period unless conditions mentioned in Ind AS 34 are fulfilled. Accordingly, Rs. 1,23,000 should be deducted from the net profit of the current quarter Rs. 15,00,000.

(ii) Deferment of sales promotion expenses of Rs. 4,50,000 is not correct. It should be charged in the quarter in which the expenses have been incurred. Hence, it should be charged in the first quarter only.

(iii) Recognising additional depreciation of Rs. 3,50,000 in the same quarter is correct and is in tune with Ind AS 34.

(iv) The treatment of extra-ordinary loss of Rs. 1,36,000 being recognized in the same quarter is correct.
Thus considering the above, the correct net profits to be shown in Interim Financial Report of the third quarter shall be Rs. 15,00,000 - Rs. 1,23,000 - Rs. 4,50,000 = Rs. 9,27,000.

2. What is Integrated Reporting and what are its salient features?
[MTP - MARCH 2019 - 5 MARKS]
Answer:
Integrated reporting is a concept that has been created to better articulate the broader range of measures that contribute to long-term value and the role organizations play in society. Integrated Reporting is enhancing the way organizations think, plan and report the story of their business. Central to this is the proposition that value is increasingly shaped by factors additional to financial performance, such as reliance on the environment, social reputation, human capital skills and others.
This value creation concept is the backbone of integrated reporting and is the direction for the future of corporate reporting. In addition to financial capital, integrated reporting examines five additional capitals that should guide an organization's decision-making and long-term success — its value creation in the broadest sense. An integrated report is a concise communication about how an organization's:

- Strategy
- Governance
- Performance And
- Prospects

In the context of its external environment leads to the creation of value over:
- Short
- Medium And
- Long term

It's a portal by which the organization communicates a holistic view of:
- Its Current position
- Where it's going and
- How it intends to get there

The report enables readers to make an assessment of the organization's ability to create value in the future, with value creation referring to the value created for both the organization and for others.

<u>Salient features of Integrated Reporting Framework</u>

Principle Based Approach

The International Framework (the Framework) takes a principles-based approach. This Framework identifies information to be included in an integrated report for use in assessing an organization's ability to create value; it does not set benchmarks for such things as the quality of an organization's strategy or the level of its performance. It intent to strike an appropriate balance between flexibility and prescription that recognizes the wide variation in individual circumstances of different organizations while enabling a sufficient degree of comparability across organizations to meet relevant information needs.

Targets the Private Sector or Profit Making Companies

This Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

Identifiable Communication

An integrated report may be prepared in response to existing compliance requirements, and may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication. It should include, transitionally on a comply or explain basis, a statement by those charged with governance accepting responsibility for the report. An integrated report is intended to be more than a summary of information in other communications (e.g., financial statements, a sustainability report, analyst calls, or on a website); rather, it makes explicit the connectivity of information to communicate how value is created over time.

Financial and Non-financial Items

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time. It, therefore, contains relevant information, both financial and other.

Value Creation

Value created by an organization over time manifests itself in increases, decreases or transformations of the capitals caused by the organization's business activities and outputs. That value has two interrelated aspects – value created for:

• The organization itself, which enables financial returns to the providers of financial capital
• Others (i.e., stakeholders and society at large)

3. A company normally produced 1,00,000 units of a high precision equipment each year over past several years. In the current year, due to lack of demand and competition, it produced only 50,000 units. Further information is as follows:
Material = ` 200 per unit;
Labour = ` 100 per unit;
Variable manufacturing overhead = ` 100 per unit;
Fixed factory production overhead =` 1,00,00,000;
Fixed factory selling overhead = ` 50,00,000;
Variable factory selling overhead = ` 150 per unit.

Calculate the value of inventory per unit in accordance with Ind AS 2. What will be the treatment of fixed manufacturing overhead? (RTP- NOV 2020)

ANSWER:

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?

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.

UNIT 3: INDIAN ACCOUNTING STANDARD 7: STATEMENT OF CASH FLOWS

Questions from STUDY MATERIAL

Illustrations

1. Company has provided the following information regarding the various assets held by company on 31st March 20X1. Find out, which of the following items will be part of cash and cash equivalents for the purpose of preparation of cash flow statement as per the guidance provided in Ind AS 7:

Sr. No.	*Name of the Security*	*Additional Information*
1.	*Fixed deposit with SBI*	*12%, 3 years maturity on 1st January 20X4*
2.	*Fixed deposit with HDFC*	*10%, original term was for 2 years, but due for maturity on 30th June 20X1*
3.	*Redeemable Preference shares in ABC ltd*	*Acquired on 31st January 20X1 and the redemption is due on 30th April 20X1*
4.	*Cash balances at various banks*	*All branches of all banks in India*
5.	*Cash balances at various banks*	*All international branches of Indian banks*
6.	*Cash balances at various banks*	*Branches of foreign banks outside India*
7.	*Bank overdraft of SBI Fort branch*	*Temporary overdraft, which is payable on demand*
8.	*Treasury Bills*	*90 days maturity*

Answer:

Sr. No.	Name of the Security	Decision
1.	Fixed deposit with SBI	Not to be considered – long term
2.	Fixed deposit with HDFC	Exclude as original maturity is not less than 90 days from the date of acquisition
3.	Redeemable Preference shares in ABC Ltd.	Include as due within 90 days from the date of acquisition
4.	Cash balances at various banks	Include
5.	Cash balances at various banks	Include
6.	Cash balances at various banks	Include
7.	Bank overdraft of SBI Fort branch	Include (Assumed as integral part of an entity's cash management)
8.	Treasury Bills	Include

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

Sr. No.	Nature of Transaction
1	Receipt from sale of mobile phones
2	Purchases of mobile phones from various companies
3	Employees expenses paid
4	Advertisement expenses paid
5	Credit sales of mobile
6	Miscellaneous charges received from customers for repairs of mobiles
7	Loss due to decrease in market value of the closing stock of old mobile phones
8	Payment to suppliers of mobile phones
9	Depreciation on furniture of sales showrooms
10	Interest paid on cash credit facility of the bank
11	Profit on sale of old computers and printers, in exchange of new laptop and printer
12	Advance received from customers
13	Sales Tax and excise duty paid

Answer:

Sr. No.	Nature of Transaction	Included / Excluded with reason
1	Receipt from sale of mobile phones	Include – main revenue generating activity
2	Purchases of mobile phones from various companies	Include – expenses related to main operations of business
3	Employees expenses paid	Include – expenses related to main operations of business
4	Advertisement expenses paid	Include – expenses related to main operations of business
5	Credit sales of mobile	Do not include – Credit transaction will not be included in cash flow (receipts from customers will be included)
6	Misc. charges received from customers for repairs of mobiles	Include – supplementary revenue generating activity
7	Loss due to decrease in market value of the closing stock of old mobile phones	Do not include - Non cash transaction
8	Payment to suppliers of mobile phones	Include – cash outflow related to main operations of business
9	Depreciation on furniture of sales showrooms	Do not include – non cash item
10	Interest paid on cash credit facility of the bank	Do not include – cost of finance
11	Profit on sale of old computers and printers, in exchange of new laptop and printer	Do not include – non cash item
12	Advance received from customers	Include – Related to operations of business
13	Sales tax and excise duty paid	Include – related to operations of business

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

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

Answer:

Sr. No.	Nature of transaction paid	Operating / Investing / Not to be considered
1	Interest received on loans	Operating – Main revenue generating activity
2	Interest paid on Deposits	Operating – Main expenses of operations
3	Deposits accepted	Operating – in case of financial institutes
4	Loans given to customers	Operating – in case of financial institutes
5	Loans repaid by the customers	Operating – in case of financial institutes
6	Deposits repaid	Operating – in case of financial institutes
7	Commission received	Operating – Main revenue generating activity
8	Lease rentals paid for various branches	Operating – Main expenses of operations
9	Service tax paid	Operating – Main expenses of operations
10	Furniture for new branches	Investing – Assets purchased
11	Implementation of upgraded banking software	Investing – Purchased for long term purpose
12	Purchase of shares in 100% subsidiary for opening a branch in Abu Dhabi	Investing – strategic investment
13	New cars purchased from Honda dealer, in exchange of old cars and cash payment	Investing-for cash payment
14	Provident fund paid for the employees	Operating
15	Issued employee stock options	Not to be considered. No cash flow

4. From the following transactions taken from a parent company having multiple businesses and multiple segments, identify which transactions will be classified as Operating, Investing and Financing:

Sr. No.	Nature of transaction
1	Issued preference shares
2	Purchased the shares of 100% subsidiary company
3	Dividend received from shares of subsidiaries
4	Dividend received from other companies
5	Bonus shares issued
6	Purchased license for manufacturing of special drugs
7	Royalty received from the goods patented by the company
8	Rent received from the let out building (letting out is not main business)
9	Interest received from loans and advances given
10	Dividend paid
11	Interest paid on security deposits
12	Purchased goodwill
13	Acquired the assets of a company by issue of equity shares (not parting any cash)
14	Interim dividends paid
15	Dissolved the 100% subsidiary and received the amount in final settlement

Answer:

Sr. No.	Nature of transaction	Operating / Investing / Financing /Not to be considered
1	Issued preference shares	Financing
2	Purchased the shares of 100% subsidiary company	Investing
3	Dividend received from shares of subsidiaries	Investing
4	Dividend received from other companies	Investing
5	Bonus shares issued	No cash flow
6	Purchased license for manufacturing of special drugs	Investing
7	Royalty received from the goods patented by the company	Operating
8	Rent received from the let out building (letting out is not main business)	Investing
9	Interest received from loans and advances given	Investing
10	Dividend paid	Financing
11	Interest paid on security deposits	Financing
12	Purchased goodwill	Investing
13	Acquired the assets of a company by issue of equity shares (not parting any cash)	Not to be considered
14	Interim dividends paid	Financing
15	Dissolved the 100% subsidiary and received the amount in final settlement	Investing

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

Answer:

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

6.

Find out the cash from operations by direct method and indirect method from the following information:

Operating statement of ABC Ltd. for the year ended 31.3.20X2

Particulars		₹
Sales		5,00,000.00
Less:	Cost of goods sold	3,50,000.00
	Administration & Selling Overheads	55,000.00
	Depreciation	7,000.00
	Interest Paid	3,000.00
	Loss on sale of asset	2,000.00
Profit before tax		83,000.00
	Tax	(30,000.00)
Profit After tax		**53,000.00**

Balance Sheet as on 31st March

	20X2	20X1
Assets		
Non-current Assets		
Property, Plant and Equipment	75,000.00	65,000.00
Investment	12,000.00	10,000.00
Current Assets		
Inventories	12,000.00	13,000.00
Trade receivables	10,000.00	7,000.00
Cash and cash equivalents	6,000.00	5,000.00
Total	**1,15,000.00**	**1,00,000.00**
Equity and Liabilities		
Shareholders' Funds	60,000.00	50,000.00
Non-current Liabilities	33,000.00	35,000.00
Current Liabilities		
Trade Payables	12,000.00	8,000.00
Payables for Expenses	10,000.00	7,000.00
Total	**1,15,000.00**	**1,00,000.00**

Answer:

1. **Cash flow from Operations by Direct Method**

Particulars	**₹**	**See Note**
Cash Sales	4,97,000.00	1
Less: Cash Purchases	3,45,000.00	2
Overheads	52,000.00	3
Interest	-	Financing
Depreciation	-	Non cash item
Loss on sale of asset	-	Investing item
Cash profit	**100,000.00**	
Less: Tax	(30,000.00)	
Cash profit after tax	**70,000.00**	

Note No 1 - Cash Receipts from Sales and Trade receivables	
Particulars	**₹**
Sales	5,00,000.00
Add : Opening Trade receivables	7,000.00
Less : Closing Trade receivables	(10,000.00)
Cash Receipts	**4,97,000.00**

Note No 2 :- Payment to Trade Payables for Purchases	
Particulars	**₹**
Cost of goods sold	3,50,000.00
Closing inventories	12,000.00
Less: Opening inventories	(13,000.00)
Purchases	3,49,000.00
Add: Opening Trade Payables	8,000.00
Less: Closing Trade Payables	(12,000.00)
Payment to creditors	**3,45,000.00**
Particulars	**₹**
Overheads	55,000.00
Add: Opening payables	7,000.00
Less: Closing payables	(10,000.00)
Payment for Overheads	**52,000.00**

2. Cash flow from Operations by Indirect Method

Indirect Method	₹
Profit After Tax	53,000.00
Add/(Less): Depreciation	7,000.00
Loss on Asset	2,000.00
Interest paid	3,000.00
Decrease in Inventory	1,000.00
Increase in Trade Receivables	(3,000.00)
Increase in Trade Payables	4,000.00
Increase in Payables for expenses	3,000.00
Total	**70,000.00**

Note: Cash flow derived from operations ` 70,000 is same in both Direct Method and Indirect Method.

7. A firm invests in a five-year bond of another company with a face value of ` 10,00,000 by paying`5,00,000. The effective rate is 15%. The firm recognises proportionate interest income in its income statement throughout the period of bond. Based on the above information answer the following question:
a) How the interest income will be treated in cash flow statement during the period of bond?
b) On maturity, whether the receipt of ` 10,00,000 should be split between interest income and receipts from investment activity.
Answer:
Interest income will be treated as income over the period of bond in the income statement. However, there will be no cash flow in these years because no cash has been received. On maturity, receipt of ` 10,00,000 will be classified as investment activity with a bifurcation of interest income & money received on redemption of bond.

8. X Limited has paid an advance tax amounting to ` 5,30,000 during the current year. Out of the above paid tax, ` 30,000 is paid for tax on long term capital gains. Under which activity the above said tax be classified in the cash flow statements of X Limited?
Answer:
Cash flows arising from taxes on income should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities. In the case of X Limited, the tax amount of ` 30,000 is specifically related with investing activities. ` 5,00,000 to be shown under operating activities. ` 30,000 to be shown under investing activities.

9. X Limited acquires fixed asset of ` 10,00,000 from Y Limited by accepting the liabilities of ` 8,00,000 of Y Limited and balance amount it paid in cash. How X Limited will treat all those items in its cash flow statements?
Answer:
Investing and financing transactions that do not require the use of cash and cash equivalents shall be excluded from a statement of cash flows. X Limited should classify cash payment of ` 2,00,000 under investing activities. The non-cash transactions –liabilities and asset should be disclosed in the notes to the financial statements.

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

Answer:

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

	Amount (₹)
Profit before tax	100
Less: Unrealised exchange gain	(100)
Cash flow from operating activities	Nil
Cash flow from investing activities	Nil
Cash flow from financing activities	Nil
Net increase in cash and cash equivalents during the year	Nil
Add: Opening balance of cash and cash equivalents	4,500
Cash and cash equivalents as at the year-end	4,500

Reconciliation of cash and cash equivalents

Cash and cash equivalents as per statement of cash flows	4,500
Add: Unrealised gain on cash and cash equivalents	100
Cash and cash equivalents as per the balance sheet	4,600

If any changes in the policies take place, that will be dealt with as per the provisions of Ind AS 8.

11. Following is the balance sheet of Kuber Limited for the year ended 31 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		
Financial liabilities		
Long-term borrowings	2,000	5,000
Other non-current liabilities	2,740	3,615
Total non-current liabilities	4,740	8,615
Current liabilities		
Financial liabilities		
Trade payables	150	90
Bank overdraft	75	60
Other current liabilities	300	200
Total current liabilities	525	350
Total liabilities	5,265	8,965
Total equity and liabilities	17,565	17,265

Additional Information:

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

(2) Interim dividend paid during the year - ₹ 450 lacs

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

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

(b) Intangible Assets - ₹ 20 lacs

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

(5) Income taxes paid during the year ₹ 105 lacs

(6) Other non-current / current assets and liabilities are related to operations of Kuber Ltd. and do not contain any element of financing and investing activities.

Using the above information of Kuber Limited, construct a statement of cash flows under indirect method.

[ALSO IN RTP - NOV 2019]

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**

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

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

Extracts from Consolidated Statement of Profit and Loss

for the year ended 31st March 20X2

Particulars	Amount (₹ in Lac)
Revenue	12,380
Cost of Goods Sold	(9,860)
Gross Profit	2,520
Other Income	300
Operating Expenses	(450)
Other expenses	(540)
Interest expenses	(110)
Share of Profit of Associate	120
Profit before Tax	1,840

The below information is relevant for A Ltd Group.

1. A Ltd had spent ₹ 30 Lac on renovation of a building. A Ltd charged the entire renovation cost to profit and loss account.

2. On 1st April 20X1, A Ltd acquired 100% shares in S Ltd, for cash of ₹ 300 Lac. Fair value of the assets acquired and liabilities assumed under the acquisition are as under:

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

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

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

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

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

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

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

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

The goodwill impairment relates to 100% subsidiaries.
Assume that interest cost is all paid in cash.
You are required to determine cash generated from operations for group reporting purposes for the year ended 31st March 20X2.
Answer:

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

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

Working Notes:

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

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

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

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

3. Changes in Inventories Amount in ₹ Lacs

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

4. Changes in Trade Payables Amount in ₹ Lacs

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

Questions

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

(Amount in ₹)

	20X2	20X1
Cash	4,000	14,000
Accounts Receivable	25,000	32,500
Prepaid Insurance	5,000	7,000
Inventory	37,000	34,000
Fixed Assets	3,16,000	2,70,000
Accumulated Depreciation	(45,000)	(30,000)
Total Assets	3,42,000	3,27,500
Accounts Payable	18,000	16,000
Wages Payable	4,000	7,000
Debentures	1,73,000	1,60,000
Equity Shares	88,000	84,000
Retained Earnings	59,000	60,500
Total Liabilities & Equity	3,42,000	3,27,500
	20X2	
Sales	2,00,000	
Cost of Goods Sold	(1,23,000)	
Depreciation	(15,000)	
Insurance Expense	(11,000)	
Wages	(50,000)	
Net Profit	1,000	

During the financial year 20X2 company ABC Ltd. declared and paid dividend of ` 2,500. During 20X2, ABC Ltd. paid ` 46,000 in cash to acquire new fixed assets. The accounts payable was used only for inventory. No debt was retired during 20X2.

Answer:

A. DIRECT METHOD

Cash flows from operating activities		**20X2**
Cash received from customers	2,07,500	
Cash paid for inventory	(1,24,000)	
Cash paid for insurance	(9,000)	
Cash paid for wages	(53,000)	
Net cash flow from operating activities		21,500

Cash flows from investing activities		
Purchase of fixed assets		(46,000)
Cash flows from financing activities		
Dividend paid	(2,500)	
Proceeds from issuance of debentures	13,000	
Proceeds from issue of equity	4,000	
Net cash flows from financing activities		14,500
Net decrease in cash and cash equivalents		**(10,000)**
Opening Cash Balance		**14,000**
Closing Cash Balance		**4,000**

B. INDIRECT METHOD

Cash flows from operating activities		**20X2**
Net Profit	1,000	
Adjustments for Depreciation	15,000	
	16,000	
Decrease in accounts receivable	7,500	
Decrease in prepaid insurance	2,000	
Increase in inventory	(3,000)	
Increase in accounts payable	2,000	
Decrease in wages payable	(3,000)	
Net cash flow from operating activities		21,500
Cash flows from investing activities		
Purchase of fixed assets		(46,000)
Cash flows from financing activities		
Dividend paid	(2,500)	
Proceeds from issue of debentures	13,000	
Proceeds from issue of equity	4,000	
Net cash flows from financing activities		14,500
Net decrease in cash and cash equivalents		**(10,000)**
Opening Cash Balance		**14,000**
Closing Cash Balance		**4,000**

Working notes:

Fixed Assets Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	2,70,000	By Balance c/d	3,16,000
To Cash (Purchase of Fixed Assets)	46,000		
	3,16,000		3,16,000

Inventory Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	34,000	By Cost of goods sold	1,23,000
To Creditors account (credit purchase)	2,000	By Balance c/d	37,000
To Purchase (Bal. Figure)	1,24,000		
	1,60,000		**1,60,000**

Accounts Payable Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	18,000	By Balance b/d	16,000
		By Inventory Account (credit purchase) (Bal.Fig.)	2,000
	18,000		**18,000**

Equity Share Capital Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Bal. c/d	88,000	By Balance b/d	84,000
		By Bank account (Proceeds from equity share issued)	4,000
	88,000		**88,000**

2. From the following summary cash account of XYZ Ltd, prepare cash flow statement for the year ended March 31, 20X1 in accordance with Ind AS 7 using direct method.

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

	₹ '000		₹ '000
Balance on 1.4.20X0	50	Payment to creditors	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from customers	2,800	Overhead Expenses	200
Sale of Fixed Assets	100	Payroll	100
		Tax Payment	250
		Dividend	50
		Repayment of Bank loan	300
		Balance on 31.3.20X1	150
	3,250		3,250

Answer:

XYZ Ltd.

Cash Flow Statement for the year ended March 31, 20X1 (Using the Direct Method)

Cash flows from operating activities	₹ '000	₹ '000
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash from operating activities		250
Cash flow from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		*(50)*
Net increase in cash		**100**
Cash at the beginning of the period		**50**
Cash at end of the period		**150**

3. Z Ltd. has no foreign currency cash flow for the year 2017. It holds some deposit in a bank in the USA. The balances as on 31.12.2017 and 31.12.2018 were US $ 100,000 and US $ 102,000 respectively. The exchange rate on December 31, 2017 was US $ 1 = Rs. 45. The same on 31.12.2018 was US $ 1 = Rs. 50. The increase in the balance was on account of interest credited on 31.12.2018. Thus, the deposit was reported at Rs. 45,00,000 in the balance sheet as on December 31, 2017. It was reported at Rs. 51,00,000 in the balance sheet as on 31.12.2018. How these transactions should be presented in cash flow for the year ended 31.12.2018 as per Ind AS 7?
[Also asked In RTP - MAY 2019]
Answer:
The profit and loss account was credited by Rs. 1,00,000 (US$ 2000 × Rs. 50) towards interest income. It was credited by the exchange difference of US$ 100,000 × (Rs. 50 - Rs.45) that is, Rs. 500,000. In preparing the cash flow statement, Rs. 500,000, the exchange difference, should be deducted from the 'net profit before taxes, and extraordinary item'. However, in order to reconcile the opening balance of the cash and cash equivalents with its closing balance, the exchange difference Rs. 500,000, should be added to the opening balance in note to cash flow statement.
Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

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

(a) Cash consideration of ` 15,00,000
(b) 200,000 equity shares having face of ` 10 and fair value of ` 15 per share.
On the date of acquisition, Company B has cash and cash equivalent balance of ` 2,50,000 in its books of account. On October 10, 20X2, Company A further acquires 10% stake in Company B for cash consideration of ` 8,00,000. Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7. [ALSO IN RTP - MAY 2018]
Answer:
As per para 39 of Ind AS 7, the aggregate cash flows arising from obtaining control of subsidiary shall be presented separately and classified as investing activities. As per para 42 of Ind AS 7, the aggregate amount of the cash paid or received as consideration for obtaining subsidiaries is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.
Further, investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.
As per para 42A of Ind AS 7, cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity, as defined in Ind AS 110, and is required to be measured at fair value through profit or loss. Such transactions are accounted for as equity transactions and accordingly, the resulting cash flows are classified in the same way as other transactions with owners. Considering the above, for the financial year ended March 31, 20X2 total consideration of ` 15,00,000 less ` 250,000 will be shown under investing activities as —Acquisition of the subsidiary (net of cash acquired)‖. There will not be any impact of issuance of equity

shares as consideration in the cash flow statement however a proper disclosure shall be given elsewhere in the financial statements in a way that provides all the relevant information about the issuance of equity shares for non - cash consideration. Further, in the statement of cash flows for the year ended March 31, 20X3, cash consideration paid for the acquisition of additional 10% stake in Company B will be shown under financing activities.

5. Entity A acquired a subsidiary, Entity B, during the year. Summarized information from the Consolidated Statement of Profit and Loss and Balance Sheet is provided, together with some supplementary information. [ALSO IN RTP - MAY 2020]

Consolidated Statement of Profit and Loss

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

Consolidated balance sheet

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

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

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

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

Answer:

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

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

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

Working Notes:

1.

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

2.

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

3.

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

PAST EXAMINATION, MTPs, RTPs QUESTIONS

1. 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 1 st April, 2017. During the year 2017-2018, the entity entered into the following foreign currency transactions:

:- A 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.

: - A 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.

: - A 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.

: - A 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.

: - In 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.

: - Ignore taxation.

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

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

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

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

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

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

- Income tax Refund of ` 1.5 crore (Refund on taxes paid in earlier periods for business profits).

You need to determine the net cash flow from operating activities, investing activities and financing activities of Akola Limited as per relevant Ind AS. (RTP- NOV 2020)

ANSWER:

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

CHAPTER- 3 INDAS-115 REVENUE FROM CONTRACTS WITH CUSTOMERS

Questions from STUDY MATERIAL

Illustrations

1. New way limited decides to enter a new market that is currently experiencing economic difficulty and expects that in future economy will improve. New way enters into an arrangement with a customer in the new region for networking products for promised consideration of ` 1,250,000. At contract inception, New way expects that it may not be able to collect the full amount from the customer.
Determine how New way will recognise this transaction?

Answer

Assuming the contract meets the other criteria covered within the scope of the model in Ind AS 115, New way need to assesses whether collectability is probable. In making this assessment, New way considers whether the customer has the ability and intent to pay the estimated transaction price, which may be an amount less than the contract price.

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

Answer:

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

3. Contractor P enters into a manufacturing contract to produce 100 specialized CCTV Cameras for Customer Q for a fixed price of ` 1,000 per sensor. Customer Q can cancel the contract without a penalty after receiving 10 CCTV Cameras. Specify the contract units.

Answer:

P determines that because there is no substantive compensation amount payable by Q on termination of the contract – i.e. no termination penalty in the contract – it is akin to a contract to produce 10 CCTV Cameras that gives Customer Q an option to purchase an additional 90 CCTV Cameras. Hence, contract is for 10 units.

4. Manufacturer of airplanes for the air force negotiates a contract to design and manufacture new fighter planes for a Kashmir air base. At the same meeting, the manufacturer enters into a separate contract to supply parts for existing planes at other bases. Would these contracts be combined?

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

5. Software Company S enters into a contract to license its customer relationship management software to Customer B. Three days later, in a separate contract, S agrees to provide consulting services to significantly customise the licensed software to function in B's IT environment. B is unable to use the software until the customisation services are complete. Would these contracts be combined?
Answer:
S determines that the two contracts should be combined because they were entered into at nearly the same time with the same customer, and the goods or services in the contracts are a single performance obligation.

6. Manufacturer M enters into a contract to manufacture and sell a cyber-security system to Government-related Entity P. One week later, in a separate contract, M enters into a contract to sell the same system to Government-related Entity Q. Both entities are controlled by the same government. During the negotiations, M agrees to sell the systems at a deep discount if both P and Q purchases the security system. Should these contracts be combined or separately accounted?
Answer:
M concludes that the said two contracts should be combined because, among other things, P is a related party of Q, the contracts were entered into at nearly the same time and the contracts were negotiated as a single commercial package, which is clearly evident from the fact that discount is being offered if both the parties purchases the security system, thereby also making the consideration in one contract dependent on the other contract.

7. An entity promises to sell 120 products to a customer for ` 120,000 (` 1,000 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer at a price of ` 950 per product which is the standalone selling price for such additional products at the time of placing this additional order. The additional 30 products were not included in the initial contract.
It is assumed that additional products are contracted for a price that reflects the stand –alone selling price. Determine the accounting for the modified contract?
Answer:
When the contract is modified, the price of the contract modification for the additional 30 products is an additional ` 28,500 or ` 950 per product. The pricing for the additional products reflects the stand-alone selling price of the products at the time of the contract modification and the additional products are distinct from the original products. Accordingly, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract and ` 950 per product for the 30 products in the new contract.

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

On 1st October, 20X1, KLC Ltd. and Mr. K agree to modify the contract to reduce the amount of services from ` 55,000 per month to ` 45,000 per month. Determine the effect of change in the contract?

Answer:

The next six months of services are distinct from the services provided in the first six months before modification in contract, Therefore, KLC Ltd. will account for the contract modification as if it were a termination of the existing contract and the creation of a new contract.

The consideration allocated to remaining performance obligation is ` 270,000, which is the sum of

- The consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and had not yet been recognized as revenue. This amount is zero.
- The consideration promised as part of the contract modification ie ` 270,000.

(b) Second, when the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied, the entity recognizes the effect of the modification on a cumulative catch-up basis. This is the case in many construction contracts where a modification does not result in the transfer of additional distinct goods or services.

9. 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.

Determine how contract modification will be accounted as per Ind AS 115?

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 = 140

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

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

11. An entity provides broadband services to its customers along with voice call service. Customer buys modem from the entity. However, customer can also get the connection from the entity and modem from any other vendor. The installation activity requires limited effort and the cost involved is almost insignificant. It has various plans where it provides either broadband services or voice call services or both.

Are the performance obligations under the contract distinct?

Answer:
Entity promises to customer to provide
:- Broadband Service
: -Voice Call services
: -Modem

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

For broadband and voice call services -
: - Broadband and voice services are separately identifiable from other promises as company has various plans to provide the two services separately. These two services are not dependent or interrelated. Also the customer can benefit on its own from the services received.

For sale of modem -
: Customer can either buy product from entity or third party. No significant customisation or modification is required for selling product.
Based on the evaluation we can say that there are three separate performance obligation: -
: - Broadband Service
: -Voice Call services
: -Modem

12. An entity enters into a contract to build a power plant for a customer. The entity will be responsible for the overall management of the project including services to be provided like engineering, site clearance, foundation, procurement, and construction of the structure, piping and wiring, installation of equipment and finishing. Determine how many performance obligations does the entity have?

Answer:

Based on the discussion above it needs to be determined that the promised goods and services are capable of being distinct as per the principles of Ind AS 115. That is, whether the customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling or holding those goods or services.

However, the goods and services are not distinct within the context of the contract. That is, the entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. This is evidenced by the fact that the entity provides a significant service of putting together the various inputs or goods and services into the power plant or the output for which the customer has contracted. Since both the criteria has not met, the goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

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

Answer:

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

14. Entity A, a specialty construction firm, enters into a contract with Entity B to design and construct a multi-level shopping centre with a customer car parking facility located in sub-levels underneath the shopping centre. Entity B solicited bids from multiple firms on both phases of the project — design and construction. The design and construction of the shopping centre and parking facility involves multiple goods and services from architectural consultation and engineering through procurement and installation of all of the materials. Several of these goods and services could be considered separate performance obligations because Entity A frequently sells the services, such as architectural consulting and engineering services, as well as standalone construction services based on third party design, separately. Entity A may require to continually alter the design of the shopping centre and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project.

Determine how many performance obligations does the entity A have?

Answer:

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

15. An entity, a software developer, enters into a contract with a customer to transfer a software license, perform an installation service and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the license, installation service and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support. Determine how many performance obligations does the entity have?

Answer:

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity observes that the software is delivered before the other goods and services and remains functional without the updates and the technical support. Thus, the entity concludes that the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available. The entity also considers the factors of Ind AS 115 and determines that the promise to transfer each good and service to the customer is separately identifiable from each of the other promises. In particular, the entity observes that the installation service does not significantly modify or customise the software itself and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output. On the basis of this assessment, the entity identifies four performance obligations in the contract for the following goods or services:

- The software license
- An installation service
- Software updates
- Technical support

16 . Significant customisation

The promised goods and services are the same as in the above Illustration, except that the contract specifies that, as part of the installation service, the software is to be substantially customised to add significant new functionality to enable the software to interface with other customised software applications used by the customer. The customised installation service can be provided by other entities.

Determine how many performance obligations does the entity have?

Answer:

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity observes that the terms of the contract result in a

promise to provide a significant service of integrating the licensed software into the existing software system by performing a customised installation service as specified in the contract. In other words, the entity is using the license and the customised installation service as inputs to produce the combined output (i.e. a functional and integrated software system) specified in the contract. In addition, the software is significantly modified and customised by the service. Although the customised installation service can be provided by other entities, the entity determines that within the context of the contract, the promise to transfer the license is not

separately identifiable from the customised installation service and, therefore, the criterion on the basis of the factors is not met. Thus, the software license and the customised installation service are not distinct.
The entity concludes that the software updates and technical support are distinct from the other promises in the contract. This is because the customer can benefit from the updates and technical support either on their own or together with the other goods and services that are readily available and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises. On the basis of this assessment, the entity identifies three performance obligations in the contract for the following goods or services:
a) Customised installation service (that includes the software license);
b) Software updates; and
c) Technical support.

17. 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?

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.

18. V Ltd. grants Customer C a three-year license for anti-virus software. Under the contract, V Ltd. promises to provide C with when-and-if-available updates to that software during the license period. The updates are critical to the continued use of the anti -virus software. Determine how many performance obligations does the entity have?

Answer:

V Ltd. concludes that the license and the updates are capable of being distinct because the anti -virus software can still deliver its original functionality during the license period without the updates. C can also benefit from the updates together with the license transferred when the contract is signed.

However, V Ltd. concludes that the license and the updates are not separately identifiable because the software and the service are inputs into a combined item in the contract − i.e. the nature of V Ltd.'s promise is to provide continuous anti-virus protection for the term of the contract. Therefore, V Ltd. accounts for the license and the updates as a single performance obligation.

19. Media Company P Ltd. offers magazine subscriptions to customers. When customers subscribe, they receive a printed copy of the magazine each month and access to the magazine's online content. Determine how many performance obligations does the entity have?
Answer:
P evaluates whether the promises to provide printed copies and online access are separate performance obligations. P determines that the arrangement includes two performance obligations for the following reasons:
- The printed copies and online access are both capable of being distinct because the customer could use them on their own.
- The printed copies and online access are distinct within the context of the contract because they are different formats so they do not significantly customise or modify each other, nor is there any transformative relationship into a single output.

20 .Software Company K Ltd. enters into a contract with reseller D, which then sells software products to end users. K Ltd. has a customary business practice of providing free telephone support to end users without involving the reseller, and both reseller and the customer expect K Ltd. to continue to provide this support. Determine how many performance obligations does the entity K Ltd. have?

Answer:
In evaluating whether the telephone support is a separate performance obligation, K Ltd. Notes that the promise to provide telephone support free of charge to end users is considered a service that meets the definition of a performance obligation when control of the software product transfers to D. As a result, K Ltd. accounts for the telephone support as a separate performance obligation in the transaction with D.

21. Implied performance obligation
Carmaker N Ltd. has a historical practice of offering free maintenance services – e.g. oil changes and tyre rotation – for two years to the end customers of dealers who buy its vehicles. However, the two years' free maintenance is not explicitly stated in the contract with its dealers, but it is typically stated in N's advertisements for the vehicles. Determine how many performance obligations does the entity have?
Answer:
The maintenance is treated as a separate performance obligation in the sale of the vehicle to the dealer. Revenue from the sale of the vehicle is recognised when control of the vehicle is transferred to the dealer. Revenue from the maintenance services is recognised separately as and when the maintenance services are provided to the retail customer.

22. 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.
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.

23. An entity enters into a contract for the sale of Product A for ` 1,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to ` 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 ` 500 of additional products. Determine how many performance obligations does the entity have and their stand-alone selling price and allocated transaction price?

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 ` 500 of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is ` 120 (` 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 the resulting allocation of the ` 1,000 transaction price are as follows:

Performance obligations	Stand-alone selling price
Product A	₹ 1000
Discount voucher	₹ 120
Total	₹ 1120

Performance obligations		Allocated transaction price (to nearest ₹10)
Product A	(₹ 1000 ÷ ₹ 1120 × ₹ 1000)	₹ 890
Discount voucher	(₹ 120 ÷ ₹ 1120 × ₹ 1000)	₹ 110
Total		₹ 1000

24. A cable company provides television services for a fixed rate fee of ` 800 per month for a period of 3 years. Cable services is satisfied overtime because customer consumes and receives benefit from services as it is provided i.e. customer generally benefits each day that they have access to cable service. Determine how many performance obligations does the cable company have?

Answer:

Cable company determines that each increment of its services e.g. day or month, is a distinct performance obligation because customer benefits from that period of services on its own. Additionally, each increment of service is separately identifiable from those preceding and
following it i.e. one service period does not significantly affect, modify or customise another. Therefore, it can be concluded that its contract with customer is a single performance obligation to provide three years of cable service because each of the distinct increments of service is satisfied over time. Also, cable company uses the same measure of progress to recognise revenue on its cable television service regardless of the contract's time period.

25. Manufacturer M enters into a 60-day consignment contract to ship 1,000 dresses to Retailer A's stores. Retailer A is obligated to pay Manufacturer M ` 20 per dress when the dress is sold to an end customer. During the consignment period, Manufacturer M has the contractual right to require Retailer A to either return the dresses or transfer them to another retailer. Manufacturer M is also required to accept the return of the inventory. State when the control is transferred.

Answer:

Manufacturer M determines that control has not been transferred to Retailer A on delivery, for the following reasons:

(a) Retailer A does not have an unconditional obligation to pay for the dresses until they have been sold to an end customer;

(b) Manufacturer M is able to require that the dresses be transferred to another retailer at any time before Retailer A sells them to an end customer; and

(c) Manufacturer M is able to require the return of the dresses or transfer them to another retailer.

Manufacturer M determines that control of the dresses transfers when they are sold to an end customer i.e. when Retailer A has an unconditional obligation to pay Manufacturer M and can no longer return or otherwise transfer the dresses. Manufacturer M recognises revenue as the dresses are sold to the end customer.

26. An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and will pay for those tickets even if it is not able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance. The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are sold ; therefore, there is no credit risk.

The entity also assists the customers in resolving complaints with the service provided by airlines.However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

Determine whether the entity is a principal or an agent.

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. 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 for more than the entity's cost.
(c) the entity has discretion in setting the sales prices for tickets to its customers.
The entity concludes that its promise is to provide a ticket (i.e. a right to fly) to the customer. On the basis of the indicators, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.

27. Company D Ltd. provides advertising services to customers. D Ltd. enters into a sub-contract with a multinational online video sharing company, F Ltd. Under the sub-contract, F Ltd. places all of D Ltd.'s customers' adverts.
D Ltd. notes the following:
– D Ltd. works directly with customers to understand their advertising needs before placing adverts.
– D Ltd. is responsible for ensuring that the advert meets the customer's needs after the advert is placed.
– D Ltd. directs F Ltd. over which advert to place and when to place it.
– D Ltd. does not bear inventory risk because there is no minimum purchase requirement with F Ltd.
– D Ltd. does not have discretion in setting the price because fees are charged based on F Ltd.'s scheduled rates.
D is Principal or an agent?
Answer:
D Ltd. is primarily responsible for fulfilling the promise to provide advertising services. Although F Ltd. delivers the placement service, D Ltd. directly works with customers to ensure that the services are performed to their requirements. Even though D Ltd. does not bear inventory risk and does not have discretion in setting the price, it controls the advertising services before they are provided to the customer. Therefore, D Ltd. is a principal in this case.

28. Customer buy a new data connection from the telecom entity. It pays one-time registration and activation fees at the time of purchase of new connection. The customer will be charged based on the usage of the data services of the connection on monthly

basis. Are the performance obligations under the contract distinct?
Answer:
By selling a new connection, the entity promises to supply data services to customer. Customer will not be able to benefit from just buying a data card and data services from third party. The activity of registering and activating connection is not a service to customer and therefore does not represent satisfaction of performance obligation. Entity's obligation is to provide data service and hence activation is not a separate performance obligation.

29. XYZ Limited enters into a contract with a customer to build a sophisticated machinery. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is ` 2.5 crore, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31st March, 20X1 that the asset is incomplete, the promised consideration is reduced by ` 1 lakh. For each day before 31st March, 20X1 that the asset is complete, the promised consideration increases by ` 1 lakh. In addition, upon completion of the asset, a third party will inspect the asset and assign a rating based on metrics that are defined in the contract. If the asset receives a specified rating, the entity will be entitled to an incentive bonus of ` 15 lakh.
Determine the transaction price.
Answer:

In determining the transaction price, the entity prepares a separate estimate for each element of variable consideration to which the entity will be entitled using the estimation methods described in paragraph 53 of Ind AS 115:
a) the entity decides to use the expected value method to estimate the variable consideration associated with the daily penalty or incentive (i.e. ` 2.5 crore, plus or minus ` 1 lakh per day). This is because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

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

30 : Estimating variable consideration
AST Limited enters into a contract with a customer to build a manufacturing facility. The entity determines that the contract contains one performance obligation satisfied over time. Construction is scheduled to be completed by the end of the 36th month for an agreed-upon price of ` 25 crore.
The entity has the opportunity to earn a performance bonus for early completion as follows:

- 15 percent bonus of the contract price if completed by the 30th month (25% likelihood)
- 10 percent bonus if completed by the 32nd month (40% likelihood)
- 5 percent bonus if completed by the 34th month (15% likelihood)
In addition to the potential performance bonus for early completion, AST Limited is entitled to a quality bonus of ` 2 crore if a health and safety inspector assigns the facility a gold star rating as defined by the agency in the terms of the contract. AST Limited concludes that it is 60% likely that it will receive the quality bonus. Determine the transaction price.
Answer:
In determining the transaction price, AST Limited separately estimates variable consideration for each element of variability i.e the early completion bonus and the quality bonus. AST Limited decides to use the expected value method to estimate the variable consideration associated with the early completion bonus because there is a range of possible outcomes and the entity has experience with a large number of similar contracts that provide a reasonable basis to predict future outcomes. Therefore, the entity expects this method to best predict the amount of variable consideration associated with the early completion bonus. AST's best estimate of the early completion bonus is ` 2.13 crore, calculated as shown in the following table:

Bonus %	Amount of bonus (₹ in crore)	Probability	Probability-weighted amount (₹ in crore)
15%	3.75	25%	0.9375
10%	2.50	40%	1.00
5%	1.25	15%	0.1875
0%	-	20%	-
			2.125

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

31. HT Limited enters into a contract with a customer on 1st April, 20X1 to sell Product X for ` 1,000 per unit. If the customer purchases more than 100 units of Product A in a financial year, the contract specifies that the price per unit is retrospectively reduced to ` 900 per unit. Consequently, the consideration in the contract is variable. For the first quarter ended 30th June, 20X1, the entity sells 10 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 100 unit threshold required for the volume discount in the financial year. HT Limited determines that it has

significant experience with this product and with the purchasing pattern of the customer. Thus, HT Limited concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ` 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known). Further, in May, 20X1, the customer acquires another company and in the second quarter ended
30th September, 20X1 the entity sells an additional 50 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 100 unit threshold for the financial year and therefore it will be required to retrospectively reduce the price per unit to ` 900. Determine the amount of revenue to be recognise by HT Ltd. for the quarter ended 30th June, 20X1 and 30th September, 20X1.

Answer:

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

32 : <u>Measurement of variable consideration</u>

An entity has a fixed fee contract for ` 1 million to develop a product that meets specified performance criteria. Estimated cost to complete the contract is ` 9,50,000. The entity will transfer control of the product over five years, and the entity uses the cost-to-cost input method to measure progress on the contract. An incentive award is available if the product meets the following weight criteria:

Weight (kg)	Award % of fixed fee	Incentive fee
951 or greater	0%	—
701–950	10%	₹ 100,000
700 or less	25%	₹ 250,000

The entity has extensive experience creating products that meet the specific performance criteria. Based on its experience, the entity has identified five engineering alternatives that will achieve the 10 percent incentive and two that will achieve the 25 percent incentive. In this case, the entity determined that it has 95 percent confidence that it will achieve the 10 percent incentive and 20 percent confidence that it will achieve the 25 percent incentive. Based on this analysis, the entity believes 10 percent to be the most likely amount when estimating the transaction price. Therefore, the entity includes only the 10 percent award in the transaction price when calculating revenue because the entity has concluded it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved due to its 95 percent confidence in achieving the 10 percent award. The entity reassesses its production status quarterly to determine whether it is on track to meet the criteria for the incentive award. At the end of the year four, it becomes apparent that this contract will fully achieve the weight-based criterion. Therefore, the entity revises its estimate of variable consideration to include the entire 25 percent incentive fee in the year four because, at this point, it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when including the entire variable consideration in the transaction price. Evaluate the impact of changes in variable consideration when cost incurred is as follows:

Year	₹
1	50,000
2	1,75,000
3	4,00,000
4	2,75,000
5	50,000

Answer:

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

Fixed consideration	A	1,000,000				
Estimated costs to complete*	B	950,000				
		Year 1	Year 2	Year 3	Year 4	Year 5
Total estimated variable consideration	C	100,000	100,000	100,000	250,000	250,000
Fixed revenue	D=A x H/B	52,632	184,211	421,053	289,474	52,632
Variable revenue	E=C x H/B	5,263	18,421	42,105	72,368	13,158
Cumulative revenue adjustment	F (see below)	—	—	—	99,370	—
Total revenue	G=D+E+F	57,895	202,632	463,158	461,212	65,790
Costs	H	50,000	175,000	400,000	275,000	50,000
Operating profit	I=G–H	7,895	27,632	63,158	186,212	15,790
Margin (rounded off)	J=I/G	14%	14%	14%	40%	24%

* For simplicity, it is assumed there is no change to the estimated costs to complete throughout the contract period.
* In practice, under the cost-to-cost measure of progress, total revenue for each period is determined by multiplying the total transaction price (fixed and variable) by the ratio of cumulative cost incurred to total estimated costs to complete, less revenue recognized to date.

Calculation of cumulative catch-up adjustment:			
Updated variable consideration	L		250,000
Percent complete in Year 4: (rounded off)	M=N/O		95%
Cumulative costs through Year 4	N	900,000	
Estimated costs to complete	O	950,000	
Cumulative variable revenue through Year 4:	P		138,130
Cumulative catch-up adjustment	F=L x M–P		99,370

33. Management fees subject to the constraint On 1st April, 20X1, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a two per cent quarterly management fee based on the client's assets under management at the end of each quarter. At 31st March, 20X2, the client's assets under management are ` 100 crore. In addition, the entity receives a performance-based incentive fee of 20 per cent of the fund's return in excess of the return of an observable market index over the five-year period. Consequently, both the management fee and the performance fee in the contract are variable consideration. Analyze the revenue to be recognised on 31st March, 20X2.

Answer:

The entity accounts for the services as a single performance obligation because it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress — that is, a time-based measure of progress).

The entity observes that the promised consideration is dependent on the market and thus is highly susceptible to factors outside the entity's influence. In addition, the incentive fee has a large number and a broad range of possible consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.
At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception —the variability of the fee based on the market index indicates that the entity cannot conclude that it is highly probable that a
significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the incentive fee in the transaction price. At 31st March, 20X2, the client's assets under management are ` 100 crore. Therefore, the
resulting quarterly management fee and the transaction price is ` 2 crore. At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter. This is because the fee relates specifically to the entity's efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters.
Consequently, the entity recognises ` 2 crore as revenue for the quarter ended 31st March, 20X2.

<u>34 : Right of return</u>

An entity enters into 1,000 contracts with customers. Each contract includes the sale of one product for ` 50 (1,000 total products × ` 50 = ` 50,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is ` 30.
The entity applies the requirements in Ind AS 115 to the portfolio of 1,000 contracts because it reasonably expects that, in accordance with paragraph 4, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of Ind AS 115) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 970 products will not be returned. The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit. Determine the amount of revenue, refund liability and the asset to be recognised by the entity for the said contracts. [ALSO IN MTP - APRIL 2019 - 6 MARKS]
Answer:
The entity also considers the requirements in paragraphs 56–58 of Ind AS 115 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of ` 48,500 (` 50 × 970 products not expected to be returned) can be included in the transaction price. The entity considers the factors in paragraph 57 of Ind AS 115 and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (ie the 30-day return period). Thus, the entity

concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ` 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 ` 48,500 (` 50 × 970 products not expected to be returned);
(b) a refund liability of ` 1,500 (` 50 refund × 30 products expected to be returned); and
(c) an asset of ` 900 (` 30 × 30 products for its right to recover products from customers on settling the refund liability).

35 : Warranty
An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional 'extended coverage' plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty. Since the optional 'extended coverage' plan is sold separately, the entity determines that the three years of extended coverage represent a separate performance obligation (i.e. a service-type warranty). The total transaction price for the sale of a computer and the extended warranty is ` 36,000. The entity determines that the stand-alone selling prices of the computer and the extended warranty are ` 32,000 and ` 4,000, respectively. The inventory value of the computer is ` 14,400. Furthermore, the entity estimates that, based on its experience, it will incur ` 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty Pass required journal entries.

Answer:

The entity will record the following journal entries:

		₹	₹
Cash / Trade receivables	Dr.	36,000	
Warranty expense	Dr.	2,000	
To Accrued warranty costs (assurance-type warranty)			2,000
To Contract liability (service-type warranty)			4,000
To Revenue			32,000
(To record revenue and contract liabilities related to warranties)			
Cost of goods sold	Dr.	14,400	
To Inventory			14,400
(To derecognise inventory and recognise cost of goods sold)			

The entity derecognizes the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer. The entity recognises the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognises the costs associated with providing the service-type warranty as they are incurred. The entity

had to determine whether the repair costs incurred are applied against the warranty reserve already established for claims that occur during the first 90 days or recognised as an expense as incurred.

36 : Warranty

Entity sells 100 ultra-life batteries for ` 2,000 each and provides the customer with a five-year guarantee that the batteries will withstand the elements and continue to perform to specifications. The entity, which normally provides a one-year guarantee to customer purchasing ultra-life batteries, determines that years two through five represent a separate performance obligation. The entity determines that ` 1,70,000 of the ` 2,00,000 transaction price should be allocated to the batteries and ` 30,000 to the service warranty (based on estimated stand-alone selling prices and a relative selling price allocation). The entity's normal one-year warranty cost is ` 1 per battery. Pass required journal entries.

Answer:

The entity will record the following journal entries:

Upon delivery of the batteries, the entity records the following entry:

Cash/Receivables	Dr.	2,00,000	
To Revenue			1,70,000
To Contract liability (service warranty)			30,000
Warranty expense	Dr.	10,000	
To Accrued warranty costs (assurance warranty)			10,000

The contract liability is recognised as revenue over the service warranty period (years 2 - 5). The costs of providing the service warranty are recognised as incurred. The assurance warranty obligation is used / derecognized as defective units are replaced / repaired during the initial year of the warranty. Upon expiration of the assurance warranty period, any remaining assurance warranty obligation is reversed.

37 : Financing component: significant or insignificant?

A commercial airplane component supplier enters into a contract with a customer for promised consideration of ` 70,00,000. Based on an evaluation of the facts and circumstances, the supplier concluded that ` 1,40,000 represented a insignificant financing component because of an advance payment received in excess of a year before the transfer of control of the product. State whether company needs to make any adjustment in determining the transaction price. What if the advance payment was larger and received further in advance, such that the entity concluded that ` 14,00,000 represented the financing component based on an analysis of the facts and circumstances.

Answer:

The entity may conclude that ` 1,40,000, or 2 percent of the contract price, is not significant, and the entity may not need to adjust the consideration promised in determining the transaction price. However, when the advance payment was larger and received further in

advance, such that the entity may conclude that ` 14,00,000 represents the financing component based on an analysis of the facts and circumstances. In such a case, the entity may conclude that ` 14,00,000, or 20 percent of the contract price, is significant, and the entity should adjust the consideration promised in determining the transaction price.

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

38 : <u>Accounting for significant financing component</u>
NKT Limited sells a product to a customer for ` 1,21,000 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence. The cash selling price of the product is ` 1,00,000 which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is ` 80,000. The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ` 1,21,000 to the cash selling price of ` 1,00,000). Analyze the above transaction with respect to its financing component .
Answer:
The contract includes a significant financing component. This is evident from the difference between the amount of promised consideration of ` 1,21,000 and the cash selling price of ` 1,00,000 at the date that the goods are transferred to the customer. The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ` 1,21,000 to the cash selling price of ` 1,00,000). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.
Until the entity receives the cash payment from the customer, interest revenue would be recognised in accordance with Ind AS 109. In determining the effective interest rate in accordance with Ind AS 109, the entity would consider the remaining contractual term.

39. <u>Determining the discount rate</u>
VT Limited enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed. The price stated in the contract is ` 1 crore plus a 10% contractual rate of interest, payable in 60 monthly instalments of ` 212,470.
Determine the discounting rate and the transaction price when
Case A—Contractual discount rate reflects the rate in a separate financing transaction

Case B—Contractual discount rate does not reflect the rate in a separate financing transaction ie 14%.
Answer:
<u>Case A—Contractual discount rate reflects the rate in a separate financing transaction</u>
In evaluating the discount rate in the contract that contains a significant financing component, VT Limited observes that the 10% contractual rate of interest reflects the rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% reflects the credit characteristics of the customer). The market terms of the financing mean that the cash selling price of the equipment is ` 1 crore. This amount is recognised as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with Ind AS 109.

<u>Case B—Contractual discount rate does not reflect the rate in a separate financing transaction</u>
In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 10% contractual rate of interest is significantly lower than the 14% interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than ` 1 crore. VT Limited determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 14% interest rate that

reflects the credit characteristics of the customer. Consequently, the entity determines that the transaction price is ` 9,131,346 (60 monthly payments of ` 212,470 discounted at 14%). The entity recognises revenue and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with Ind AS 109.

<u>40. Advance payment and assessment of discount rate</u>

ST Limited enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (i.e. the performance obligation will be satisfied at a point in time). The contract includes two alternative payment options:

1) Payment of ` 5,000 in two years when the customer obtains control of the asset or

2) Payment of ` 4,000 when the contract is signed. The customer elects to pay ` 4,000 when the contract is signed. ST Limited concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market. The interest rate implicit in the transaction is 11.8 per cent,

which is the interest rate necessary to make the 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

Answer:

Journal Entries showing accounting for the significant financing component:

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

Cash	Dr.	₹ 4,000	
To Contract liability			₹ 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 ₹ 4,000 at 6% for two years:

Interest expense	Dr.	₹ 494*	
To Contract liability			₹ 494
* ₹ 494 = ₹ 4,000 contract liability × (6% interest per year for two years).			

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

Contract liability	Dr.	₹ 4,494	
To Revenue			₹ 4,494

41 : Withheld payments on a long-term contract

ABC Limited enters into a contract for the construction of a power plant that includes scheduled milestone payments for the performance by ABC Limited throughout the contract term of three years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with the expected performance by ABC Limited. The contract provides that a specified percentage of each milestone payment is to be withheld as retention money by the customer throughout the arrangement and paid to the entity only when the building is complete. Analyze whether the contract contains any financing component.

Answer:

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

42 : Advance payment

XYZ Limited, a personal computer (PC) manufacturer, enters into a contract with a customer to provide global PC support and repair coverage for three years along with its PC. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional ` 3,000. Customers electing to buy this service must pay for it upfront (i.e. a monthly payment option is not available). Analyse whether there is any significant financing component in the contract or not.

Answer:

To determine whether there is a significant financing component in the contract, the entity considers the nature of the service being offered and the purpose of the payment terms. The entity charges a single upfront amount, not with the primary purpose of obtaining financing from the customer but, instead, to maximize profitability, taking into consideration the risks associated with providing the service. Specifically, if customers could pay monthly, they would be less likely to renew and the population of customers that continue to use the support service in the later years may become smaller and less diverse over time (i.e. customers that choose to renew historically are those that make greater use of the service, thereby increasing the entity's costs). In addition, customers tend to use services more if they pay monthly rather than making an upfront payment. Finally, the entity would incur higher administration costs such as the costs related to administering renewals and collection of monthly payments. In assessing whether or not the contract contains a significant financing component, XYZ Limited determines that the payment terms were structured primarily for reasons other than the provision of finance to the entity. XYZ Limited charges a single upfront amount for the services because other payment terms (such as a monthly payment plan) would affect the nature of the risks it assumes to provide the service and may make it uneconomical to provide the service. As a result of its analysis, XYZ Limited concludes that there is not a significant financing component.

43 : Advance payment

A computer hardware vendor enters into a three-year arrangement with a customer to provide support services. For customers with low credit ratings, the vendor requires the customer to pay for the entire arrangement in advance of the provision of service. Other customers pay over time. Analyse whether there is any significant financing component in the contract or not.

Answer:

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

44 : <u>Sales based royalty</u>

A software vendor enters into a contract with a customer to provide a license solely in exchange for a sales-based royalty. Analyse whether there is any significant financing component in the contract or not.

Answer:

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

45 : <u>Payment in arrears</u>

An EPC contractor enters into a two-year contract to develop customized machine for a customer. The contractor concludes that the goods and services in this contract constitute a single performance obligation. Based on the terms of the contract, the contractor determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to the customer. The customer agrees to provide the contractor monthly progress payments, with the final 25 percent payment (holdback payment) due upon contract completion. As a result of the holdback payment, there is a gap between when control transfers and when consideration is received, creating a financing component. Analyse whether there is any significant financing component in the contract or not.

Answer:

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

46 : <u>Payment in arrears</u>

Company Z is a developer and manufacturer of defense systems that is primarily a Tier -II supplier of parts and integrated systems to original equipment manufacturers (OEMs) in the commercial markets. Company Z enters into a contract with Company X for the development and delivery of 5,000 highly technical, specialized missiles for use in one of Company X's platforms. As a part of the contract, Company X has agreed to pay Company Z for their cost plus an award fee up to ` 100 crore. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such costs. However, the ` 100 crore award fee is awarded upon successful completion of the development and test fire of a missile to occur in 16 months from the time the contract is executed. The contract specifies Company Z will earn up to ` 100 crore based on Company X's assessment of Company Z's ability to develop and manufacture a missile that achieves multiple factors, including final weight, velocity, and accuracy.

Partial award fees may be awarded based on a pre-determined scale based on their success. Assume Company Z has assessed the contract under Ind AS 115 and determined the award fee represents variable consideration. Based on their assessment, Company Z has estimated a total of ` 80 crore in the transaction price related to the variable consideration pursuant to guidance within Ind AS 115. Further, the entity has concluded it should recognize revenue over time for a single performance obligation using a cost-to-cost input method. Analyse whether there is any significant financing component in the contract or not.

Answer:

Company Z will transfer control over time beginning shortly after the contract is executed, but will not receive the cash consideration related to the award fee component from Company X for more than one year in the future. Hence, Company Z should assess whether the award fee represents a significant financing component. The intention of the parties in negotiating the award fee due upon completion of the test fire, and based on the results of that test fire, was to provide incentive to Company Z to produce high functioning missiles that achieved successful scoring from Company X. Therefore, it was determined the contract does not contain a significant financing component, and Company Z should not adjust the transaction price.

As per Ind AS 115.63, as a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between:

(a) when the entity transfers a promised good or service to a customer and

(b) when the customer pays for that good or service will be one year or less

47 : Applying practical expedient

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

Based on the terms of the contract, Company H determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to Company C. Company C agrees to provide Company H monthly progress payments. Based on the expectation of the timing of costs to be incurred, Company H concludes that progress payments are being made such that the timing between the transfer of control and payment is never expected to exceed one year.

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

Answer:

Company H concludes it will not need to further assess whether a significant financing component is present and does not adjust the promised consideration in determining the transaction price, as they are applying the practical expedient under Ind AS 115. As per Ind AS 115.65, an entity shall present the effects of financing (interest revenue or interest

expense) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognised only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer.

48 : <u>Entitlement to non-cash consideration</u>

An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on 1st April, 20X1 and work begins immediately. The entity concludes that the service is a single performance obligation. This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress — that is, a time-based measure of progress).

In exchange for the service, the customer promises its 100 equity shares per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service. How should the entity decide the transaction price?

Answer:

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

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

RT Limited enters into a contract to build an office building for AT Limited over an 18 –month period. AT Limited agrees to pay the construction entity ` 350 crore for the project. RT Limited will receive a bonus of 10 lakh equity shares of AT Limited if it completes construction of the office building within one year. Assume a fair value of ` 100 per share at contract inception.

Determine the transaction price.

Answer:

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

1) the entity earns or does not earn the shares and
2) the fair value per share may change during the contract term.

When determining the transaction price, the entity would reflect changes in the number of shares to be earned. However, the entity would not reflect changes in the fair value per share. Said another way, the share price of ` 100 is used to value the potential bonus throughout the life of the contract. As a result, if the entity earns the bonus, its revenue would be ` 350 crore plus 10 lakh equity shares at ` 100 per share for total consideration of ` 360 crore.

50. Non-cash consideration - Free advertising

Production Company Y sells a television show to Television Company X. The consideration under the arrangement is a fixed amount of ` 1,000 and 100 advertising slots. Y determines that the stand-alone selling price of the show would be ` 1,500. Based on market rates, Y determines that the fair value of the advertising slots is ` 600. Determine the transaction price.

Answer:

Y determines that the transaction price is ` 1,600, comprising of ` 1,000 fixed amount plus the fair value of the advertising slots i.e ` 600. If the fair value of the advertising slots could not be reasonably estimated, then the transaction price would be ` 1,500 i.e. Y would use the stand-alone selling price of the goods or services promised for the non-cash consideration.

51 : Customer-provided goods or services

MS Limited is a manufacturer of cars. It has a supplier of steering systems – SK Limited. MS Limited places an order of 10,000 steering systems on SK Limited. It also agrees to pay ` 25,000 per steering system and contributes tooling to be used in SK's production process. The tooling has a fair value of ` 2 crore at contract inception. SK Limited determines that each steering system represents a single performance obligation and that control of the steering system transfers to MS Limited upon delivery.

SK Limited may use the tooling for other projects and determines that it obtains control of the tooling.

Determine the transaction price?

Answer:

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

52 : Consideration payable to a customer

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least ` 15 crore of products during the year. The contract also requires the entity to make a non-refundable payment of ` 1.5 crore to the customer at the inception of the contract. The ` 1.5 crore payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products. The entity does not obtain control of any rights to the customer's shelves.

Determine the transaction price.

Answer:

The entity considers the requirements in paragraphs 70 – 72 of Ind AS 115 and concludes that the payment to the customer is not in exchange for a distinct good or service that

transfers to the entity. This is because the entity does not obtain control of any rights to the customer's shelves. Consequently, the entity determines that, in accordance with paragraph 70 of Ind AS 115, the ` 1.5 crore payment is a reduction of the transaction price. The entity applies the requirements in paragraph 72 of Ind AS 115 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognises revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by 10 per cent [(` 1.5 crore ÷ ` 15 crore) x 100]. Therefore, in the first month in which the entity transfers goods to the customer, the entity recognises revenue of ` 1.125 crore (` 1.25 crore invoiced amount less ` 0.125 crore of consideration payable to the customer).

53: Credits to a new customer

Customer C is in the middle of a two-year contract with Telco B Ltd., its current wireless service provider, and would be required to pay an early termination penalty if it terminated the contract today. If C cancels the existing contract with B Ltd. and signs a two-year contract with Telco D Ltd. for ` 800 per month, then D Ltd. promises at contract inception to give C a one-time credit of ` 2,000 (referred to as a 'port-in credit'). The amount of the port-in credit does not depend on the volume of service subsequently purchased by C during the two-year contract. Determine the transaction price.

Answer:

D Ltd. determines that it should account for the port-in credit as consideration payable to a customer. This is because the credit will be applied against amounts owing to D Ltd. Since, D Ltd. does not receive any distinct goods or services in exchange for this credit, it will account for it as a reduction in the transaction price ` 17,200 [(` 800 x 24 month) – ` 2,000]. D Ltd. Will recognise the reduction in the transaction price as the promised goods or services are transferred.

54: Allocation methodology

An entity enters into a contract with a customer to sell Products A, B and C in exchange for ` 10,000. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.

Because the stand-alone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximizes the use of observable inputs. The entity estimates the stand-alone selling prices as follows:

Product	Stand-alone selling price	Method
	₹	
Product A	5,000	Directly observable
Product B	2,500	Adjusted market assessment approach
Product C	7,500	Expected cost plus a margin approach
Total	15,000	

Determine the transaction price allocated to each product.

Answer:

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

Product	Allocated transaction price (to nearest ₹100)	
	₹	
Product A	3,300	(₹ 5,000 ÷ ₹ 15,000 × ₹ 10,000)
Product B	1,700	(₹ 2,500 ÷ ₹ 15,000 × ₹ 10,000)
Product C	5,000	(₹ 7,500 ÷ ₹ 15,000 × ₹ 10,000)
Total	10,000	

55 : Allocating a discount

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

Product	Stand-alone selling price
	₹
Product X	50,000
Product Y	25,000
Product Z	45,000
Total	1,20,000

In addition, the entity regularly sells Products Y and Z together for ` 50,000.

Case A—Allocating a discount to one or more performance obligations. The entity enters into a contract with a customer to sell Products X, Y and Z in exchange for ` 100,000. The entity will satisfy the performance

obligations for each of the products at different points in time; or Product Y and Z at same point of time. Determine the allocation of transaction price to Product Y and Z.

Case B—Residual approach is appropriate
The entity enters into a contract with a customer to sell Products X, Y and Z as described in Case A. The contract also includes a promise to transfer Product Alpha. Total consideration in the contract is ` 130,000. The stand-alone selling price for Product Alpha is highly variable because the entity sells Product Alpha to different customers for a broad range of amounts (` 15,000 – ` 45,000). Determine the stand-alone selling price of Products, X, Y, Z and Alpha using the residual approach.

Case C—Residual approach is inappropriate
The same facts as in Case B apply to Case C except the transaction price is ` 1,05,000 instead of ` 130,000.
Answer:
<u>Case A—Allocating a discount to one or more performance obligations</u>
The contract includes a discount of ` 20,000 on the overall transaction, which would be allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method. However, because the entity regularly sells Products Y and Z together for ` 50,000 and Product X for ` 50,000, it has evidence that the entire discount should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.
If the entity transfers control of Products Y and Z at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate ` 50,000 of the transaction price to the single performance obligation and recognise revenue of ` 50,000 when Products Y and Z simultaneously transfer to the customer.
If the contract requires the entity to transfer control of Products Y and Z at different points in time, then the allocated amount of ` 50,000 is individually allocated to the promises to transfer Product Y (stand-alone selling price of ` 25,000) and Product Z (stand-alone selling price of ` 45,000) as follows:

Product	Allocated transaction price	
	₹	
Product Y	17,857	(₹ 25,000 ÷ ₹ 70,000 total stand-alone selling price × ₹ 50,000)
Product Z	32,143	(₹ 45,000 ÷ ₹ 70,000 total stand-alone selling price × ₹ 50,000)
Total	50,000	

<u>Case B—Residual approach is appropriate</u>
Before estimating the stand-alone selling price of Product Alpha using the residual approach, the entity determines whether any discount should be allocated to the other performance obligations in the contract. As in Case A, because the entity regularly sells Products Y and Z together for ` 50,000 and

Product X for ` 50,000, it has observable evidence that ` 100,000 should be allocated to those three products and a ` 20,000 discount should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115. Using the residual approach, the entity estimates the stand-alone selling price of Product Alpha to
be ` 30,000 as follows:

Product	Stand-alone selling price	Method
	₹	
Product X	50,000	Directly observable
Products Y and Z	50,000	Directly observable with discount
Product Alpha	30,000	Residual approach
Total	130,000	

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

Case C—Residual approach is inappropriate
The same facts as in Case B apply to Case C except the transaction price is ` 105,000 instead of ` 130,000. Consequently, the application of the residual approach would result in a stand –alone selling price of ` 5,000 for Product Alpha (` 105,000 transaction price less ` 100,000 allocated to Products X, Y and Z).
The entity concludes that ` 5,000 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product Alpha, because ` 5,000 does not approximate the stand-alone selling price of Product Alpha, which ranges from ` 15,000 – ` 45,000. Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product Alpha using another suitable method. The entity allocates the transaction price of ` 1,05,000 to Products X, Y, Z and Alpha using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of Ind AS 115.

56. Allocation of variable consideration
An entity enters into a contract with a customer for two intellectual property licences (Licences A and B), which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences A and B are ` 1,600,000 and `2,000,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.

Case A—Variable consideration allocated entirely to one performance obligation
The price stated in the contract for Licence A is a fixed amount of ` 1,600,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B. For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be ` 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 ` 600,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (ie the variable consideration) is ` 3,000,000. Here, Licence A is transferred 3 months later. The royalty due from the customer’s first month of sale is ` 4,00,000. Allocate the transaction price and determine the revenue to be recognised for each licence and the contract liability, if any. [ALSO IN MTP - MARCH 2019 - 8 MARKS]
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 (ie the sales-based royalties) should be allocated entirely to Licence B. The entity concludes that the criteria are met for the following reasons:
(a) the variable payment relates specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B).

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

The entity transfers Licence B at inception of the contract and transfers Licence A one month later. Upon the transfer of Licence B, the entity does not recognise revenue because the consideration allocated to Licence B is in the form of a sales-based royalty. Therefore, the entity recognises revenue for the sales-based royalty when those subsequent sales occur. When Licence A is transferred, the entity recognises as revenue the ` 1,600,000 allocated to Licence A.

Case B—Variable consideration allocated on the basis of stand-alone selling prices
To allocate the transaction price, the entity applies the criteria in paragraph 85 of Ind AS 115 to determine whether to allocate the variable consideration (ie the sales-based royalties) entirely to Licence B.

In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B), allocating the variable consideration entirely to Licence B would be inconsistent with the principle for allocating the transaction price. Allocating ` 600,000 to Licence A and ` 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 ` 1,600,000 and ` 2,000,000, respectively. Consequently, the entity applies the general allocation requirements of Ind AS 115.

The entity allocates the transaction price of ` 600,000 to Licences A and B on the basis of relative stand-alone selling prices of ` 1,600,000 and ` 2,000,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative stand-alone selling price basis. However, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognise revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied). Licence B is transferred to the customer at the inception of the contract and Licence A is transferred three months later. When Licence B is transferred, the entity recognises as revenue ` 333,333 [(` 2,000,000 ÷ ` 3,600,000) × ` 600,000] allocated to Licence B. When Licence A is transferred, the entity recognises as revenue ` 266,667 [(` 1,600,000 ÷ ` 3,600,000) × ` 600,000] allocated to Licence A.

In the first month, the royalty due from the customer's first month of sales is ` 400,000. Consequently, the entity recognises as revenue ` 222,222 (` 2,000,000 ÷ ` 3,600,000 × ` 400,000) allocated to Licence B (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognises a contract liability for the ` 177,778 (` 1,600,000 ÷ ` 3,600,000 × ` 400,000) allocated to Licence A. This is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

57 : <u>Allocating a change in transaction price</u>

On 1st April, 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for ` 2 crore. The consultant can earn ` 20 lakh bonus if it completes the software implementation by 30th September, 20X0 or ` 10 lakh bonus if it completes the software implementation by 31st December, 20X0. The due diligence, valuation, and software implementation services are distinct and therefore are accounted for as separate performance obligations. The consultant allocates the transaction price, disregarding the potential bonus, on a relative stand-alone selling price basis as follows:

: Due diligence – ` 80 lakh

: Valuation – ` 20 lakh

: Software implementation – ` 1 crore

At contract inception, the consultant believes it will complete the software implementation by 30th January, 20X1. After considering the factors in Ind AS 115, the consultant cannot conclude that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty is resolved since the consultant lacks experience in completing similar projects. As a result, the consultant does not include the amount of the early completion bonus in its estimated transaction price at contract inception.

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

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

Answer:

On 1st July, 20X0, the consultant allocates the bonus of ` 20 lakh to the software implementation performance obligation, for total consideration of ` 1.2 crore allocated to that performance obligation, and adjusts the cumulative revenue to date for the software implementation services to ` 72 lakh (60 percent of ` 1.2 crore).

58 : <u>Discretionary credit</u>

Telco G Ltd. grants a one-time credit of ` 50 to a customer in Month 14 of a two-year contract. The credit is discretionary and is granted as a commercial gesture, not in response to prior service issues (often referred to as a 'retention credit'). The contract includes a subsidised handset and a voice and data plan. G Ltd. does not regularly provide these credits and therefore customers do not expect them to be granted.

How this will be accounted for under Ind AS 115?

Answer:

G Ltd. concludes that this is a change in the transaction price and not a variable consideration. Since, the credit does not relate to a satisfied performance obligation, the change in transaction price resulting from the credit is accounted for as a contract modification and recognised over the remaining term of the contract. If, in this example, rather than providing a one-time credit, G Ltd. granted a discount of ` 5 per month for the remaining contract term, then also G Ltd. Would conclude that it was a change in the transaction price. It would apply the contract modification guidance and recognise the credit over the remaining term of the contract.

59. Minitek Ltd. is a payroll processing company. Minitek Ltd. enters into a contract to provide monthly payroll processing services to ABC limited for one year. Determine how entity will recognise the revenue?
Answer:
Payroll processing is a single performance obligation. On a monthly basis, as Minitek Ltd carries out the payroll processing –
- The customer, ie, ABC Limited simultaneously receives and consumes the benefits of the entity's performance in processing each payroll transaction .

- Further, once the services have been performed for a particular month, in case of termination of the agreement before maturity and contract is transferred to another entity, then such new entity will not need to re-perform the services for expired months.
Therefore, it satisfies the first criterion, ie, services completed on a monthly basis are consumed by the entity at the same time and hence, revenue shall be recognised over the period of time. For certain performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In such cases, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer.
In making such determination, an entity shall make both of the following assumptions:
(a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and
(b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any work in progress.

60. T&L Limited ('T&L') is a logistics company that provides inland and sea transportation services. A customer – Horizon Limited ('Horizon') enters into a contract with T&L for transportation of its goods from India to Sri Lanka through sea. The voyage is expected to take 20 days from Mumbai to Colombo. T&L is responsible for shipping the goods from Mumbai port to Colombo port. Whether T&L's performance obligation is met over period of time?
Answer:
T&L has a single performance to ship the goods from one port to another. The following factors are critical for assessing how services performed by T&L are consumed by the customer –
: As the voyage is performed, the service undertaken by T&L is progressing, such that no other entity will need to re-perform the service till so far as the voyage has been performed, if T&L was to deliver only part-way.
: The customer is directly benefitting from the performance of the voyage as & when it progresses.
Therefore, such performance obligation is said to be met over a period of time.

61.AFS Ltd. is a risk advisory firm and enters into a contract with a company – WBC Ltd to provide audit services that results in AFS issuing an audit opinion to the Company. The professional opinion relates to facts and circumstances that are specific to the company. If the Company was to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the Company to compensate the risk advisory firm for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts.
Whether risk advisory firm's performance obligation is met over period of time?
Answer:

AFS has a single performance to provide an opinion on the professional audit services proposed to be provided under the contract with the customer. Evaluating the criterion for recognising revenue over a period of time or at a point in time, Ind AS 115 requires one of the following criterion to be met –
: **Criterion (a)** – whether the customer simultaneously receives and consumes the benefits from services provided by AFS: Company shall benefit only when the audit opinion is provided upon completion. And in case the contract was to be terminated, any other firm engaged to perform similar services will have to substantially re-perform. Hence, this criterion is not met.

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

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

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

62. Space Ltd. enters into an arrangement with a government agency for construction of a space satellite. Although Space Ltd is in this business for building such satellites for various customers across the world, however the specifications for each satellite may vary based on technology that is incorporated in the satellite. In the event of termination, Company has right to enforce payment for work completed to date. Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.
Answer:
While evaluating the pattern of transfer of control to the customer, the Company shall evaluate conditions laid in para 35 of Ind AS 115 as follows:
: **Criterion (a)** – whether the customer simultaneously receives and consumes the benefits:
Customer can benefit only when the satellite is fully constructed and no benefits are consumed as its constructed. Hence, this criterion is not met.
:**Criterion (b)** – An asset created that customer controls: Per provided facts, the customer does not acquire control of the asset as its created.
:Criterion (c) – no alternate use to entity and right to seek payment:
--The asset is being specifically created for the customer. The asset is customised to customer's requirements, such that any diversion for a different customer will require significant work. Therefore, the asset has practical limitation in being put to alternate use.
--Further, Space Ltd. has a right to enforce payment if contract was early terminated, for reasons other than Space Ltd.'s failure to perform.
Therefore, criterion (c) is met and such performance obligation is said to be met over a period of time.

63. ABC enters into a contract with a customer to build an i tem of equipment. The customer pays 10% advance and then 80% in instalments of 10% each over the period of construction with balance 10% payable at the end of construction period. The payments are non-refundable unless the company fails to perform as

per the contract. Further, if the customer terminates the contract, then entity is entitled to retain payments made. The company will have no further right to compensation from the customer.
Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.
Answer:
The Company shall evaluate conditions laid in para 35 of Ind AS 115 as follows:
:Criterion (a) – whether the customer simultaneously receives and consumes the benefits:
Customer can benefit only when the asset is fully constructed and no benefits are consumed as its constructed. Hence, this criterion is not met.
:Criterion (b) – An asset created that customer controls: As per provided facts, the customer does not acquire control of the asset as it is created.
:Criterion (c) – no alternate use to entity and right to seek payment:
---The customer has specific right over the asset and company does not have right to divert it for any alternate use. In other words, there is contractual restriction to use the asset for any alternate purpose.
---In the event of early termination, Company has a right to retain any payments made by the customer. However, such payments need not necessarily compensate the selling price of the partially constructed asset, if the customer was to stop making payments. Therefore, Company does not have a legally enforceable right to payment for work completed to date and the criterion under para 35 is not satisfied. Thus, revenue cannot be recognised over a period of time.

64 : Measuring progress on straight line basis
An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month. The entity's promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes. Evaluate if contract will qualify for satisfaction of performance obligation over a period of time. If yes, how should an entity measure its progress of service provided?
Answer:
The entity shall determine if revenue should be recognised over a period of time by evaluating the conditions laid in para 35 of Ind AS 115.
- Applying the first criterion of para 35 to establish if the customer simultaneously receives and consumes the benefits, as the entity provides service – The health club provides access to services uniformly through the year. The extent to which the customer uses the health clubs does not affect the amount of the remaining goods and services to which the customer is entitled. The customer therefore simultaneously receives and consumes the benefits of the entity's performance as it performs by making the health clubs available.
- Consequently, the entity's performance obligation is satisfied over time
- Once the pattern of satisfying performance obligation is defined, the Company then determines how progress should be measured. The services are uniformly provided to the customer through the year. Therefore, the best measure of progress is to recognise revenue on a straight line basis over the year.

65 : Uninstalled materials
On 1st January, 20X1, an entity contracts to renovate a building including the installation of new elevators. The entity estimates the following with respect to the contract:

Particulars	Amount (₹)
Transaction price	5,000,000
Expected costs:	
(a) Elevators	1,500,000
(b) Other costs	2,500,000
Total	4,000,000

The entity purchases the elevators and they are delivered to the site six months before they will be installed. The entity uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of 500,000 by 31st March, 20X1. How will the Company recognize revenue, if performance obligation is met over a period of time?

Answer:

Costs to be incurred comprise two major components – elevators and cost of construction service.

(a) The elevators are part of the overall construction project and are not a distinct performance obligation

(b) The cost of elevators is substantial to the overall project and are incurred well in advance.

(c) Upon delivery at site, customer acquires control of such elevators.

(d) And there is no modification done to the elevators, which the company only procures and delivers at site.

Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also. Therefore, applying the guidance on Input method –

- The measure of progress should be made based on percentage of costs incurred relative to the total budgeted costs.
- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	Amount (₹)
Transaction price	5,000,000
Costs incurred:	
(a) Cost of elevators	1,500,000
(b) Other costs	500,000
Measure of progress:	500,000 / 2,500,000 = 20%
Revenue to be recognised:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 3,500,000 % of work completed = 20% Revenue to be recognised = 700,000
(b) Revenue for elevators	1,500,000 (equal to costs incurred)
Total revenue to be recognised	1,500,000 + 700,000 = 2,200,000

Therefore, for the year ended 31st March, 20X1, the Company shall recognize revenue of ` 2,200,000 on the project.

66. An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ` 1 million. The contract includes a call option that gives the entity the right to repurchase the asset for ` 1.1 million on or before 31st December, 20X1. How would the entity account for this transaction?

Answer:

In the above case, where the entity has a right to call back the goods upto a certain date –

: The customer cannot be said to have acquired control, owing to the repurchase right with the seller entity

: Since the original selling price (` 1 million) is lower than the repurchase price (` 1.1 million), this is construed to be a financing arrangement and accounted as follows:

(a) Amount received shall be recognized as ‗liability'

(b) Difference between sale price and repurchase price to be recognised as ‗finance cost'and recognised over the repurchase term.

67. An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ` 1,000,000. The contract includes a put option that gives the customer the right to sell the asset for ` 900,000 on or before 31st December, 20X1. The market price for such goods is expected to be ` 750,000 How would the entity account for this transaction?

Answer:

In the above case, where the entity has an obligation to buy back the goods upto a certain date –

: The entity shall evaluate if the customer has a significant economic incentive to return the goods. Since the repurchase price is significantly higher than market price, therefore, customer has a significant economic incentive to return the goods. There are no other factors which entity may affect this assessment.

: Therefore, company determines that control' of goods is not transferred to the customer till 31st December, 20X1, ie, till the put option expires.

: Against payment of ` 1,000,000; the customer only has a right to use the asset and put it back to the entity for ` 900,000. Therefore, this will be accounted as a lease transaction in which difference between original selling price (ie, ` 1,000,000) and repurchase price (ie, ` 900,000) shall be recognized as lease income over the period of lease.

: At the end of repurchase term, ie, 31st December, 20X1, if the customer does not exercise such right, then the control of goods would be passed to the customer at that time and revenue shall be recognized for sale of goods for repurchase price (ie, ` 900,000).

68. An entity enters into a contract with a customer on 1st April, 20X1 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years. Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31st March, 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

How will the Company recognise revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods?

Answer:
In the facts provided above, the entity has made sale of two goods – machine and space parts, whose control is transferred at a point in time. Additionally, company agrees to hold the spare parts for the customer for a period of 2-4 years, which is a separate performance obligation. Therefore, total transaction price shall be divided amongst 3 performance obligations –
(i) Sale of machinery
(ii) Sale of spare parts
(iii) Custodial services for storing spare parts.
Recognition of revenue for each of the three performance obligations shall occur as follows:
- Sale of machinery: Machine has been sold to the customer and physical possession as well as legal title passed to the customer on 31st March, 20X3. Accordingly, revenue for sale of machinery shall be recognised on 31st March, 20X3.
- Sale of spare parts: The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill - n-hold basis if all below criteria are met:

(a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);	The customer has specifically requested for entity to store goods in their warehouse, owing to close proximity to customer's factory.
(b) the product must be identified separately as belonging to the customer;	The spare parts have been specifically identified and inspected by the customer.
(c) the product currently must be ready for physical transfer to the customer; and	The spares are identified and segregated, therefore, read for delivery.
(d) the entity cannot have the ability to use the product or to direct it to another customer	Spares have been segregated and cannot be redirected to any other customer.

Therefore, all conditions of bill-and-hold are met and hence, company can recognize revenue for sale of spare parts on 31st March, 20X3.
- Custodial services: Such services shall be given for a period of 2 to 4 years from 31st March, 20X3. Where services are given uniformly and customer receives & consumes benefits simultaneously, revenue for such service shall be recognized on a straight line basis over a period of time.

69. An entity, a music record label, licenses to a customer a 1975 recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio and online advertisements for two years in Country A. In exchange for providing the licence, the entity receives fixe consideration of ` 50,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is non-cancellable. Determine how the revenue will be recognised?
Answer:
The entity assesses the goods and services promised to the customer to determine which goods and services

are distinct in accordance with paragraph 27 of Ind AS 115. The entity concludes that its only performance obligation is to grant the licence. The entity does not have any contractual or implied obligations to change the licensed recording. The licensed recording has significant stand-alone functionality (i.e. the ability to be played) and, therefore, the ability of the customer to obtain the benefits of the recording is not substantially derived from the entity's ongoing activities. The entity therefore determines that the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the licensed recording. Consequently, the entity concludes that the nature of its promise in transferring the licence is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the licence is a performance obligation satisfied at a point in time. The entity recognises all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

70 : Assessing the nature of a software licence with unspecified upgrades
Software Company X licenses its software application to Customer Y. Under the agreement, X will provide updates or upgrades on a when-and-if-available basis; Y can choose whether to install them. Y expects that X will undertake no other activities that will change the functionality of the software. Determine the nature of license.
Answer:
Basis on the facts given in question it can be concluded that, although the updates and upgrades will change the functionality of the software, they are not activities considered in determining the nature of the entity's promise in granting the licence. The activities of X to provide updates or upgrades are not considered because they transfer a promised good or service to Y – i.e. updates or upgrades are distinct from the licence. Therefore, the software licence provides a right to use the IP that is satisfied at a point in time.

71 : Assessing the nature of a film licence and the effect of marketing activities
Film Studio C grants a licence to Customer D to show a completed film. C plans to undertake significant marketing activities that it expects will affect box office receipts for the film. The marketing activities will not change the functionality of the film, but they could affect its value. Determine the nature of license.
Anwer:
C would probably conclude that the licence provides a right to use its IP and, therefore, is transferred at a point in time. There is no expectation that C will undertake activities to change the form or functionality of the film. Because the IP has significant stand-alone functionality, C's marketing activities do not significantly affect D's ability to obtain benefit from the film, nor do they affect the IP available to D.

72 : Assessing the nature of a team name and logo
Sports Team D enters into a three-year agreement to license its team name and logo to Apparel Maker M. The licence permits M to use the team name and logo on its products, including display products, and in its advertising or marketing materials.
(i) Determine the nature of license in the above case.
(ii) Modifying above facts that, Sports Team D has not played games in many years and the licensor is Brand Collector B, an entity that acquires IP such as old team or brand names and logos from defunct entities or those in financial distress. B's business model is to license the IP, or obtain settlements from entities that use the IP without permission, without undertaking any ongoing activities to promote or support the IP Would the answer be different in this situation?

Answer:

(i) The nature of D's promise in this contract is to provide M with the right to access the sports team's IP and, accordingly, revenue from the licence will be recognised over time. In reaching this conclusion, D considers all of the following facts:

– M reasonably expects D to continue to undertake activities that support and maintain the value of the team name and logo by continuing to play games and field a competitive team throughout the licence period. These activities significantly affect the IP's ability to provide benefit to M because the value of the team name and logo is substantially derived from, or dependent on, those ongoing activities.

– The activities directly expose M to positive or negative effects (i.e. whether D plays games and fields a competitive team will have a direct effect on how successful M is in selling its products featuring the team's name and logo).

– D's ongoing activities do not result in the transfer of a good or a service to M as they occur (i.e. the team playing games does not transfer a good or service to M).

(ii) Based on B's customary business practices, Apparel Maker M probably does not reasonably expect B to undertake any activities to change the form of the IP or to support or maintain the IP. Therefore, B would probably conclude that the nature of its promise is to provide M with a right to use its IP as it exists at the point in time at which the licence is granted.

73. Customer outsources its information technology data centre
Term = 5 years plus two 1-yr renewal options
Average customer relationship is 7 years
Entity spends ` 400,000 designing and building the technology platform needed to accommodate outsourcing contract:

Design services	*₹ 50,000*
Hardware	*₹ 140,000*
Software	*₹ 100,000*
Migration and testing of data centre	*₹ 110,000*
TOTAL	***₹ 400,000***

Answer

Design services	₹ 50,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
Hardware	₹ 140,000	Account for asset under Ind AS 16
Software	₹ 100,000	Account for asset under Ind AS 38
Migration and testing of data centre	₹ 110,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
TOTAL	**₹ 400,000**	

74 : Amortization
An entity enters into a service contract with a customer and incurs incremental costs to obtain the contract and costs to fulfil the contract. These costs are capitalized as assets in accordance with Ind AS 115. The initial term of the contract is five years but it can be renewed for subsequent one year periods up to a maximum of 10 years. The average contract term for similar contracts entered into by entity is seven years. Determine appropriate method of amortization?
Answer:
The most appropriate amortisation period is likely to be seven years (i.e. the initial term of five years plus two anticipated one year renewals) because that is the period over which the entity expects to provide services under the contract to which the capitalised costs relate.

75. A Ltd. is in the business of the infrastructure and has two divisions under the same; (I) Toll Roads and (II) Wind Power. The brief details of these business and underlying project details are as follows:
I. Bhilwara-Jabalpur Toll Project - The Company has commenced the construction of the project in the current year and has incurred total expenses aggregating to ` 50 crore as on 31st December, 20X1. Under IGAAP, the Company has 'recorded such expenses as Intangible Assets in the books of account. The brief details of the Concession Agreement are as follows:
-Total Expenses estimated to be incurred on the project ` 100 crore;
-Fair Value of the construction services is ` 110 crore;
-Total Cash Flow guaranteed by the Government under the concession agreement is ` 200 crore;
-Finance revenue over the period of operation phase is ` 15 crore:
-Other income relates to the services provided during the operation phase.

II. Kolhapur- Nagpur Expressway - The Company has also entered into another concession agreement with Government of Maharashtra in the current year. The construction cost for the said project will be ` 110 crore. The fair value of such construction cost is approximately ` 200 crore. The said concession agreement is Toll based project and the Company needs t collect the toll from the users of the expressway. Under IGAAP, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Asset.
(i) What would be the classification of Bhilwara-Jabalpur Toll Project as per applicable Ind AS? Give brief reasoning for your choice.
(ii) What would be the classification of Kolhapur-Nagpur Expressway Toll Project as per applicable Ind AS? Give brief reasoning for your choice.
(iii) Also, suggest suitable accounting treatment for preparation of financial statements as per Ind AS for the above 2 projects.

Answer:
(i) Here the operator has a contractual right to receive cash from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, operator recognizes a financial asset to the extent it has a contractual right to receive cash.
(ii) Here the operator has a contractual right to charge users of the public services. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service. Therefore, the operator shall recognise an intangible asset to the extent it receives a right (a licence) to charge users of the public service.

(iii) Accounting treatment for preparation of financial statements

Bhilwara-Jabalpur Toll Project

Journal Entries

	Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
1	During construction: Financial asset A/c Dr. To Construction revenue [To recognise revenue relating to construction services, to be settled in case]	110	110
2	Cost of construction (profit or loss) Dr. To Bank A/c (As and when incurred) [To recognise costs relating to construction services]	100	100
3	During the operation phase: Financial asset Dr. To Finance revenue (As and when received or due to receive) [To recognise interest income under the financial asset model]	15	15
4	Financial asset Dr. To Revenue [(200-110) – 15] [To recognise revenue relating to the operation phase]	75	75
5	Bank A/c Dr. To Financial asset [To recognise cash received from the grantor]	200	200

Kolhapur-Nagpur Expressway -Intangible asset

Journal Entries

	Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
1	During construction: Cost of construction (profit or loss) Dr. To Bank A/c (As and when incurred) [To recognise costs relating to construction services]	110	110
2	Intangible asset Dr. To Revenue [To recognise revenue relating to construction services provided for non-cash consideration]	200	200
3	During the operation phase: Amortisation expense Dr. To Intangible asset (accumulated amortisation) [To recognise amortisation expense relating to the operation phase over the period of operation]	200	200
4	Bank A/c Dr. To Revenue [To recognise revenue relating to the operation phase]	?	?

Note: Amount in entry 4 is kept blank as no information in this regard is given in the question.

Questions

1. Q TV released an advertisement in Deshabandhu, a vernacular daily. Instead of paying for the same, Q TV allowed Deshabandhu a free advertisement spot, which was duly utilised by Deshabandu. How revenue for these nonmonetary transactions in the area of advertising will be recognised and measured?

Answer:

Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis. In industries with homogenous products, it is common for entities in the same line of business to exchange products in order to sell them to customers or potential customers other than parties to exchange. The current scenario, on the contrary, will be covered under Ind AS 115 since the same is exchange of dissimilar goods or services because both of the entities deal in different mode of media, i.e., one is print media and another is electronic media and both parties are acting as customers and suppliers for each other. Further, in the current scenario, it seems it is for consumption by the said parties and hence it does not fall under paragraph 5(d). It may also be noted that, even if it was to facilitate sales to customers or potential customers, it would not be scoped out since the parties are not in the same line of business. As per paragraph 47 of Ind AS 115, —An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both. Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value. In accordance with the above, Q TV and Deshabandhu should measure the revenue promised in the form of non-cash consideration as per the above referred principles of Ind AS 115.

2. A Ltd. a telecommunication company, entered into an agreement with B Ltd. which is engaged in generation and supply of power. The agreement provided that A Ltd. will provide 1,00,000 minutes of talk time to employees of B Ltd. in exchange for getting power equivalent to 20,000 units. A Ltd. normally charges ` 0.50 per minute and B Ltd. charges ` 2.5 per unit. How should revenue be measured in this case?

Answer:

Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

However, the current scenario will be covered under Ind AS 115 since the same is exchange of dissimilar goods or services.

As per paragraph 47 of Ind AS 115, —an entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferrin promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of noncash consideration) at fair value. On the basis of the above, revenue recognised by A Ltd. will be the consideration in the form of power units that it expects to be entitled for talktime sold, i.e. ` 50,000 (20,000 units x ` 2.5). The revenue recognised by B Ltd. will be the consideration in the form of talk time that it expects to be entitled for the power units sold, i.e., ` 50,000 (1,00,000 minutes x ` 0.50).

3. Company X enters into an agreement on 1st January, 20X1 with a customer for renovation of hospital and install new air-conditioners for total consideration of ` 50,00,000. The promised renovation service, including the installation of new air -conditioners is a single performance obligation satisfied over time. Total expected costs are ` 40,00,000 including ` 10,00,000 for the air conditioners.
Company X determines that it acts as a principal in accordance with paragraphs B34-B38 of Ind AS 115 because it obtains control of the air conditioners before they are transferred to the customer. The customer obtains control of the air conditioners when they are delivered to the hospital premises.
Company X uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation. As at 31st March, 20X1, other costs incurred excluding the air conditioners are ` 6,00,000. Whether Company X should include cost of the air conditioners in measure of its progress of performance obligation? How should revenue be recognised for the year ended March 20X1?
Answer:
Paragraph B19 of Ind AS 115 inter alia, states that, ―an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 39, do not depict the entity's performance in transferring control of goods or services to the customer.
In accordance with the above, Company X assesses whether the costs incurred to procure the air conditioners are proportionate to the entity's progress in satisfying the performance obligation. The costs incurred to procure the air conditioners (` 10,00,000) are significant relative to the total costs to completely satisfy the performance obligation (` 40,00,000). Also, Company X is not involved in manufacturing or designing the air conditioners. Company X concludes that including the costs to procure the air conditioners in the measure of progress would overstate the extent of the entity's performance. Consequently, in accordance with paragraph B19 of Ind AS 115, the entity adjusts its measure of progress to
exclude the costs to procure the air conditioners from the measure of costs incurred and from the transaction price. The entity recognises revenue for the transfer of the air conditioners at an amount equal to the costs to procure the air conditioners (i.e., at a zero margin). Company X assesses that as at March, 20X1, the performance is 20 per cent complete (i.e.,
` 6,00,000 / ` 30,00,000). Consequently, Company X recognises the following-

As at 31st March, 20X1

	Amount in ₹
Revenue	18,00,000
Cost of goods sold	16,00,000
Profit	2,00,000

Revenue recognised is calculated as (20 per cent × ` 40,00,000) + ` 10,00,000.
(` 40,00,000 = ` 50,00,000 transaction price – ` 10,00,000 costs of air conditioners.)
Cost of goods sold is ` 6,00,000 of costs incurred + ` 10,00,000 costs of air conditioners.

4. 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? [ALSO IN RTP - NOV 2019]

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) the parties 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, para 15 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 customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or

(b) the contract has been terminated and the consideration received from the customer is non-refundable.

Para 16 states that 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 received substantially all of the consideration nor it has terminated the contract. Consequently, in accordance with paragraph 16, G Ltd. will continue to account for the initial deposit as well as any future payments of principal and interest as a deposit liability until the criteria in paragraph 9 are met (i.e. the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. Further, G Ltd. will continue to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

5. 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 (` 1.5 million) and which entity I is willing to accept because it wants to grow its presence in this market. Entity I has granted similar price concessions in comparable contracts.
Entity I concludes that it is highly probable that it will collect ` 1.75 million, and such amount is not constrained under the variable consideration guidance. What is the transaction price in this arrangement?
Answer:
Entity I is likely to provide a price concession and accept an amount less than ` 2 million in exchange for the machinery. The consideration is therefore variable. The transaction price in this arrangement is ` 1.75 million, as this is the amount which entity I expects to receive after providing the concession and it is not constrained under the variable consideration guidance. Entity I can also conclude that the collectability threshold is met for ` 1.75 million and therefore contract exists.

6. 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
₹ 100	1 - 1,000,000 containers
₹ 90	1,000,001 - 3,000,000 containers
₹ 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 31st March 20X8 for a contract price of ` 100 per container. How should entity J determine the transaction price?
Answer:
The transaction price is ` 90 per container based on entity J's estimate of total sales volume for the year, since the estimated cumulative sales volume of 2.8 million containers would result in a price per container of ` 90. Entity J concludes that based on a transaction price of ` 90 per container, it is highly probable that a significant

reversal in the amount of cumulative revenue recognised will not occur when the uncertainty is resolved. Revenue is therefore recognised at a selling price of ` 90 per container as each container is sold. Entity J will recognise a liability for cash received in excess of the transaction price for the first 1 million containers sold at ` 100 per container (that is, ` 10 per container) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced. For the quarter ended 31st March, 20X8, entity J recognizes revenue of ` 63 million (700,000 containers x ` 90) and a liability of ` 7 million [700,000 containers x (` 100 - ` 90)]. Entity J will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

7. Entity K sells electric razors to retailers for C 50 per unit. A rebate coupon is included inside the electric razor package that can be redeemed by the end consumers for C 10 per unit. Entity K estimates that 20% to 25% of eligible rebates will be redeemed, based on its experience with similar programmes and rebate redemption rates available in the market for similar programmes. Entity K concludes that the transaction price should incorporate an assumption of 25% rebate redemption, as this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change. How should entity K determine the transaction price?

Answer:

Entity K records sales to the retailer at a transaction price of ` 47.50 (` 50 less 25% of ` 10). The difference between the per unit cash selling price to the retailers and the transaction price is recorded as a liability for cash consideration expected to be paid to the end customer. Entity K will update its estimate of the rebate and the transaction price at each reporting date if estimates of redemption rates change.

8. A manufacturer enters into a contract to sell goods to a retailer for ` 1,000. The manufacturer also offers price protection, whereby it will reimburse the retailer for any difference between the sale price and the lowest price offered to any customer during the following six months. This clause is consistent with other price protection clauses offered in the past, and the manufacturer believes that it has experience which is predictive for this contract.

Management expects that it will offer a price decrease of 5% during the price protection period. Management concludes that it is highly probable that a significant reversal of cumulative revenue will not occur if estimates change. How should the manufacturer determine the transaction price?

Answer:

The transaction price is ` 950, because the expected reimbursement is ` 50. The expected payment to the retailer is reflected in the transaction price at contract inception, as that is the amount of consideration to which the manufacturer expects to be entitled after the price protection. The manufacturer will recognise a liability for the difference between the invoice price and the transaction price, as this represents the cash that it expects to refund to the retailer. The manufacturer will update its estimate of expected reimbursement at each reporting date until the uncertainty is resolved.

9. Electronics Manufacturer M sells 1,000 televisions to Retailer R for ` 50,00,000 (` 5,000 per television). M provides price protection to R by agreeing to reimburse R for the difference between this price and the lowest price that it offers for that television during the following six months. Based on M's extensive experience with similar arrangements, it estimates the following outcomes.

Price reduction in next six months (₹)	Probability
0	70%
₹ 500	20%
₹ 1,000	10%

Determine the transaction price.

Answer:

After considering all relevant facts and circumstances, M determines that the expected value method provides the best prediction of the amount of consideration to which it will be entitled. As a result, it estimates the transaction price to be ` 4,800 per television – i.e. (` 5,000 x 70%) + (` 4,500 x 20%) + (` 4,000 x 10%).

10. Construction Company C enters into a contract with Customer E to build an asset. Depending on when the asset is completed, C will receive either ` 1,10,000 or ` 1,30,000.

Outcome	Consideration (₹)	Probability
Project completes on time	1,30,000	90%
Project is delayed	1,10,000	10%

Determine the transaction price.

Answer:

Because there are only two possible outcomes under the contract, C determines that using the most likely amount provides the best prediction of the amount of consideration to which it will be entitled. C estimates the transaction price to be ` 1,30,000, which is the single most likely amount.

11. Franchisor Y Ltd. licenses the right to operate a store in a specified location to Franchisee F. The store bears Y Ltd.'s trade name and F will have a right to sell Y Ltd.'s products for 10 years. F pays an up-front fixed fee. The franchise contract also requires Y Ltd. to maintain the brand through product improvements, marketing campaigns etc. Determine the nature of license.

Answer:

The licence provides F access to the IP as it exists at any point in time in the licence period.

This is because:

– Y Ltd. is required to maintain the brand, which will significantly affect the IP by affecting F's ability to obtain benefit from the brand;

– any action by Y Ltd. may have a direct positive or negative effect on F; and

– these activities do not transfer a good or service to F.

Therefore, Y Ltd. recognises the up-front fee over the 10-year franchise period. The licence provides F access to the IP as it exists at any point in time in the licence period.

This is because:

– Y Ltd. is required to maintain the brand, which will significantly affect the IP by affecting F's ability to obtain benefit from the brand;

– any action by Y Ltd. may have a direct positive or negative effect on F; and

– these activities do not transfer a good or service to F.

Therefore, Y Ltd. recognises the up-front fee over the 10-year franchise period.

PAST EXAMINATION, MTPs, RTPs QUESTIONS

1. Deluxe bike manufactured by Zed Limited is sold with an extended warranty of 2 years for Rs. 87,300 while an identical Deluxe bike without the extended warranty is sold in the market for Rs. 80,000 and equivalent warranty is given in the market for Rs. 10,000. How should Zed Limited recognize and measure revenue in the books on the sale of the bikes and warranty?
[NOV 2018 - 5 MARKS]
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)	Rs. 90,000
Less: Sale price of the Deluxe bike with extended warranty	(Rs. 87,300)
Discount	Rs. 2,700

Discount and revenue attributable to each component of the transaction:

Proportionate discount attributable to sale of Deluxe bike (2,700 x 80,000 / 90,000)	Rs. 2,400
Revenue from sale of Deluxe bike (80,000 – 2,400)	Rs. 77,600
Proportionate discount attributable to extended warranty (2,700 x 10,000 / 90,000)	Rs. 300
Revenue from extended warranty (10,000 - 300)	Rs. 9,700

Revenue in respect of sale of Deluxe bike of Rs. 77,600 should be recognised immediately and revenue from warranty of Rs. 9,700 should be recognised over the period of warranty ie. 2 years.

2. Orange Ltd. contracts to renovate a five star hotel including the installation of new elevators on 01.10.2017. Orange Ltd. estimates the transaction price of Rs. 480 lakh. The expected cost of elevators is Rs. 144 lakh and expected other costs is Rs. 240 lakh. Orange Ltd. purchases elevators and they are delivered to the site six months before they will be installed. Orange Ltd. uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of Rs. 48 lakh by 31.03.2018. How much revenue will be recognised as per relevant Ind AS 115 for the year ended 31st March, 2018, if performance obligation is met over a period of time?
[MAY 2019 - 5 MARKS]
Answer:
Cost to be incurred comprises two major components – cost for elevators and cost of construction service.
(a) The elevators are part of the overall construction project and are not a distinct performance obligation
(b) The cost of elevators is substantial to the overall project and are incurred well in advance.
(c) Upon delivery at site, customer acquires control of such elevators.
(d) There is no modification done to the elevators, which the company only procures and

delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method –
- The measure of progress should be based on percentage of costs incurred relative to the total budgeted costs.
- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	Amount (₹ 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 recognised	144 + 67.2 = 211.20

Therefore, for the year ended 31st March, 2018, the company shall recognize revenue of ₹ 211.20 lakhs on the project.

Note: The above solution is given on the basis of Ind AS 115 irrespective of the financial year mentioned in the question.

3. 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 sales value of Rs. 40 lakh. It was envisaged that the contract would run for two years and that the total expected costs would be Rs. 32 lakh. On 31st March, 2019, Nivaan Limited revised its estimate of the total expected cost to Rs. 34 lakh on the basis of the additional rectification cost of Rs. 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 31st March, 2019 of Rs. 16 lakh and has received payments on account of Rs. 13 lakh. The second contract with B & Co. commenced on 1st September, 2018 and was for 18 months. The total sales value of contract was Rs. 30 lakh and the total expected cost is Rs. 24 lakh. Payments on account already received were Rs. 9.50 lakh and total costs incurred to date were Rs. 8 lakh. Nivaan Limited has insisted on a large deposit B & Co. because the companies had not traded together prior to the contract. The independent surveyor estimated that on 31st March, 2019 the contract was 20% complete. The two contracts meet the requirement of Ind AS 115 '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 31st March, 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 31st March, 2019.
Prepare financial statement extracts for Nivaan Limited in respect of the two construction contracts for the year ending 31st March, 2019.
[NOV 2019 - 12 MARKS]
Answer:
Extracts of Balance Sheet of Nivaan Ltd. as on 31st March, 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

	₹ in lakh
Revenue from contracts (Refer W.N. 1)	18
Cost of Revenue (Refer W.N. 1)	(16.4)
Net Profit on Contracts (Refer W.N. 1)	1.6

Working Notes:
1. Table showing calculation of total revenue, expenses and profit or loss on contract for the year (Rs. 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 Rs. 2 lakh has been treated as normal cost. Hence total expected cost has been considered as Rs. 34 lakh. However, in case this Rs. 2 lakh is treated as abnormal cost then expense due for the year would be Rs. 11.6 lakh (ie 30% of Rs. 32 lakh plus Rs. 2 lakh). Accordingly, with respect to A & Co., the profit for the year would be Rs. 0.4 lakh and work-in-progress recognised at the end of the year would be Rs. 4.4 lakh.

2. Calculation of amount due from / (to) customers (Rs. in lakh)

	A & Co.	B & Co.	Total
Billing on the basis of 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 recognised as 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	9.0

4. X Ltd. is engaged in manufacturing and selling of designer furniture. It sells goods on extended credit. X Ltd. sold furniture for Rs. 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 - 6 MARKS]

Answer:
X Ltd. should determine the fair value of revenue by calculating the present value of the cash flows receivable.

Total amount receivable = Rs. 40,00,000 x 1.03 = Rs. 41,20,000.
Present Value of receivable (Revenue) = Rs. 41,20,000/1.08 = Rs. 38,14,815.
Interest income = Rs. 41,20,000 - Rs. 38,14,815 = Rs. 3,05,185.

Therefore, on transaction date, Rs. 38,14,815 will be recognised as revenue from sale of goods and Rs. 3,05,185 will be recognised as interest income receivable for the period in accordance with Ind AS 109.

5. A Ltd. has sold goods to B Ltd. at a consideration of Rs. 10 lakhs, receivable in three equal installments of Rs. 3,33,333 over a two-year period (ie on 1st April 2018, 31st March 2019 and 31st March 2020).
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 expected to be received from such sale is Rs. 10 lakhs. 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 with Ind AS. If not, advise the correct treatment along with the workings for the same.
[MTP - OCTOBER 2018 - 8 MARKS]
Answer:
As per Ind AS 18, 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)	Present value factor	Present value of consideration
Time of sale	3,33,333	-	3,33,333
End of 1st year	3,33,333	0.949	3,16,333
End of 2nd year	3,33,334	0.901	3,00,334
	10,00,000		**9,50,000**

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

Initial recognition of sale of goods		INR	
Cash	Dr.	3,33,333	
Trade Receivable	Dr.	6,16,667	
To Sale			9,50,000
Recognition of interest and receipt of second installment			
Cash	Dr.	3,33,333	
To Interest Income			33,053
To Trade Receivable			3,00,280
Recognition of interest and payment of final installment			
Cash	Dr.	3,33,334	
To Interest Income (Balancing figure)			16,947
To Trade Receivable			3,16,387

Balance Sheet (extracts) as at 31st March 2019 and 31st March 2020

	As at Mar 31, 2019	As at Mar 31, 2020
Income		
Sale of Goods	9,50,000	-
Other Income (Finance income)	33,053	16,947

Statement of Profit and Loss (extracts)

for the year ended 31st March 2019 and 31st March 2020

	As at Mar 31, 2019	As at Mar 31, 2020
Assets		
Current Assets		
Financial Assets		
Trade Receivables	3,16,387	XXX

6. 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. 1st October, 2017 without any additional charges. The total amount payable by the customer is agreed as follows:

- **Rs. 8,00,000, if paid by 31st January, 2018;**
- **Rs. 8,10,000, if paid by 28th February, 2018;**
- **Rs. 8,20,000, if paid by 31st March, 2018.**

Based on past experience it is highly probable that the customer makes the payment before 28th February, 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 considered 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 - OCTOBER 2018 - 8 MARKS]

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 (30,000 x 7,00,000 / 8,40,000)	25,000	
Revenue from sale of item (7,00,000 – 25,000)		6,75,000
Proportionate discount attributable to two years' service period (30,000 x 1,40,000 / 8,40,000)		5,000
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 31st March, 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).

7. KK Ltd. runs a departmental store which awards 10 points for every purchase of Rs. 500 which can be discounted by the customers for further shopping with the same merchant. Unutilised points will lapse on expiry of two years from the date of credit. Value of each point is Rs. 0.50. During the accounting period 20X1-20X2, 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 Rs. 10,00,000 on a particular day?
(b) How should the redemption transaction be recorded in the year 20X1-20X2? The Company has requested you to present the sale of goods and redemption as independent transaction. Total sales of the entity is Rs. 5,000 lakhs.
(c) How much of the deferred revenue should be recognised at the year-end (20X1-20X2) because of the estimation that only 80% of the outstanding points will be redeemed?
(d) In the next year 20X2-20X3, 60% of the outstanding points were discounted Balance 40% of the outstanding points of 20X1-20X2 still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 20X2-20X3 and what will be the amount of balance deferred revenue?
(e) How much revenue will the merchant recognized in the year 20X2-20X3, if 3,00,000 points are redeemed in the year 20X2-20X3?
[RTP - MAY 2019 | MTP - OCTOBER 2019/OCT 2020 - 14 MARKS]
Answer:
(a) Points earned on Rs. 10,00,000 @ 10 points on every Rs. 500 = [(10,00,000/500) x 10] = 20,000 points.
Value of points = 20,000 points x Rs. 0.5 each point = Rs. 10,000

Revenue recognized for sale of goods	Rs. 9,90,099	[10,00,000 x (10,00,000/10,10,000)]
Revenue for points deferred	Rs. 9,901	[10,00,000 x (10,000/10,10,000)]

Journal Entry

		Rs.	Rs.
Bank A/c	Dr.	10,00,000	
To Sales A/c			9,90,099
To Liability under Customer Loyalty programme			9,901

(b) Points earned on Rs. 50,00,00,000 @ 10 points on every Rs. 500 = [(50,00,00,000/500) x 10] = 1,00,00,000 points.

Value of points = 1,00,00,000 points x Rs. 0.5 each point = Rs. 50,00,000

Revenue recognized for sale of goods = Rs. 49,50,49,505 [50,00,00,000 x (50,00,00,000 / 50,50,00,000)]

Revenue for points = Rs. 49,50,495 [50,00,00,000x (50,00,000 / 50,50,00,000)]

Journal Entry in the year 20X1

		Rs.	Rs.
Bank A/c	Dr.	50,00,00,000	
To Sales A/c			49,50,49,505
To Liability under Customer Loyalty programme			49,50,495
(On sale of Goods)			
Liability under Customer Loyalty programme	Dr.	42,11,002	
To Sales A/c			42,11,002
(On redemption of (100 lakhs -18 lakhs) points)			

Revenue for points to be recognized
Undiscounted points estimated to be recognized next year 18,00,000 x 80% = 14,40,000 points

Total 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
Total 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 programme	Dr.	5,54,620	
To Sales A/c			5,54,620
(On redemption of further 10,80,000 points)			

The Liability under Customer Loyalty programme at the end of the year 20X2-20X3 will 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. 1,84,87 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 programme	Dr.	1,84,873	
To Sales A/c			1,84,873
(On redemption of remaining points)			

8. (a) Entity I sells a piece of machinery to the customer for Rs. 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 Rs. 1.75 million, which is sufficient to cover entity I's cost of sales (Rs. 1.5 million) and which entity I is willing to accept because it wants to grow its presence in this market.
Entity I has granted similar price concessions in comparable contracts. Entity I concludes that it is highly probable that it will collect Rs. 1.75 million, and such amount is not constrained under the variable consideration guidance. What is the transaction price in this arrangement?

(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:
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?

(c) Entity K sells electric razors to retailers for C 50 per unit. A rebate coupon is included inside the electric razor package that can be redeemed by the end consumers for C 10 per unit. Entity K estimates that 20% to 25% of eligible rebates will be redeemed, based on its experience with similar programmes and rebate redemption rates available in the market for similar programmes. Entity K concludes that the transaction price should incorporate an assumption of 25% rebate redemption, as this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change. How should entity K determine the transaction price?

(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?
[RTP - MAY 2020]
Answer:
(a) 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) 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 31st March, 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.
(c) 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.
(d) 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.

9. 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.
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.

CHAPTER 4. IND AS ON MEASUREMENT BASED ON ACCOUNTING POLICIES

UNIT 1: INDAS 8: ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

QUESTIONS FROM ICAI STUDY MATERIAL

Illustrations

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

Answer:

A change in an accounting policy can be made only if the change is required or permitted by Ind AS 8. As per para 14 of Ind AS 8, an entity shall change an accounting policy only if the change: (a) is required by an Ind AS; or (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. Para 15 of the standard states that the users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the above criteria. Paragraph 14(b) lays down two requirements that must be complied with in order to make a voluntary change in an accounting policy. First, the information resulting from application of the changed (i.e., the new) accounting policy must be reliable. Second, the changed accounting policy must result in —more relevant‖ information being presented in the financial statements.

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

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

Answer:

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

As per Ind AS 16, ‗property, plant and equipment are tangible items that:
(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
(b) are expected to be used during more than one period.

As per Ind AS 40, ‗investment property' is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:
(a) use in the production or supply of goods or services or for administrative purposes; or
(b) sale in the ordinary course of business.

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

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

in which the entity operates. Paragraphs 9-12 of Ind AS 21 list factors to be considered by an entity in determining its functional currency. It is recognised that there may be cases where the functional currency is not obvious. In such cases, Ind AS 21 requires the management to use its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. Paragraph 13 of Ind AS 21 specifically notes that an entity‘s functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions. Thus, functional currency of an entity is not a matter of an accounting policy choice. In view of the above, a change in functional currency of an entity does not represent a change in accounting policy and Ind AS 8, therefore, does not apply to such a change. Ind AS 21 requires that when there is a change in an entity‘s functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

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

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

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

Answer:

Paragraph 29 of Ind AS 16 provides that an entity shall choose either the cost model or the revaluation model as its accounting policy for subsequent measurement of an entire class of PPE. A change from revaluation model to cost model for a class of PPE can be made only if it meets the condition specified in Ind AS 8 paragraph 14(b) i.e. the change results in the financial statements providing reliable and more relevant information to the users of financial statements. For example, an unlisted entity planning IPO may change its accounting

policy from revaluation model to cost model for some or all classes of PPE to align the entity's accounting policy with that of listed markets participants within that industry so as to enhance the comparability of its financial statements with those of other listed market participants within the industry. Such a change – from revaluation model to cost model is not expected to be frequent. Where the change in accounting policy from revaluation model to cost model is considered permissible in accordance with Ind AS 8 paragraph 14(b), it shall be accounted for retrospectively, in accordance with Ind AS 8.

6. Whether an entity is required to disclose the impact of any new Ind AS which is issued but not yet effective in its financial statements as per Ind AS 8?

Answer:

Paragraph 30 of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors, states as follows:
—When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:
(a) this fact; and
(b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS will have on the entity's financial statements in the period of initial application.‖
Accordingly, it may be noted that an entity is required to disclose the impact of Ind AS which has been issued but is not yet effective.

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

Answer:

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

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

As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.
In accordance with the above, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 20X2, the comparative amounts as at 31st March, 20X1 would be restated to reflect the correct classification.
Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the 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 1st April, 20X0 in addition to the comparatives for the financial year 20X0-20X1.

Questions

1. A carpet retail outlet sells and fits carpets to the general public. It recognizes revenue when the carpet is fitted, which on an average is six weeks after the purchase of the carpet.
It then decides to sub-contract the fitting of carpets to self-employed fitters. It now recognizes revenue at the point-of-sale of the carpet. Whether this change in recognising the revenue is a change in accounting policy as per the provision of Ind AS 8?
Answer:
This is not a change in accounting policy as the carpet retailer has changed the way that the carpets are fitted. Therefore, there would be no need to retrospectively change prior period figures for revenue recognized.

2. When is an entity required to present a third balance sheet as at the beginning of the preceding period?
Answer:
As per paragraph 40A of Ind AS 1, Presentation of Financial Statements, an entity shall

present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required by paragraph 38A of the standard if:

-- it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and

-- the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period

3. During 20X2, Delta Ltd., changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.
In years before 20X2, Delta Ltd.'s asset records were not sufficiently detailed to apply a components approach fully. At the end of 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.
Delta Ltd.'s management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta Ltd.'s new policy prospectively from the start of 20X2.
Additional information:
(i) Delta Ltd.'s tax rate is 30%

(ii) Property, plant and equipment at the end of 20X1:	**Cost**	**` 25,000**
	Depreciation	**` 14,000**
	Net book value	**` 11,000**

(iii) Prospective depreciation expense for 20X2 (old basis) ` 1,500
(iv) Some results of the engineering survey:

Valuation	**` 17,000**
Estimated residual value	**` 3,000**
Average remaining asset life	**7 years**
Depreciation expense on existing property, plant and equipment for 20X2 (new basis)	**` 2,000**

You are required to prepare relevant note for disclosure in accordance with Ind AS 8.
Answer:
Extract from the notes
From the start of 20X2, Delta Ltd., changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of 20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively, or prospectively from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years. The effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by ` 6,000;

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

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

Answer:

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

As per the above, depreciation method for a depreciable asset has to reflect the expected pattern of consumption of future economic benefits embodied in the asset. Determination of depreciation method involves an accounting estimate and thus depreciation method is not a matter of an accounting policy. Accordingly, Ind AS 16 requires a change in depreciation method to be accounted for as a change in an accounting estimate, i.e., prospectively.

5. An entity charged off certain expenses as finance costs in its financial statements for the year ended 31st March, 20X1. While preparing annual financial statements for the year ended 31st March, 20X2, management discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 20X1). Would this reclassification of expenses from finance costs to other expenses in the comparative amounts will be considered as correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

Answer:

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

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

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

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

6. While preparing the annual financial statements for the year ended 31st March, 20X3, an entity discovers that a provision for constructive obligation for payment of bonus to selected employees in corporate office (material in amount) which was required to be recognised in the annual financial statements for the year ended 31st March, 20X1 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31st March, 20X2 and was recognised as an expense in the annual financial statements for the said year. Would this situation require retrospective restatement of comparatives considering that the error was material?

Answer:

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

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

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

(a) restate the comparative amounts (i.e., those for the year ended 31st March, 20X2) in the statement of profit and loss; and

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

7. While preparing interim financial statements for the half-year ended 30th September, 20X1, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30th June, 20X1. The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management's view is acceptable?

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 as follows:

—While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from 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.

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

How should the error be corrected in the financial statements for the year ended 31st March, 20X4, assuming the impact of the same is considered material? For simplicity, ignore tax effects.

Answer:

The error shall be corrected by retrospectively restating the figures for financial year 20X2-20X3 and also by presenting a third balance sheet as at April 1, 20X2 which is the beginning of the earliest period presented in the financial statements.

9. ABC Ltd. changed its method adopted for inventory valuation in the year 20X2-20X3. Prior to the change, inventory was valued using the first in first out method (FIFO). However, it was felt that in order to match current practice and to make the financial statements more relevant and reliable, a weighted average valuation model would be more appropriate.

The effect of the change in the method of valuation of inventory was as follows:

--- 31st March, 20X1 - Increase of ` 10 million

--- 31st March, 20X2 - Increase of ` 15 million

--- 31st March, 20X3 - Increase of ` 20 million

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

	20X2-20X3	20X1-20X2
Revenue	324	296
Cost of goods sold	(173)	(164)
Gross profit	**151**	**132**
Expenses	(83)	(74)
Profit	68	58

Retained earnings at 31st March, 20X1 were ` 423 million

Present the change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8.

Answer:

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

	20X2-20X3	20X1-20X2 (Restated)
Revenue	324	296
Cost of goods sold	(168)	(159)
Gross profit	**156**	**137**
Expenses	(83)	(74)
Profit	**73**	**63**

Statement of changes in Equity (extract)

	Retained earnings	Retained earnings (Original)
At 1st April, 20X1	423	423
Change in inventory valuation policy	10	-
At 1st April, 20X1 (Restated)	**433**	**-**
Profit for the year 20X1-20X2	63	58
At 31st March, 20X2	**496**	**481**
Profit for the 20X2-20X3	73	68
At 31st March, 20X3	**569**	**549**

PAST EXAMINATION, MTPs, RTPs QUESTIONS

1. ABC changed its accounting policy for inventory in 2016-2017. Prior to the change, inventory had been valued using the first in first out method (FIFO). However, it was felt that in order to match current practice and to make the financial statements more relevant and reliable a weighted average valuation model should be used.

The effect of the change on the valuation of inventory was as follows:

- **31st March, 2015 - Increase of Rs. 10 million**
- **31st March, 2016 - Increase of Rs. 15 million**
- **31st March, 2017- Increase of Rs. 20 million**

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

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

Retained earnings at 31st March, 2015 were Rs. 423 million.
Present the change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8.
[RTP - MAY 2019 | MTP - OCTOBER 2018 - MARKS]
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. 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:

	₹
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. [RTP - NOV 2019]

Answer:

Cheery Limited

Extract from the Statement of profit and loss

		(Restated)
	20X4-X5	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	___	9,450	9,450
Balance at 31st March, 20X4	**50,000**	**29,450**	**79,450**
Profit for the year ended 31st March, 20X5	___	16,800	16,800
Balance at 31st March, 20X5	**50,000**	**46,250**	**96,250**

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.

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

Issue 1:

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

Issue 2:

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

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

[RTP - MAY 2020]

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 com ply 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 (1April 20X1). Therefore, the entity is not required to present a third balance sheet.

4. An entity's accounting year ends is 31st December, but its tax year end is 31st March. The entity publishes an interim financial report for each quarter of the year ended 31st December, 2019. The entity's profit before tax is steady at `10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31st March, 2019 and 30% for the year ended 31st March, 2020.

How the related tax charge would be calculated for the year 2019 and its quarters. (rtp- nov 2020)

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	10,000	10,000	10,000	10,000	40,000
Tax charge	(2,500)	(3,000)	(3,000)	(3,000)	(11,500)
	7,500	7,000	7,000	7,000	28,500

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.

5. 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 2020)

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% holding

Mr. 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 A and 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.

6. Shaurya Limited owns Building A which is specifically used for the purpose of earning rentals. The Company has not been using the building A or any of its facilities for its own use for a long time. The company is also exploring the opportunities to sell the building if it gets the reasonable amount in consideration.

Following information is relevant for Building A for the year ending 31st March, 2020:

Building A was purchased 5 years ago at the cost of `10 crore and building life is estimated to be 20 years. The company follows straight line method for depreciation.

During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 2019 at the cost of ` 2 crore. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.

Further, during the year 2019-2020, the company earned / incurred following direct operating expenditure relating to Building A and Building B:

Rental income from Building A = ` 75 lakh

Rental income from Building B = ` 25 lakh

Sales promotion expenses = ` 5 lakh

Fees & Taxes = ` 1 lakh

Ground rent = ` 2.5 lakh

Repairs & Maintenance = ` 1.5 lakh

Legal & Professional = ` 2 lakh

Commission and brokerage = ` 1 lakh

The company does not have any restrictions and contractual obligations against buildings - A and B. For complying with the requirements of Ind AS, the management sought an independent report from the specialists so as to ascertain the fair value of 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 ` 50 - ` 60. It is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at ` 10.50 crore on 31st March, 2020.

What would be the treatment of Building A and Building B in the balance sheet of Shaurya Limited? Provide detailed disclosures and computations in line with relevant Indian accounting standards. Treat it as if you are preparing a separate note or schedule, of the given assets in the balance sheet.

(RTP- NOV 2020)

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, 2020 (₹ in crore)
Gross Amount:	
Opening balance (A)	10.00
Additions during the year (B)	2.00
Closing balance (C) = (A) + (B)	12.00
Depreciation:	
Opening balance (D)	2.50
Depreciation during the year (E) (0.5 + 0.05)	0.55

Closing balance (F) = (D) + (E)	3.05
Net balance (C) - (F)	8.95

The changes in the carrying value of investment properties for the year ended 31st March, 2020 are as follows:

Amount recognised in Profit and Loss with respect to Investment Properties

Particulars	Period ending 31st March, 2020 (₹ in crore)
Rental income from investment properties (0.75 + 0.25)	1.00
Less: Direct operating expenses generating rental income (5+1+2.5+1.5+2+1)	(0.13)
Profit from investment properties before depreciation and indirect expenses	0.87
Less: Depreciation	(0.55)
Profit from earnings from investment properties before indirect expenses	0.32

Disclosure Note on Investment Properties acquired by the entity

The investment properties consist Property A and Property B. As at 31st March, 2020, the fair value of the properties is ₹10.50 crore. The valuation is performed by independent valuers, who are specialists in valuing investment properties. A valuation model as recommended by International Valuation Standards Committee has been applied. The Company considers factors like management intention, terms of rental agreements, area leased out, life of the assets etc. to determine classification of assets as investment properties.

The Company has no restrictions on the realisability of its investment properties and no contractual obligations to purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

Description of valuation techniques used and key inputs to valuation on investment properties:

Valuation technique	Significant unobservable inputs	Range (Weighted average)
Discounted cash flow (DCF) method	- Estimated rental value per sq. ft. per month - Rent growth per annum - Discount rate	- ₹ 50 to ₹ 60 - 10% every 3 years - 12% to 13%

UNIT 2: INDIAN ACCOUNTING STANDARD 10: EVENTS AFTER THE REPORTING PERIOD

Questions from STUDY MATERIAL

Illustrations

1 What is the date of approval for issue of the financial statements prepared for the reporting period from 1st April, 20X1 to 31st March, 20X2, in a situation where following dates are available? Completion of preparation of financial statements 28th May, 20X2 Board reviews and approves it for issue 19th June, 20X2
Available to shareholders 1s July , 20X2
Annual General Meeting 15th September, 20X2
Filed with regulatory authority 16th October, 20X2
Will your answer differ if the entity is a partnership firm?
Answer:
As per Ind AS 10 the date of approval for issue of financial statements is the date on which the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity. Accordingly, in the instant case, the date of approval is the date on which the financial statements are approved by the Board of Directors of the company, i.e., 19th June, 20X2.
If the entity is a partnership firm, the date of approval will be the date when the relevant approving authority of such entity approves the financial statements for issue i.e. the date when the partner(s) of the firm approve(s) the financial statements.

2 . ABC Ltd. prepared interim financial report for the quarter ending 30th June, 20X1. The interim financial report was approved for issue by the Board of Directors on 15th July, 20X1. Whether events occurring between end of the interim financial report and date of approval by Board of Directors, i.e., events between 1st July, 20X1 and 15th July, 20X1 that provide evidence of conditions that existed at the end of the interim reporting period shall be adjusted in the interim financial report ending 30th June, 20X1?
Answer:
Paragraph 3 of Ind AS 10, inter alia, defines 'Events after the reporting period' as those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue.

What is reporting period has not been dealt with in Ind AS 10. Absence of any specific guidance regarding reporting period implies that any term for which reporting is done by preparing financial statements is the reporting period for the purpose of Ind AS 10. Accordingly, financial reporting done for interim period by preparing either complete set of financial statements or by preparing condensed financial statements will be treated as reporting period for the purpose of Ind AS 10.
Paragraph 2 of Ind AS 34, inter alia, provides that each financial report, annual or interim, is evaluated on its own for conformity with Ind AS. Further, paragraph 19 of Ind AS 34, provides that an interim financial report shall not be described as complying with Ind AS unless it complies with all of the requirements of Ind AS.

In accordance with the above, an entity describing that its interim financial report is in compliance with Ind AS, has to comply with all the Ind AS including Ind AS 10. In order to comply with the requirements of Ind AS 10, each interim financial report should be adjusted for the adjusting events occurring between end of the interim financial report and the date of approval by Board of Directors. Therefore, in the instant case, events occurring between 1st July, 20X1 and 15th July, 20X1 that provide evidence of conditions that existed at the end of the interim reporting period should be adjusted in the interim financial report ending 30th June, 20X1.

3. The Board of Directors of ABC Ltd. approved the financial statements for the reporting period 20X1-20X2 for issue on 15th June, 20X2. The management of ABC Ltd. discovered a major fraud and decided to reopen the books of account. The financial statements were subsequently approved by the Board of Directors on 30th June, 20X2. What is the date of approval for issue as per Ind AS 10 in the given case?

Answer:

As per paragraph 3 of Ind AS 10, the – date of approval is the date on which the financial statements are approved by the Board of Directors in case of a company, and by the corresponding approving authority in case of any other entity for issue. In the given case, there are two dates of approval by Board of Directors. The financial statements were reopened for further adjustments subsequent to initial approval. The date of approval should be taken as the date on which financial statements are finally approved by the Board of Directors. Therefore, in the given case, the date of approval for issue as per Ind AS 10 should be considered as 30th June, 20X2.

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

Answer:

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

5. While preparing its financial statements for the year ended 31st March, 20X1, XYZ Ltd. made a general provision for bad debts @ 5% of its debtors. In the last week of February, 20X1 a debtor for Rs. 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. Considering the event of earthquake, XYZ Ltd. made a provision @ 50% of the amount receivable from that debtor apart from the general provision of 5% on remaining debtors. In April, 20X1 the debtor became bankrupt. Can XYZ Ltd. provide for the full loss arising out of insolvency of the debtor in the financial statements for the year ended 31st March, 20X1?

Would the answer be different if earthquake had taken place after 31st March, 20X1, and therefore, XYZ Ltd. did not make any specific provision in context that debtor and made only general provision for bad debts @ 5% on total debtors?

Answer:

As per the definition of 'Events after the Reporting Period' and paragraph 8 of Ind AS 10, Events after the Reporting Period, financial statements should be adjusted for events occurring after the reporting period that provide evidence of conditions that existed at the end of the reporting period. In the instant case, the earthquake took place in February 20X1 (i.e. before the end of the reporting period). Therefore, the condition exists at the end of the reporting date though the debtor is declared insolvent after the reporting period. Accordingly, full provision for bad debt amounting to ` 2 lakhs should be made to cover the loss arising due to the bankruptcy of the debtor in the financial statements for the year ended 31st March, 20X1. In this case, assuming that the financial statements are approved by the approving authority after April, 20X1, XYZ Ltd should provide for the remaining amount as a consequence of declaration of this debtor as bankrupt.
In case, the earthquake had taken place after the end of the reporting period, i.e., after 31st March, 20X1, and XYZ Ltd. had not made any specific provision for the debtor who was declared bankrupt later on, since the earthquake occurred after the end of the reporting period no condition existed at the end of the reporting period. The company had made only general provision for bad debts in the ordinary business course – without taking cognizance of the catastrophic situation of an earthquake. Accordingly, bankruptcy of the debtor in this case is a non-adjusting event.
As per para 21 of Ind AS 10, if non-adjusting events after the reporting period are material, their non-disclosure could influence the economic decisions that users make based on the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:
(a) the nature of the event; and
(b) an estimate of its financial effect, or a statement that such an estimate cannot be made."
If the amount of bad debt is considered to be material, the nature of this non -adjusting event, i.e., event of bankruptcy of the debtor should be disclosed along with the estimated financial effect of the same in the financial statements.

6. A company has inventory of 100 finished cars on 31st March, 20X2, which are having a cost of ` 4,00,000 each. On 30th April, 20X2, as per the new government rules, higher road tax and penalties are to be paid by the buyers for such cars (which were already expected to come) and hence the selling price of a car has come down and the demand for such cars has dropped drastically. The selling price has come down to ` 3,00,000 each. The financial statements of the company for the year 20X1-20X2 are not yet approved. Should the company value its stock at ` 4,00,000 each or should it value at ` 3,00,000 each? Ignore estimated costs necessary to make the sale.
Answer:
Events after the reporting period provide the evidence about the net realisable value of the cars at the end of the reporting period and, therefore, the amount of ` 3,00,000 should be considered for the valuation of stock.

7. ABC Ltd. has purchased a new machinery during the year 20X1-20X2. The asset was finally installed and made ready for use on 15th March, 20X2. However, the company involved in installation and training, which was also the supplier, has not yet submitted the final bills for the same. The supplier company sent the bills on 10th April, 20X2, when the financial statements were not yet approved. Should the company adjust the amount of capitalisation in the year 20X1-20X2 or in the year 20X2-20X3?
Answer:
As per the provisions of the contract, the cost of installation and training of new machine is an integral part of the cost of asset purchased. Therefore, even if the details are available after reporting period, they provide proof about the circumstances that existed at the end of reporting period. Therefore, the cost of installation and training will be considered for capitalisation in the year 20X1-20X2.

8. Company XYZ Ltd. was formed to secure the tenders floated by a telecom company for publication of telephone directories. It bagged the tender for publishing directories for Pune circle for 5 years. It has made a profit in 20X1- 20X2, 20X2-20X3, 20X3-20X4 and 20X4-20X5. It bid in tenders for publication of directories for other circles – Nagpur, Nashik, Mumbai, Hyderabad but as per the results declared on 23rd April, 20X5, the company failed to bag any of these. Its only activity till date is publication of Pune directory. The contract for publication of directories for Pune will expire on 31st December 20X5. The financial statements for the F.Y. 20X4-20X5 have been approved by the Board of

Directors on 10th July, 20X5. Whether it is appropriate to prepare financial statements on going concern basis? [ALSO IN RTP - MAY 2019]

Answer:

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

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

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

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

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

9. 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?

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, since there is only one plant which has been damaged due to fire. If the effect of deterioration in operating results and financial position is so pervasive that management determines after the reporting period either that it intends to liquidate the

entity or to cease trading, or that it has no realistic alternative but to do so, preparation of financial statements for the F.Y.20X0-20X1 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 the fire, no adjustment is required in the financial statements for the year ending 31st March, 20X1.

10. ABC Ltd. declares the dividend on 15th July, 20X2 as the results of year 20X1-20X2 as well as Q1 ending 30th June, 20X2 are better than expected. The financial statements of the company are approved on 20th July, 20X2 for the financial year ending 31st March, 20X2. Will the dividend be accounted for in the financial year 20X2-20X3 or will it be accounted for in the year 20X1-20X2?
Answer:
The dividend is declared in the year 20X2-20X3. Therefore, the obligation towards dividend did not exist at the end date of reporting period i.e., on 31st March, 20X2. Therefore, it will be accounted for in the year 20X2-20X3 and not in 20X1-20X2, even if financial statements for 20X1-20X2 were approved after the declaration of dividend. It will, however, be disclosed in the notes in the financial statements for the year 20X1-20X2 in accordance with Ind AS 1.

11. What would be the treatment for dividends declared to redeemable preference shareholders after the reporting period but before the financial statements are approved for issue for the year 20X1-20X2. Whether Ind AS 10 prescribes any accounting treatment for such dividends?
Answer:
Paragraph 12 of Ind AS 10 prescribes accounting treatment for dividends declared to holders of equity instruments. If an entity declares dividends to holders of equity instruments (as defined in Ind AS 32, Financial Instruments: Presentations) after the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period.
However, Ind AS 10 does not prescribe accounting treatment for dividends declared to redeemable preference shareholders. As per the principles of Ind AS 32, Financial Instruments: Presentation, a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability. Thus, dividend payments to such preference shares are recognised as expense in the same way as interest on a bond. Since interest will be charged on time basis, the requirements of Ind AS 10 regarding date of declaration of dividend is not relevant for its recognition.

Questions

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

As per Ind AS 10, even if partial information has already been published, the reporting period will be considered as the period between the end of reporting period and the date of approval of financial statements. In the above case, the financial statements for the year 20X1-20X2 were approved on 15th July, 20X2. Therefore, for the purposes of Ind AS 10, 'after the reporting period' would be the period between 31st March, 20X2 and 15th July, 20X2.

2. ABC Ltd. is in a legal suit with the GST department. The company gets a court order in its favour on 15th April, 20X2, which resulted into reducing the tax liability as on 31st March, 20X2. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The management has not considered the effect of the transaction as the event is favourable to the company. The company's view is that favourable events after the reporting period should not be considered as it would hamper the realisation concept of accounting. Comment on the company's views in the light of Ind AS 10.

Answer:

As per Ind AS 10, even favourable events need to be considered. What is important is whether a condition exists as at the end of the reporting period and there is evidence for the same.

3. ABC Ltd. is trading in laptops. On 31st March, 20X2, the company has 50 laptops which were purchased at ` 45,000 each. The company has considered the same price for calculation of closing inventory valuation. On 15th April, 20X2, advanced version of same series of laptops is introduced in the market. Therefore, the price of the current laptops crashes to ` 35,000 each. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The company does not want to value the stock at ` 35,000 less estimated costs necessary to make the sale as the event of reduction in selling price took place after 31st March, 20X2 and the reduced prices were not applicable as on 31st March, 20X2. Comment on the company's views.

Answer:

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

4. XY Ltd had taken a large-sized civil construction contract, for a public sector undertaking, valued at ` 200 Crores. Execution of the project started during 20X1-20X2, and continued in the next financial year also. During the course of execution of the work on 29th May, 20X2, the company found while raising the foundation work that it had met a rocky surface and cost of contract would go up by an extra ` 50 crore, which would not be recoverable from the Contractee as per the terms of the contract. The Company's financial year ended on 31st March, 20X2, and the financial statements were considered and approved by the Board of Directors on 15th June, 20X2. How will you treat the above in the financial statements for the year ended 31st March, 20X2?

Answer:

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

5. A Ltd. was required to pay penalty for a breach in the performance of a contract. A Ltd. believed that the penalty was payable at a lower amount than the amount demanded by the other party. A Ltd. created provision for the penalty but also approached the arbitrator with a submission that the case may be dismissed with costs. A Ltd. prepared the financial statements for the year 20X1-20X2, which were approved in July 20X2. The arbitrator, in June 20X2, awarded the case in favour of A Ltd. As a result of the award of the arbitrator, the provision earlier made by A Ltd. was required to be reduced. The arbitrator also decided that cost of the case should be borne by the other party. Now, whether A Ltd. is required to remeasure its provision and what would be the accounting treatment of the cost that will be recovered by A Ltd., which has already been charged to the Statement of Profit and Loss as an expense for the year 20X1-20X2?

Answer:

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

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

As per para 35 of Ind AS 37, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

On the basis of the above, a contingent asset should be recognised in the financial statements of the period in which the realisation of asset and the related income becomes virtually certain. In the instant case, the recovery of cost became certain when the arbitrator decided the award during F.Y. 20X2-20X3. Accordingly, the recovery of cost should be recognised in the financial year 20X2-20X3.

6. A company manufacturing and supplying process control equipment is entitled to duty drawback if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2, the company has exceeded the specified limit of turnover by the end of the reporting period but the application for duty drawback is filed on 20th April, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on 28th June, 20X2 and financial statements have been approved by the Board of Directors of the company on 26th July, 20X2. Whether duty drawback credit should be treated as an adjusting event? [ALSO ASKED IN RTP - MAY 2020]

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 draw back but the application for the same has been filed after the stipulated time. Therefore, credit of duty drawback is discretionary in the hands of the Department. Accordingly, the duty drawback credit is a contingent asset as at the end of the reporting period, which may be realised if the Department credits the same.

As per para 35 of Ind AS 37, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of

the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.
In accordance with the above, the duty draw back credit which was contingent asset for the F.Y. 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

7. XYZ Ltd. sells goods to its customer with a promise to give discount of 5% on list price of the goods provided that the payments are received from customer within 15 days. XYZ Ltd. sold goods of ` 5 lakhs to ABC Ltd. Between 17th March, 20X2 and 31st March, 20X2. ABC Ltd. paid the dues by 15th April, 20X2 with respect to sales made between 17th March, 20X2 and 31st March, 20X2. Financial statements were approved for issue by Board of Directors on 31st May, 20X2. State whether discount will be adjusted from the sales at the end of the reporting period.
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 with 15 days' time after the end of the reporting period and before the approval of the financial statements confirms that the discount is to be provided on those sales. Therefore, it is an adjusting event. Accordingly, XYZ Ltd. should adjust the sales made to ABC Ltd. with respect to discount of 5% on the list price of the goods.

8. Whether the fraud related to 20X1-20X2 discovered after the end of the reporting period but before the date of approval of financial statements for 20X3-20X4 is an adjusting event?
Answer:
In the instant case, the fraud is discovered after the end of the reporting period of 20X3-20X4, which related to F.Y. 20X1-20X2. Since the fraud has taken place before the end of the reporting period, the condition was existing which has been confirmed by the detection of the same after the end of the reporting period but before the approval of financial statements. Therefore, it is an adjusting event.
Moreover, Ind AS 10 in paragraph 9, specifically provides that the discovery of fraud or error after the end of the reporting period, that shows that financial statements are incorrect, is an adjusting event. Such a discovery of fraud should be accounted for in accordance with Ind AS 8, if it meets the definition of prior period error.

9. X Ltd. was having investment in form of equity shares in another company as at the end of the reporting period, i.e., 31st March, 20X2. After the end of the reporting period but before the approval of the financial statements it has been found that value of investment was fraudulently inflated by committing a computation error. Whether such event should be adjusted in the financial statements for the year 20X1-20X2?
Answer:
Since it has been detected that a fraud has been made by committing an intentional error and as a result of the same financial statements present an incorrect picture, which has been

detected after the end of the reporting period but before the approval of the financial statements. The same is an adjusting event. Accordingly, the value of investments in the financial statements should be adjusted for the fraudulent error in computation of value of investments.

10. ABC Ltd. received a demand notice on 15th June, 20X2 for an additional amount of ` 28,00,000 from the Excise Department on account of higher excise duty levied by the Excise Department compared to the rate at which the company was creating provision and depositing the same in respect of transactions related to financial year 20X1-20X2. The financial statements for the year 20X1-20X2 are approved on 10th August, 20X2. In July, 20X2, the company has appealed against the demand of ` 28,00,000 and the company has expected that the demand would be settled at ` 15,00,000 only. Show how the above event will have a bearing on the financial statements for the year 20X1-20X2. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly. [ALSO IN RTP - NOV 2019]

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 15th June, 20X2, which is between the end of the reporting period and the date of approval of financial statements. Therefore, it is an event after the reporting period. This demand for additional amount has been raised because of higher rate of excise duty levied by the Excise Department in respect of goods already manufactured during the reporting period. Accordingly, condition exists on 31st March, 20X2, as the goods have been manufactured during the reporting period on which additional excise duty has been levied and this event has been confirmed by the receipt of demand notice. Therefore, it is an adjusting event.

In accordance with the principles of Ind AS 37, the company should make a provision in the financial statements for the year 20X1-20X2, at best estimate of the expenditure to be incurred, i.e., ` 15,00,000.

PAST EXAMINATION, MTPs, RTPs QUESTIONS

1. 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, 2019 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 31.03.2019 on 1st May, 2019. The management did not consider the effect of the above transaction in Financial Year 2018-2019, as it was favourable to the Company and the award came after the end of the financial year.

(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, 2019. The manufacturers of phone had announced the release of the new version on 1st March, 2019 but had not announced the price. Zoom Ltd. has valued inventory at cost of Rs. 5,000 each at the year ending 31st March, 2019. Due to arrival of new advance version of Mobile Phone on 8th April, 2019, 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 31.03.2019.

(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, 2019. The debtor was declared insolvent on 15th April, 2019.

(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?
[NOV 2019 - 8 MARKS]
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 per Ind 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 nonadjusting 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.

2. On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March 20X2 costing Rs. 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at Rs. 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of Rs. 2 lakhs on repairing and repackaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of

Rs. 9 lakhs. The accountant of Jupiter Ltd. treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows: (Rs. In lakhs) Analyse whether the above accounting treatment made by the accountant in regard to financial year ending on 31.0.20X2 is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same. [MTP - APRIL 2019 - 8 MARKS]

Answer:

The above treatment needs to be examined in the light of the provisions given in Ind AS 10 'Events after the Reporting Period' and Ind AS 2 'Inventories'. Para 3 of Ind AS 10 'Events after the Reporting Period' defines "Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue.

Two types of events can be identified: (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (nonadjusting 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 nonadjusting events after the reporting period".

Further, paragraph 6 of Ind AS 2 defines: "Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale".

Further, paragraph 9 of Ind AS 2 states that: "Inventories shall be measured at the lower of cost and net realisable value".

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

Accordingly, the event causing the damage to the inventory occurred after the reporting date and as per the principles laid down under Ind AS 10 'Events After the Reporting Date' is a nonadjusting 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

3. Mac Ltd. purchased goods on credit from Toy Ltd. for Rs. 580 lakhs for export. The export order was cancelled. Mac Ltd. decided to sell the same goods in the local market with a price discount. Toy Ltd. was requested to offer a price discount of Rs. 10%. Toy Ltd. wants to adjust the sales figure to the extent of the discount requested by Mac Ltd. Discuss whether such a treatment in the books of Toy Ltd. is justified as per the provisions of the relevant Ind AS.

Also, Toy Ltd. entered into a sale deed for its Land on 15th March, 20X1. But registration was done with the registrar on 20th April, 20X1. But before registration, is it possible to recognize the sale and the gain at the balance sheet date? Give reasons in support of your answer.

[RTP - MAY 2018]

Answer:

Toy Ltd. had sold goods to Mac Ltd on credit worth for Rs. 580 lakhs and the sale was completed in all respects. Mac Ltd.'s decision to sell the same in the domestic market at a discount does not affect the amount recorded as sales by Toy Ltd. The price discount of 10% offered by Toy Ltd. after request of Mac Ltd. was not in the nature of a discount given during

the ordinary course of trade because otherwise the same would have been given at the time of sale itself. However, there appears to be an uncertainty relating to the collectability of the debt, which has arisen subsequent to sale. Therefore, it would be appropriate to make a separate provision to reflect the uncertainty relating to collectability rather than to adjust the amount of revenue originally recorded. Hence such discount should be charged to the Statement of Profit and Loss and not shown as deduction from the sales figure. With respect to sale of land, both sale and gain on sale of land earned by Toy Ltd. shall be recognized in the books at the balance sheet date. In substance, the land was transferred with significant risk & rewards of ownership to the buyer before the balance sheet date and what was pending

was merely a formality to register the deed. The registration post the balance sheet date only confirms the condition of sale at the balance sheet date as per Ind AS 10 "Events after the Reporting Period."

4. An entity engaged in automobile sector has assessed the impact of COVID-19 outbreak on its future viability of business model. Senior Management has identified the need for restructuring some of its business activities and retrenching its employees in many areas. Senior Management is drawing up a plan for the consideration of the Board of Directors in their meeting scheduled in May 2020, which is subsequent to the reporting date of the current financial year i.e. 31 March 2020. Can the entity recognise provisions for restructuring costs in the financial statements of the current year i.e. 2019-2020? (MTP- OCT 2020 4 Marks)

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 business concerned; the principal locations affected; the location, function, and approximate number of employees who will be compensated for terminating their services; the expenditures that will be undertaken; and when the plan will be implemented; and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Further, paragraph 75 of Ind AS 37 provides that a management or board decision to restructure taken before the end of the reporting period does not give rise to a constructive obligation at the end of the reporting period unless the entity has, before the end of the reporting period

(a) started to implement the restructuring plan; or

(b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

In the given case, since COVID-19 pandemic impact started during March 2020, it is likely that the senior management started drawing up the plan for restructuring some of its business activities after the end of the reporting period, i.e., 2019-2020. If that be so, as per Ind AS 37, the management decisions subsequent to reporting date do not give rise to constructive obligation as of reporting date and no provision is required for restructuring costs as at 31 March 2020.

In this regard, paragraph 75 of Ind AS 37 provides that if an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting period, disclosure is required under Ind AS 10, Events after the Reporting Period, if the restructuring is material and non-disclosure could influence the economic decisions that users make on the basis of the financial statements.

6. 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 repayable after 3 years from the date of granting such loan. The current market rate of interest for similar loan is 10%. Considering the same, the fair value of the loan at initial recognition is `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)

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/c	Dr.	₹ 10,00,000	
To Loan from KK Ltd. A/c			₹ 10,00,000
On repayment			
Loan from KK Ltd. A/c	Dr.	₹ 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 something other than the financial instrument, an entity shall measure the fair value of the financial instrument. The difference in fair value and transaction cost will treated as investment in Subsidiary YK Ltd.

Both KK Ltd. and YK Ltd. should recognise financial asset and liability, respectively, at fair value on initial recognition, i.e., the present value of ₹ 10,00,000 payable at the end of 3 years using discounting factor of 10%. Since the question mentions fair value of the loan at initial recognition as ₹ 8,10,150, the same has been considered. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Journal entries in the books of KK Ltd. (for one year)

At origination			
Loan to YK Ltd. A/c	Dr.	₹ 8,10,150	
Investment in YK Ltd. A/c	Dr.	₹ 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/c	Dr.	₹ 81,015	
To Interest income A/c			₹ 81,015
Transferring of interest to Profit and Loss			
Interest income A/c	Dr.	₹ 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/c	Dr.	₹ 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/c	Dr.	₹ 81,015	
To Loan from KK Ltd. A/c			₹ 81,015
On repayment			
Loan from KK Ltd. A/c	Dr.	₹ 10,00,000	
To Bank A/c			₹ 10,00,000

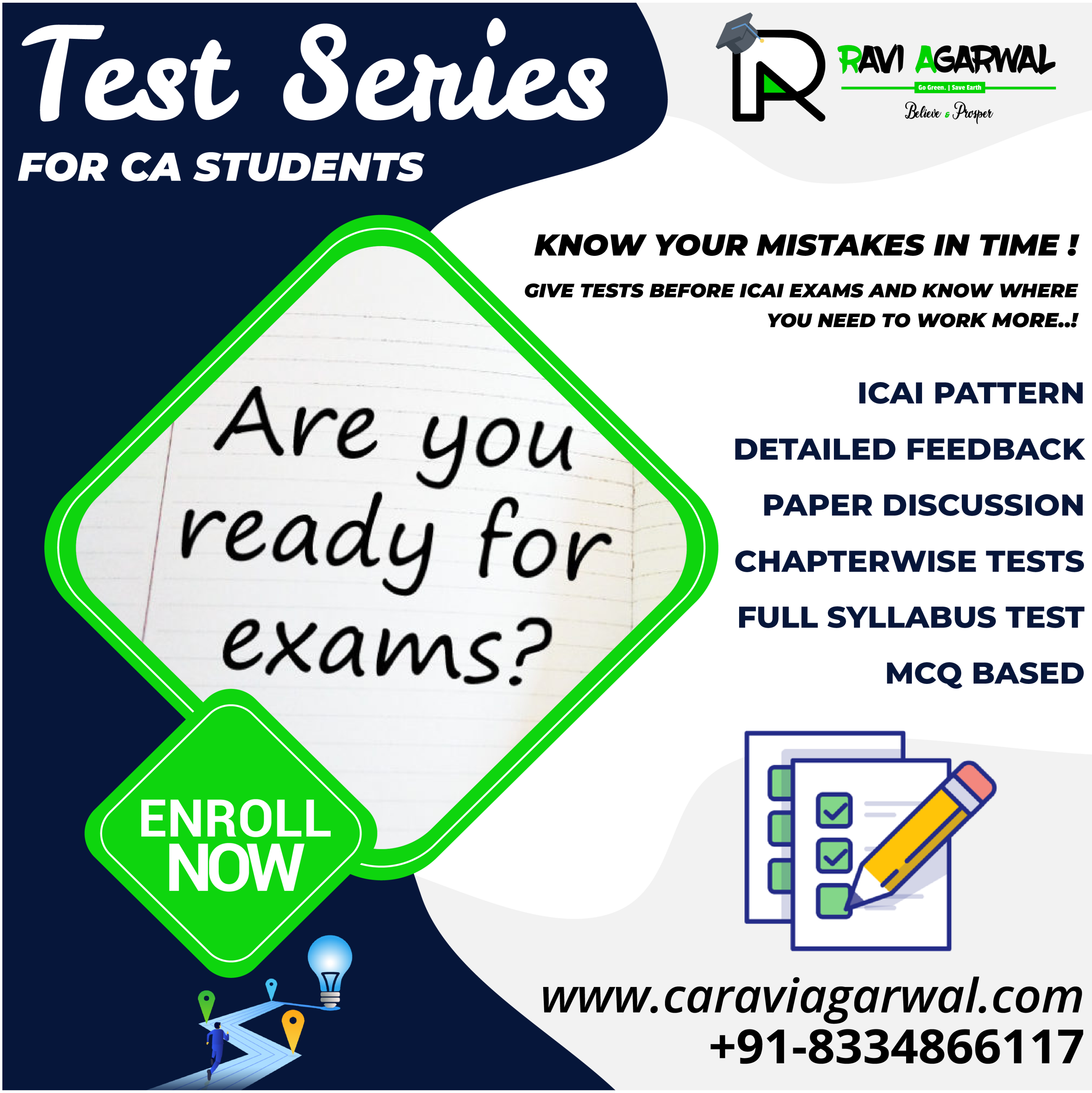
In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

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.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UNIT 3: INDIAN ACCOUNTING STANDARD 113: FAIR VALUE MEASUREMENT

QUESTIONS FROM ICAI STUDY MATERIAL

ILLUSTRATIONS

1. Discount Rate assessment to measure present value:

Investment 1 is a contractual right to receive ` 800 in 1 year. There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

a. Investment 2 is a contractual right to receive ` 1,200 in 1 year and has a market price of ` 1,083.

b. Investment 3 is a contractual right to receive ` 700 in 2 years and has a market price of ` 566.

All three assets are comparable with respect to risk (that is, dispersion of possible payoffs and credit).

You are required to measure the fair value of Asset 1 basis above information.

Answer:

On the basis of the timing of the contractual payments to be received for Investment 1 relative to the timing for Investment 2 and Investment 3 (that is, one year for Investment 2 versus two years for Investment 3), Investment 2 is deemed more comparable to Investment 1. Using the contractual payment to be received for Investment 1 (` 800) and the 1-year market rate derived from Investment 2, the fair value of Investment 1 is calculated as under:

Investment 2 Fair Value	` 1,083
Contractual Cash flows in 1 year	` 1,200

IRR = ` 1,083 x (1 + r) = ` 1,200
= (1 + r) = (` 1,200 / ` 1,083) = 1.108

r = 1.108 – 1 = 0.108 or 10.8%
Value of Investment 1 = ` 800 / 1.108 = ` 722

Alternatively, in the absence of available market information for Investment 2, the one-year market rate could be derived from Investment 3 using the build-up approach. In that case, the 2-year market rate indicated by Investment 3 would be adjusted to a 1-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

Questions

1. An asset is sold in 2 different active markets 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.

<u>In Market A:</u>
The price that would be received is ` 26, transaction costs in that market are ` 3 and the costs to transport the asset to that market are ` 2.
<u>In Market B:</u>
The price that would be received is ` 25, transaction costs in that market are ` 1 and the costs to transport the asset to that market are ` 2.
You are required to calculate:
(i) The fair value of the asset, if market A is the principal market, and
(ii) The fair value of the asset, if none of the markets is principal market.
[[MTP - AUGUST 2018 - 4 MARKS/ALSO IN NOV 2018 - 5 MARKS]
Answer:
(i) If Market A is the principal market
If Market A is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costs.
Fair Value will be

	₹
Price receivable	26
Less: Transportation cost	(2)
Fair value of the asset	24

(ii) If neither of the market is the principal market
If neither of the market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximizes the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (i.e., the net amount that would be received in the respective markets).

	₹	₹
	Market A	**Market B**
Price receivable	26	25
Less: Transaction cost	(3)	(1)
Less: Transportation cost	(2)	(2)
Fair value of the asset	21	22

Since the entity would maximise the net amount that would be received for the asset in

Market B i.e. ` 22, the fair value of the asset would be measured using the price in Market B.
Fair value

	₹
Price receivable	25
Less: Transportation cost	(2)
Fair value of the asset	23

2. Company J acquires land in a business combination. The land is currently developed for industrial use as a factory site. Although the land‘s current use is presumed to be its highest and best use unless market or other factors suggest a different use, Company J considers the fact that nearby sites have recently been developed for residential use as high-rise apartment buildings.
On the basis of that development and recent zoning and other changes to facilitate that development, Company J determines that the land currently used as a factory site could be developed as a residential site (e.g., for high-rise apartment buildings) and that market participants would take into account the potential to develop the site for residential use when pricing the land.
Determine the highest and best use of the land.

Answer:
The highest and best use of the land is determined by comparing the following:
: The value of the land as currently developed for industrial use (i.e., an assumption that the land would be used in combination with other assets, such as the factory, or with other assets and liabilities); and

: The value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs necessary to convert the land to a vacant site. The value under this use would take into account risks and uncertainties about whether the entity would be able to convert the asset to the alternative use (i.e., an assumption that the land would be used by market participants on a stand-alone basis).

The highest and best use of the land would be determined on the basis of the higher of these values. In situations involving real estate appraisal, the determination of highest and best use might take into account factors relating to the factory operations (e.g., the factory‘s operating cash flows) and its assets and liabilities (e.g., the factory‘s working capital).

3. ABC Ltd. acquired 5% equity shares of XYZ Ltd. for ` 10 crore in the year 20X1-X2. The company is in process of preparing the financial statements for the year 20X2-X3 and is assessing the fair value at subsequent measurement of the investment made in XYZ Ltd. Based on the observable input, the ABC Ltd. identified a similar nature of transaction in which PQR Ltd. acquired 20% equity shares in XYZ Ltd. for ` 60 crore. The price of such transaction was determined on the basis of Comparable Companies Method (CCM)- Enterprise Value (EV) / EBITDA which was 8. For the current year, the EBITDA of XYZ Ltd. is ` 40 crore. At the time of acquisition, the valuation was determined after considering 5% of liquidity discount and 5% of non-controlling stake discount. What will be the fair value of ABC Ltd.‘s investment in XYZ Ltd. as on the balance sheet date?
Answer:

Determination of Enterprise Value of XYZ Ltd.

Particulars	₹ in crore
EBITDA as on the measurement date	40
EV/EBITDA multiple as on the date of valuation	8
Enterprise value of XYZ Ltd.	320

Determination of subsequent measurement of XYZ Ltd.

Particulars	₹ in crore
Enterprise Value of XYZ Ltd.	320
ABC Ltd.'s share based on percentage of holding (5% of 320)	16
Less: Liquidity discount & Non-controlling stake discount (5%+5%=10%)	(1.6)
Fair value of ABC Ltd.'s investment in XYZ Ltd.	14.4

4. UK Ltd. is in the process of acquisition of shares of PT Ltd. as part of business reorganization plan. The projected free cash flow of PT Ltd. for the next 5 years are as follows:

(₹ in crore)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965

The weightage average cost of capital of PT Ltd. is 11%. The total debt as on measurement date is ` 1,465 crore and the surplus cash & cash equivalent is ` 106.14 crore. The total numbers of shares of PT Ltd. as on the measurement date is 8,52,84,223 shares. Determine value per share of PT Ltd. as per Income Approach.

Answer:

Determination of equity value of PT Ltd.

(₹ in crore)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965
Discount rate	0.9009	0.8116	0.7312	0.6587	0.5935
Free Cash Flow available to the firm	168.56	152.26	89.06	177.19	2,518.69
Total of all years					3,105.76
Less: Debt					(1,465)
Add: Cash & Cash equivalent					106.14
Equity Value of PT Ltd.					1,746.90
No. of Shares					85,284,223.0
Per Share Value					204.83

5. You are a senior consultant of your firm and are in process of determining the valuation of KK Ltd. You have determined the valuation of the company by two approaches i.e. Market Approach and Income approach and selected the highest as the final value. However, based upon the discussion with your partner you have been requested to assign equal weights to both the approaches and determine a fair value of shares of KK Ltd. The details of the KK Ltd. are as follows:

Particulars	₹ in crore
Valuation as per Market Approach	5268.2
Valuation as per Income Approach	3235.2
Debt obligation as on Measurement date	1465.9
Surplus cash & cash equivalent	106.14
Fair value of surplus assets and Liabilities	312.4
Number of shares of KK Ltd.	8,52,84,223 shares

Determine the Equity value of KK Ltd. as on the measurement date on the basis of above details.
Answer:

Equity Valuation of KK Ltd.

Particulars	Weights	(₹ in crore)
As per Market Approach	50	5268.2
As per Income Approach	50	3235.2
Enterprise Valuation based on weights (5268.2 x 50%) + (3235.2 x 50%)		4,251.7
Less: Debt obligation as on measurement date		(1465.9)
Add: Surplus cash & cash equivalent		106.14
Add: Fair value of surplus assets and liabilities		312.40
Enterprise value of KK Ltd.		3204.33
No. of shares		85,284,223
Value per share		375.72

6. 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? [ALSO IN RTP - NOV 2019]

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 into account 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 into account 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 the zoning 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 entity intends 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 value of 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 113 does 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.

PAST EXAMINATION, MTPs, RTPs QUESTIONS

1. An asset is sold in two different active markets at different prices. Manor Ltd. enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.
In Mumbai market, the price that would be received is Rs. 290, transaction costs in that market are Rs. 40 and the costs to transport the asset to that market are Rs. 30. Thus, the net amount that would be received is Rs. 220. In Kolkata market the price that would be received is Rs. 280, transaction costs in that market are Rs. 20 and the costs to transport the asset to that market are Rs. 30. Thus, the net amount that would be received in Kolkata market is Rs. 230.
(i) What should be the fair value of the asset if Mumbai Market is the principal market? What should be fair value if none of the markets is principle market?
(ii) It the net realization after expenses is more in export market, say Rs. 280, but Government allows only 15% of the production to be exported out of India. Discuss what would be fair value in such case.
[NOV 2019 - 8 MARKS]
Answer:
(i) (a) If Mumbai Market is the principal market
If Mumbai Market is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transportation costs.
Fair Value will be

	₹
Price receivable	290
Less: Transportation cost	(30)
Fair value of the asset	260

(b) If neither of the market is the principal market
If neither of the market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transportation costs (i.e., the net amount that would be received in the respective markets).

	₹	₹
	Mumbai Market	Kolkata Market
Fair value of the asset as per the question	220	230

Since the entity would maximise the net amount that would be received for the asset in Kolkata Market i.e. Rs. 230, the fair value of the asset would be measured using the price in Kolkata Market.

Fair value

	₹
Price receivable	280
Less: Transportation cost	(30)
Fair value of the asset	250

(ii) Export prices are more than the prices in the principal market and it would give highest return comparing to the domestic market. Therefore, the export market would be considered as most advantageous market. But since the Government has capped the export, maximum upto 15% of total output, maximum sale activities are being done at domestic market only i.e. 85%. Since the highest level of activities with highest volume is being done at domestic market, principal market for asset would be domestic market. Therefore, the prices received in domestic market would be used for fair valuation of assets.

CHAPTER 5: OTHER INDIAN ACCONTING STANDARDS

UNIT 1: INDAS 20: ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

Illustrations

1. Government gives a grant of ` 10,00,000 for past research of H1N1 vaccine to A Pharmaceuticals Limited. There is no condition attached to the grant. Examine how the Government grant be recognised in the books of A Pharmaceuticals Limited.

Answer:

The entire grant should be recognised immediately in profit or loss.

2. Government gives a grant of ` 10,00,000 for research and development of H1N1 vaccine to A Pharmaceuticals Limited even though similar vaccines are available in the market but are expensive. The entity has to ensure by developing a manufacturing process over a period of 2 years that the costs come down by at least 40%. Examine how the Government grant be recognised assuming that A Pharmaceuticals Limited has reasonable assurance that the conditions attached to the grant will be complied with.

Answer:

The entire grant should be recognised immediately as deferred income and charged to profit or loss over a period of two years.

3. A village of artisans in a district got devastated because of an earthquake. A Limited was operating in that district and was providing employment to the artisans. The government gave a grant of ` 10,00,000 to A Limited so that 100 artisans are rehabilitated over a period of 3 years. Government releases ` 2,00,000. Examine how the Government grant be realized.

Answer:

A Limited will recognise ` 10,00,000 as government grant and set it up as a deferred income and will recognise it in its profit or loss over the period of three years as per the principles enunciated in Ind AS 20.

Once a government grant is recognised, any related contingent liability or contingent asset is treated in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government or in the form of a non-monetary asset.

4. A Limited received from the government a loan of ` 50,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be recognised.

Answer:

The fair value of the loan is calculated at ` 37,38,328.

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on ₹ 50,00,000 + principal paid	Closing Balance
(a)	(b)	(c) = (b) x 12%	(d)	(e) =(b) + (c) – (d)
1	37,38,328	4,48,600	2,50,000	39,36,928
2	39,36,928	4,72,431	2,50,000	41,59,359
3	41,59,359	4,99,123	2,50,000	44,08,482
4	44,08,482	5,29,018	2,50,000	46,87,500
5	46,87,500	5,62,500	52,50,000	Nil

A Limited will recognise ₹ 12,61,672 (₹ 50,00,000 – ₹ 37,38,328) as the government grant and will make the following entry on receipt of loan:

Bank Account	Dr.	50,00,000	
To Deferred Income			12,61,672
To Loan Account			37,38,328

` 12,61,672 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognise as expenses the related costs for which the grant is intended to compensate. (see Illustration 5 in this regard)

5. Continuing with the facts given in the Illustration 4, state how the grant will be recognized in the statement of profit or loss assuming:

(a) the loan is an immediate relief measure to rescue the enterprise

(b) the loan is a subsidy for staff training expenses, incurred equally, for a period of 4 years

(c) the loan is to finance a depreciable asset.

Answer:

` 12,61,672 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognised as expenses the related costs for which the grant is intended to compensate. Assuming (a), the loan is an immediate relief measure to rescue the enterprise. ` 12,61,672 will be recognised in profit or loss immediately. Assuming (b), the loan is a subsidy for staff training expenses, incurred equally, for a period of 4 years. ` 12,61,672 will be recognised in profit or loss over a period of 4 years. Assuming (c), the loan is to finance a depreciable asset. ` 12,61,672 will be recognised in profit or loss on the same basis as depreciation.

6. A Limited wants to establish a manufacturing unit in a backward area and requires 5 acres of land. The government provides the land on a leasehold basis at a nominal value of ` 10,000 per acre. The fair value of the land is ` 100,000 per acre. Calculate the amount of the Government grant to be recognized by an entity.

Answer:

A limited will recognise the land at fair value of ` 5,00,000 and ` 450,000 [(` 100,000 – ` 10,000) x 5)] as government grant. This government grant should be presented in the balance sheet by setting up the grant as deferred income.

Alternatively, the land may be recognised by A Ltd. at nominal value of ` 50,000 (` 10,000 x 5).

7.A Limited establishes solar panels to supply solar electricity to its manufacturing plant. The cost of solar panels is ` 1,00,00,000 with a useful life of 10 years. The depreciation is provided on straight line method basis. The government gives ` 50,00,000 as a subsidy. Examine how the Government grant be realized.

Answer:

A Limited will set up ` 50,00,000 as deferred income and will credit ` 5,00,000 equally to its statement of profit and loss over next 10 years. Alternatively, A Ltd. may deduct ` 50,00,000 from the cost of solar panel of ` 1,00,00,000.

8. Continuing with the facts given in the Illustration 7 above, state how the same will be disclosed in the Statement of cash flows.

Answer:

A Limited will show ` 1,00,00,000 being acquisition of solar panels as outflow in investing

activities. The receipt of ` 50,00,000 from government will be shown as inflow under financing activities.

9. A Ltd. received a government grant of ` 10,00,000 to defray expenses for environmental protection. Expected environmental costs to be incurred is ` 3,00,000 per annum for the next 5 years. How should A Ltd. present such grant related to income in its financial statements?

Answer:

As per paragraph 29 of Ind AS 20, Grants related to income are presented as part of profit or loss, either separately or under a general heading such as „Other income‟; alternatively, they are deducted in reporting the related expense.

10. A Ltd. has received a grant of ` 10,00,00,000 in the year 20X1-20X2 from local government in the form of subsidy for selling goods at lower price to lower income group population in a particular area for two years. A Ltd. had accounted for the grant as income in the year 20X1-20X2. While accounting for the grant in the year 20X1-20X2, A Ltd. was reasonably assured that all the conditions attached to the grant will be complied with. However, in the year 20X5-20X6, it was found that A Ltd. has not complied with the above condition and therefore notice of refund of grant has been served to it. A Ltd. has contested but lost in court in 20X5-20X6 and now grant is fully repayable. How should A Ltd. reflect repayable grant in its financial statements ending 20X5-20X6?

Answer:

Note: It is being assumed that the accounting done in previous years was not incorrect and was not in error as per Ind AS 8.

Paragraph 32 of Ind AS 20, states that a Government grant that becomes repayable shall be accounted for as a change in accounting estimate (see Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors).

Questions

1. ABC Ltd. has received the following grants from the Government of Delhi for its newly started pharmaceutical business:
● ` 20 lakhs received for immediate start-up of business without any condition.
● ` 50 lakhs received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:
� that drugs should be available to the public at 20% cheaper from current market price; and

� the drugs should be in accordance with quality prescribed by the World Health Organisation [WHO].
● Two acres of land (fair Value: ` 10 Lakhs) received for set up plant.
● ` 2 lakhs received for purchase of machinery of ` 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis.
How should ABC Ltd. recognise the government grants in its books of accounts?
Answer:
ABC Ltd. should recognise the grants in the following manner:
● ` 20 lakhs have been received for immediate start-up of business. This should be recognised in Statement of Profit and Loss immediately as there are no conditions attached to the grant.
● ` 50 lakhs should be recognised in profit or loss on a systematic basis over the periods which the entity recognises as expense the related costs for which the grants are intended to compensate provided that there is reasonable assurance that ABC Ltd. will comply with the conditions attached to the grant.
● Land should be recognised at fair value of ` 10 lakhs and government grants should be presented in the balance sheet by setting up the grant as deferred income. Alternatively, deduct the amount of grant from the cost of the asset. In the given case, the land is granted at no cost. It will be presented in the books at nominal value.
● ` 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this cases, ` 40,000 [` 2 lakhs/5] should be credited to profit and loss each year over period of 5 years. Alternatively, ` 2,00,000 will be deducted from the cost of the asset and depreciation will be charged at ` 8,00,000 (` 10,00,000 – ` 2,00,000).

2. A Limited received from the government a loan of `1,00,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be realized. Also state how the grant will be recognized in the statement of profit or loss assuming that the loan is to finance a depreciable asset. [ALSO IN MTP - AUGUST 2018 - 6 MARKS]
Answer:

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

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on ₹ 1,00,00,000 + principal paid	Closing Balance
(a)	(b)	(c) = (b) x 12%	(d)	(e) =(b) + (c) – (d)
1	74,76,656	8,97,200	5,00,000	78,73,856
2	78,73,856	9,44,862	5,00,000	83,18,718
3	83,18,718	9,98,246	5,00,000	88,16,964
4	88,16,964	10,58,036	5,00,000	93,75,000
5	93,75,000	11,25,000	1,05,00,000	Nil

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

Bank Account	Dr.	1,00,00,000	
To Deferred Income			25,23,344
To Loan Account			74,76,656

` 25,23,344 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognised as expenses the related costs for which the grant is intended to compensate.
If the loan is to finance a depreciable asset. ` 25,23,344 will be recognised in profit or loss on the same basis as depreciation.

3. MNC Ltd. has received grant in the nature of exemption of custom duty on capital goods with certain conditions related to export of goods under Export Promotion Capital Goods (EPCG) scheme of Government of India. Whether the same is a government grant under Ind AS 20, Government Grants and Disclosure of Government Assistance? If yes, then how the same is to be accounted for if it is
(a) A Grant related to asset or
(b) A Grant related to income?
Answer:
Paragraph 3 of Ind AS 20 states that Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.
In accordance with the above, in the given case exemption of custom duty under EPCG scheme is a government grant and should be accounted for as per the provisions of Ind AS 20.

Ind AS 20 defines grant related to assets and grants related to income as follows:
"Grants related to asset are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.
Grants related to income are government grants other than those related to assets."
Presentation of grants related to assets
Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income.

The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset. Alternatively, the amount of grant will be deducted from the cost of the asset and depreciation will be charged on the reduced value of the asset.

Presentation of grants related to income

Grants related to income are presented as part of profit or loss, either separately or under a general heading such as „Other income‟; alternatively, they are deducted in reporting the related expense.

Presentation

In the given case, based on the terms and conditions of the scheme, the grant received is to compensate the import cost of assets subject to an export obligation as prescribed in the EPCG Scheme and does not relate to purchase, construction or acquisition of a long term asset. Hence it is a grant related to income.

Accounting of such grant

It may be further noted that as per paragraph 12 of Ind AS 20, government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate

Grants related to income are presented as part of profit or loss, over a period of six years, either separately or under a general heading such as „Other income‟. Alternatively, they are deducted in reporting the related expense.

4. ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters‟ contribution have been recognised in capital reserve and treated as part of shareholders‟ funds in accordance with the provisions of AS 12, Accounting for Government Grants. State whether the accounting treatment of the grants in the nature of promoters‟ contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance. [ALSO IN RTP - MAY 2018]

Answer:

Paragraph 2 of Ind AS 20, "Accounting for Government Grants and Disclosure of Government Assistance" inter alia states that the Standard does not deal with government participation in the ownership of the entity. Since ABC Ltd. is a Government company, it implies that government has 100% shareholding in the entity. Accordingly, as per Ind AS 20, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will be shown in the Statement of Profit and Loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101 „First Time Adoption of Ind AS‟. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter‟s contribution directly to shareholders‟ funds.

5. Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of ` 1,00,000 each, relating to the following ongoing research and development projects:

(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 before 30th June, 20X2 with necessary figures. The financial statements of Rainbow Limited are to be adopted on 31st May, 20X2, by which date the claim form would not have been filed with the State Government.

Suggest the accounting treatment of, if any, for the two grants received and the flood-related compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2. [ALSO IN RTP - MAY 2020]

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 31st March, 20X2.

Alternatively, in case, the grant is conditional as to expenditure on research, the grant will be recognised in the books of Rainbow Limited over the year the expenditure is being incurred.

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 31st March, 20X2 and 31st March, 20X3. Once the equipment starts being used in the manufacturing process, the deferred grant income of ` 100,000 should be recognised over the asset‟s useful life to compensate for depreciation costs.

Alternatively, as per Ind AS 20, Rainbow Limited would also be permitted to offset the deferred income of ` 100,000 against the cost of the equipment as on 1st April, 20X3.

3. For flood related compensation

Rainbow Limited will be able to submit an application form only after 31st May, 20X2 ie in the year 20X2-20X3. Although flood happened in September, 20X1 and loss was incurred due to flood related to the year 20X1-20X2, the entity should recognise the income from the government grant in the year when the application form related to it is submitted and approved by the government for compensation.

Since, in the year 20X1-20X2, the application form could not be submitted due to adoption of financials with respect to sales figure before flood occurred, Rainbow Limited should not recognise the grant income as it has not become receivable as on 31st March,20X2.

6. An entity opens a new factory and receives a government grant of ` 15,000 in respect of capital equipment costing ` 1,00,000. It depreciates all plant and machinery at 20% per annum on straight-line basis. Show the statement of profit and loss and balance sheet extracts in respect of the grant for first year under both the methods as per Ind AS 20.

Answer:

(a) When grant is treated as deferred income

Statement of profit and loss – An extract `

	₹
Depreciation (₹ 1,00,000 x 20%)	(20,000)
Government grant credit (W.N.1)	3,000

Balance Sheet - An extract

		₹
Non-current assets		
Property, plant and equipment	1,00,000	
Less: Accumulated depreciation	(1,00,000 x 20%) (20,000)	80,000
		????
Non-current liabilities		
Government grant	[12,000 – 3,000 (current liability)]	9,000
Current liabilities		
Government grant	(15,000 x 20%)	3,000
		????

Working Note:

1. Government grant deferred income account

	₹		₹
To Profit or loss	3,000	By Grant cash received	15,000
(15,000 × 20%)			
To Balance c/f	12,000		
	15,000		15,000

(b) When grant is deducted from cost of the asset

Statement of profit and loss – An extract

	₹
Depreciation [(₹ 1,00,000 – 15,000) x 20%]	(17,000)

Balance Sheet - An extract

		₹
Non-current assets		
Property, plant and equipment	(1,00,000-15,000) 85,000	
Less: Accumulated depreciation	(17,000)	68,000

7. A company receives a cash grant of ` 30,000 on 31 March 20X1. The grant is towards the cost of training young apprentices. Training programme is expected to last for 18 months

starting from 1 April 20X1. Actual costs of the training incurred in 20X1-20X2 was ` 50,000 and in 20X2-20X3 ` 25,000. State, how this grant should be accounted for?

Answer:

At 31st March 20X1 the grant would be recognised as a liability and presented in the balance sheet as a split between current and non-current amounts.

` 20,000 [(12 months / 18 months) x 30,000] is current and would be recognised in profit and loss for the year ended 31st March, 20X1. The balance amount of ` 10,000 will be shown as non-current. At the end of year 20X1-20X2, there would be a current balance of 10,000 (being the non-current balance at the end of year 20X1-20X1 reclassified as current) in the balance sheet. This would be recognised in profit in the year 20X2-20X3.

Extracts from the financial statements are as follows:

Balance Sheet (extracts)

	31 March 20X1	31 March 20X2	31 March 20X3
Current liabilities			
Deferred income	20,000	10,000	-
Non-current liabilities			
Deferred income	10,000	-	-

Statement of profit and loss (extracts)

	31 March 20X2	31 March 20X3
Method 1		
Other Income - Government grant received	20,000	10,000
Training costs	(50,000)	(25,000)
Method 2		
Training costs (50,000 – 20,000)	30,000	
Training costs (25,000 – 10,000)		15,000

PAST EXAMINATION PAPER, MOCK TEST PAPERS (MTP) & REVISION TEST PAPER (RTP)

1. How will you recognize and present the grants received from the Government in the following cases as per Ind AS 20?
(i) A Ltd. received one acre of land to setup a plant in backward area (fair value of land Rs. 12 lakh and acquired value by Government is Rs. 8 Iakhs).
(ii) B Ltd. received an amount of loan for setting up a plant at concessional rate of interest from the Government.
(iii) D Ltd. received an amount of Rs. 25 lakh for immediate start-up of a business without any condition.
(iv) S Ltd. received Rs. 10 lakh for purchase of machinery costing Rs. 80 lakh. Useful life of machinery is 10 years. Depreciation on this machinery is to be charged on straight line basis.
(v) Government gives a grant of Rs. 25 lakh to U Limited for research and development of medicine for breast cancer, even though similar medicines are available in the market but are expensive. The company is to ensure by developing a manufacturing process over a period of two years so that the cost comes down at least to 50%.
[NOV 2018 - 5 MARKS/MTPOCT 2020]
Answer:

(i) The land and government grant should be recognized by A Ltd. at fair value of Rs. 12,00,000 and this government grant should be presented in the books as deferred income

(ii) As per para 10A of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', loan at concessional rates of interest is to be measured at fair value and recognised as per Ind AS 109. Value of concession is the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for as Government grant.

(iii) Rs. 25 lakh has been received by D Ltd. for immediate start-up of business. Since this grant is given to provide immediate financial support to an entity, it should be recognised in the Statement of Profit and Loss immediately with disclosure to ensure that its effect is clearly understood, as per para 21 of Ind AS 20.

(iv) Rs. 10 lakh should be recognized by S Ltd. as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 1,00,000 [Rs. 10 lakh / 10 years] should be credited to profit and loss each year over period of 10 years.

(v) As per para 12 of Ind AS 20, the entire grant of Rs. 25 lakh should be recognized immediately as deferred income and charged to profit and loss over a period of two years based on the related costs for which the grants are intended to compensate provided that there is reasonable assurance that U Ltd. will comply with the conditions attached to the grant.

2. 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 Rs. 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 Rs. 4 lakh in Statement of Profit and Loss as income following the principles laid down under Ind AS 20 "Accounting for Government Grants and Disclosure of Government Assistance".
Required:
Evaluate whether the above accounting treatment made by the management is in compliance with the applicable Ind AS. If not, advise the correct treatment
[NOV 2019 -4 MARKS]
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 Rs. 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 Rs. 4 lakh (20 lakh / 5) as income is correct since the entity has reasonable assurance that the entity will comply with the conditions attached to the grant.
Note: In case eucalyptus tree is considered as bearer plant by Arun Ltd., then Ind AS 20 will be applicable and not Ind AS 41.

3. Entity A is awarded a government grant of `60,000 receivable over three years (`40,000 in year 1 and `10,000 in each of years 2 and 3), contingent on creating 10 new jobs and maintaining them for three years. The employees are recruited at a total cost of `30,000, and the wage bill for the first year is ` 1,00,000, rising by `10,000 in each of the subsequent years. Calculate the grant income and deferred income to be accounted for in the books for year 1, 2 and 3.
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	1,30,000	21,667	60,000 x (130/360)	18,333	(40,000 – 21,667)
2	1,10,000	18,333	60,000 x (110/360)	10,000	(50,000 – 21,667 – 18,333)
3	1,20,000	20,000	60,000 x (120/360)	-	(60,000 – 21,667 – 18,333 – 20,000)
	3,60,000	60,000			

Therefore, Grant income to be recognised in Profit & Loss for years 1, 2 and 3 are ` 21,667, ` 18,333 and ` 20,000 respectively.
Amount of grant that has not yet been credited to profit & loss i.e; deferred income is to be reflected in the balance sheet. Hence, deferred income balance as at year end 1, 2 and 3 are ` 18,333, ` 10,000 and Nil respectively.

3. 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.

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.

4. In one of the plant of PQR Ltd., fire broke out on 10.05.2020 in 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 31.03.2020 were approved by the Board of Directors on 12th June, 2020. Discuss the accounting treatment of the above situation. (RTP- NOV 2020)

ANSER:

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).

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 2019-2020 on going concern assumption may not be appropriate. In that case, the financial statements may have to be prepared on a basis other than going concern.

However, if the going concern assumption is considered to be appropriate even after the fire, no adjustment is required in the financial statements for the year ending 31.03.2020.

UNIT 2: INDAS 102: SHARE BASED PAYMENT

Illustrations

1-Equity Settled Shared Based Payment- Service conditions

ABC Limited granted to its employees, share options with a fair value of ` 5,00,000 on 1st April, 20X0, if they remain in the organization upto 31st March, 20X3. On 31st March, 20X1, ABC Limited expects only 91% of the employees to remain in the employment. On 31st March, 20X2, company expects only 89% of the employees to remain in the employment. However, only 82% of the employees remained in the organisation at the end of March, 20X3 and all of them exercised their options. Pass the Journal entries?

Answer:

Period	Proportion	Fair value	To be vested	Cumulative expenses	Expenses
	a	b	c	d= b x c x a	e = d-previous period d
Period 1	1/3	5,00,000	91%	1,51,667	1,51,667
Period 2	2/3	5,00,000	89%	2,96,667	1,45,000
Period 3	3/3	5,00,000	82%	4,10,000	1,13,333
					4,10,000

Journal Entries

31st March, 20X1			
Employee benefits expenses	Dr.	1,51,667	
To Share based payment reserve (equity)			1,51,667
(1/3 of expected vested equity instruments value)			
31st March, 20X2			
Employee benefits expenses	Dr.	1,45,000	
To Share based payment reserve (equity)			1,45,000
(2/3 of expected vested equity instruments value)			
31st March, 20X3			
Employee benefits expenses	Dr.	1,13,333	
To Share based payment reserve (equity)			1,13,333
(Final vested equity instruments value)			
Share based payment reserve (equity)	Dr.	4,10,000	
To Share Capital			4,10,000
(re-allocated and issued shares)			

2 - Cash Settled Shared Based Payment-Service conditions

XYZ issued 10,000 Share Appreciation Rights (SARs) that vest immediately to its employees on 1st April, 20X0. The SARs will be settled in cash. Using an option pricing model, at that date it is estimated that the fair value of a SAR is ` 95. SAR can be exercised any time upto 31st March, 20X3. At the end of period on 31st March, 20X1 it is expected that 95% of total employees will exercise the option, 92% of total employees will exercise the option at the end of next year and finally 89% were exercised at the end of the 3rd year. Fair Values at the end of each period have been given below:

Fair value of SAR		₹
31st March, 20X1		112
31st March, 20X2		109
31st March, 20X3		114

Pass the Journal entries?

Answer:

Period	Fair value a	To be vested b	Cumulative c= a x b x 10,000	Expense d= c-prev. period c
Start	95	100%	9,50,000	9,50,000
Period 1	112	95%	10,64,000	1,14,000
Period 2	109	92%	10,02,800	(61,200)
Period 3	114	89%	10,14,600	11,800
				10,14,600

Journal Entries

1st April, 20X0			
Employee benefits expenses	Dr.	9,50,000	
To Share based payment liability			9,50,000
(Fair value of the SAR recognized)			
31st March, 20X1			
Employee benefits expenses	Dr.	1,14,000	
To Share based payment liability			1,14,000
(Fair value of the SAR re-measured)			
31st March, 20X2			
Share based payment liability	Dr.	61,200	
To Employee benefits expenses			61,200
(Fair value of the SAR re-measured & reversed)			
31st March,-20X3			
Employee benefits expenses	Dr.	11,800	
To Share based payment liability			11,800
(Fair value of the SAR recognized)			
Share based payment liability	Dr.	10,14,600	
To Cash			10,14,600
(Settlement of SAR)			

3 - Share-based payment with cash alternative

On 1st January, 20X1, ABC limited gives options to its key management personnel (employees) to take either cash equivalent to 1,000 shares or 1,500 shares. The minimum service requirement is 2 years and shares being taken must be kept for 3 years.

Fair values of the shares are as follows:	₹
Share alternative fair value (with restrictions)	*102*
Grant date fair value on 1st January, 20X1	*113*
Fair value on 31st December, 20X1	*120*
Fair Value on 31st December, 20X2	*132*
The employees exercise their cash option at the end of 20X2. Pass the journal entries.	

Answer:

	1st January, 20X1 ₹	31st December, 20X1 ₹	31st December, 20X2 ₹
Equity alternative (1,500 x 102)	1,53,000		
Cash alternative (1,000 x 113)	1,13,000		
Equity option (1,53,000 - 1,13,000)	40,000		
Cash Option (cumulative) (using period end fair value)		(1,000 x 120 x ½) 60,000	1,32,000
Equity Option (cumulative)		(40,000 x ½) 20,000	40,000
Expense for the period			
Equity option		20,000	20,000
Cash Option		60,000	72,000
Total		80,000	92,000

Journal Entries

31st December, 20X1			₹
Employee benefits expenses	Dr.	80,000	
To Share based payment reserve (equity)*			20,000
To Share based payment liability			60,000
(Recognition of Equity option and cash settlement option)			
31st December, 20X2			
Employee benefits expenses	Dr.	92,000	
To Share based payment reserve (equity)*			20,000
To Share based payment liability			72,000
(Recognition of Equity option and cash settlement option)			
Share based payment liability	Dr.	1,32,000	
To Bank/ Cash			1,32,000
(Settlement in cash)			

*The equity component recognized (` 40,000) shall remain within equity. By electing to receive cash on settlement, the employees forfeited the right to receive equity instruments. However, ABC Limited may transfer the share based payment reserve within equity, i.e. a transfer from one component of equity to another.

4-<u>Share-based payment - Purchase of goods</u>

Indian Inc. issued 995 shares in exchange for purchase of an office building. The title was transferred in the name of Indian Inc. on February, 20X1 and shares were issued. Fair value of the office building was ` 2,00,000 and face value of each share of Indian Inc was ` 100. Pass the journal entries?

Answer:

1st February, 20X1			₹
Office Building	Dr.	2,00,000	
To Share capital (995 x 100)			99,500
To Securities premium (balance)			1,00,500
(Recognition of equity option and cash settlement option)			

5-<u>Share-based payment - Services</u>

Reliance limited hired a maintenance company for its oil fields. The services will be settled by issuing 1,000 shares of Reliance. Period for which the service is to be provided is 1st April, 20X1 to 1st July, 20X1 and fair

value of the service was estimated using market value of similar contracts for ` 1,00,000. Nominal value per share is ` 10. Record the transactions?

Answer:

Fair value of services	1,00,000
Number of months	3
Monthly expense	33,333.33

			₹
30th April, 20X1			
Repair & Maintenance	Dr.	33,333.33	
To Share based payment reserve (equity)			33,333.33
(Recognition of Equity settled SBP using fair value of services rendered)			
31st May, 20X1			
Repair & Maintenance	Dr.	33,333.33	
To Share based payment reserve (equity)			33,333.33
(Recognition of Equity settled SBP using fair value of services rendered)			
30th June, 20X1			
Repair & Maintenance	Dr.	33,333.33	
To Share based payment reserve (equity)			33,333.33
(Recognition of Equity settled SBP using fair value of services rendered)			

1st July, 20X1			
Share based payment reserve (equity)	Dr.	1,00,000	
To Equity Shares (1000 x 10)			10,000
To Securities premium (balancing figure)			90,000

6 - Share-based payment - Cash & equity alternatives

Tata 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	*Period*	*₹*
No of cash settled shares		*74,000*
Service condition	*3 years*	
Option II		
No of equity settled shares of face value of ₹ 100 each		*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 at grant date		*135*
Fair value 20X0		*138*
20X1		*140*
20X2		*147*

Pass the Journal entries?

Answer:

Fair value of Equity option components:		
Fair value of a share with restrictive clause		₹ 115
Number of shares		90,000
Fair value (90,000 x 115)	A	₹ 1,03,50,000
Fair value of a share at the date of grant		₹ 135
Number of cash settled shares		74,000
Fair value (74,000 x 135)	B	₹ 99,90,000
Fair value of equity component in compound instrument (A-B)		₹ 3,60,000

Journal Entries

31/12/20X0		₹
Employee benefit expenses Dr.	35,24,000	
To Share based payment reserve (equity) (3,60,000/3)		1,20,000
To Share based payment liability (138 x 74,000) / 3		34,04,000
(Recognition of equity option and cash settlement option)		
31/12/20X1		
Employee benefits expenses Dr.	36,22,667	
To Share based payment reserve (equity) (3,60,000/3)		1,20,000
To Share based payment liability (140 x 74,000) 2/3 -34,04,000		35,02,667
(Recognition of equity option and cash settlement option)		

31/12/20X2		
Employee benefits expenses Dr.	40,91,333	
To Share based payment reserve (equity) (3,60,000/3)		1,20,000
To Share based payment liability (147 x 74,000) 3/3 - (34,04,000 + 35,02,667)		39,71,333
(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)		
Share based payment reserve (equity) Dr.	3,60,000	
To Retained Earnings		3,60,000
(Being transfer of equity from one account to another one)		
Upon equity alternative chosen		
Share based payment liability Dr.	1,08,78,000	
To Share Capital		90,00,000
To Share Premium		18,78,000
(Being settlement made in equity)		
Share based payment reserve (equity) Dr.	3,60,000	
To Retained Earnings		3,60,000
(Being transfer of equity from one account to another one)		

7 - Equity Settled – Non market conditions

Ankita Holding Inc. grants 100 shares to each of its 500 employees on 1st January, 20X1. The employees should remain in service during the vesting period. The shares will vest at the end of the First year if the company's earnings increase by 12%; Second year if the company's earnings increase by more than 20% over the two-year period; Third year if the entity's earnings increase by more than 22% over the three-year period. The fair value per share at the grant date is ` 122. In 20X1, earnings increased by 10%, and 29 employees left the organisation. The company expects that the shares will vest at the end of the year 20X2. The company also expects that additional 31 employees will leave the organisation in the year 20X2 and that 440 employees will receive their shares at the end of the year 20X2. At the end of 20X2, company's earnings 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 pass appropriate journal entries?

Answer:

Since the earnings of the entity is non-market related, hence it will not be considered in fair value calculation of the shares given. However, the same will be considered while calculating number of shares to be vested.

Workings:

	20X1	20X2	20X3
Total employees	500	500	500
Employees left (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	1/2	2/3	3/3
Expenses-20X1 (Note 1)	26,84,000		
Expenses-20X2 (Note 2)		7,23,867	
Expenses-20X3 (Note 3)			17,28,333

Note 1:

Expense for 20X1 = Number of employees x Shares per employee x Fair value of share x Proportionate vesting period

= 440 x 100 x 122 X ½ = 26,84,000

Note 2:

Expense for 20X2 = (Number 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 value of 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.

Journal Entries

31st December, 20X1			
Employee benefits expenses	Dr.	26,84,000	
To Share based payment reserve (equity)			26,84,000
(Equity settled shared based payment expected vesting amount)			
31st December, 20X2			
Employee benefits expenses	Dr.	7,23,867	
To Share based payment reserve (equity)			7,23,867
(Equity settled shared based payment expected vesting amount)			
31st December, 20X3			
Employee benefits expenses	Dr.	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)			

8 - Equity Settled – Non market conditions (Reversals)

ACC limited granted 10,000 share options to one of its managers. In order to get the options, the manager has to work for next 3 years in the organization and reduce the cost of production by 10% over the next 3 years. Fair value of the option at grant date was ` 95 Cost reduction achieved-
Year 1 12% Achieved
Year 2 8% Not expected to vest in future
Year 3 10% Achieved How the expenses would be recorded?
Answer:
It is a non-market related condition. Hence the target to achieve cost reduction would be taken while estimating the number of options to be vested.

Year	Options	Fair value		FV of the options vested
Year 1	10,000	95	1/3	3,16,667
Year 2	10,000	95	0	(3,16,667)
Year 3	10,000	95	3/3	9,50,000

The condition to achieve 10% cost reduction each was not fulfilled in the year 2 and there was no expectation to vest this non-market condition in future as well and hence earlier expense amount was reversed in year 2. Since in the year 3 the non-market condition was again met, hence all such expense will be charged to Profit and Loss.

9 - <u>Equity Settled – Market based conditions</u>

Apple Limited has granted 10,000 share options to one of its directors for which he must work for next 3 years and the price of the share should increase by 20% over next 3 years. The share price has moved as per below details -

Year 1 22%

Year 2 19%

Year 3 25%

At the grant date, the fair value of the option was ` 120. How should we recognize the transaction?

Answer:

The share price movement is a market based vesting condition hence its expectations are taken into consideration while calculating the fair value of the option. Even if the required market condition as required is not fulfilled, there is no requirement to reverse the expense previously booked. Irrespective of the outcome of the market prices (as it is already taken care of in the fair value of the option), each period an amount of (120 x 10,000)/3 = `

4,00,000 will be charged to profit and loss.

<u>10 – Modifications – Equity-settled share based payment</u>

Marathon Inc. issued 150 share options to each of its 1,000 employees subject to the service condition of 3 years. Fair value of the option given was calculated at ` 129. Below are the details and activities related to the SBP plan- Year 1: 35 employees left and further 60 employees are expected to leave

Share options re-priced (as MV of shares has fallen) as the FV fell to ` 50. After the re-pricing they are now worth ` 80, hence expense is expected to increase by ` 30. Year 2: 30 employees left and further 36 employees are expected to leave Year 3: 39 employees left

How the modification/ re-pricing will be accounted?

Answer:

The re-pricing has been done at the end of year 1, and hence the increased expense would be spread over next 2 years equally.

Total increased value due to modification is	₹ 30	(1/2 weight each years)

	Year 1	Year 2	Year 3
Number of employees	1,000	1,000	1,000
Employee left	(35)	(65)	104
Expected to leave	(60)	(36)	
Net employees	905	899	896
Options per employee	150	150	150
Fair value of the option	129	129	129
Period weight	1/3	2/3	3/3
Modification		30	30
Expense (original)	58,37,250	57,59,850	57,40,500
Modification	Nil	20,22,750	20,09,250
		(899x150x30x1/2)	(896x150x30x2/2)- 20,22,750)

11 - Cancellation- Equity Settled Share based payment

Anara Fertilisers Limited issued 2000 share options to its 10 directors for an exercise price of ` 100.The directors are required to stay with the company for next 3 years. Fair value of the option estimated ` 130 Expected number of directors to vest the option 8 During the year 2, there was a crisis in the company and Management decided to cancel the scheme immediately. It was estimated further as below- Fair value of option at the time of cancellation was ` 90 Market price of the share at the cancellation date was ` 99 There was a compensation which was paid to directors and only 9 directors were currently in employment. At the time of cancellation of such scheme, it was agreed to pay an amount of ` 95 per option to each of 9 directors. How the cancellation would be recorded?

Answer:

	Year 1	Year 2	
A)			
Expected directors to vest	8	9	
Fair value of option	130	130	
Number of options	2,000	2,000	
Total	20,80,000	23,40,000	
Expense weightage	1/3		Full, as it is cancelled
Expense for the year	6,93,333	16,46,667	Remaining amount since cancelled

B) Cancellation compensation	
Number of directors	9
Amount agreed to pay	95
Number of options/ director	2,000
Compensation amount (9 x 95 x 2,000) Also refer working notes 1 and 2	17,10,000

Working Notes:

1. **Amount to be deducted from Equity**

Number of directors	9
Fair value of option (at the date of cancellation)	90
Number of options / director	2,000
Total	16,20,000

2. **Amount transferred to Profit and Loss**

Total cancellation compensation	17,10,000
Less: To deduct from Equity	(16,20,000)
Balance transferred to Profit and Loss	90,000

12 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. [ALSO IN RTP - MAY 2019]

Answer:

As required by paragraph B53 of the Ind AS 102, over the two-year vesting period, the subsidiary measures the services received from the employees in accordance, the requirements applicable to equity-settled share-based payment transactions as given in paragraph 43B. Thus, the subsidiary measures the services received from the employees on the basis of the fair value of the share options at grant date. An increase in equity is recognised as a contribution from the parent in the separate or individual financial statements of the subsidiary.

The journal entries recorded by the subsidiary for each of the two years are as follows:

Year 1		Rs.	Rs.
Remuneration expense	Dr.	2,40,000	
(200 x 100 employees x Rs. 30 x 80% x ½)			
To Equity (Contribution from the parent)			2,40,000

Year 2			
Remuneration expense	Dr.	2,46,000	
[(200 x 81 employees x Rs. 30) – 2,40,000]			
To Equity (Contribution from the parent)			2,46,000

Questions

1. An entity issued 100 shares each to its 1,000 employees subject to service condition of next 2 years. Grant date fair value of the share is ` 195 each. There is an expectation 97% of the employees will remain in service at the end of 1st year. However, at the end of 2nd year the expected employees to remain in service would be 91% of the total employees. Calculate expense for the year 1 & 2?

Answer:

Year end	% Vest	Expense (current period)
FIRST	97%	100 x 1,000 x 195 x 97% x 1/2 = 94,57,500
SECOND	91%	100 x 1,000 x 195 x 91% x 2/2 – 94,57,500= 82,87,500

2. An entity issued 50 shares each to its 170 employees subject to service condition of next 2 years. The settlement is to be made in cash. Grant date fair value of the share is ` 85 each, however, the fair value as at end of 1st year, 2nd year were ` 80 & ` 90 respectively. Calculate expense for years 1 and 2?
Answer:

Year end	Vest	Expense (current period)
FIRST	1/2	50 x 170 x 80 x 1/2 = 3,40,000
SECOND	2/2	50 x 170 x 90 x 2/2 – 3,40,000 = 4,25,000

-- Liability will be re-measured at each reporting date.

-- Fair value at the end of the year will be used.

3. Company P is a holding company for company B. A group share-based payment is being organized in which Parent issues its own equity-shares for the employees of company B. The details are as below –

Number of employees of company B	100
Grant date fair value of share	₹ 87
Number of shares to each employee granted	25
Vesting conditions	Immediately

Pass the journal entry in the books of company P & company B?

Answer:
Books of Company P

Investment in Company B	Dr.	` 2,17,500	
To Equity (Issue of Shares)			` 2,17,500

Books of Company B

Expense	Dr.	` 2,17,500	
To Capital contribution from Parent P			` 2,17,500

4. Entity X acquired entity Y in a business combination as per Ind AS 103. There is an existing share-based plan in entity Y with a vesting condition for 3 years in which 2 years have already lapsed at the date of such business acquisition. Entity X agrees to replace the existing award for the employees of combined entity. The details are as below –
Acquisition date fair value of share-based payment plan ` 300
Number of years to vest after acquisition 1 year
Fair Value of award which replaces existing plan ` 400
Answer:
Pre-acquisition period = 2
Post-acquisition period = 1

Total fair value at acquisition date = ` 300
Value to be recorded as per business combination under Ind AS 103
= ` 300/3 x 2 = ` 200
Value to be recorded as per Ind AS 102 (**A**) = ` 300/3 x 1 = ` 100
Fair value of the replacement of such award = ` 400
Difference from acquisition date fair value (**B**) = ` 400 – ` 300
= ` 100
Total value to be accounted over vesting period as per Ind AS 102 = A + B
= ` 100 + ` 100 = ` 200

5. An entity P issues share-based payment plan to its employees based on the below details:

Number of employees	100
Fair value at grant date	₹ 25
Market condition	Share price to reach at ₹ 30
Service condition	To remain in service until market condition is fulfilled
Expected completion of market condition	4 years

Define expenses related to such share-based payment plan in each year subject to the below scenarios-
a) Market condition if fulfilled in year 3, or
b) Market condition is fulfilled in year 5.
Answer:
Market conditions are required to be considered while calculating fair value at grant date. However, service conditions will be considered as per the expected vesting right to be exercised by the employees and would be re-estimated during vesting period. However, if the market related condition is fulfilled before it is expected then all remaining expenses would immediately be charged off. If market related condition takes longer than the expected period then original expected period will be followed.
a) Market condition is fulfilled in year 3:
Year 1----- 2,500/4 = 625
Year 2 ---- 2,500/4 = 625
Year 3------ 2,500-625-625=1,250
Year 4-------- NIL

b) Market condition is fulfilled in year 5:
Year 1 ------2,500/4 = 625
Year 2 ------2,500/4 = 625
Year 3-------- 2,500/4 = 625
Year 4-------- 2,500/4 = 625 Year 5 NIL

6. Entity X grants 10 shares each to its 1000 employees on the conditions as mentioned below-
- To remain in service & entity's profit after tax (PAT) shall reach to ` 100 million.
- It is expected that PAT should reach to ` 100 million by the end of 3 years.
- Fair value at grant date is ` 100.

- Employees expected for vesting right by 1st year 97%, then it revises to 95% by 2nd year and finally to 93% by 3rd year.
Calculate expenses for next 3 years in respect of share-based payment?
Answer:
Entity's PAT is one of the non-market related condition and hence would be included while making an expectation of vesting shares and there is no requirement to make any changes in the non-market condition whether this is fulfilled or not because it has already been considered in the expectation of vesting rights at the end of each year.

Year -1	1,000 x 10 x 100 x 97% x1/3 = 3,23,333
Year-2	1,000 x 10 x 100 x 95% x 2/3 - 3,23,333 = 3,10,000
Year -3	1,000 x 10 x 100 x 93% x 3/3 - 6,33,333 = 2,96,667

7. At 1st January, 20X0, Ambani Limited grants its CEO an option to take either cash amount equivalent to 800 shares or 990 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	₹
Share alternative fair value (with restrictions)	212
Grant date fair value on 1st January, 20X0	213
Fair value on 31st December, 20X0	220
Fair value on 31st December, 20X1	232

The key management exercises his cash option at the end of 20X2. Pass journal entries.
Answer:

	1st January, 20X0	31st December, 20X0	31st December, 20X1
Equity alternative (990 x 212)	2,09,880		
Cash alternative (800 x 213)	1,70,400		
Equity option (2,09,880 – 1,70,400)	39,480		
Cash Option (cumulative) (using period end fair value)		88,000	1,85,600
Equity Option (cumulative)		19,740	39,480
Expense for the period			
Equity option		19,740	19,740
Cash Option		88,000	97,600
Total		1,07,740	1,17,340

Journal Entries

31st December, 20X0			₹
Employee benefits expenses	Dr.	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 December, 20X1			
Employee benefits expenses	Dr.	1,17,340	
To Share based payment reserve (equity)			19,740
To Share based payment liability			97,600
(Recognition of Equity option and cash settlement option)			
Share based payment liability	Dr.	1,85,600	
To Bank/ Cash			1,85,600
(Settlement in cash)			

8. MINDA issued 11,000 share appreciation rights (SARs) that vest immediately to its employees on 1st April, 20X0. The SARs will be settled in cash. Using an option pricing model, at that date it is estimated that the fair value of a SAR is ` 100. SAR can be exercised any time until 31st March, 20X3. It is expected that out of the total employees, 94% at the end of period on 31st March, 20X1, 91% at the end of next year will exercise the option. Finally, when these were vested i.e. at the end of the 3rd year, only 85% of the total employees exercised the option.

Fair value of SAR	₹
31st March, 20X1	132
31st March, 20X2	139
31st March, 20X3	141
Pass the Journal entries?	

Answer:

Period	Fair value	To be vested	Cumulative	Expense
Start	100	100%	11,00,000	11,00,000
Period 1	132	94%	13,64,880	2,64,880
Period 2	139	91%	13,91,390	26,510
Period 3	141	85%	13,18,350	(73,040)
				13,18,350

Journal Entries

1st April, 20X0			
Employee benefits expenses	Dr.	11,00,000	
To Share based payment liability			11,00,000
(Fair value of the SAR recognised)			
31st March, 20X1			
Employee benefits expenses	Dr.	2,64,880	
To Share based payment liability			2,64,880
(Fair value of the SAR re-measured)			
31st March, 20X2			
Employee benefits expenses	Dr.	26,510	
To Share based payment liability			26,510
(Fair value of the SAR re-measured)			
31st March, 20X3			
Share based payment liability	Dr.	73,040	
To Employee benefits expenses			73,040
(Fair value of the SAR reversed)			
Share based payment liability	Dr.	13,18,350	
To Cash			13,18,350
(Settlement of SAR)			

9. P Ltd. granted 400 stock appreciation rights (SAR) each to 75 employees on 1st April 20X1 with a fair value ` 200. The terms of the award require the employee to provide service for four years in order to earn the award. The fair value of each SAR at each reporting date is as follows:

31st March 20X2 ` 210
31st March 20X3 ` 220
31st March 20X4 ` 215
31st March 20X5 ` 218

What would be the difference if at the end of the second year of service (i.e. at 31st March 20X3), P Ltd. modifies the terms of the award to require only three years of service? [ALSO IN RTP - NOV 2018]

Answer:

Journal entries in the books of P Ltd (without modification of service period of stock appreciation rights)

(` in lakhs)

Date	Particulars	Debit	Credit
31.03.20X2	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	15.75	15.75
31.03.20X3	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	17.25	17.25
31.03.20X4	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	15.38	15.38
31.03.20X5	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	17.02	17.02

Journal entries in the books of P Ltd (with modification of service period of stock appreciation rights)

(` in lakhs)

Date	Particulars	Debit	Credit
31.03.20X2	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	15.75	15.75
31.03.20X3	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	28.25	28.25
31.03.20X4	Profit and Loss account Dr. To Liability for SARs (Being expenses liability for stock appreciation rights recognised)	20.50	20.50

Working Notes:

Calculation of expenses for issue of stock appreciation rights without modification of service period

For the year ended 31st March 20X2

= ` 210 x 400 awards x 75 employees x 1 year /4 years of service

= ` 15,75,000

For the year ended 31st March 20X3
= ` 220 x 400 awards x 75 employees x 2 years /4 years of service - ` 15,75,000 previous recognised
= ` 33,00,000 - ` 15,75,000 = ` 17,25,000

For the year ended 31st March 20X4
= ` 215 x 400 awards x 75 employees x 3 years/4 years of service - ` 33,00,000 previously recognised
= ` 48,37,500 - ` 33,00,000 = ` 15,37,500

For the year ended 31st March, 20X5
= ` 218 x 400 awards x 75 employees x 4 years / 4 years of service – ` 48,37,500 previously recognised
= ` 65,40,000 – ` 48,37,500 = ` 17,02,500

Calculation of expenses for issue of stock appreciation rights with modification of service period
For the year ended 31st March 20X2
= ` 210 x 400 awards x 75 employees x 1 year / 4 years of service = ` 15,75,000

For the year ended 31st March 20X3
= ` 220 x 400 awards x 75 employees x 2 years / 3 years of service - ` 15,75,000 previous recognised
= ` 44,00,000 - ` 15,75,000 = ` 28,25,000

For the year ended 31st March 20X4
= ` 215 x 400 awards x 75 employees x 3 years/ 3 years of service - ` 44,00,000 previous recognised
= ` 64,50,000 - ` 44,00,000 = ` 20,50,000.

10. QA Ltd. had on 1st April, 20X1 granted 1,000 share options each to 2,000 employees. The options are due to vest on 31st March, 20X4 provided the employee remains in employment till 31st March, 20X4.
On 1st April, 20X1, the Directors of Company estimated that 1,800 employees would qualify for the option on 31st March, 20X4. This estimate was amended to 1,850 employees on 31st March, 20X2 and further amended to 1,840 employees on 31st March, 20X3.
On 1st April, 20X1, the fair value of an option was ` 1.20. The fair value increased to ` 1.30 as on 31st March, 20X2 but due to challenging business conditions, the fair value declined thereafter. In September, 20X2, when the fair value of an option was ` 0.90, the Directors repriced the option and this caused the fair value to increase to ` 1.05. Trading conditions improved in the second half of the year and by 31st March, 20X3 the fair value of an option was ` 1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30th September, 20X2 should be spread over the remaining vesting period from 30th September, 20X2 to 31st March, 20X4.
The Company has requested you to suggest the suitable accounting treatment for these transaction as on 31st March, 20X3. [ALSO IN RTP - NOV 2019]
Answer:

Paragraph 27 of Ind AS 102 requires the entity to recognise the effects of repricing that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.

If the repricing increases the fair value of the equity instruments granted paragraph B43(a) of Appendix B requires the entity to include the incremental fair value granted (ie the difference between the fair value of the repriced equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted.
If the repricing occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the repricing date until the date when the repriced equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.
Accordingly, the amounts recognised in years 1 and 2 are as follows:

Year	Calculation	Compensation expense for period	Cumulative compensation expense
		₹	₹
1	[1,850 employees x 1,000 options x ₹ 1.20] x 1/3	7,40,000	7,40,000
2	(1,840 employees x 1,000 options x [(₹ 1.20 x 2/3) + {(₹ 1.05 - 0.90) x 0.5/1.5}] – 7,40,000	8,24,000	15,64,000

Note: Year 3 calculations have not been provided as it was not required in the question.

11. A parent, Company P, grants 30 shares to 100 employees each of its subsidiary, Company S, on condition that the employees remain employed by Company S for three years. Assume that at the outset, and at the end of Years 1 and 2, it is expected that all the employees will remain employed for all the three years. At the end of Year 3, none of the employees has left. The fair value of the shares on grant date is ` 5 per share. Company S agrees to reimburse Company P over the term of the arrangement for 75 percent of the final expense recognised by Company S. What would be the accounting treatment in the books of Company P and Company S?
Answer:

Company S expects to recsognise an expense totalling ` 15,000 (30 shares x 100 employees x ` 5 per share) and, therefore, expects the total reimbursement to be ` 11,250 (` 15,000 x 75%). Company S therefore reimburses Company P ` 3,750 (` 11,250 x 1/3) each year.
Accounting by Company S
In each of Years 1 to 3, Company S recognises an expense in profit or loss, the cash paid to Company P, and the balance of the capital contribution it has received from Company P.

Journal Entry			₹
Employee benefits expenses	Dr.	5,000	
To Cash/Bank			3,750
To Equity (Contribution from the parent)			1,250
(To recognise the share-based payment expense and partial reimbursement to parent)			

Accounting by Company P

In each of Years 1 to 3, Company P recognises an increase in equity for the instruments being granted, the cash reimbursed by Company S, and the balance as investment for the capital contribution it has made to Company S.

Journal Entry			₹
Investment in Company S	Dr.	1,250	
Cash/Bank	Dr.	3,750	
To Equity			5,000
(To recognise the grant of equity instruments to employees of subsidiary less partial reimbursement from subsidiary)			

12. An entity which follows its financial year as per the calendar year grants 1,000 share appreciation rights (SARs) to each of its 40 management employees as on 1st January 20X5. The SARs provide the employees with the right to receive (at the date when the rights are exercised) cash equal to the appreciation in the entity's share price since the grant date. All of the rights vest on 31st December 20X6; and they can be exercised during 20X7 and 20X8. Management estimates that, at grant date, the fair value of each SAR is ` 11; and it estimates that overall 10% of the employees will leave during the two-year period. The fair values of the SARs at each year end are shown below:

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 31st December 20X7 (when the intrinsic value of each SAR was ` 10), six employees exercised their options; and the remaining 30 employees exercised their options at the end of 20X8 (when the intrinsic value of each SAR was equal to the fair value of ` 12).
How much expense and liability is to be recognized at the end of each year? Pass Journal entries.

Answer:

Year	*Expense* ₹	*Liability* ₹	Calculation of Liability
31 December 20X5	2,16,000	2,16,000	= 36 x 1,000 x 12 x ½
31 December 20X6	72,000	2,88,000	= 36 x 1,000 x 8
31 December 20X7	1,62,000*	3,90,000	= 30 x 1,000 x 13
31 December 20X8	(30,000)**	0	Liability extinguished

***** Expense comprises an increase in the liability of ` 102,000 and cash paid to those exercising their SARs of ` 60,000 (6 x 1,000 x 10).
****** Difference of opening liability (` 3,90,000) and actual liability paid [` 3,60,000 (30 x 1,000 x 12)] is recognised to Profit and loss i.e ` 30,000.

Journal Entries

31 December 20X5			
Employee benefits expenses	Dr.	2,16,000	
To Share based payment liability			2,16,000
(Fair value of the SAR recognized)			
31 December 20X6			
Employee benefits expenses	Dr.	72,000	
To Share based payment liability			72,000
(Fair value of the SAR re-measured)			
31 December 20X7			
Employee benefits expenses	Dr.	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
(Fair value of the SAR recognized)			
Share based payment liability	Dr.	3,60,000	
To Cash			3,60,000
(Settlement of SAR)			

Note: Last two entries can be combined.

PAST EXAMINATION, MTPs, RTPs QUESTIONS

1. ABC Limited issued 20,000 Share Appreciation Rights (SARs) that vest immediately to its employees on 1st April 2015. The SARs will be settled in cash. At that date it is estimated using an option pricing model, that the fair value of a SAR is Rs. 95. SAR can be exercised any time up to 31st March 2018. At the end of 31st March 2016 it is expected that 95% of total employees will exercise the option, 92% of total employees will exercise the option at the end of next year and finally 89% will be vested only at the end of the 3 rd

year. Fair values at the end of each period have been given below:

Fair value of SAR	₹
31st March, 2016	110
31st March, 2017	107
31st March, 2018	112

Discuss the applicability of Cash Settled Share based payments under the relevant Ind AS and pass the journal entries.
[MAY 2018 - 10 MARKS]
Answer:
Applicability of cash settled share-based payment transactions

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability.

1. When vesting conditions are attached to the share based payment plans
The recognition of such share based payment plans should be done by recognizing fair value of the liability at the time of goods/ services received and not at the date of grant.

2. When no vesting period / condition is attached or to be fulfilled
Cash settled share based payment can be recognized in full at initial recognition itself.
Until the liability is settled, the entity shall remeasure the fair value of the liability at the end of each reporting period date and difference in fair value will be charged to profit or loss for the period as employee benefit expenses.
At the date of settlement, the liability is paid in cash based on the fair value on the date of settlement.

Calculation of expenses recognized during the year on account of change in the fair value of SARs

Period	Fair value	To be vested	Cumulative expenses	Expense / (benefit) for the current year
	a	b	c = a x b x 20,000	d = c-of current period – c of previous period
1st April, 2015	95	100%	19,00,000	19,00,000
31st March, 2016	110	95%	20,90,000	1,90,000
31st March, 2017	107	92%	19,68,800	(1,21,200)
31st March, 2018	112	89%	19,93,600	24,800
				19,93,600

2. Golden Era Limited grants 200 shares to each of its 400 employees on 1st January, 2016.
The employee should remain in service during the vesting period so as to be eligible. The shares will vest at the end of the
1st year - If the company's earnings increase by 12%.

2nd year - If the company's earnings increase by more than 20% over the two year period.
3rd year - If the company's earnings increase by more than 20% over the three year period.
The fair value per share (non-market related) at the grant date is Rs. 61. In 2016, earnings increased by 10% and 22 employees left the company. The company expects that earnings will continue at a similar rate in 2017 and expect that the shares will vest at the end of the year 2017. The company also expects that additional 18 employees will leave the organization in the year 2017 and that 360 employees will receive their shares at the end of the year 2017. At the end of 2017 company's earnings increased by 18% (over the 2 years period). Therefore, the shares did not vest. Only 16 employees left the organization during 2017.
The company believes that additional 14 employees will leave in 2020 and earnings will further increase so that the performance target will be achieved in 2018. At the end of the year 2018, only 9 employees have left the organization. Assume that the company's earnings increased to desired level and the performance target has been met.
You are required to determine the expense as per Ind AS for each year (assumed as financial year) and pass appropriate journal entries.
[MAY 2018 - 8 MARKS]

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.

Calculation of yearly expenses to be charged:

		2016	2017	2018
(a)	Total employees	400	400	400
(b)	Employees left (Actual)	(22)	(38)*	(47)**
(c)	Employees expected to leave in the next year	(18)	(14)	-
(d)	Year end – No of employees (a-b-c)	360	348	353
(e)	Shares per employee	200	200	200
(f)	Fair value of a share at the grant date	61	61	61
	Conditional increase in earnings	12%	20%	20%
	Actual increase in earnings	10%	18%	20%
(g)	Vesting period	1/2	2/3	3/3
(h)	Expenses (Refer Working Notes)	21,96,000	6,34,400	14,76,200

*22 + 16 = 38
** 22 +16 + 9 = 47

Journal Entries

		₹	₹
31st March, 2016			
Employee benefits expenses A/c	Dr.	5,49,000	
To Share based payment reserve (equity) A/c			5,49,000
(Equity settled shared based payment based on conditional vesting period)			
Profit and Loss A/c	Dr.	5,49,000	
To Employee benefits expenses A/c			5,49,000
(Employee benefits expenses transferred to Profit and Loss A/c)			
31st March, 2017			
Employee benefits expenses	Dr.	18,05,600	
To Share based payment reserve (equity)			18,05,600
(Equity settled shared based payment based on conditional expected vesting period)			
Profit and Loss A/c	Dr.	18,05,600	
To Employee benefits expenses A/c			18,05,600
(Employee benefits expenses transferred to Profit and Loss A/c)			
31st March, 2018			
Employee benefits expenses	Dr.	8,44,850	
To Share based payment reserve (equity)			8,44,850
(Equity settled shared based payment based on conditional expected vesting period)			
Profit and Loss A/c	Dr.	8,44,850	
To Employee benefits expenses A/c			8,44,850
(Employee benefits expenses transferred to Profit and Loss A/c)			
31st March, 2019			
Employee benefits expenses	Dr.	11,07,150	
To Share based payment reserve (equity)			11,07,150
(Equity settled shared based payment based on conditional expected vesting period)			
Profit and Loss A/c	Dr.	11,07,150	
To Employee benefits expenses A/c			11,07,150
(Employee benefits expenses transferred to Profit and Loss A/c)			
Share based payment reserve (equity) (353 x 200 x 61)	Dr.	43,06,600	
To Share Capital			43,06,600
(Share capital Issued)			

Working Notes:

1. Expense for 2016 (Jan to Dec) = No. of employees x Shares per employee x Fair value of share x Proportionate vesting period
= 360 x 200 x 61 X 1/2

= 21,96,000
Expense recognized in the financial year 2015-2016= 21,96,000 x 3/12 = 5,49,000

2. Expense for 2017 (Jan to Dec) = No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expense recognized in year 2016
= [(348 x 200 x 61) x 2/3] – 21,96,000
= 6,34,400
Expense recognized in the financial year 2016-2017= (21,96,000 x 9/12) + (6,34,400 x 3/12) = 16,47,000 + 1,58,600 = 18,05,600

3. Expense for 2018 (Jan to Dec) = (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expense recognized in year 2016 and 2017
= [(353 x 200 x 61) x 3/3] – (21,96,000 + 6,34,400)
= 14,76,200
Expense recognized in the financial year 2017-2018= (6,34,400 x 9/12) + (14,76,200 x 3/12) = 4,75,800 + 3,69,050 = 8,44,850

4. Expense recognized in the financial year 2018-2019=(14,76,200x9/12)= 11,07,150

3. Beetel Holding Inc. grants 100 shares to each of its 300 employees on 1st January, 2015. The employees should remain in service during the vesting period. The shares will vest at the end of the

First year	*if the company's earnings increase by 13%*
Second year	*if the company's earnings increased by more than 21% over the two-year period*
Third year	*if the entity's earning increased by more than 23% over the three-year period.*

The fair value per share at the grant date is Rs. 125.
In 2015, earnings increased by 9% and 20 employees left the organization. The company expects that earnings will continue at a similar rate in 2016 and expects that the shares will vest at the end of the year 2016. The company also expects that additional 30 employees will leave the organization in the year 2016 and that 250 employees will receive their shares at the end of the year 2016.
At the end of 2016, company's earnings increased by 19%. Therefore, the shares did not vest. Only 20 employees left the organization during 2016. Company believes that additional 25 employees will leave in 2017 and earnings will further increase so that the performance target will be achieved in 2017.
At the end of the year 2017, only 22 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 pass appropriate journal entries.
[MAY 2019 – 8 MARKS]

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.

Determination of expenses for each year:

		2015	2016	2017
a	Total employees	300	300	300
b	Cumulative- Employees left (Actual)	(20)	(40)	(62)
c	Employees expected to leave in the next year	(30)	(25)	-
d	Year end – No of employees	250	235	238
e	Shares per employee	100	100	100
f	Fair value of a share at grant date	125	125	125
g	Vesting period	1/2	2/3	3/3
h	Cumulative expenses (d x e x f x g)	15,62,500	19,58,333	29,75,000
i	Expenses to be recognised (h-h of previous year)		3,95,833	10,16,667

Journal Entries

31st December, 2015			₹
Employee benefits expenses	Dr.	15,62,500	
To Share based payment reserve (equity)			15,62,500
(Equity settled shared based payment expected vesting amount)			
31st December, 2016			
Employee benefits expenses	Dr.	3,95,833	
To Share based payment reserve (equity)			3,95,833
(Equity settled shared based payment expected vesting amount)			
31st December, 2017			
Employee benefits expenses	Dr.	10,16,667	
To Share based payment reserve (equity)			10,16,667
(Equity settled shared based payment expected vesting amount)			
Share based payment reserve (equity)	Dr.	29,75,000	
To Share Capital			2,97,5,000
(Share capital issued)			

4. ABC Limited granted 500 stock appreciation rights (SAR) each to 80 employees on 1 st April, 2017 with a fair value Rs. 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:
31st March, 2018 Rs. 110
31st March, 2019 Rs. 120
31st March, 2020 Rs. 115
31st March, 2021 Rs. 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
[NOV 2019 8 MARKS]
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
	a	b	c = 40,000 x a x b	d = [{(c / no. of total years) x years completed} – e of pvs year]	e
1st April, 2017	100	100%	40,00,000	-	-
31st March, 2018	110	100%	44,00,000	11,00,000	11,00,000
31st March, 2019	120	100%	48,00,000	13,00,000	24,00,000
31st March, 2020	115	100%	46,00,000	10,50,000	34,50,000
31st March, 2021	130	100%	52,00,000	17,50,000	52,00,000

Journal Entries

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.	13,00,000	
To Share based payment liability (Fair value of SARs has been re-measured)			13,00,000
31st March, 2020			
Employee benefits expenses/Profit and Loss A/c To Share based payment liability (Fair value of SARs has been recognized)	Dr.	10,50,000	10,50,000
31st March, 2021			
Employee benefits expenses A/c To Share based payment liability (Fair value of SARs has been recognized)	Dr.	17,50,000	17,50,000

2. When the term of the awards is modified to 3 years of service instead of 4 years of service

Period	Fair value a	%age of vesting B	Cumulative c = 40,000 x a x b	Expense in proportion to the award earned d = [{(c / no. of total years) x years completed} – e of pvs year]	Cumulative expenses recognized E
1st April, 2017	100	100%	40,00,000	-	-
31st March, 2018	110	100%	44,00,000	11,00,000	11,00,000
31st March, 2019	120	100%	48,00,000	21,00,000	32,00,000
31st March, 2020	115	100%	46,00,000	14,00,000	46,00,000

Journal Entries

31st March, 2018			
Employee benefits expenses	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	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	Dr.	14,00,000	
To Share based payment liability			14,00,000
(Fair value of SARs has been recognized)			

5. A Ltd. grants 100 shares to each of its 500 employees on 1st January 20X1. The employees should remain in service during the vesting period. The shares will vest at the end of the
First year if the company's earnings increase by 12%; Second year if the company's earnings increase by more than 20% over the two-year period; Third year if the entity's earnings increase by more than 22% over the three-year period. The fair value per share at the grant date is INR 122. In 20X1, earnings increased by 10%,
and 29 employees left the organisation. The company expects that earnings will continue at a similar rate in 20X2 and expects that the shares will vest at the end of the year 20X2. The company also expects that additional 31 employees will leave the organisation in the year 20X2 and that 440 employees will receive their shares at the end of the year 20X2. At the end of 20X2, company's earnings increased by 18%. 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. The company's earnings increased to desired level and the performance target has been met. Determine the expense for each year and pass appropriate journal entries as per the relevant Ind AS?
[MTP MARCH 2018 & APRIL 2019 12 MARKS]

Answer:
Since the earnings of the entity is non-market related, hence it will not be considered in fair value calculation of the shares given. However, the same will be considered while calculating number of shares to be vested.

Workings:

	20X1	20X2	20X3
Total employees	500	500	500
Employees left (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	1/2	2/3	3/3
Expenses-20X1 (Note 1)	26,84,000		
Expenses-20X2 (Note 2)		7,23,867	
Expenses-20X3 (Note 3)			17,28,333

Note 1:
Expenses for 20X1
= No. of employees x Shares per employee x Fair value of share x Proportionate vesting period
= 440 x 100 x 122 X ½ = 26,84,000
Note 2:
Expenses for 20X2
= (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expenses recognized in year 20X1
= (419 x 100 x 122 x 2/3) – 26,84,000 = 7,23,867
Note 3:
Expenses for 20X3
= (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expenses recognized in year 20X1 and 20X2
= (421 x 100 x 122 x 3/3) – (26,84,000 + 7,23,867) = 17,28,333.

Journal Entries

31-Dec-20X1			
Employee benefits expenses	Dr.	26,84,000	
To Share based payment reserve (equity)			26,84,000
(Equity settled shared based payment expected vesting amount)			
31-Dec-20X2			
Employee benefits expenses	Dr.	7,23,867	
To Share based payment reserve (equity)			7,23,867
(Equity settled shared based payment expected vesting amount)			
31-Dec-20X3			
Employee benefits expenses	Dr.	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)			

6. 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			*Period*	*INR*
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 March	*2016*			*138*
	2017			*140*
	2018			*147*

Pass the Journal entries?
[MTP ⍰ APRIL 2018 ⍰ 15 MARKS]
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		**Rs.**
Employee benefit expenses Dr.	35,24,000	
To Share based payment reserve (equity) (3,60,000/3)		1,20,000
To Share based payment liability (138 x 74,000) / 3		34,04,000
(Recognition of equity option and cash settlement option)		
31/3/2017		
Employee benefits expenses Dr.	36,22,667	
To Share based payment reserve (equity) (3,60,000/3)		1,20,000
To Share based payment liability (140 x 74,000) 2/3 -34,04,000		35,02,667
(Recognition of equity option and cash settlement option)		
31/3/2018		
Employee benefits expenses Dr.	40,91,333	
To Share based payment reserve (equity) (3,60,000/3)		1,20,000
To Share based payment liability (147 x 74,000) 3/3 - (34,04,000 + 35,02,667)		39,71,333
(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)		

7. 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 1st January, 2016	213
Fair value on 31st December, 2016	220
Fair value on 31st December, 2017	232

The key management exercises his cash option at the end of 2018. Pass journal entries
[MTP ? AUGUST 2018 ? 10 MARKS]
Answer:

	1st Jan., 2017	31st Dec., 2017	31st Dec., 2018
Cash alternative (990 x 212)	2,09,880		
Equity alternative (800 x 213)	1,70,400		
Equity option (2,09,880 – 1,70,400)	39,480		
Cash Option (cumulative) (using period end fair value)		88,000	1,85,600
Equity Option (cumulative)		19,740	39,480
Expense for the period			
Equity option		19,740	19,740
Cash Option		88,000	97,600
Total		1,07,740	1,17,340

Journal Entries

31st Dec., 2016			INR
Employee benefits expenses	Dr.	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 expenses	Dr.	1,17,340	
To Share based payment reserve (equity)			19,740
To Share based payment liability			97,600
(Recognition of Equity option and cash settlement option)			
Share based payment liability	Dr.	1,85,600	
To Bank/ Cash			1,85,600
(Settlement in cash)			

8. 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 31st March 2019. It is expected that out of the total employees, 94% at the end of period on 31st March 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 ⍰ OCTOBER 2018 ⍰ 6 MARKS]

Answer:

Period	Fair value	To be vested	Cumulative	Expense
Start	100	100%	11,00,000	11,00,000
Period 1	132	94%	13,64,880	2,64,880
Period 2	139	91%	13,91,390	26,510
Period 3	141	85%	13,18,350	(73,040)
				13,18,350

Journal Entries

1-Apr-2016			
Employee benefits expenses	Dr.	11,00,000	
To Share based payment liability			11,00,000
(Fair value of the SAR recognised)			
31-Mar-2017			
Employee benefits expenses	Dr.	2,64,880	
To Share based payment liability			2,64,880
(Fair value of the SAR re-measured)			
31-Mar-2018			
Employee benefits expenses	Dr.	26,510	
To Share based payment liability			26,510
(Fair value of the SAR re-measured)			
31-Mar-2019			
Share based payment liability	Dr.	73,040	
To Employee benefits expenses			73,040
(Fair value of the SAR reversed)			
Share based payment liability	Dr.	13,18,350	
To Cash			13,18,350
(Settlement of SAR)			

9. During the year, QA Ltd. delivered manufactured products to customer K. The products were faulty and on 1st October, 2016 customer K commenced legal action against the Company claiming damages in respect of losses due to the supply of faulty product. Upon investigating the matter, QA Ltd. discovered that the products were faulty due to defective raw material procured from supplier F. Therefore, on 1st December, 2016, the Company commenced legal action against F claiming damages in respect of the supply of defec tive raw materials. QA Ltd. has estimated that it's probability of success of both legal actions, the action of K against QA Ltd. and action of QA Ltd. against F, is very high.
On 1st October, 2016, QA Ltd. has estimated that the damages it would have to pay K would be Rs. 5 crores. This estimate was revised to Rs. 5.2 crores as on 31st March, 2017 and Rs. 5.25 crores as at 15th May, 2017. This case was eventually settled on 1st June, 2017, when the Company paid damages of Rs. 5.3 crores to K. On 1st December, 2016, QA Ltd. had estimated that it would receive damages of Rs. 3.5 crores from F. This estimate was revised to Rs. 3.6 crores as at 31st March, 2017 and Rs. 3.7 crores as on 15th May, 2017. This case was eventually settled on 1st June, 2017 when F paid Rs. 3.75 crores to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31st March, 2017, provided Rs. 3.6 crores as the financial statements were approved by the Board of Directors on 26th April, 2017.

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

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

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

(iii) What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable Ind AS?
[MTP ? MARCH 2019 ? 6 MARKS]
Answer:

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

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

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

CHAPTER-6 IND AS 101: FIRST-TIME ADOPTION OF IND AS

1. X Ltd. is required to adopt Ind AS from April 1, 20X1, with comparatives for one year, i.e., for 20X0-20X1. What will be its date of transition?
Answer:
The date of transition for X Ltd. will be April 1, 20X0 being the beginning of the earliest comparative period presented. To explain it further, X Ltd. is required to adopt an Ind AS from April 1, 20X1 (i.e. year 20X1-20X2), and it will give comparatives as per Ind AS for 20X0-20X1. Accordingly, the beginning of the comparative period will be April 1, 20X0 which will be considered as date of transition.

2 Company B is a foreign subsidiary of Company A and has adopted IFRS as issued by IASB as its primary GAAP for its local financial reporting purposes. Company B prepares its financial statements as per Accounting Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 for the purpose of consolidation with Company A. On transition of Company A to Ind-AS, what would be the previous GAAP of the foreign subsidiary Company B for its financial statements prepared for consolidation with Company A?
Answer
Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used for its statutory reporting requirements in India (emphasis added) immediately before adopting Ind AS. For instance, companies preparing their financial statements in accordance with the Accounting Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 shall consider those financial statements as previous GAAP financial statements.
Accordingly, the previous GAAP of the foreign subsidiary for the purpose of consolidation under Ind-AS with the parent company would be accounting standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 and not the IFRS as issued by the IASB since the first time adoption has to be considered in the context of India only.

3. E Ltd. is required to first time adopt Indian Accounting Standards (Ind AS) from 1 April 20X1. The management of E Ltd. has prepared its financial statements in accordance with Ind AS and an explicit and unreserved statement of compliance with Ind AS has been given by the management. However, the there is a disagreement on application of one Ind AS between the management and the auditor. Can such financial statements of E Ltd. be treated as first Ind AS financial statements?
Answer
Ind AS 101 defines first Ind AS financial statements as "The first annual financial statements in which an entity adopts Indian Accounting Standards (Ind AS), by an explicit and unreserved statement of compliance with Ind AS." In accordance with the above definition, if an explicit and unreserved statement of compliance with Ind AS has been given in the financial statements, even if the auditor‟s report contains a qualification because of disagreement on application of Indian Accounting Standard(s), it would be considered that E Ltd. has done the first time adoption of Ind AS. In such a case, exemptions given under Ind AS 101 cannot be availed again. If,

however, the unreserved statement of compliance with Ind AS is not given in the financial statements, such financial statements would not be considered to be first Ind AS financial statements.

4. Ind AS requires allocation of losses to the non-controlling interest, which may ultimately lead to a debit balance in non-controlling interests, even if there is no contract with the non-controlling interest holders to contribute assets to the Company to fund the losses. Whether this adjustment is required or permitted to be made retrospectively?

Answer

In case an entity elects not to restate past business combinations, Ind AS 101 requires the measurement of non-controlling interests (NCI) to follow from the measurement of other assets and liabilities on transition to Ind AS. However, Ind AS 101 contains a mandatory exception that prohibits retrospective allocation of accumulated profits between the owners of the parent and the NCI. In case an entity elects not to restate past business combinations, the previous GAAP carrying value of NCI is not changed other than for adjustments made (remeasurement of the assets and liabilities subsequent to the business combination) as part of the transition to Ind AS. As such, the carrying value of NCI in the opening Ind AS balance sheet cannot have a deficit balance on account of recognition of the losses attributable to the non-controlling interest, which was not recognised under the previous GAAP as part of NCI in the absence of contract to contribute assets to fund such a deficit. However, the NCI could have a deficit balance due to remeasurement of the assets and liabilities subsequent to the business combination as part of the transition to Ind AS. In case an entity restates past business combination, Ind AS 101 requires that the balance in NCI as at the date of transition shall be determined retrospectively in accordance with Ind AS, taking into account the impact of other elections made as part of the adoption of Ind AS.

As such, the NCI could have a deficit balance on account of losses attributable to the NCI, even if there is no obligation on the holders of NCI to contribute assets to fund such a deficit.

5 .A Ltd. had made certain investments in B Ltd.'s convertible debt instruments. The conversion rights are substantive rights and would provide A Ltd. with a control over B Ltd. A Ltd. has evaluated that B Ltd. would be treated as its subsidiary under Ind AS and, hence, would require consolidation in its Ind AS consolidated financial statements. B Ltd. was not considered as a subsidiary, associate or a joint venture under previous GAAP. How should B Ltd. be consolidated on transition to Ind AS assuming that A Ltd. has opted to avail the exemption from retrospective restatement of past business combinations?

Answer

Ind AS 101 prescribes an optional exemption from retrospective restatement in relation to past business combinations. Ind AS 101 prescribes that when the past business combinations are not restated and a parent entity had not consolidated an entity as a subsidiary in accordance with its previous GAAP (either because it was not regarded as a subsidiary or no consolidated financial statements were required under previous GAAP), then the subsidiary‟s assets and liabilities would be included in the parent‟s opening consolidated financial statements at such values as would appear in the subsidiary‟s separate financial statements if the subsidiary were to adopt the Ind AS as at the parent‟s date of transition. For this purpose, the subsidiary‟s separate financial statements would be prepared as if it was a first-time adopter of Ind AS i.e. after applying the relevant first-time adoption mandatory exceptions and voluntary exemptions. In other words, the parent will adjust the carrying amount of the subsidiary‟s assets and liabilities to the amounts that Ind AS would require in the subsidiary‟s balance sheet.

The deemed cost of goodwill equals the difference at the date of transition between:

(a) the parent"s interest in those adjusted carrying amounts; and
(b) the cost in the parent"s separate financial statements of its investment in the subsidiary.
The measurement of non-controlling interest and deferred tax follows from the measurement of other assets and liabilities. It may be noted here that the above exemption is available only under those circumstances where the parent, in accordance with the previous GAAP, has not presented consolidated financial statements for the previous year; or where the consolidated financial statements were prepared in accordance with the previous GAAP but the entity was not treated as a subsidiary, associate or joint venture under the previous GAAP.

6. A Ltd. has a subsidiary B Ltd. On first time adoption of Ind AS by B Ltd., it availed the optional exemption of not restating its past business combinations. However, A Ltd. in its consolidated financial statements has decided to restate all its past business combinations. Whether the amounts recorded by subsidiary need to be adjusted while preparing the consolidated financial statements of A Ltd. considering that A Ltd. does not avail the business combination exemption? Will the answer be different if A Ltd. adopts Ind AS after B Ltd?
Answer
As per Ind AS 101: "A first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS). However, if a first-time adopter restates any business combination to

comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date.
For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 20X0, it shall restate all business combinations that occurred between 30 June 20X0 and the date of transition to Ind AS, and it shall also apply Ind AS 110 from 30 June 20X0." Based on the above, if A Ltd. restates past business combinations, it would have to be applied to all business combinations of the group including those by subsidiary B Ltd. for the purpose of Consolidated Financial Statements. Ind AS 101 states, "However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary." Thus, in case where the parent adopts Ind AS later than the subsidiary (for example, if the parent is a non-banking financial company and the subsidiary is a trading or manufacturing company) then it does not change the amounts already recognised by the subsidiary.

7.X Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X1. It has given 200 stock options to its employees. Out of these, 75 options have vested on November 30, 20X0 and the remaining 125 will vest on November 30, 20X1. What are the options available to X Ltd. at the date of transition?
Answer
Ind AS 101 provides that a first-time adopter is encouraged, but not required, to apply Ind AS 102 on „Share-based Payment" to equity instruments that vested before the date of transition to Ind AS. However, if a first time adopter elects to apply Ind AS 102 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.
Having regard to the above, X Ltd. has the following options:

-- For 75 options that vested before the date of transition:

(a) To apply Ind AS 102 and account for the same accordingly, provided it has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.
(b) Not to apply Ind AS 102.
However, for all grants of equity instruments to which Ind AS 102 has not been applied, i.e., equity instruments vested but not settled before date of transition to Ind AS, X Ltd. would still need to disclose the information.
-- For 125 options that will vest after the date of transition: X Ltd. will need to account for the same as per Ind AS 102.

8. X Ltd. is the holding company of Y Ltd. X Ltd. is required to adopt Ind AS from April 1, 20X1. X Ltd. wants to avail the optional exemption of using the previous GAAP carrying values in respect of its property, plant and equipment whereas Y Ltd. wants to use fair value of its property, plant and equipment as its deemed cost on the date of transition. Examine whether X Ltd. can do so for its consolidated financial statements. Also, examine whether different entities in a group can use different basis for arriving at deemed cost for property, plant and equipment in their respective standalone financial statements

Answer

Where there is no change in its functional currency on the date of transition to Ind AS, a first-time adopter to Ind AS may elect to continue with the carrying value of all of its property, plant and equipment as at the date of transition measured as per the previous GAAP and use that as its deemed cost at the date of transition after making necessary adjustments. If a first time adopter chooses this option then the option of applying this on selective basis to some of the items of property, plant and equipment and using fair value for others is not available. Nothing prevents different entities within a group to choose different basis for arriving at deemed cost for the standalone financial statements. However, in Consolidated Financial Statements, the entire group should be treated as one reporting entity. Accordingly, it will not be permissible to use different basis for arriving at the deemed cost of property, plant and equipment on the date of transition by different entities of the group for the purpose of preparing Consolidated Financial Statements.

9.For the purpose of deemed cost on the date of transition, an entity has the option of using the carrying value as the deemed cost. In this context, suggest which carrying value is to be considered as deemed cost: original cost or net book value? Also examine whether this would have any impact on future depreciation charge?

Answer

For the purpose of deemed cost on the date of transition, if an entity uses the carrying value as the deemed cost, then it should consider the net book value on the date of transition as the deemed cost and not the original cost because carrying value here means net book value. The future depreciation charge will be based on the net book value and the remaining useful life on the date of transition. Further, as per the requirements of Ind AS 16, the depreciation method, residual value and useful life need to be reviewed atleast annually. As a result of this, the depreciation charge may or may not be the same as the depreciation charge under the previous GAAP.

10.Is it possible for an entity to allocate cost as per the previous GAAP to a component based on its fair value on the date of transition even when it does not have the component-wise historical cost?

Answer

Yes, an entity can allocate cost to a component based on its fair value on the date of transition. This is permissible even when the entity does not have component-wise historical cost.

11.Revaluation under previous GAAP can be considered as deemed cost if the revaluation was, at the date of the revaluation, broadly comparable to fair value or cost or depreciated cost of assets in accordance with Ind AS, adjusted to reflect, e.g., changes in a general or specific price index. What is the acceptable time gap of such revaluation from the date of transition? Can adjustments be made to take effects of events subsequent to revaluation?

Answer

There are no specific guidelines in Ind AS 101 to indicate the acceptable time gap of such revaluation from the date of transition. The management of an entity needs to exercise judgement in this regard. However, generally, a period of 2–3 years may be treated as an acceptable time gap of such revaluation from the date of transition. In any case, adjustments should be made to reflect the effect of material events subsequent to revaluation.

12.Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X1. On the date of transition, there is a long- term foreign currency monetary liability of ` 60 crores (US $ 10 million converted at an exchange rate of US $ 1 = ` 21 60). The accumulated exchange difference on the date of transition is nil since Y Ltd. was following AS 11 notified under the Companies (Accounting Standards) Rules, 2006 and has not exercised the option provided in paragraph 46/46A of AS 11. The Company wants to avail the option under paragraph 46A of AS 11 prospectively or retrospectively on the date of transition to Ind AS. How should it account for the translation differences in respect of this item under Ind AS 101?

Answer

Ind AS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.

13 .Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X5. On April 1, 20X1, it obtained a 7 year US$ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition, the company wants to continue the same accounting policy with regard to amortising of exchange differences. Whether the Company is permitted to do so?

Answer

Ind AS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. In view of the above, the Company can continue to follow the existing accounting policy of amortising the exchange differences in respect of this loan over the balance period of such long term liability.

14.A Ltd. acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd. did not recognise the said contingent consideration (since it was not considered probable). A Ltd. considered the previous GAAP carrying amounts of investment as its deemed cost on first-time adoption. In that case, does the carrying amount of investment required to be adjusted for this transaction?

Answer

In accordance with Ind AS 101, an entity has an option to treat the previous GAAP carrying values, as at the date of transition, of investments in subsidiaries, associates and joint ventures as its deemed cost on transition to Ind AS. If such an exemption is adopted, then the carrying values of such investments are not adjusted. Accordingly, any adjustments in relation to recognition of contingent consideration on first time adoption shall be made in the statement of profit and loss.

15 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 31 March 20X5 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10%. The date of transition to Ind AS is 1 April 20X3. Suggest how should Sigma Ltd. account for this compound financial instrument on the date of transition. The present value of ` 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as: [ALSO IN RTP - MAY 2020]

End of year	6%	10%
1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

Answer

The carrying amount of the debenture on the date of transition under previous GAAP, assuming that all interest accrued other than premium on redemption have been paid, will be ` 31,20,000 [(30,000 x 100) + (30,000 x 100 x 10/100 x 2/5)]. The premium payable on redemption is being recognised as borrowing costs as per para 4(b) of AS 16 ie under previous GAAP on straight-line basis. As per para D18 of Ind AS 101, Ind AS 32, Financial Instruments: Presentation, requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of Ind AS 32 would involve separating two

portions of equity. The first portion is recognised in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with this Ind AS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind AS. In the present case, since the liability is outstanding on the date of transition, Sigma Ltd. will need to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, we will first measure the liability component by discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option).

	(₹)
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment for years 1 to 4 (6 × 3.17) (Note 1)	19.02
PV of principal repayment (including premium) 110 × 0.68 (Note 2)	74.80
Total liability component per debenture	93.82
Equity component per debenture (Balancing figure)	6.18
Face value of debentures	100.00
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 initial recognition, the amount of ` 30,00,000 being the amount of debentures will be split as under:

Debt	₹ 28,14,600
Equity	₹ 1,85,400

However, on the date of transition, unwinding of ` 28,14,600 will be done for two years as follows:

Year	Opening balance	Finance cost @ 10%	Interest paid	Closing balance
1	28,14,600	2,81,460	1,80,000	29,16,060
2	29,16,060	2,91,606	1,80,000	30,27,666

Therefore, on transition date, Sigma Ltd. shall –
a. recognise the carrying amount of convertible debentures at ` 30,27,666;
b. recognise equity component of compound financial instrument of ` 1,85,400;
c. debit ` 93,066 to retained earnings being the difference between the previous GAAP amount of ` 31,20,000 and ` 30,27,666 and the equity component of compound financial instrument of ` 1,85,400; and
d. derecognise the debenture liability in previous GAAP of ` 31,20,000.

Notes:
1. 3.17 is present value of annuity factor of ` 1 at a discount rate of 10% for 4 years.
2. On maturity, ` 110 will be paid (` 100 as principal payment + ` 10 as premium)

16 H Ltd. has the following assets and liabilities as at March 31, 20X1, prepared in accordance with previous GAAP:

Particulars	*Notes*	*Amount (₹)*
Property, Plant & Equipment	*1*	*1,34,50,000*
Investments in S. Ltd.	*2*	*48,00,000*
Trade Receivables		*2,00,000*

Advances for purchase of inventory		50,00,000
Inventory		8,00,000
Cash		49,000
Total assets		2,42,99,000
VAT deferral loan	3	60,00,000
Creditors		30,00,000
Short term borrowing		8,00,000
Provisions		12,00,000
Total liabilities		1,10,00,000
Share capital		1,30,00,000
Reserves:		2,99,000
Cumulative translation difference	4	1,00,000
ESOP reserve	4	20,000
Retained earnings		1,79,000
Total equity		1,32,99,000
Total equity and liabilities		2,42,99,000

The following GAAP differences were identified by the Company on first-time adoption of Ind AS with effect from April 1, 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 ₹4,50,000 and was classified as investment property as per Ind AS 40.
   - Exchange differences of ₹ 1,00,000 were capitalised to depreciable property, plant and equipment on which accumulated depreciation of ₹40,000 was recognised.
   - There were no asset retirement obligations.
   - The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.
2. The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for ₹48,00,000 that carried a fair value of ₹ 68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.
3. Financial instruments:
   - VAT deferral loan ₹60,00,000 :

     The VAT deferral loan of ₹60,00,000 was obtained on March 31, 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 ₹37,25,528. The entity chooses to exercise the option given in paragraph B11 of Ind AS 101, i.e., the entity chooses to apply the requirements of Ind AS 109, Financial Instruments and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially accounting for VAT deferral loan*

4. *The retained earnings of the Company contained the following:*

- ***ESOP reserve of ₹20,000:***

  The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised ₹12,000 towards the vested options and ₹8,000 over a period of time as ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been ₹15,000 and ₹9,000 for the vested and unvested shares respectively. The Company intends to avail Ind AS 101 exemption for share-based payments for not restating the ESOP charge as per previous GAAP for vested options.

- ***Cumulative translation difference :***

  ₹1,00,000 The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of ₹ 1,00,000 as part of reserves. On first-time adoption of Ind AS, the Company intends to avail Ind AS 101 exemption of resetting the cumulative translation difference to zero.

Prepare transition date Ind AS balance sheet of Company H showing adjustments to the values of assets and liabilities.

[ALSO IN MTP - OCTOBER 2019 - 15 MARKS]

Answer Adjustments for opening balance sheet as per Ind AS 101

1. Property, Plant & 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 ` 68,00,000.

3. Financial instruments: As the VAT deferral loan is a financial liability under Ind AS 109, that liability should be recognised at its present value discounted at an appropriate discounting factor. Consequently, the VAT deferral loan should be recognised at ` 37,25,528 and the remaining ` 22,74,472 would be recognised as deferred government grant.

4. ESOPs: Ind AS 101 provides an exemption of not restating the accounting as per the previous GAAP in accordance with Ind AS 102 for all options that have vested by the transition date. Accordingly, out of 1000 ESOPs granted, the first-time adoption exemption is available on 800 options that have already vested. As such, its accounting need not be restated. However, the 200 options that are not vested as at the transition date, need to be restated in accordance with Ind AS 102. As such, the additional impact of ` 1,000 (i.e., 9,000 less 8,000) would be recognised in the opening Ind AS balance sheet.

5. Cumulative translation difference : As per paragraph D12 of Ind AS 101, the first-time adopter can avail an exemption regarding requirements of Ind AS 21 in context of cumulative translation differences. If a first-time adopter uses this exemption the cumulative translation differences for all foreign operation are deemed to be zero as at the transition date. In that case, the balance is transferred to retained earnings. As such, the balance of ` 1,00,000 should be transferred to retained earnings

6. **Retained earnings:**

	₹
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
Increase in Retained Earnings	20,99,000

The transition date Ind AS Balance Sheet after the above adjustments in the carrying values of assets and liabilities is as under:

Transition date Ind AS Balance Sheet of H Ltd. as at 1st April, 20X1

Particular	Notes	Previous GAAP	Adjustments	Ind AS GAAP
Non-Current Assets				
Property, Plant & Equipment	1	1,34,50,000	(4,50,000)	1,30,00,000
Investment property	1	0	4,50,000	4,50,000
Current Assets				
Inventory		8,00,000		8,00,000
Financial assets:				
Investment in S Ltd.	2	48,00,000	20,00,000	68,00,000
Trade Receivables		2,00,000		2,00,000
Cash		49,000		49,000
Other current asset – (Advances for purchase of inventory)		50,00,000		50,00,000
Total assets		2,42,99,000	20,00,000	2,62,99,000
Share capital		1,30,00,000		1,30,00,000
Other Equity:				
Cumulative translation difference	5	1,00,000	(1,00,000)	0
ESOP reserve	4	20,000	1,000	21,000
Retained earnings	6	1,79,000	20,99,000	22,78,000
Total equity		1,32,99,000	20,00,000	1,52,99,000
Non-current Liabilities				
Financial liability:				
VAT 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				
Financial Liabilities				
Trade payables		30,00,000		30,00,000
Short term borrowings		8,00,000		8,00,000
Provisions		12,00,000		12,00,000
Total liabilities		1,10,00,000		1,10,00,000
Total equity and liabilities		2,42,99,000	20,00,000	2,62,99,000

17. Shaurya Limited is the company having its registered and corporate office at New Delhi. 60% of Shaurya Limited's shares are held by the Government of India and rest by other investors.
This is the first time that Shaurya limited would be applying Ind AS for the preparation of its financials for the current financial year 2019-2020. Following balance sheet is prepared as per earlier GAAP as at the beginning of the preceding period along with the additional information:

Balance Sheet as at 31 March 2018

(All figures are in '000, unless otherwise specified)

Particulars	Amount
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	10,00,000
(b) Reserves & Surplus	25,00,000
(2) Non-Current Liabilities	
(a) Long Term Borrowings	4,50,000
(b) Long Term Provisions	3,50,000
(c) Deferred tax liabilities	3,50,000
(3) Current Liabilities	
(a) Trade Payables	22,00,000
(b) Other Current Liabilities	4,50,000
(c) Short Term Provisions	12,00,000
TOTAL	85,00,000
ASSETS	
(1) Non-Current Assets	
(a) Property, Plant & Equipment (net)	20,00,000
(b) Intangible assets	2,00,000
(c) Goodwill	1,00,000
(d) Non-current Investments	5,00,000
(e) Long Term Loans and Advances	1,50,000
(f) Other Non-Current Assets	2,00,000
(2) Current Assets	
(a) Current Investments	18,00,000
(b) Inventories	12,50,000
(c) Trade Receivables	9,00,000
(d) Cash and Bank Balances	10,00,000
(e) Other Current Assets	4,00,000
TOTAL	85,00,000

Additional Information (All figures are in '000) :

1. Other current liabilities include ₹ 3,90,000 liabilities to be paid in cash such as expense payable, salary payable etc. and ₹ 60,000 are statutory government dues.

2. *Long term loans and advances include ₹ 40,000 loan and the remaining amount consists Advance to staff of ₹ 1,10,000.*

3. *Other non-current assets of ₹ 2,00,000 consists Capital advances to suppliers.*

4. *Other current assets include ₹ 3,50,000 current assets receivable in cash and Prepaid expenses of ₹ 50,000.*

5. *Short term provisions include Dividend payable of ₹ 2,00,000. The dividend payable had been as a result of board meeting wherein the declaration of dividend for financial year 2017-2018 was made. However, it is subject to approval of shareholders in the annual general meeting.*

Chief financial officer of Shaurya Limited has also presented the following information against corresponding relevant items in the balance sheet:

a) *Property, Plant & Equipment consists a class of assets as office buildings whose carrying amount is ₹ 10,00,000. However, the fair value of said office building as on the date of transition is estimated to be ₹ 15,00,000. Company wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements.*

b) *The fair value of Intangible assets as on the date of transition is estimated to be ₹ 2,50,000. However, the management is reluctant to incorporate the fair value changes in books of account.*

c) *Shaurya Ltd. had acquired 80% shares in a company, Excel private limited few years ago thereby acquiring the control upon it at that time. Shaurya Ltd. recognised goodwill as per erstwhile accounting standards by accounting the excess of consideration paid over the net assets acquired at the date of acquisition. Fair value exercise was not done at the time of acquisition.*

d) *Trade receivables include an amount of ₹ 20,000 as provision for doubtful debts measured in accordance with previous GAAP. Now as per latest estimates using hindsights, the provision needs to be revised to ₹ 25,000.*

e) *Company had given a loan of ₹ 1,00,000 to an entity for the term of 10 years six years ago. Transaction costs were incurred separately for this loan. The loan carries an interest rate of 7%. The principal amount is to be repaid in equal installments over the period of ten years at the year end. Interest is also payable at each year end. The fair value of loan as on the date of transition is ₹ 50,000 as against the carrying amount of loan which at present amounts to ₹ 40,000. However, Ind AS 109 mandates to recognise the interest income as per effective interest method after the adjustment of transaction costs. Management says it is tedious task in the given case to apply the effective interest rate changes with retrospective effect and hence is reluctant to apply the same retrospectively in its first time adoption.*

f) *In the long-term borrowings, ₹ 4,50,000 of component is due towards the State Government. Interest is payable on the government loan at 4%, however the prevailing rate in the market at present is 8%. The fair market value of loan stands at ₹ 4,20,000 as on the relevant date.*

g) *Under Previous GAAP, the mutual funds were measured at cost or market value, whichever is lower. Under Ind AS, the Company has designated these investments at fair value through profit or loss. The value of mutual funds as per previous GAAP is ₹ 2,00,000 as included in 'current investment'. However, the fair value of mutual funds as on the date of transition is ₹ 2,30,000.*

h) *Ignore separate calculation of deferred tax on above adjustments. Assume the net deferred tax income to be ₹ 50,000 on account of Ind AS transition adjustments.*

Requirements:

- *Prepare transition date balance sheet of Shaurya Limited as per Indian Accounting Standards*
- *Show necessary explanation for each of the items presented by chief financial officer in the form of notes, which may or may not require the adjustment as on the date of transition.*

Answer: (MTP-OCT 2020)

Transition date (opening) IND-AS BALANCE SHEET of SHAURYA LIMITED
As at 1 April 2018
(All figures are in "000, unless otherwise specified)

Particulars	Previous GAAP	Transitional Ind AS adjustments	Opening Ind AS Balance Sheet
ASSETS			
Non-current assets			
Property, plant and equipment (Note 1)	20,00,000	5,00,000	25,00,000
Goodwill (Note 2)	1,00,000	-	1,00,000
Other Intangible assets (Note 3)	2,00,000	-	2,00,000
Financial assets:			
Investment	5,00,000	-	5,00,000
Loans (Note 4)	40,000	10,000	50,000
Other financial assets	1,10,000	-	1,10,000
Other non-current assets	2,00,000	-	2,00,000
Current assets			
Inventories	12,50,000	-	12,50,000

Financial assets			
Investment (Note 5)	18,00,000	30,000	18,30,000
Trade receivables (Note 6)	9,00,000	-	9,00,000
Cash and cash equivalents/Bank	10,00,000	-	10,00,000
Other financial assets	3,50,000	-	3,50,000
Other current assets	50,000	-	50,000
TOTAL ASSETS	85,00,000	5,40,000	90,40,000
EQUITY AND LIABILITIES			
Equity			
Equity share capital	10,00,000	-	10,00,000
Other equity	25,00,000	7,90,000	32,90,000
Non-current liabilities			
Financial liabilities			
Borrowings (Note-7)	4,50,000	-	4,50,000
Provisions	3,50,000	-	3,50,000
Deferred tax liabilities (Net)	3,50,000	(50,000)	3,00,000
Current liabilities			
Financial liabilities			
Trade payables	22,00,000	-	22,00,000
Other financial liabilities	3,90,000	-	3,90,000
Other current liabilities	60,000	-	60,000
Provisions (Note-8)	12,00,000	(2,00,000)	10,00,000
TOTAL EQUITY AND LIABILITIES	85,00,000	5,40,000	90,40,000

OTHER EQUITY

	Retained Earnings (₹)	Fair value reserve	Total
As at 31 March, 2018	27,90,000 (W.N.1)	5,00,000	32,90,000

Working Note 1:
Retained earnings balance:

Balance as per Earlier GAAP	25,00,000
Transitional adjustment due to loan‟s fair value	10,000
Transitional adjustment due to increase in mutual fund‟s fair value	30,000
Transitional adjustment due to decrease in deferred tax liability	50,000
Transitional adjustment due to decrease in provisions (dividend)	2,00,000
Total	27,90,000

Questions

1. Company A intends to restate its past business combinations with effect from 30 June 20X0 (being a date prior to the transition date). If business combinations are restated, whether certain other exemptions, such as the deemed cost exemption for property, plant and equipment (PPE), can be adopted?

Answer:

Ind-AS 101 prescribes that an entity may elect to use one or more of the exemptions of the Standard. As such, an entity may choose to adopt a combination of optional exemptions in relation to the underlying account balances.

When the past business combinations after a particular date (30 June 20X0 in the given case) are restated, it requires retrospective adjustments to the carrying amounts of acquiree‟s assets and liabilities on account of initial acquisition accounting of the acquiree‟s net assets, the effects of subsequent measurement of those net assets (including amortisation of non-current assets that were recognised at its fair value), goodwill on consolidation and the consolidation adjustments. Therefore, the goodwill and equity (including non-controlling interest (NCI)) cannot be computed by considering the deemed cost exemption for PPE. However, the entity may adopt the deemed cost exemption for its property, plant and equipment other than those acquired through business combinations.

2. X Ltd. was using cost model for its property, plant and equipment till March 31, 20X2 under previous GAAP. The Ind AS become applicable to the company for financial year beginning April 1, 20X2. On April 1, 20X1, i.e., the date of its transition to Ind AS, it used fair value as the deemed cost in respect of its property, plant and equipment. X Ltd. wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements. Whether use of fair values as deemed cost on the date of transition and use of revaluation model in the first annual Ind AS financial statements would amount to a change in accounting policy?

Answer:

In the instant case, X Ltd. is using revaluation model for property, plant and equipment for the first annual Ind AS financial statements and using fair value of property, plant and equipment on the date of the transition, as deemed cost. Since the entity is using fair value at the transition date as well as in the first Ind AS financial statements, there is no change in

accounting policy and mere use of the term „deemed cost‟ would not mean that there is a change in accounting policy.

3. Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X5. On April 1, 20X0, it obtained a 7 year US $ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition to Ind AS, Y Ltd. wants to discontinue the accounting policy as per the previous GAAP and follow the requirements of Ind AS 21 with respect to recognition of foreign exchange differences. Whether the Company is permitted to do so?

Answer:

Ind AS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Ind AS 101 gives an option to continue the existing accounting policy. Hence, Y Ltd. may opt for discontinuation of accounting policy as per previous GAAP and follow the requirements of Ind AS 21. The cumulative amount lying in the Foreign Currency Monetary Item Translation Difference Account (FCMITDA) as per AS 11 should be derecognised by an adjustment against retained earnings on the date of transition.

4. A company has chosen to elect the deemed cost exemption in accordance with Ind AS 101. However, it does not wish to continue with its existing policy of capitalising exchange fluctuation on long term foreign currency monetary items to property, plant and equipment i.e. it does not want to elect the exemption available as per Ind AS 101. In such a case, how would the company be required to adjust the foreign exchange fluctuation already capitalised to the cost of property, plant and equipment under previous GAAP?

Answer:

Ind AS 101 permits to continue with the carrying value for all of its property, plant and equipment as per the previous GAAP and use that as deemed cost for the purposes of first time adoption of Ind AS. Accordingly, the carrying value of property, plant and equipment as per previous GAAP as at the date of transition need not be adjusted for the exchange fluctuations capitalized to property, plant and equipment. Separately, it allows a company to continue with its existing policy for accounting for exchange differences arising from translation of long term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Accordingly, given that Ind AS 101 provides these two choices independent of each other, it may be possible for an entity to choose the deemed cost exemption for all of its property, plant and equipment and not elect the exemption of continuing the previous GAAP policy of capitalising exchange fluctuation to property, plant and equipment. In such a case, in the given case, a harmonious interpretation of the two exemptions would require the company to recognise the property, plant and equipment at the transition date at the previous GAAP carrying value (without any adjustment for the exchanges differences capitalized under previous GAAP) but for the purposes of the first (and all subsequent) Ind AS financial statements, foreign exchange fluctuation on all long term foreign currency borrowings that arose after the transition date would be recognised in the statement of profit and loss.

5. XYZ Pvt. Ltd. is a company registered under the Companies Act, 2013 following Accounting Standards notified under Companies (Accounting Standards) Rules, 2006. The Company has decided to voluntarily adopt Ind AS w.e.f 1st April, 20X2 with a transition date of 1st April, 20X1.

The Company has one Wholly Owned Subsidiary and one Joint Venture which are into manufacturing of automobile spare parts.

The consolidated financial statements of the Company under Indian GAAP are as under:

Consolidated Financial Statements

(₹ in Lakhs)

Particulars	31.03.20X2	31.03.20X1
Shareholder's Funds		
Share Capital	7,953	7,953
Reserves & Surplus	16,547	16,597
Non-Current Liabilities		
Long Term Borrowings	1,000	1,000
Long Term Provisions	1,101	691
Other Long-Term Liabilities	5,202	5,904
Current Liabilities		
Trade Payables	9,905	8,455
Short Term Provisions	500	475
Total	42,208	41,075
Non-Current Assets		
Property Plant & Equipment	21,488	22,288
Goodwill on Consolidation of subsidiary and JV	1,507	1,507
Investment Property	5,245	5,245
Long Term Loans & Advances	6,350	6,350
Current Assets		
Trade Receivables	4,801	1,818
Investments ·	1,263	3,763
Other Current Assets	1,554	104
Total	42,208	41,075

Additional Information:

The Company has entered into a joint arrangement by acquiring 50% of the equity shares of ABC Pvt. Ltd. Presently, the same has been accounted as per the proportionate consolidated method. The proportionate share of assets and liabilities of ABC Pvt. Ltd.

included in the consolidated financial statement of XYZ Pvt. Ltd. is as under:

Particulars	**` in Lakhs**
Property, Plant & Equipment	**1,200**
Long Term Loans & Advances	**405**
Trade Receivables	**280**
Other Current Assets	**50**
Trade Payables	**75**
Short Term Provisions	**35**

The Investment is in the nature of Joint Venture as per Ind AS 111.

The Company has approached you to advice and suggest the accounting adjustments which are required to be made in the opening Balance Sheet as on 1st April, 20X1. [RTP - MAY 2019]

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 belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the **relative** carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged. The balance of the investment in joint venture at the date of transition to Ind AS, determined in accordance with paragraph D31AA above is regarded as the deemed cost of the investment at initial recognition.

Accordingly, the deemed cost of the investment will be

Property, Plant & Equipment	1,200
Goodwill (Refer Note below)	119
Long Term Loans & Advances	405
Trade Receivables	280
Other Current Assets	50
Total Assets	2,054
Less: Trade Payables	75
Short Term Provisions	35
Deemed cost of the investment in JV	1,944

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

Note: Only those assets and liabilities have been taken into account for calculation of „proportionate goodwill share of Joint Venture‟, which were given in the question as „proportionate share of assts and liabilities of ABC Ltd. added to XYZ Ltd.‟
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 31.3.20X1 and Investment in JV will appear under non-current asset in the transition date balance sheet as on 1.4.20X1.
Adjustments made in previous GAAP balance sheet to arrive at Transition date Ind AS Balance Sheet

Transition Date Ind AS Balance Sheet of XYZ Pvt. Ltd. as at 1st April, 20X1

Particulars	Previous GAAP	Ind AS Adjustment	Ind AS GAAP
Non-Current Assets			
Property, Plant & Equipment	22,288	(1,200)	21,088
Investment Property	5,245	-	5,245
Intangible assets - Goodwill on Consolidation	1,507	(119)	1,388
Financial Assets			
Long Term Loans & Advances	6,350	(405)	5,945
Non- current investment in JV	-	1,944	1,944
Current Assets	-		
Financial Assets			
Investments -	3,763	-	3,763
Trade Receivables	1,818	(280)	1,538
Other Current Assets	104	(50)	54
Total	**41,075**	**(110)**	**40,965**
Equity and liabilities			
Equity			
Share Capital	7,953	-	7,953
Other equity	16,597	-	16,597
Non-Current Liabilities			
Financial Liabilities			
Borrowings	1,000		1,000
Long Term Provisions	691		691
Other Long-Term Liabilities	5,904		5,904
Current Liabilities			
Financial Liabilities			
Trade Payables	8,455	(75)	8,380
Short Term Provisions	475	(35)	440
Total	**41,075**	**(110)**	**40,965**

6. Mathur India Private Limited has to present its first financials under Ind AS for the year ended 31st March, 20X3. The transition date is 1st April, 20X1.
The following adjustments were made upon transition to Ind AS:
(a) The Company opted to fair value its land as on the date on transition.
The fair value of the land as on 1st April, 20X1 was ` 10 crores. The carrying amount as on 1st April, 20X1 under the existing GAAP was ` 4.5 crores.
(b) The Company has recognised a provision for proposed dividend of ` 60 lacs and related dividend distribution tax of ` 18 lacs during the year ended 31st March, 20X1. It was written back as on opening balance sheet date.
(c) The Company fair values its investments in equity shares on the date of transition. The increase on account of fair valuation of shares is ` 75 lacs.

(d) The Company has an Equity Share Capital of ` 80 crores and Redeemable Preference Share Capital of ` 25 crores.
(e) The reserves and surplus as on 1st April, 20X1 before transition to Ind AS was ` 95 crores representing ` 40 crores of general reserve and ` 5 crores of capital reserve acquired out of business combination and balance is surplus in the Retained Earnings.
(f) The company identified that the preference shares were in nature of financial liabilities.
What is the balance of total equity (Equity and other equity) as on 1st April, 20X1 after transition to Ind AS? Show reconciliation between total equity as per AS (Accounting Standards) and as per Ind AS to be presented in the opening balance sheet as on 1st April, 20X1.
Ignore deferred tax impact. [ALSO IN RTP - NOV 2019]

Answer:

			₹ 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	57.03	102.03
Balance total equity as on 1st April, 20X1 after transition to Ind AS			182.03

Reconciliation between Total Equity as per AS and Ind AS to 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	6.25
Equity as on 1st April, 20X1 after transition to Ind AS		182.03

7. ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters‟ contribution have been recognised in capital reserve and treated as part of shareholders‟ funds in accordance with the provisions of AS 12, Accounting for Government Grants.

State whether the accounting treatment of the grants in the nature of promoters‟ contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance. If not, then what will be the accounting treatment of such grants recognised in capital reserve as per previous GAAP on the date of transition to Ind AS.

Answer;

Paragraph 2 of Ind AS 20, "Accounting for Government Grants and Disclosure of Government Assistance" inter alia states that the Standard does not deal with government participation in the ownership of the entity. Since ABC Ltd. is a Government company, it implies that government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will be shown in the Statement of Profit and Loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101 „First Time Adoption of Ind AS‟. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter‟s contribution directly to shareholders‟ funds.

Where it is concluded that the contributions are in the nature of shareholder contributions and are recognised in capital reserve under previous GAAP, the provisions of paragraph 10 of Ind AS 101 would be applied which states that except in certain cases, an entity shall in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind AS;

(b) not recognise items as assets or liabilities if Ind AS do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and

(d) apply Ind AS in measuring all recognised assets and liabilities.

Accordingly, as per the above requirements of paragraph 10(c) in the given case, contributions recognised in the Capital Reserve should be transferred to appropriate category under „Other Equity‟ at the date of transition to Ind AS.

PAST PAPERS QUESTIONS ,MOCK TEST PAPERS & REVISION TEST PAPERS

1. 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?

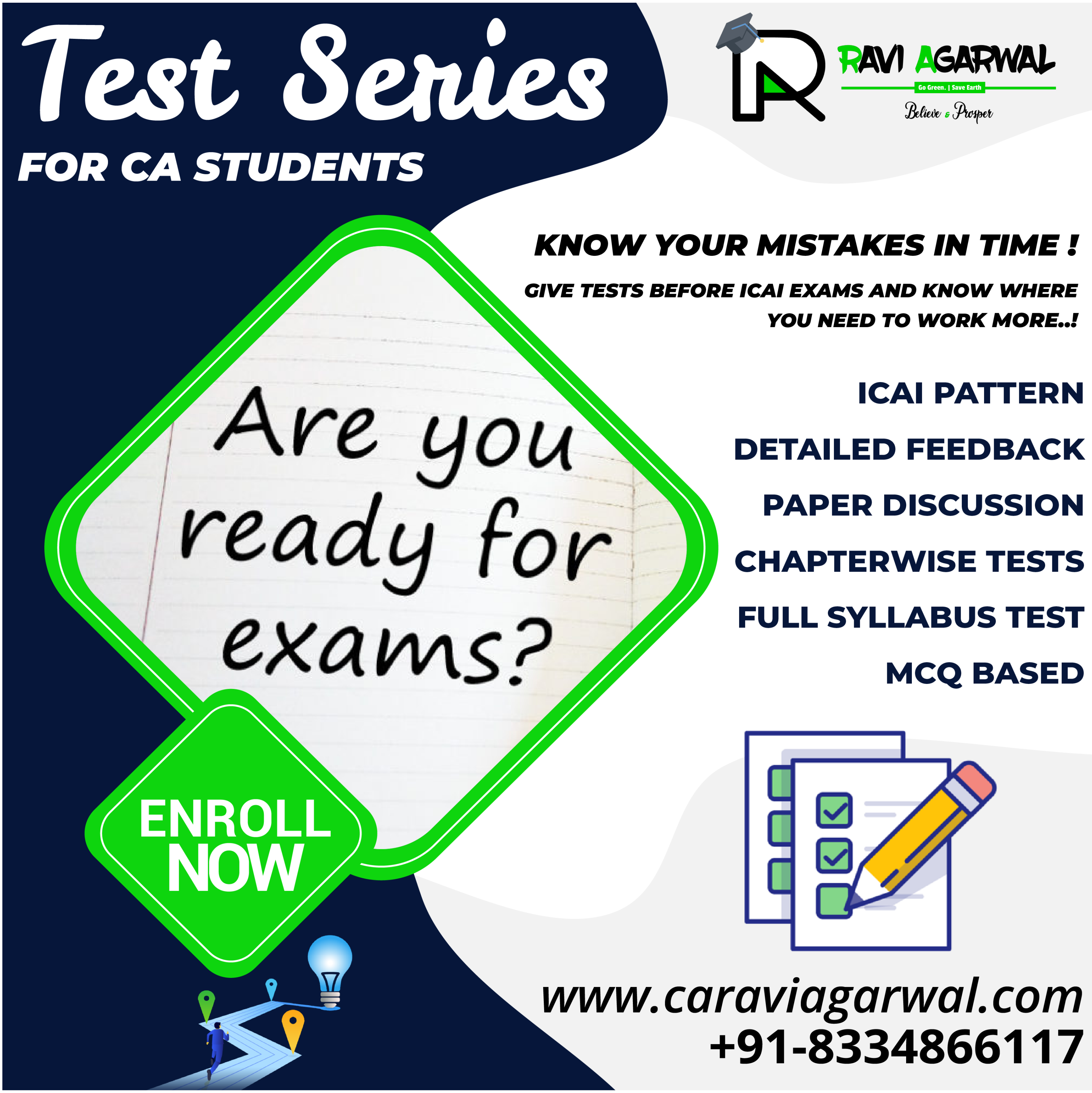
Will the answer be different if X Ltd. adopts Ind AS after Y Ltd?

[MTP - APRIL 2018 - 5 MARKS]

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 if 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.



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CHAPTER 7. IND AS ON ASSETS OF THE FINANCIAL STATEMENTS

UNIT 1: INDAS 2: INVENTORIES

1. As per Ind AS 2, inventories include 'materials and supplies awaiting use in the production process'. Whether packing material and publicity material are covered by the term 'materials and supplies awaiting use in the production process'.

Solution

While the primary packing material may be included within the scope of the term 'materials and supplies awaiting use in the production process' but the secondary packing material and publicity material cannot be so included, as these are selling costs which are required to be excluded as per Ind AS 2. For this purpose, the primary packing material is one which is essential to bring an item of inventory to its saleable condition, for example, bottles, cans etc., in case of food and beverages industry. Other packing material required for transporting and forwarding the material will normally be in the nature of secondary packing material.

2. ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X was ` 1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.

The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this.

Import duties (basic custom duties) of ` 60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost of ` 5,000 to have the components taken to its warehouse.

Calculate the cost of inventory.

Solution

	`
Purchase price (1,000 x 1,200 x 95%)	11,40,000
Import duties (1,000 x 60)	60,000
Delivery cost	5,000
Cost of inventory	12,05,000

Note: The intention to take settlement discount is irrelevant.

3: Normal production capacity
A business plans for production overheads of ` 10,00,000 per annum.
The normal level of production is 1,00,000 units per annum.
Due to supply difficulties the business was only able to make 75,000 units in the current year. Other costs per unit were ` 126.
Calculate the per unit cost and amount of overhead to be expensed during the year.

Solution

Calculation of cost per unit:	₹
Other costs	126
Production overhead (10,00,000/1,00,000 units)	10
Unit cost	136

Overhead to be expensed:	₹
Total production overhead	10,00,000
The amount absorbed into inventory is (75,000 x 10)	(7,50,000)
The amount not absorbed into inventory	2,50,000

` 2,50,000 that has not been included in inventory is expensed during the year i.e. recognised in the statement of profit and loss**.**

4: Conversion costs

ABC Ltd. manufactures control units for air conditioning systems.

Each control unit requires the following:

1 component X at a cost of ₹ 1,205 each

1 component Y at a cost of ₹ 800 each

Sundry raw materials at a cost of ₹ 150 each

The company faces the following monthly expenses:

Factory rent ₹ 16,500

Energy cost ₹ 7,500

Selling and administrative costs ₹ 10,000

Each unit takes two hours to assemble. Production workers are paid ₹ 300 per hour.

Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours.

Determine the cost of inventory.

Answer:

The cost of a single control unit :	₹
Materials:	
Component X	1,205
Component Y	800
Sundry raw materials	150
	2,155
Labour (2 hours x 300)	600
Production overhead [(16,500 + 7,500/1,000 hours) x 2 hours]	48
	2,803

Note: The selling and administrative costs are not part of the cost of inventory.

5: Conversion costs

A dealer has purchased 1,000 cars costing ` 2,80,000 each on deferred payment basis as ` 25,000 per month per car to be paid in 12 equal instalments.

At year end 31 March 20X1, twenty cars are in stock. What would be the cost of goods sold, finance cost and inventory carrying amount?

Answer:

	₹
Deferred payment price (25,000 x 12)	3,00,000
Less: Cash price	2,80,000
Interest expense	20,000

		₹
Cost of inventory	20 cars x 2,80,000	56,00,000
Finance cost	1,000 cars x 20,000	2,00,00,000
Cost of goods sold	980 cars x 2,80,000	27,44,00,000

6: Cost of Inventory

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

1. Trade discounts on purchase2. Handling costs relating to imports

3. Salaries of accounting department

4. Sales commission paid to sales agents

5. After sales warranty costs

6. Import duties

7. Costs of purchases (based on supplier's invoices)

8. Freight expense

9. Insurance of purchases
10. Brokerage commission paid to indenting agents
Evaluate which costs are allowed by Ind AS 2 for inclusion in the cost of inventory in the books of Venus.
Solution
Items number 1, 2, 6, 7, 8, 9, 10 are allowed by Ind AS 2 for the calculation of cost of inventories. Salaries of accounts department, sales commission, and after sale warranty costs are not considered to be the cost of inventory. Therefore, they are not allowed by Ind AS 2 for inclusion in cost of inventory and are expensed off in the profit and loss account.

7
As per Ind AS 2, selling costs are excluded from the cost of inventories and are required to be recognised as an expense in the period in which these are incurred. Whether the distribution costs would now be included in the cost of inventories under Ind AS 2.
Solution
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

8
In a manufacturing process of Mars Ltd, 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 31.3.20X1
Raw material	14,500	1,50,000	MP 1-5,000 units	250
Wages	-	90,000	MP II - 4,000 units	100
Fixed overhead	-	65,000	BP- 2,000 units	
Variable overhead	-	50,000		

Average market price of MP1 and MP2 is ` 60 per unit and ` 50 per unit respectively, by- product is sold @ ` 20 per unit. There is a profit of ` 5,000 on sale of by-product after incurring separate processing charges of ` 8,000 and packing charges of ` 2,000, ` 5,000 was realised from sale of scrap.
Calculate the value of closing stock of MP1 and MP2 as on 31.3.20X1.
Answer:
As per Ind AS 2 ‘Inventories’, most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.
1) Calculation of NRV of By-product BP

Selling price of by-product	2,000 units x 20 per unit	40,000
Less: Separate processing charges of by- product BP		(8,000)
Packing charges		(2,000)
Net realizable value of by-product BP		**30,000**

2) Calculation of cost of conversion for allocation between joint products MP1 and MP2

Raw material		1,50,000
Wages		90,000
Fixed overhead		65,000
Variable overhead		50,000
Less: NRV of by-product BP (See calculation 1)	30,000	
Sale value of scrap	5,000	(35,000)
Joint cost to be allocated between MP1 and MP2		**3,20,000**

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

	MP I	MP 2
Output in units (a)	5,000	4,000
Sales price per unit (b)	60	50
Sales value (a x b)	3,00,000	2,00,000
Ratio of allocation	3	2
Joint cost of ₹ 3,20,000 allocated in the ratio of 3:2 (c)	1,92,000	1,28,000
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 units	100 units
Cost per unit	38.4	32
Value of closing stock	9,600	3,200

9 : Measurement techniques of Cost

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

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

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

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

Solution

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

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

10

Whether an entity can use different cost formulae for inventories held at different geographical locations having similar nature and use to it.

Solution

Paragraph 25 of Ind AS 2 prescribes that the cost of inventories, other than the items of

inventories which are not ordinarily interchangeable as dealt with in paragraph 23, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having similar nature and use to it. In this case, since the inventories held at different geographical location are of similar nature and use to the entity, different cost formula cannot be used for inventory valuation purposes.

11

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

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

Physical inventory at 31.3.20X2 400 units. Calculate ending inventory value and cost of sales using:

(a) FIFO

(b) Weighted Average

Solution

FIFO inventory 31.3.20X2	350 @14 = 50 @ 12 =	4,900 600 5,500
Cost of Sales	12,250-5,500 =	6,750
Weighted average cost per item	12,250/1000 =	12.25
Weighted average inventory at 31.3.20X2	400 x 12.25 =	4,900
Cost of sales 20X1-20X2	12,250-4,900 =	7,350

12

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

Solution

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.
The Guidance Note on Terms Used in Financial Statements defines Trade Discount as "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.
The Guidance Note on Terms Used in Financial Statements defines Cash Discount as "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.

13

ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of ` 50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was ` 40 per pack. Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of ` 15 per pack for repairing and reapplying glue to the envelopes.
Calculate the net realizable value and inventory write-down (loss) amount.

Solution

The net realisable value is the expected sale price ` 40, less cost incurred to bring the goods to its saleble condition ie ` 15.

Thus, NRV of envelopes pack = ` 40 – ` 15 = ` 25 per pack. The loss (inventory write-down) per pack is the difference between cost and net realizable value = ` 50 – ` 25= ` 25 per pack.

14
At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of ` 10 per unit. The current market price is ` 8 per unit at which these units can be sold. Company P has a firm sales contract with Company Q to sell 60 units at ` 11 per unit, which cannot be settled net. Estimated incremental selling cost is ` 1 per unit.
Determine Net Realisable Value (NRV) of the inventory of Company P.
Solution
While performing NRV test, the NRV of 60 units that will be sold to Company Q is ` 10 per unit (i.e. 11-1).
NRV of the remaining 40 units is ` 7 per unit (i.e. 8-1).
Therefore, Company P will write down those remaining 40 units by ` 120 (i.e. 40 x 3).
Total cost of inventory would be

Goods to be sold to Company	Q 60 units x ` 10 +		` 600
Remaining goods	40 unit x ` 7 `		280
		` 880	

15. A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:
`

	Cost Estimated	Sales price	Selling costs
Inventory item A	**1 8,000**	**7,800**	**500**
Inventory item A2	**14,000**	**18,000**	**200**
Inventory item B1	**16,000**	**17,000**	**200**
Inventory item C1	**6,000**	**7,500**	**150**

Determine the value of closing inventory in the financial statements of a business.
Solution
The value of closing inventory in the financial statements:

Item of inventory	Cost	NRV (Estimated Sales price- Selling costs)	Measurement base (lower of cost or NRV)	Value
A1	8,000	(7,800 – 500) 7,300	NRV	7,300
A2	14,000	(18,000 – 200) 17,800	Cost	14,000
B1	16,000	(17,000 – 200) 16,800	Cost	16,000
C1	6,000	(7,500 – 150) 7,350	Cost	6,000
Value of Inventory				43,300

16.

Particulars		Kg.	₹
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ` 20 per kg and the replacement cost for the raw material was ` 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date.

Solution

Calculation of cost for closing inventory

Particulars	₹
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead $\frac{75,000 \times 10,200}{15,000}$	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

Since net realisable value is less than cost, closing inventory will be valued at ` 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ` 9.50.

Therefore, value of closing inventory: Finished Goods (1,200 x 20) ` 24,000

Raw Materials (900 x 9.50) ` 8,550

` 32,550

17 .Sun Pharma Limited, a renowned company in the field of pharmaceuticals has the following four items in inventory: The Cost and Net realizable value is given as follows:

Item	Cost	Net Realisable Value
A	2,000	1,900
B	5,000	5,100
C	4,400	4,550
D	3,200	2,990
Total	14,600	14,540

Determine the value of Inventories:
a. On an item by item basis
b. On a group basis
Solution
Inventories shall be measured at the lower of cost and net realisable value.
Item by item basis:

A	1,900
B	5,000
C	4,400
D	2,990
	14,290
Group basis	14,540

Questions
1. UA Ltd. purchased raw material @ ` 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is ` 300 per kg. How will you value the inventory of raw material?
Answer:
As per Ind AS 2 "Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, UA Ltd. will value the inventory of raw material at ` 30,00,000 (10,000 kg. @ ` 300 per kg.).

2. Sun Ltd. has fabricated special equipment (solar power panel) during 20X1-20X2 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.
As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31.3.20X3 are as follows:
Solar power panel (WIP) ` 85 lakhs
Solar power panel (finished products) ` 55 lakhs
Sundry Debtor (solar power panel) ` 65 lakhs
The petition for winding up against the customer has been filed during 20X2-20X3 by Sun Ltd. Comment with explanation on provision to be made of ` 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 20X2-20X3.

Answer:

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

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

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

As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 20X2-20X3, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for ` 65 lakhs shall be made in the books against the debtor's amount.

3. On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was ` 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is ` 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to ` 8 million. The estimated selling expense required to make the sales would ` 0.5 million. Financial statements were approved by the Board of Directors on 20th April 20X1.

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

What will be the value inventory at the following dates:

(a) 31st March 20X1

(b) 31st March 20X2

Answer:

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

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

(b) As per para 33 of Ind AS 2, a new assessment is made of net realizable value in each subsequent period. It Inter alia states that if there is increase in net realizable value because of changed economic circumstances, the amount of write down is reversed so that new carrying amount is the lower of the cost and the revised net realizable value. Accordingly, as at 31 March 20X2, again inventory would be valued at cost or net realisable value whichever is lower. In the present case, cost is ` 10 million and net realisable value would be ` 10.5 million (i.e. expected selling price ` 11 million – estimated selling expense ` 0.5 million). Accordingly, inventory would be recorded at ` 10 million and inventory write down carried out in previous year for ` 2.5 million shall be reversed.

4. The following is relevant information for an entity:
- **Full capacity is 10,000 labour hours in a year.**
- **Normal capacity is 7,500 labour hours in a year.**
- **Actual labour hours for current period are 6,500 hours.**
- **Total fixed production overhead is ` 1,500.**
- **Total variable production overhead is ` 2,600.**
- **Total opening inventory is 2,500 units.**
- **Total units produced in a year are 6,500 units.**
- **Total units sold in a year are 6,700 units.**
- **The cost of inventories is assigned by using FIFO cost formula.**

How overhead costs are to be allocated to cost of goods sold and closing inventory? [RTP MAY 2020]
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 / 6,500 hours
= ` 0.4 per hour
Management should allocate variable overhead costs to units produced at a rate of ` 0.4 per hour.
The above rate results in the allocation of all variable overheads to units produced during the year.
Closing inventory = Opening inventory + Units produced during year – Units sold during year
= 2,500 + 6,500 – 6,700 = 2,300 units
As each unit has taken one hour to produce (6,500 hours / 6,500 units produced), total fixed and variable production overhead recognised as part of cost of inventory:
= Number of units of closing inventory x Number of hours to produce each unit x (Fixed production overhead absorption rate + Variable production overhead absorption rate)

= 2,300 units x 1 hour x (` 0.2 + ` 0.4)
= ` 1,380
The remaining ` 2,720 [(` 1,500 + ` 2,600) – ` 1,380] is recognised as an expense in the income statement as follows:

	`
Absorbed in cost of goods sold (FIFO basis) (6,500 – 2,300) = 4,200 x ` 0.6	2,520
Unabsorbed fixed overheads, not included in the cost of goods sold	200
Total	**2,720**

5. Sharp Trading Inc. purchases motorcycles from various countries and exports them to Europe. Sharp Trading has incurred these expenses during 20X1:
(a) Cost of purchases (based on vendors' invoices) 5,00,000
(b) Trade discounts on purchases 10,000
(c) Import duties 200
(d) Freight and insurance on purchases 250
(e) Other handling costs relating to imports 100
(f) Salaries of accounting department 15,000
(g) Brokerage commission payable to indenting agents for arranging imports 300
(h) Sales commission payable to sales agents 150
(i) After-sales warranty costs 600
Sharp Trading Inc. is seeking your advice as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per Ind AS 2.

Answer:

Items (a), (b), (c), (d), (e), and (g) are permitted to be included in the cost of inventory since these elements contribute to cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition, as per Ind AS 2

Statement showing cost of inventory `

Cost of purchases (based on vendors' invoices)	5,00,000
Trade discounts on purchases	(10,000)
Import duties	200
Freight and insurance on purchases	250
Other handling costs relating to imports	100
Brokerage commission payable to indenting agents for arranging imports	300
Cost of inventory under Ind AS 2	4,90,850

PAST PAPERS, MOCK TEST PAPERS (MTP) & REVISION TEST PAPER (RTP)

1. 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 Rs. 30,00,000, Fixed overhead, therefore based on normal capacity is Rs. 3 per unit. Determine Fixed overhead as per Ind AS 2 'Inventories' if
(i) Actual production is 7,50,000 units.
(ii) Actual production is 15,00,000 units.
[MAY 2018 – 4 MARKS]
Answer:
(i) Actual production is 7,50,000 units: Fixed overhead is not going to change with the change in output and will remain constant at Rs. 30,00,000, therefore, overheads on actual basis is Rs. 4 per unit (30,00,000 / 7,50,000). Hence, by valuing inventory at Rs. 4 each for fixed overhead purpose, it will be overvalued and the losses of Rs. 7,50,000 will also be included in closing inventory leading to a higher gross profit then actually earned.
Therefore, it is advisable to include fixed overhead per unit on normal capacity to actual production (7,50,000 x 3) Rs. 22,50,000 and balance Rs. 7,50,000 shall be transferred to Profit & Loss Account.

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

2. In a manufacturing process of Solar Ltd., 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	14,500	1,50,000	MP I-5,000 units	250
Wages	-	90,000	MP II - 4,000 units	100
Fixed overhead	-	65,000	BP- 2,000 units	
Variable overhead	-	50,000		

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 MP 1 and MP 2 as on 31-03-2018.
[MTP - OCTOBER 2018 - 8 MARKS]
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 *Less:* Separate processing charges of by- product BP Packing charges	2,000 units x 20 per unit	40,000 (8,000) (2,000)
Net realizable value of by-product BP		**30,000**

(2) Calculation of cost of conversion for allocation between joint products MP1 and MP2

Raw material Wages Fixed overhead Variable overhead *Less:* NRV of by-product BP (See calculation 1) Sale value of scrap	30,000 5,000	1,50,000 90,000 65,000 50,000 (35,000)
Joint cost to be allocated between MP1 and MP2		3,20,000

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

	MP I	MP 2
Output in units (a)	5,000	4,000
Sales price per unit (b)	60	50
Sales value (a x b)	3,00,000	2,00,000
Ratio of allocation	3	2
Joint cost of Rs. 3,20,000 allocated in the ratio of 3:2 (c)	1,92,000	1,28,000
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 units	100 units
Cost per unit	38.4	32
Value of closing stock	9,600	3,200

3. On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare partswas Rs. 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is Rs. 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to Rs. 8 million. The estimated selling expense required to make the sales would Rs. 0.5 million. Financial statements were authorised by Board of Directors on 20th April 20X1. As at 31st March 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market conditions have improved, estimated selling price of inventory is Rs. 11 million and estimated selling expenses are same Rs. 0.5 million What will be the value inventory at the following dates:

(a) 31st March 20X1
(b) 31st March 20X2
[RTP MAY 2018]
Answer:

As per Ind AS 2 ‘Inventories’, inventory is measured at lower of ‘cost’ or ‘net realisable value’. Further, as per Ind AS 10: ‘Events after Balance Sheet Date’, decline in net realisable value below cost provides additional evidence of events occurring at the balance sheet date and hence shall be considered as ‘adjusting events’.
(a) In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be Rs. 10 million and net realisable value would be Rs. 7.5 million (i.e. Expected selling price Rs. 8 million- estimated selling expenses Rs. 0.5 million). Accordingly, inventory shall be measured at Rs. 7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of Rs. 2.5 million would be recorded in income statement of that year.
(b) As per para 33 of Ind AS 2, a new assessment is made of net realizable value in each subsequent period. It Inter alia states that if there is increase in net realizable value because of changed economic circumstances, the amount of write down is reversed so that new carrying amount is the lower of the cost and the revised net realizable value. Accordingly, as at 31 March 20X2, again inventory would be valued at cost or net realisable value whichever is lower. In the present case, cost is Rs. 1 million and net realisable value would be Rs. 10. 5 million (i.e. expected selling price Rs. 11 million – estimated selling expense Rs. 0.5 million). Accordingly, inventory would be recorded at Rs. 10 million and inventory write down carried out in previous year for Rs. 2.5 million shall be reversed.


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UNIT 2: INDAS 16: PROPERTY, PLANT AND EQUIPMENT

Illustrations

1. Deferred Payment Credit

On 1st April, 20X1, an item of property is offered for sale at ` 10 million, with payment terms being three equal installments of ` 33,33,333 over a two-year period (payments are made on 1st April, 20X1, 31st March, 20X2 and 31st March, 20X3). Implicit interest rate of 5.36 percent p.a.

Show how the property will be recorded in accordance with Ind AS 16 and also pass necessary journal entries.

Solution:

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

		(₹)	(₹)
On 1st April, 20X1			
Property, Plant and Equipment (W.N. 1)	Dr.	95,00,000	
To Bank A/c			33,33,333
To Accounts Payable (W.N. 2)			61,66,667
(Initial recognition of property)			
On 31st March, 20X2			
Interest Expense (W.N. 2)	Dr.	3,30,533	
Accounts payable (W.N. 2)	Dr.	30,02,800	
To Bank A/c			33,33,333
(Recognition of interest expense and payment of second installment)			
On 31st March, 20X3			
Interest Expense (W.N. 2)	Dr.	1,69,467	
Accounts payable (W.N. 2)	Dr.	31,63,867	
To Bank A/c			33,33,334
(Recognition of interest expense and payment of final installment)			

Working Notes:

1. **Calculation of cash price equivalent at initial recognition**

Year	Payment	Discounting factor @ 5.36%	Present value
1.4.20X1	33,33,333	1.000	33,33,333
31.3.20X2	33,33,333	0.949	31,63,333
31.3.20X3	33,33,334	0.901	30,03,334
Initial date cash price equivalent	1,00,00,000		95,00,000

2. **Calculation of interest expenses**

Year	Opening balance (a)	Interest @ 5.36% (b) = (a) x 5.36%	Total payment at year beginning (c)	Principal amount in the instalment (d) = (c) – (b)	Closing balance (e) = (a) - (d)
1.4.20X1	95,00,000	-	33,33,333	33,33,333	61,66,667
31.3.20X2	61,66,667	3,30,533	33,33,333	30,02,800	31,63,867
31.3.20X3	31,63,867	1,69,467*	33,33,334	31,63,867	Nil

*Difference of ` 116 [(31,63,867 x 5.36%) – (33,33,334 - 31,63,867)] is due to approximation.

2 – Exchange of Assets

Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of ` 10 million. The fair value of such asset is ` 15 million. It exchanges the land and building for a private jet, which has a fair value of ` 20 million, and pays additional ` 3 million in cash.

Show the necessary treatment as per Ind AS 16 and pass journal entry for the transaction.

Solution

Provided that the transaction has commercial substance, the entity should recognise the private jet at a cost of ` 18 million (being ` 15 million plus 3 million cash) and should recognise a profit on disposal of the land and building of ` 5 million, calculated as follow:

	(₹ 000)
Recognition of fair value of asset acquired (15,000 + 3,000)	18,000
Less: Carrying amount of land and building disposed	(10,000)
Cash Paid	(3,000)
Profit on exchange of assets	5,000

The required journal entry is therefore as follow:

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

3: Accumulated depreciation at the date of revaluation

Jupiter Ltd. has an item of property, plant and equipment with an initial cost of ` 100,000. At the date of revaluation accumulated depreciation amounted to ` 55,000. The fair value of asset, by reference to transactions in similar assets, is assessed to be ` 65,000.

Find out the entries to be passed?

Solution

Method – I: Depreciation Elimination Approach

Accumulated depreciation Dr. 55,000

To Asset Cost 55,000

Asset Cost Dr. 20,000

To Revaluation reserve 20,000

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

Method – II: Restatement Approach

Carrying amount (100,000 – 55,000) = 45,000

Fair value (revalued amount) 65,000

Surplus 20,000

% of surplus to the carrying amount (20,000 / 45,000) 44.44%
Entries to be Made:

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

(Being the entry to increase both the original cost and the accumulated depreciation by 44.44%)

4: Revaluation model for entire class

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

Solution

Venus's Ltd. management can apply the revaluation model only to the office buildings.
The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location.
Ind AS 16 permits assets to be revalued on a class-by-class basis.
The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can therefore be applied to these classes for subsequent measurement. All properties within the class of office buildings must therefore be carried at revalued amount. Separate disclosure of the two classes must be given in accordance with para 73 of Ind AS 16.

5: <u>Utilisation of Revaluation Surplus</u>

An item of PPE was purchased for ` 9,00,000 on 1st April, 20X1. It is estimated to have a useful life of 10 years and is depreciated on a straight line basis. On 1st April, 20X3, the asset is revalued to ` 9,60,000. The useful life remains unchanged as ten years. Ignore impact of deferred taxes.
Show the necessary treatment as per Ind AS 16 to calculate depreciation and revaluation surplus for 20X3-20X4.

Solution

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

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

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

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

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

6: Revision of Useful Life
An asset which cost ` 10,000 was estimated to have a useful life of 10 years and residual value ` 2000. After two years, useful life was revised to 4 remaining years.
Calculate the depreciation charge for the years 1,2,3.
Solution:

	Year-1	Year-2	Year-3
Cost	10,000	10,000	10,000
Less: Accumulated Depreciation	(800)	(1,600)	(3,200)
Carrying Amount	9,200	8,400	6,800
Charges for year	$\frac{10,000-2,000}{10} = 800$	$\frac{10,000-2,000}{10} = 800$	$\frac{8,400-2,000}{4} = 1,600$

7: Change in Depreciation Method
An entity acquired an asset 3 years ago at a cost of ` 5 million. The depreciation method adopted for the asset was 10 percent reducing balance method.
At the end of Year 3, the entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight –line method from that date so as to reflect the revised estimated pattern of recovery of economic benefits.
Show the necessary treatment in accordance of Ind AS 16. Calculate the depreciation charge for respective years.
Solution
Change in Depreciation Method shall be accounted for as a change in an accounting estimate in accordance of Ind AS 8 and hence will have a prospective effect.
Depreciation Charges for year 1 to 11 will be as follows:
Year 1 ` 500,000
Year 2 ` 450,000
Year 3 ` 405,000
Year 4 to Year 11 (refer W.N.) ` 455,625 p.a.

Working Note: Year	**Opening balance of asset (a)**	**Depreciation @ 10% on (a)**	**Closing balance of asset (c) = (a)- (b)**
1	50,00,000	5,00,000	45,00,000
2	45,00,000	4,50,000	40,50,000
3	40,50,000	4,05,000	36,45,000

Year 3 onwards method of depreciation has been changed from reducing balance method to straight line method for which it is assessed that the remaining useful life is 8 years. Hence revised depreciation would be calculated as follows:

Revised depreciation as per straight line method = (Carrying amount as at the end of the 3rd year – Residual value) / Remaining useful life
= 36,45,000/8 years = `4,55,625 per annum (for year 4 to year 11).

8

MS Ltd. has acquired a heavy machinery at a cost of ` 1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, one of the major components, the turbine requires replacement, as further maintenance is uneconomical. The remainder of the machine is perfect and is expected to last for the next four years. The cost of a new turbine is ` 45,00,000. The discount rate assumed is 5%. Can the cost of the new turbine be recognised as an asset, and, if so, what treatment should be used? [ALSO IN MTP - MARCH 2018 - 8 Marks]

Solution

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.

9

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

	`
List price of machine	**80,00,000**
Import duty	**5,00,000**
Delivery fees	**1,00,000**
Electrical installation costs	**10,00,000**
Pre-production testing	**4,00,000**

Purchase of a five-year maintenance contract with vendor 7,00,000
In addition to the above information XYZ Ltd. was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5%, if payment for the machine was received within one month of purchase. XYZ Ltd. paid for the plant on 20th April, 20X1. At what cost the asset will be recognised?

Solution

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

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

Maintenance contract is a separate contract to get service, therefore, the maintenance contract cost of ` 7,00,000 should be taken as a prepaid expense and charged to the profit or loss over a period of 5 years.
In addition the settlement discount received of ` 3,60,000 (` 72,00,000 x 5%) is to be shown as other income in the profit or loss

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

Solution

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

11

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

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

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

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

Solution

Only those costs which are directly attributable to bringing the asset into working condition for its intended use should be included. Administration and general costs cannot be included. Cost of abnormal amount of wasted material/ labor or other resources is not included as per para 22 of Ind AS 16. Here, the cost of spoilt materials and faulty designs are assumed to be abnormal costs. Also it is assumed that the wastages and labor charges incurred are abnormal in nature. Hence, same are also not included in the cost of PPE.

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

	₹
Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Material (10,00,000 – 2,50,000)	7,50,000
Direct labour cost (4,00,000 – 22,000)	3,78,000
General overheads	Nil
Interest*	Nil
Total to be capitalized	**45,78,000**

*Assuming that period for Construction of building is not a substantial period (i.e. 9 months) here, borrowing cost are not eligible for capitalisation.

12

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

Solution

Change in useful economic life of an asset is change in accounting estimate, which is to be applied prospectively, i.e., the depreciation charge will need to be recalculated. On 1st January, 20X4, when the asset's net book value is ` 60,000. The company should amend the annual provision for depreciation to charge the unamortised cost (namely, ` 60,000) over the revised remaining life of four years. Consequently, it should charge depreciation for the next four years at ` 15,000 per annum.

13

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

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

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

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

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

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

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

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

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

The factory was completed on 30th November, 20X1 (which is considered as substantial period of time as per Ind AS 23) and production began on 1st February, 20X2. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

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

` 1 payable in 40 years' time at an annual discount rate of 8% is ` 0.046.

The construction of the factory was partly financed by a loan of ` 17·5 million taken out on 1st April, 20X1. The loan was at an annual rate of interest of 6%. Sun Ltd received investment income of ` 100,000 on the temporary investment of the proceeds.

Required:

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

Solution

Computation of the cost of the factory

Description	Included in P.P.E. ₹ '000	Explanation
Purchase of land	10,000	Both the purchase of the land and the associated legal costs are direct costs of constructing the factory.
Preparation and levelling	300	A direct cost of constructing the factory
Materials	6,080	A direct cost of constructing the factory
Employment costs of construction workers	1,400	A direct cost of constructing the factory for a seven-month period
Direct overhead costs	700	A direct cost of constructing the factory for a seven-month period
Allocated overhead costs	Nil	Not a direct cost of construction
Income from use as a car park	Nil	Not essential to the construction so recognised directly in profit or loss
Relocation costs	Nil	Not a direct cost of construction
Opening ceremony	Nil	Not a direct cost of construction
Finance costs	612.50	Capitalise the interest cost incurred in a seven-month period (purchase of land would not trigger off capitalisation since land is not a qualifying asset. Infact, the construction started from 1st May, 20X1)
Investment income on temporary investment of the loan proceeds	(100)	offset against the amount capitalised
Demolition cost recognised as a provision	920	Where an obligation must recognise as part of the initial cost
Total	19,912.50	
Computation of accumulated depreciation		
Total depreciable amount	9,912.50	All of the net finance cost of 512.50 (612.50 – 100) has been allocated to the depreciable amount. Also acceptable to reduce by allocating a portion to the non-depreciable land element principle
Depreciation must be in two parts:		
Depreciation of roof component	49.56	9,912.50 x 30% x 1/20 x 4/12
Depreciation of remainder	57.82	9,912.50 x 70% x 1/40 x 4/12
Total depreciation	107.38	
Computation of carrying amount	19,805.12	19,912.50 – 107.38

14
H Limited purchased an item of PPE costing ` 100 million which has useful life of 10 years. The entity has a contractual decommissioning and site restoration obligation, estimated at ` 5 million to be incurred at the end of 10th year. The current market based discount rate is 8%.
The company follows SLM method of depreciation. H Limited follows the Cost Model for accounting of PPE.
Determine the carrying value of an item of PPE and decommissioning liability at each year end when (a) There is no change in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate
(b) At the end of Year 4, the entity expects that the estimated cash outflow on account of decommissioning and site restoration to be incurred at the end of the useful life of the asset will be ` 8 million (in place of ` 5 million, estimated in the past).
Determine in case (b), how H Limited need to account for the changes in the decommissioning liability?
Answer:

The present value of such decommissioning and site restoration obligation at the end of 10th year is ` **2.32 million** [being 5 / (1.08)10]. H Limited will recognise the present value of decommissioning liability of ` 2.32 million as an **addition to cost of PPE and** will also recognize a corresponding decommissioning liability. Further, the entity will recognise the unwinding of discount as finance charge.
(a) The following table shows the relevant computations, if there is **no change** in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate:

(` in million)

Year	Opening Amount of PPE	Depreciation Charge (on SLM) for 10 Years	Carrying Amount of PPE at the end of the year	Opening Decommissioning Liability	Unwinding of Interest @ 8%	Closing Decommissioning Liability
1	102.32	10.23	92.08	2.32	0.19	2.50
2	92.08	10.23	81.85	2.50	0.20	2.70
3	81.85	10.23	71.62	2.70	0.22	2.92
4	71.62	10.23	61.39	2.92	0.23	3.15
5	61.39	10.23	51.16	3.15	0.25	3.40
6	51.16	10.23	40.93	3.40	0.27	3.68
7	40.93	10.23	30.69	3.68	0.29	3.97
8	30.69	10.23	20.46	3.97	0.32	4.29
9	20.46	10.23	10.23	4.29	0.34	4.63
10	10.23	10.23	-	4.63	0.37	5.00
Total		**102.32**			**2.68**	

(b) The changes to the estimate of expected decommissioning obligation:
-- The present value of the decommissioning liability at the end of Year 4 works out to be ` **5.04 million** [being 8 / (1.08)6].
-- As against this, the carrying amount of decommissioning liability at the end of Year 4 is ` **3.15 million** (as computed above).

-- The changes in the decommissioning liability of ` **1.89 million** (being ` 5.04 million less ` 3.15 million) shall be **added to** the cost of the asset in the current period and the related provision for decommissioning liability is also adjusted.

The journal entry will be:

PPE	Dr.	` 1.89 million	
To Provision for decommissioning liability			` 1.89 million

--- The following table shows the calculations for years 5 - 10:

Year	**Opening Amount of PPE**	**Depreciation Charge SLM – 10 Years**	**Carrying Amount of PPE at end of the year**	**Opening Decommissioning Liability**	**Unwinding of Interest @8%**	**Closing Decommissioning Liability**
5	63.28	10.55	52.73	5.04	0.40	5.44
6	52.73	10.55	42.19	5.44	0.44	5.88
7	42.19	10.55	31.64	5.88	0.47	6.35
8	31.64	10.55	21.09	6.35	0.51	6.86
9	21.09	10.55	10.55	6.86	0.55	7.41
10	10.55	10.55	-	7.41	0.59	8.00
Total		**63.28**			**2.96**	

Note that in the above table:

---Opening amount of PPE at the beginning of Year 5 is computed as ` 63.28 million (being carrying amount of ` 61.39 million at the end of Year 4 plus increase of ` 1.89 million arising due to increase in the present value of the decommissioning liability at the end of Year 4).

---The revised carrying amount of PPE (at ` 63.28 million) at the beginning of Year 5 will be depreciated over the balance 6 years of the useful life).

---Opening decommissioning liability at the beginning of Year 5 is computed as ` 5.04 million (being carrying amount of ` 3.15 million at the end of Year 4 plus increase of ` 1.89 million).

Since the entity has adjusted the increase in the decommissioning liability against the carrying amount of PPE, it needs to evaluate whether the new carrying amount (in this case, ` 63.28 million) is recoverable. If not, it will give rise to impairment loss, to be accounted for under Ind AS 36.

Questions

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

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

Please advise ABC Ltd. on the costs that can be capitalized in accordance with Ind AS 16.

Answer:

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

1.	Cost of the plant	` 25,00,000
2.	Initial delivery and handling costs	` 2,00,000
3.	Cost of site preparation	` 6,00,000
4.	Consultants' fees	` 7,00,000
5.	Net present value of estimated dismantling costs to be incurred after 7 years	` 3,00,000
		` 43,00,000

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

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

Pass Journal Entries with regard to Revaluation?

Answer:

The entries to be passed would be:

		₹	₹
Accumulated depreciation	Dr.	55,000	
To Asset A/c			55,000
(Being elimination of accumulated depreciation against the cost of the asset)			
Asset A/c	Dr	20,000	
To Revaluation Surplus			20,000
(Being increase of net asset value to Fair value)			

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

3. B Ltd. owns an asset with an original cost of ` 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be ` 20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.
At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance

program adopted by the company. As a result, the residual value will reduce to ` 10,000.
How would the above changes in estimates be accounted by B Ltd.?
Answer:
Calculation of accumulated depreciation till 8th year
Depreciable amount {Cost less residual value} = ` 2,00,000 – ` 20,000 = ` 1,80,000.
Annual depreciation = Depreciable amount / Useful life = 1,80,000 / 10 = ` 18,000.
Accumulated depreciation = 18,000 x No. of years (8) = ` 1,44,000.
Calculation of carrying amount at the end of the 8th year
The asset has a carrying amount of ` 56,000 at the end of year 8 [ie. ` 2,00,000 – ` 1,44,000]
Accounting of the changes in estimates
Revision of the useful life to 12 years results in a remaining useful life of 4 years (ie 12 years – 8 years).
The revised depreciable amount is ` 46,000 (` 56,000 – ` 10,000)
Thus, depreciation should be charged in future ie from 9th year onwards at ` 11,500 per annum (` 46,000 / 4 years).

4. X Ltd. has a machine which got damaged due to fire as on 31st January, 20X1. The carrying amount of machine was ` 1,00,000 on that date. X Ltd. sold the damaged asset as scrap for ` 10,000. X Ltd. has insured the same asset against damage. As on 31st March, 20X1, the compensation proceeds was still in process but the insurance company has confirmed the claim. Compensation of ` 50,000 is receivable from the insurance company. How X Ltd. will account for the above transaction?
Answer:
As per para 66 of Ind AS 16, impairment or losses of items of property, plant and equipment and related claims for or payments of compensation from third parties are separate economic events and should be accounted for separately.
X Ltd. should account for the above transaction as given below:
At the time of sale of scrap machine, X Ltd. should write off the carrying amount of asset from books of account and provide a loss of ` 90,000. (i.e., carrying amount of ` 1,00,000 – realised amount of ` 10,000)

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

5. An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1st April, 2XX1. The plant has a useful life of 40 years. Its initial cost was ` 1,20,000 which included an amount for decommissioning costs of ` 10,000, which represented ` 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31st March. On March, 2X11, the net present value of the decommissioning liability has decreased by ` 8,000. The discount rate has not yet changed.

How the entity will account for the above changes in decommissioning liability in the year 2X11, if it adopts cost model?
Answer:
On 31st March, 2X11, the plant is 10 years old. Accumulated depreciation is ` 30,000 (` 120,000 x 10 / 40 years). Due to unwinding of discount @ 5% over the 10 years, the amount of decommissioning liability has increased from ` 10,000 to ` 16,300 (approx.).
On 31st March, 2X11, the discount rate has not changed. However, the entity estimates that, as a result of technological advances, the net present value of the decommissioning liability has decreased by ` 8,000. Accordingly, the entity adjusts the decommissioning liability from ` 16,300 to ` 8,300. On this date, the entity passes the following journal entry to reflect the change:

		₹	₹
Provision for decommissioning liability	Dr.	8,000	
To Asset			8,000

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

6. An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1st April, 20X1. The plant has a useful life of 40 years. Its initial cost was ` 1,20,000. This included an amount for decommissioning costs of ` 10,000, which represented ` 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31st March. Assume that a market-based discounted cash flow valuation of ` 1,15,000 is obtained at 31st March, 20X4. This valuation is after deduction of an allowance of ` 11,600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. On 31st March, 20X5, the entity estimates that, as a result of technological advances, the present value of the decommissioning liability has decreased by ` 5,000. The entity decides that a full valuation of the asset is needed at 31st March, 20X5, in order to ensure that the carrying amount does not differ materially from fair value. The asset is now valued at ` 1,07,000, which is net of an allowance for the reduced decommissioning obligation. How the entity will account for the above changes in decommissioning liability if it adopts revaluation model? [ALSO IN MTP ? MARCH 2019 ? 10 MARKS]
Answer:

At 31st March, 20X4:	`
Asset at valuation (1)	1,26,600
Accumulated depreciation	Nil
Decommissioning liability	(11,600)
Net assets	1,15,000
Retained earnings (2)	(10,600)
Revaluation surplus (3)	15,600

Notes:

(1) When accounting for revalued assets to which decommissioning liabilities attach, it is important to understand the basis of the valuation obtained. For example:

(a) if an asset is valued on a discounted cash flow basis, some valuers may value the asset without deducting any allowance for decommissioning costs (a 'gross' valuation), whereas others may value the asset after deducting an allowance for decommissioning costs (a 'net' valuation), because an entity acquiring the asset will generally also assume the decommissioning obligation. For financial reporting purposes, the decommissioning obligation is recognised as a separate liability, and is not deducted from the asset. Accordingly, if the asset is valued on a net basis, it is necessary to adjust the valuation obtained by adding back the allowance for the liability, so that the liability is not counted twice.

(b) if an asset is valued on a depreciated replacement cost basis, the valuation obtained may not include an amount for the decommissioning component of the asset. If it does not, an appropriate amount will need to be added to the valuation to reflect the depreciated replacement cost of that component.

Since, the asset is valued on a net basis, it is necessary to adjust the valuation obtained by adding back the allowance for the liability. Valuation obtained of ` 1,15,000 plus decommissioning costs of ` 11,600, allowed for in the valuation but recognised as a separate liability = ` 1,26,600.

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

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

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

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

		₹	₹
Provision for decommissioning liability	Dr.	5,000	
To Revaluation surplus			5,000

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

Notes:

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

(1) Eliminating accumulated depreciation of ` 3,420 in accordance with the entity's accounting policy.
(2) The debit is to revaluation surplus because the deficit arising on the revaluation does not exceed the credit balance existing in the revaluation surplus in respect of the asset.
(3) Previous valuation (before allowance for decommissioning costs) ` 1,26,600, less cumulative depreciation ` 3,420, less new valuation (before allowance for decommissioning costs) ` 1,14,200.
Following this valuation, the amounts included in the balance sheet are:

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

Notes:
(1) ` 10,600 at 31st March, 20X4, plus depreciation expense of ` 3,420 and discount expense of ` 600 = ` 14,620.
(2) ` 15,600 at 31st March, 20X4, plus ` 5,000 arising on the decrease in the liability, less ` 8,980 deficit on revaluation = ` 11,620.

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

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

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

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

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised.
Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X4.

Answer:

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

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

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

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

The impact on Statement of Profit and Loss for the year ending 31st March, 20X4
= ` 26,00,000 – ` 25,00,000 = ` 1,00,000

This is a change in accounting estimate which is adjusted prospectively in the period in which the estimate is amended and, if relevant, to future periods if they are also affected. Accordingly, from 20X4-20X5 onward, excess of ` 1,00,000 will be charged in the Statement of Profit and Loss every year till the time there is any further revision

8. Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:-

The notes to the financial statements state that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts. How should the finance controller respond to the query from the managing director?

Answer:

Ongoing through the query raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

The accounting treatment of the majority of tangible non-current assets is governed by Ind AS 16 'Property, Plant and Equipment'. Ind AS 16 states that the accounting treatment of PPE is determined on a class by class basis. For this purpose, property and plant would be regarded as separate classes. Ind AS 16 requires that PPE

is measured using either the cost model or the revaluation model. This model is applied on a class by class basis and must be applied consistently within a class. Ind AS 16 states that when the revaluation model applies, surpluses are recorded in other comprehensive income, unless they are cancelling out a deficit which has previously been reported in profit or loss, in which case it is reported in profit or loss. Where the revaluation results in a deficit, then such deficits are reported in profit or loss, unless they are cancelling out a surplus which has previously been reported in other comprehensive income, in which case they are reported in other comprehensive income.
According to Ind AS 16, all assets having a finite useful life should be depreciated over that life. Where property is concerned, the only depreciable element of the property is the buildings element, since land normally has an indefinite life. The estimated useful life of a building tends to be much longer than for plant. These two reasons together explain why the depreciation charge of a property as a percentage of its carrying amount tends to be much lower than for plant.
Properties which are held for investment purposes are not accounted for under Ind AS 16, but under Ind AS 40 'Investment Property'. As per Ind AS 40, investment properties should be accounted for under a cost model. ABC Ltd. had applied the cost model and thus our investment properties are treated differently from the owner occupied property.

PAST PAPERS, MOCK TEST PAPERS & REVISION TEST PAPER

1. Stars Ltd. is a multinational entity that owns three properties. All the three properties were purchased on 1st April 2016. The details of purchase price and the market values of the properties are given as follows:

Particulars	*Property 1*	*Property 2*	*Property 3*
	Factory	*Factory*	*Let-out Building*
Purchase Price	*30,000*	*20,000*	*24,000*
Market Value (31-03-2017)	*32,000*	*22,000*	*27,000*
Life	*10 years*	*10 years*	*10 years*
Subsequent Measurement	*Cost Model*	*Revaluation Model*	*Revaluation Model*

Property 1 and 2 are occupied by Stars Ltd, whilst property 3 is let out to a non - related party at a market rent. The management presents all three properties in balance sheet as' 'Property, plant and equipment'. The company does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognise the difference between purchase price and fair value in Statement of Profit and Loss. Evaluate whether the accounting policies adopted by the Stars Ltd. in relation to these properties is in accordance of relevant Indian Accounting Standards (Ind AS). If not, advise the correct treatment along with workings.
[MAY 2018 - 10 Marks]
Answer:
(i) For classification of assets
As per 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.

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 Property as per Ind AS 1.

(ii) For valuation of assets

Ind AS 16 states that an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. Also, 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, 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 investment property. Since property 1 and 2 is used as factory building, they should be classified under same category or class ie. 'factory building'. Therefore, both the properties should be valued either at cost model or revaluation model. Hence, the valuation model adopted by Stars 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, Stars 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

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

Ind AS 16 states that depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Accordingly, Stars Ltd. is required to depreciate these properties irrespective of that their 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 Stars Ltd. has applied the Cost Model to an entire class of property, plant and Equipment

Balance Sheet extracts as at 31st March 2017

		₹
Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property 1 (30,000-3,000)	27,000	
Property 2 (20,000 – 2,000)	18,000	45,000
Investment Property		
Property 3 (Fair value being ₹ 27,000) (Cost = 24,000-2,400)		21,600

Case 2: If Stars Ltd. has applied the Revaluation Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 2017

		₹
Assets		
Non-current Assets		
Property, Plant and Equipment		
Property 1	32,000	
Property 2	22,000	54,000
Investment Properties		
Property 3 (Fair value being 27,000) (Cost = 24,000-2,400)		21,600
Equity and Liabilities		
Other Equity		
Revaluation Reserve *		
Property 1 (32,000 – 27,000)	5,000	
Property 2 (22,000 –18,000)	4,000	9,000

* 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 a separate column in the Statement of Changes in Equity.

2. 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?
[NOV 2019 - 8 Marks]

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:

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

(d) 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 i.e factory.

3. A Ltd. owns three properties which 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: Rs. in lakhs

Particulars	Property 1	Property 2	Property 3
	Factory Building	Factory Building	Let-out Building
Purchase price	500	200	300
Market value as on 31.03.20X2	550	220	330
Useful Life	10 Years	10 Years	10 Years
Subsequent Measurement	Cost Model	Revaluation Model	Revaluation Model

Property 1 and 2 are used by A Ltd. 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 A Ltd. in relation to these properties, on various accounting aspects, are in accordance with Ind AS or not. If not, advise the correct treatment alongwith the workings for the same in all the cases. [MTP - MARCH 2018 - 16 Marks]

Answer:

(i) For classification of assets

Para 6 of Ind AS 16 'Property, Plant and Equipment' inter alia, 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 Property as per Ind AS 1.

(ii) For valuation of assets

Paragraph 29 of Ind AS 16 states that an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. 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 classified under same category or class i.e. 'factory building'. Therefore, both the properties should be 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, as long as the asset's residual value does not exceed its carrying amount.

Accordingly, A Ltd. is required to depreciate these properties irrespective of that their 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 A Ltd. has applied the Cost Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 20X2 *INR in 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 Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 20X2 *INR in lakhs*

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	550	
Property '2'	220	770
Investment Properties		
Property '3' (Fair value being 330 lakhs) (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 a separate column in Statement of Changes in Equity.

4. On 1st April 2017, A Ltd. assumes a decommissioning iability 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 (based A 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 10th year 0.6139
@ 3.5% for 10th year 0.7089
@ 8.5% for 10th year 0.4423
[MTP - APRIL 2018 - 10 MARKS]
Answer:

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

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

Floor	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th
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 31st March, 2018, UK Ltd. obtained a valuation report from an independent valuer who has estimated the fair value of the property at Rs. 15 crores. UK Ltd. wishes to use the cost model for measuring Property, Plant & Equipment and the fair value model for measuring the Investment Property. UK Ltd. depreciates the building over an estimated useful life of 50 years, with no estimated residual value. Advise UK Ltd. on the accounting and disclosures for the above as per the applicable Ind AS. [MTP - AUGUST 2018 - 10 MARKS]**

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 a non-cancellable period of 3 years. The useful life of the building is 50 years. The lease period is far less that the useful life of the building leased out. Further, the lease rentals of three years altogether do not recover the fair value of the floors leased i.e. 15 crore x 30% = 4.50 crore. Hence the lease is an operating lease. Therefore, the 3 floors leased out as operating lease will be classified as investment property in the books of lessor ie. UK Ltd.
However, for investment property, Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property. Ind AS 40 also requires that an entity shall disclose the fair value of such investment properties.

(in crore)

	Total	PPE (70%)		Investment property (30%)
		Land (25%)	Building (75%)	
Cost	10	1.75	5.25	3
FV	15	2.625	7.875	4.5
Valuation model followed		Cost	Cost	Cost (as per para 30 of Ind AS 40)
Value recognized in the books		1.75	5.25	3
Less: Depreciation		Nil	(5.25/50) = 0.105 crore	(3/50) = 0.06
Carrying value as on 31st March, 2018		1.75	5.145	2.94
Impairment loss		No impairment loss since fair value is more than the cost		

5. ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs (or contributes to) the expenditure on the construction/ development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether ABC Ltd. Can capitalise expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd. as per Ind AS?
[RTP - NOV 2018]
Answer:
Paragraph 7 of Ind AS 16 states that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:
(a) it is probable that future economic benefits associated with the item will flow to the entity; and
(b) the cost of the item can be measured reliably.

Further, paragraph 9 provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. Paragraph 16, inter alia, states that the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on These assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery.

Depreciation

As per paragraph 43 and 47 of Ind AS 16, if these assets have a useful life which is different

from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. Nevertheless, if it has been included in the cost of
property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment. The useful lives of these assets should not exceed that of the asset to which it relates.

Presentation

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

6. 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.

ANSWER:

Ignoring depreciation, the loss that would be reported in the Profit and Loss as a result of the impairment is as follows:

	£
*Carrying value at balance sheet date-US$ 16,20,000 @ £ 1.8 =	9,00,000
Historical cost- US$ 18,00,000 @ £ 1.6 =	11,25,000
Impairment loss 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.

7. Entity X has a warehouse which is closer to factory of Entity Y and vice versa. The factories are located in the same vicinity. Entity X and Entity Y agree to exchange their warehouses. The carrying value of warehouse of Entity X is ` 1,00,000 and its fair value is ` 1,25,000. It exchanges its warehouse with that of Entity Y, the fair value of which is ` 1,20,000. It also receives cash amounting to ` 5,000. How should Entity X account for the exchange of warehouses?(RTP- NOV 2020)

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 of monetary and non-monetary assets, the cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Further as per paragraph 25 of Ind AS 16, an entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

In the given case, the transaction lacks commercial substance as the company's cash flows are not expected to significantly change as a result of the exchange because the factories are located in the same vicinity i.e. it is in the same position as it was before the transaction. Hence, Entity X will have to recognise the assets received at the carrying amount of asset given up, i.e., ` 1,00,000 being carrying amount of existing warehouse of Entity X and ` 5,000 received will be deducted from the cost of property, plant and equipment. Therefore, the warehouse of Entity Y is recognised as property, plant and equipment with a carrying value of ` 95,000 in the books of Entity X.

UNIT 3: INDAS 116: LEASES

Illustrations
1- Short-term lease
Scenario A:
A lessee enters into a lease with a nine-month non-cancellable term with an option to extend the lease for four months. The lease does not have a purchase option. At the lease commencement date, the lessee is reasonably certain to exercise the extension option because the monthly lease payments during the extension period are significantly below market rates. Whether the lessee can take a short-term exemption in accordance with Ind AS 116?
Scenario B:
Assume the same facts as Scenario A except, at the lease commencement date, the lessee is not reasonably certain to exercise the extension option because the monthly lease payments during the optional extension period are at what the lessee expects to be market rates and there are no other factors that would make exercise of the renewal option reasonably certain. Will your answer be different in this case?
Solution:
Scenario A:
As the lessee is reasonably certain to exercise the extension option (Refer section 3.2 lease term), the lease term is greater than 12 months (i.e., 13 months). Therefore, the lessee will not account for the lease as a short-term lease.
Scenario B:
In this case, the lease term is less than 12 months, i.e., nine months. Thus, the lessee may account for the said lease under the short-term lease exemption, i.e., it recognises lease payments as an expense on either a straight-line basis over the lease term or another systematic basis.

2 - Asset implicitly specified in a contract
Customer XYZ enters into a ten-year contract with Supplier ABC for the use of rolling stock specifically designed for Customer XYZ.
The rolling stock is designed to transport materials used in Customer XYZ's production process and is not suitable for use by other customers. The rolling stock is not explicitly specified in the contract but, Supplier ABC owns only one rolling stock that is suitable for Customer XYZ's use. If the rolling stock does not operate properly, the contract requires Supplier ABC to repair or replace the rolling stock.
Whether there is an identified asset?
Solution:
Yes, the said rolling stock is an identified asset.
Though the rolling stock is not explicitly specified in the contract (e.g., by serial number), it is implicitly specified because Supplier ABC must use it to fulfil the contract.

3 (Asset implicitly specified in a contract):
Customer XYZ enters into a ten-year contract with Supplier ABC for the use of a car. The specification of the car is specified in the contract (i.e., brand, type, colour, options, etc.). At inception of the contract, the car is not yet built.
Whether there is an identified asset?

Solution:
Yes, the said car is an identified asset.
Though the car cannot be identified at inception of the contract, it is **implicitly specified** at the time the same will be made available to Customer XYZ.

4 - Substantive Substitution Rights
Scenario A:
An electronic data storage provider (supplier) provides services through a centralised data centre that involve the use of a specified server (Server No. 10). The supplier maintains many identical servers in a single accessible location and determines, at inception of the contract, that it is permitted to and can easily substitute another server without the customer's consent throughout the period of use.
Further, the supplier would benefit economically from substituting an alternative asset, because doing this would allow the supplier to optimise the performance of its network at only a nominal cost. In addition, the supplier has made clear that it has negotiated this right of substitution as an important right in the arrangement, and the substitution right affected the pricing of the arrangement.
Whether the substitution rights are substantive and whether there is an identified asset?
Scenario B:
Assume the same facts as in Scenario A except that Server No. 10 is customised, and the supplier does not have the practical ability to substitute the customised asset throughout the period of use. Additionally, it is unclear whether the supplier would benefit economically from sourcing a similar alternative asset.
Whether the substitution rights are substantive and whether there is an identified asset?
Solution
Scenario A:
The customer does not have the right to use an identified asset because, at the inception of the contract, the supplier has the practical ability to substitute the server and would benefit economically from such a substitution. Thus, there is no identified asset.
However, if the customer could not readily determine whether the supplier had a substantive substitution right (**for e.g.**, there is insufficient transparency into the supplier's operations), the customer would **presume** the substitution right is not substantive and conclude that there is an identified asset.

Scenario B:
The substitution right is not substantive, and Server No. 10 would be an identified asset because the supplier does not have the practical ability to substitute the asset and there is no evidence of economic benefit to the supplier for substituting the asset. In this case, neither of the conditions of a substitution right is met (whereas both the conditions must be met for the supplier to have a substantive substitution right). Therefore, Server No 10 will be considered as an identified asset.

5 (Identified Asset – Physically Distinct):
Customer XYZ enters into a 15-year contract with Supplier ABC for the right to use five fibres within a fibre optic cable between Mumbai and Pune. The contract identifies five of the cable's 25 fibres for use by Customer XYZ. The five fibres are dedicated solely to Customer XYZ's data for the duration of the contract term. Assume that Supplier ABC does not have a substantive substitution right.
Whether there is an identified asset?

Solution:
Yes, the said five fibres are identified assets because they are physically distinct and explicitly specified in the contract.

6 (Identified Asset – Not Physically Distinct):
Scenario A:
Customer XYZ enters into a ten-year contract with Supplier ABC for the right to transport oil from India to Bangladesh through Supplier ABC's pipeline. The contract provides that Customer XYZ will have the right to use of 95% of the pipeline's capacity throughout the term of the arrangement.
Whether there is an identified asset?
Scenario B:
Assume the same facts as in Scenario A, except that Customer XYZ has the right to use 65% of the pipeline's capacity throughout the term of the arrangement.
Whether there is an identified asset?
Solution:
Scenario A:
Yes, the capacity portion of the pipeline is an identified asset.
While 95% of the pipeline's capacity is not physically distinct from the remaining capacity of the pipeline, it represents **substantially all of the capacity** of the entire pipeline and thereby provides Customer XYZ with the **right to obtain substantially all of the economic benefits** from use of the pipeline.
Scenario B:
No, the capacity portion of the pipeline is **NOT** an identified asset.
Since 65% of the pipeline's capacity is **less than substantially all** of the capacity of the pipeline, Customer XYZ does **not have the right to obtain substantially all of the economic benefits** from use of the pipeline.

7 (Right to use for a portion of the term of contract):
ABC Ltd enters into a contract with XYZ Ltd, which grants ABC Ltd exclusive rights to use a specific grain storage facility over a five-year period in the months of May and June. During these months, ABC Ltd has the right to decide which crops are placed in storage and when to remove them. XYZ Ltd provides the loading and unloading services for the warehouse activities. During the other ten months each year, XYZ Ltd has the right to determine how the warehouse will be used.
Which party has the right to control the use of the identified asset during the period of use?
Solution:
In the above case, ABC Ltd has the right to control the use of the identified asset during the period of use because they have the power to determine how the warehouse will be used during the contractually defined usage periods. The analysis should focus on the rights and economics of the use of the warehouse for the specified usage periods (May and June). During the period of use, ABC Ltd has the rights to determine how much of a crop to place in storage, and the timing of placing and removing it from storage. These rights are more significant to the economics of the use of the asset than the loading and unloading services performed by XYZ Ltd during the same period. ABC Ltd receives all of the economic benefit from use of the asset during those specified time periods. Therefore, contract contains a lease for the specified period of term.

8 (Right to obtain substantially all of the economic benefits):
Company MNO enters into a 15-year contract with Power Company PQR to purchase all of the electricity produced by a new solar farm. PQR owns the solar farm and will receive tax credits relating to the construction and ownership of the solar farm, and MNO will receive renewable energy credits that accrue from use of the solar farm.).
Who has the right to substantial benefits from the solar farm?
Solution:
Company MNO has the right to obtain substantially all of the economic benefits from use of the solar farm over the 15-year period because it obtains:

♦ the electricity produced by the farm over the lease term — i.e. the primary product from use of the asset; and

♦ the renewable energy credits — i.e. the by-product from use of the asset.

Although PQR receives economic benefits from the solar farm in the form of tax credits, these economic benefits relate to the ownership of the solar farm. The tax credits do not relate to use of the solar farm and therefore are not considered in this assessment.

9 - Right to direct the use of an asset
Customer X enters into a contract with Supplier Y to use a vehicle for a five-year period. The vehicle is identified in the contract. Supplier Y cannot substitute another vehicle unless the specified vehicle is not operational (for e.g., if it breaks down). Under the contract:
• Customer X operates the vehicle (i.e., drives the vehicle) or directs others to operate the vehicle (for e.g., hires a driver).
• Customer X decides how to use the vehicle (within contractual limitations). For example, throughout the period of use, Customer X decides where the vehicle goes, as well as when or whether it is used and what it is used for. Customer X can also change these decisions throughout the period of use.
• Supplier Y prohibits certain uses of the vehicle (for e.g., moving it overseas) and modifications to the vehicle to protect its interest in the asset.
Whether Customer X has the right to direct the use of the vehicle throughout the period of lease?
Solution:
Yes, Customer X has the right to direct the use of the identified vehicle throughout the period of use because it has the **right to change** how the vehicle is used, when or whether the vehicle is used, where the vehicle goes and what the vehicle is used for.
Supplier Y's limits on certain uses for the vehicle and modifications to it are considered **protective rights** that define the scope of Customer X's use of the asset, but do not affect the assessment of whether Customer X directs the use of the asset.

10 - Right to direct the use of an asset
Entity A contracts with Supplier H to manufacture parts in a facility. Entity A designed the facility and provided its specifications. Supplier H owns the facility and the land. Entity A specifies how many parts it needs and when it needs the parts to be available. Supplier H operates the machinery and makes all operating decisions including how and when the parts are to be produced, as long as it meets the contractual requirements to deliver the specified number on the specified date. Assuming supplier H cannot

substitute the facility and hence is an identified asset.
Which party has the right to control the use of the identified asset (i.e., equipment) during the period of use?
Solution:
Entity A does not direct the use of the asset that most significantly drives the economic benefits because Supplier H determines how and when the equipment is operated once the contract is signed. Therefore, Supplier H has the right to control the use of the identified asset during the period of use. Although Entity A stipulates the product to be provided and has input into the initial decisions regarding the use of the asset through its involvement in the design of the asset, it does not have decision making rights over how and for what purpose the asset will be used over the asset during the period of use. This arrangement is a supply agreement, not a lease.

11 - Right to direct the use of an asset
Entity L enters into a five—year contract with Company A, a ship owner, for the use of an identified ship. Entity L decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent Entity L from sailing the ship into waters at a high risk of piracy or carrying explosive materials as cargo. Company A operates and maintains the ship, and is responsible for safe passage.
Who has the right to direct the use of the ship during the period of use?
Solution:
Entity L has the right to direct the use of the ship. The contractual restrictions are protective rights. In the scope of its right of use, Entity L determines how and for what purpose the ship is used throughout the five — year period because it decides whether, where and when the ship sails, as well as the cargo that it will transport. Entity L has the right to change these decisions throughout the period of use. Therefore, the contract contains a lease.

12 - Identifying and separating lease components
Scenario A:
A lessee enters a lease of an excavator and the related accessories (for e.g., excavator attachments) that are used for mining purposes. The lessee is a local mining company that intends to use the excavator at a copper mine. How many lease and non-lease components are there?
Scenario B:
Assume the same facts as in Scenario A, except that the contract also conveys the right to use an additional loading truck. This loading truck could be deployed by the lessee for other uses (for e.g., to transport iron ores at another mine).
Solution:
Scenario A:
The lessee would be unable to benefit from the use of the excavator without also using the accessories. Therefore, the excavator is dependent upon the accessories. Thus, from the perspective of the lessee, the contract contains one lease component.
Scenario B:
The lessee can benefit from the loading truck on its own or together with other readily available resources because the loading truck could be deployed for other uses independent of the excavator. The lessee can also benefit from the use of the excavator on its own or together with other readily available resources.

Thus, from the perspective of the lessee, the contract contains two lease components, viz., a lease of the excavator (together with the accessories) and a lease of the loading truck.

13 - Identifying different components in the contract
Entity L rents an office building from Landlord M for a term of 10 years. The rental contract stipulates that the office is fully furnished and has a newly installed and tailored HVAC system. It also requires Landlord M to perform all common area maintenance (CAM) during the term of the arrangement. Entity L makes single monthly rental payment and does not pay for the maintenance separately. The office building has a useful life of 40 years and the HVAC system and office furniture each has a life of 15 years.
What are the units of account in the lease?
Solution:
There are three components in the arrangement – the building assets (office building and HVAC), the office furniture, and the maintenance agreement.
The office building and HVAC system are one lease component because they cannot function independently of each other. The HVAC system was designed and tailored specifically to be integrated into the office building and cannot be removed and used in another building without incurring substantial costs. These building assets are a lease component because they are identified assets for which Entity L directs the use. The office furniture functions independently and can be used on its own. It is also a lease component because it is a group of distinct assets for which Entity L directs the use.
The maintenance agreement is a non-lease component because it is a contract for service and not for the use of a specified asset.

14 - Activities which are not components of a lease contract
Scenario A:
A lessee enters into a five-year lease of equipment, with fixed annual payments of ` 10,000. The contract contains fixed annual payments as follows: ` 8,000 for rent, ` 1,500 for maintenance and ` 500 of administrative tasks. How the consideration would be allocated?
Scenario B:
Assume the fact pattern as in scenario A except that, in addition, the contract requires the lessee to pay for the restoration of the equipment to its original condition. How the consideration would be allocated?
Solution:
Scenario A:
The contract contains two components, viz., a lease component (lease of equipment) and a non-lease component (maintenance). The amount paid for administrative tasks does not transfer a good or service to the lessee.
Assuming that the lessee does not elect to use the practical expedient as per para 15 of Ind AS 116, both the lessee and the lessor account for the lease of equipment and maintenance components separately and the administration charge is included in the total consideration to be allocated between those components. Therefore, the total consideration in the contract of ` 50,000 will be allocated to the lease component (equipment) and the non-lease component (maintenance).

Scenario B:
The contract still contains two components, viz., a lease component (lease of equipment) and a non-lease component (maintenance). Similar to the amount paid for administrative tasks, the restoration does not transfer a good or service to the lessee as it is only performed at the end of the lease term.
Therefore, the total consideration in the contract of ` 50,000 will be allocated to the lease component (equipment) and the non-lease component (maintenance).

15 - Allocating contract consideration to lease and non-lease components – Lessees
A lessee enters into a lease of an equipment. The contract stipulates the lessor will perform maintenance of the leased equipment and receive consideration for that maintenance service. The contract includes the following fixed prices for the lease and non-lease component:

Lease	**` 80,000**
Maintenance	**` 10,000**
Total	**` 90,000**

Assume the stand-alone prices cannot be readily observed, so the lessee makes estimates, maximising the use of observable information, of the lease and non-lease components, as follows:

Lease	**` 85,000**
Maintenance	**` 15,000**
Total	**` 1,00,000**

In the given scenario, assuming lessee has not opted the practical expedient, how will the lessee allocate the consideration to lease and non-lease component?
Solution:
The stand-alone price for the lease component represents 85% (i.e., ` 85,000 / ` 1,00,000) of total estimated stand-alone prices. The lessee allocates the consideration in the contract (i.e., ` 90,000), as follows:

Lease	* ` 76,500
Maintenance	** ` 13,500
Total	` 90,000

* ` 90,000 x 85% ** ` 90,000 x 15%

16 - Determining the lease term
Scenario A:
Entity ABC enters into a lease for equipment that includes a non-cancellable term of six years and a two-year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception. There are no termination penalties or other factors indicating that Entity ABC is reasonably certain to exercise the renewal option. What is the lease term?
Scenario B:

Entity XYZ enters into a lease for a building that includes a non-cancellable term of eight years and a two-year, market-priced renewal option. Before it takes possession of the building, Entity XYZ pays for leasehold improvements. The leasehold improvements are expected to have significant value at the end of eight years, and that value can only be realised through continued occupancy of the leased property. What is the lease term?

Scenario C:

Entity PQR enters into a lease for an identified retail space in a shopping centre. The retail space will be available to Entity PQR for only the months of October, November and December during a non-cancellable term of seven years. The lessor agrees to provide the same retail space for each of the seven years. What is the lease term?

Solution:

Scenario A:

At the lease commencement date, the lease term is six years (being the non-cancellable period). The renewal period of two years is not taken into consideration since it is mentioned that Entity ABC is not reasonably certain to exercise the option.

Scenario B:

At the lease commencement, Entity XYZ determines that it is reasonably certain to exercise the renewal option because it would suffer a significant economic penalty if it abandoned the leasehold improvements at the end of the initial non-cancellable period of eight years. Thus, at the lease commencement, Entity XYZ concludes that the lease term is ten years (being eight years of non-cancellable period plus the renewal period of two years where the lessee is reasonably certain to exercise the option).

Scenario C:

At the lease commencement date, the lease term is 21 months (three months per year over the seven annual periods as specified in the contract), i.e., the period over which Entity PQR controls the right to use the underlying asset.

17 - Re-assessment of exercise of lease extension option

Retailer M enters into a five-year lease for a building floor, followed by two successive five-year renewal options. On the commencement date, Retailer M is not reasonably certain to exercise the extension option. At the end of third year, Retailer M extended to include another floor from year 4 due to a business acquisition. For this purpose, the lessee concludes a separate seven-year lease for an additional floor in the building already leased. Is Retailer M required to reassess the lease term in this case?

Solution:

Ind AS 116 requires a lessee to reassess the lease term if there is change in business decision of the company which is directly relevant to exercising or not exercising an option to renew / extend the lease. In the given case, the Retailer M at the end of third year has extended to include another floor in the same building on account of acquiring another company. As Retailer M has entered into fresh lease of another floor for a seven-year term, it is reasonably certain to exercise the renewal option of original lease for a further five-year term. Hence Retailer M will have to reassess the lease term at the end of third year.

18 - Re-assessment of non-cancellable period of lease

Company N has taken 10 vehicles on lease for an initial period of 5 years with an extension option at the option of the lessee for a further period of 5 years at the same rental amount. The remaining useful life of the vehicles as on the commencement date of the lease is 15 years. Company N has determined at the

commencement date that it is reasonably certain to exercise the extension option and hence it has taken a period of 10 years for the lease. At the end of 4th year, there is an announcement by the government that all the cars of this particular model have to be discontinued from the road within 1 year due to the change in the pollution norms in the country. Will the lease term be reassessed in this case?

Solution:

In the given case, as per Ind AS 116, the announcement by the government to discontinue the use of the underlying asset will prohibit the lessee from exercising the extension option that was already included in the non-cancellable period by Company N and hence, Company N will reassess the non-cancellable period to exclude the extension option of 5 years.

19 - Determining the fixed payments

Entity M and Lessor A enter into a 10-year lease of an office building for fixed annual lease payments of ` 200,000. Per the terms of the lease agreement, annual fixed lease payments comprise ` 170,000 for rent and ` 30,000 for real estate taxes.

What are the fixed lease payments for purposes of classifying the lease?

Solution:

The fixed lease payments are ` 2,00,000. Although real estate taxes are explicitly stated in the lease contract, they do not represent a separate non-lease component as they do not provide a separate good or service. The right to use the office building is the only component. The annual lease payments of ` 2,00,000 represent payments related to that single lease component.

20 - In substance fixed lease payments

Entity Q enters into a seven-year lease for a piece of machinery. The contract sets out the lease payments as follows.

– If Q uses the machinery within a given month, then an amount of 2,000 accrues for that month.

– If Q does not use the machinery within a given month, then an amount of 1,000 accrues for that month.

What is considered as lease payment in this case?

Solution:

Q considers the contract and notes that although the lease payments contain variability based on usage, and there is a realistic possibility that Q may not use the machinery in some months, a monthly payment of 1,000 is unavoidable. Accordingly, this is an in-substance fixed payment, and is included in the measurement of the lease liability.

21 - In-substance fixed lease payment

Entity P enters into a five-year lease for office space with Entity Q. The initial base rent is ` 1 lakh per month. Rents increase by the greater of 1% of Entity P's generated sales or 2% of the previous rental rate on each anniversary of the lease commencement date. What are the lease payments for purposes of measuring lease liability?

Solution:

In the given case, the lease payments for purposes of classifying the lease are the fixed monthly payments of ` 1 lakh plus the minimum annual increase of 2% of the previous rental rate. Entity P is required to pay no less than a 2% increase regardless of the level of sales activity; therefore, this minimum level of increase is in substance fixed lease payment.

22 - In substance fixed lease payments

Company N leases a production line. The lease payments depends on the number of operating hours of the production line – i.e., N has to pay ` 1,000 per hour of use. The annual minimum payment is ` 10,00,000. The expected usage per year is 1,500 hours

Solution:

The lease contains in substance fixed payments of ` 10,00,000 per year, which are included in the initial measurement of the lease liability. The additional ` 5,00,000 that Company N expects to pay per year are variable payments that do not depend on an index or a rate but usage.

23 - Variable lease payments that depend on an index or rate

An entity enters into a 10-year lease of property. The lease payment for the first year is ` 1,000. The lease payments are linked to the consumer price index (CPI), i.e., not a floating interest rate. The CPI at the beginning of the first year is 100. Lease payments are updated

at the end of every second year. At the end of year one, the CPI is 105. At the end of year two, the CPI is 108. What should be included in lease payments?

Solution:

At the lease commencement date, the lease payments are ` 1,000 per year for 10 years. The entity does not take into consideration the potential future changes in the index. At the end of year one, the payments have not changed and hence, the liability is not updated.

At the end of year two, when the lease payments change, the entity updates the remaining eight lease payments to ` 1,080 per year (i.e., ` 1,000 / 100 x 108).

24 - Variable lease payments that do not depend on an index or rate

Entity XYZ is a medical equipment manufacturer and a supplier of the related consumables. Customer ABC operates a medical centre. Under the agreement entered into by both parties, Entity XYZ grants Customer ABC the right to use a medical laboratory machine at no cost and Customer ABC purchases consumables for use in the equipment from Entity XYZ at ` 100 each.

The consumables can only be used for that equipment and Customer ABC cannot use other consumables as substitutes. There is no minimum purchase amount required in the contract.

Based on its historical experience, Customer ABC estimates that it is highly likely to purchase at least 8,000 units of consumables annually. Customer ABC has appropriately assessed that the arrangement contains a lease of medical equipment. There are no residual value guarantees or other forms of consideration included in the contract. Whether these payments affect the calculation of lease liability and ROU Asset? How does Entity XYZ and Customer ABC would allocate these lease payments?

Solution:

There are two components in the arrangement, viz., a lease of equipment and the purchase of consumables. Even though Customer ABC may believe that it is highly unlikely to purchase lesser than 8,000 units of consumables every year, in this example, there are no lease payments for purposes of initial measurement (for Entity XYZ and Customer ABC) and lease classification (for Entity XYZ).

Entity XYZ and Customer ABC would allocate the payments associated with the future payments to the lease and consumables component of the contract (assuming Customer ABC does not elect to combine lease and non-lease components for this class of asset).

If Customer ABC elects the practical expedient not to separate the associated non-lease component from the lease component and instead accounts for the lease component and the non-lease component as a single lease component, the future payments for the consumables will still constitute genuine variability. Hence there will also be no lease payments for purposes of initial measurement.

25 - Variable lease payments

Entity A enters into a five-year lease of an office building. The lease payments are ` 5,00,000 per year and the contract includes an additional water charge calculated as ` 0.50 per litre consumed. Payments are due at the end of year. Entity A elects to apply the practical expedient to combine lease and non-lease components

Solution:

As stated above, payments are due at the end of the year. Entity A elects to apply the practical expedient not to separate lease and non-lease components.

At the commencement date, Entity A measures the lease liability as the present value of the fixed lease payments (i.e. five annual payments of 5,00,000). Although Entity A has elected to apply the practical expedient to combine non-lease components (i.e. water charges) with the lease component, Entity A excludes the non-lease component from its lease liability because they are variable payments that depend on usage. That is, the nature of the costs does not become fixed just because Entity A has elected not to separate them from the fixed lease payments. Entity A recognises the payments for water – as a variable lease payment – in profit or loss when they are incurred.

In contrast, if B does not elect to apply the practical expedient to combine lease and non-lease components, then it recognises the payments for water – as an operating expense – in profit or loss when they are incurred.

26 - Residual value guarantee included in lease payments

An entity (a lessee) enters into a lease and guarantees that the lessor will realise ` 20,000 from selling the asset to another party at the end of the lease. At lease commencement, based on the lessee's estimate of the residual value of the underlying asset, the lessee determines that it expects that it will owe ` 8,000 at the end of the lease. Whether the lessee should include the said payment of ` 8,000 as a lease payment?

Solution:

The lessee should include the amount of ` 8,000 as a lease payment because it is expected that it will owe the same to the lessor under the residual value guarantee.

27: Initial measurement of lease liability

Entity L enters into a lease for 10 years, with a single lease payment payable at the beginning of each year. The initial lease payment is ` 100,000. Lease payments will increase by the rate of LIBOR each year. At the date of commencement of the lease, LIBOR is 2 per cent.

Assume that the interest rate implicit in the lease is 5 per cent. How lease liability is initially measured?

Solution:

In the given case, the lease payments depend on a rate (i.e., LIBOR) and hence is included in measuring lease liability, As per Ind AS 116, the lease payments should initially be measured
using the rate (i.e. LIBOR) as at the commencement date. LIBOR at that date is 2 per cent;

therefore, in measuring the lease liability, it is assumed that each year the payments will increase by 2 per cent, as follows:

Year	**Lease Payment**	**Discount factor @ 5%**	**PV of lease payments**
1	1,00,000	1	100,000
2	1,02,000	0.952	97,102
3	1,04,040	0.907	94,364
4	1,06,121	0.864	91,689
5	1,08,243	0.823	89,084
6	1,10,408	0.784	86,560
7	1,12,616	0.746	84,012
8	1,14,869	0.711	81,672
9	1,17,166	0.677	79,321
10	1,19,509	0.645	77,083
			8,80,887

Therefore, the lease liability is initially measured at ` 8,80,887

28: Measuring right-of-use asset

Entity Y and Entity Z execute a 12-year lease of a railcar with the following terms on 1 January, 20X1:

- **The lease commencement date is 1 February 20X1.**
- **Entity Y must pay Entity Z the first monthly rental payment of ` 10,000 upon execution of the lease.**
- **Entity Z will pay Entity Y ` 50,000 cash incentive to enter into the lease payable upon lease execution.**

Entity Y incurred ` 1,000 of initial direct costs, which are payable on 1 February 20X1. Entity Y calculated the initial lease liability as the present value of the lease payments discounted using its incremental borrowing rate because the rate implicit in the lease could not be readily determined; the initial lease liability is ` 8,50,000.

How would Lessee Company measure and record this lease?

Solution:

Entity Y would calculate the right-of-use asset as follows:

Initial measurement of lease liability	8,50,000
Lease payments made to Entity Z at or before the commencement date	10,000
Lease incentives received from Entity Z	(50,000)
Initial direct cost	1,000
Initial measurement of right-of-use asset	**8,11,000**

29 - Dismantling costs to be included in initial measurement of ROU Asset

Company H leases an aircraft for a period of 5 years. The aircraft must undergo a planned check after every 100,000 flight hours. At the end of the lease, company H must have a check performed (or refund the costs to the lessor), irrespective of the actual number of flight hours. What are the lease payments for purposes of calculating ROU asset?

Solution:
In the given case, the legal requirement to perform a check after every 1,00,000 flight hours does not directly lead to an obligation as it depends on future circumstances. However, as the check must be carried out at the end of the lease irrespective of the actual number of flight hours gives rise to an obligation.
As a result, company H has to recognize a provision for the costs of the final check ("present value of the expected cost") at the beginning of the lease term. At the same time, these costs must be included in the cost of the right-of-use (ROU) asset pursuant to para 24 (d) of Ind AS 116.

30 - Lessee Accounting
Entity ABC (lessee) enters into a three-year lease of equipment. Entity ABC agrees to make the following annual payments at the end of each year:
` 20,000 in year one
` 30,000 in year two
` 50,000 in year three.
For simplicity purposes, there are no other elements to the lease payments (like purchase options, lease incentives from the lessor or initial direct costs). Assumed a discount rate of 12% (which is Entity ABC's incremental borrowing rate because the interest rate implicit in the lease cannot be readily determined). Entity ABC depreciates the ROU Asset on a straight-line basis over the lease term.
How would Entity ABC would account for the said lease under Ind AS 116?
Solution:
At the commencement date, Entity ABC would initially recognise ROU Asset and the corresponding Lease Liability of ` **77,364** which is calculated as follows:

Year	**Payments (Cash flows)**	**Discounting Factor @12%**	**Discounted Cash flows / Present Value**
1	20,000	0.8929	17,858
2	30,000	0.7972	23,916
3	50,000	0.7118	35,590
	1,00,000		**77,364**

Then, the next step would be to prepare a schedule for Lease Liability and ROU Asset as follows:

Lease Liability

Year	**Opening balance**	**Interest Expense**	**Payments**	**Closing balance**
1	77,364	9,284	(20,000)	66,648
2	66,648	7,998	(30,000)	44,646
3	44,646	5,354*	(50,000)	-

***** Difference of ` 4 is due to approximation.
ROU Asset (assuming no lease incentives, no initial direct costs, etc.):

Year	**Opening balance**	**Depreciation**	**Closing balance**
1	77,364	(25,788)	51,576
2	51,576	(25,788)	25,788
3	25,788	(25,788)	-

At lease commencement, Entity ABC would recognise the Lease Liability and the corresponding ROU Asset as follows:

ROU Asset	Dr.	77,364	
To Lease Liability			77,364

To initially recognise the Lease Liability and the corresponding ROU Asset

The following journal entries would be recorded in the first year:

Interest Expense	Dr.	9,284	
To Lease Liability			9,284

To record interest expense and accrete the lease liability using the effective interest method (` 77,364 x 12%)

Depreciation Expense	Dr.	25,788	
To ROU Asset			25,788

To record interest expense and accrete the lease liability using the straight line method (` 77,364 / 3 years)

Lease Liability	Dr.	20,000	
To Cash / Bank			20,000

To record lease payment

Following is the summary of the said lease contract's accounting (assuming no changes due to reassessment):

Particulars	Initially	Year 1	Year 2	Year 3
Cash lease payments	20,000	30,000	50,000	
Lease Expense Recognised:				
Interest Expense	9,284	7,998	5,354	
Depreciation Expense	25,788	25,788	25,788	
Total Periodic Expense	35,072	33,786	31,142	
Balance Sheet:				
ROU Asset	77,364	51,576	25,788	-
Lease Liability	(77,364)	(66,648)	(44,646)	-

31 - Subsequent measurement using cost model

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 ` 50 Lacs. Company EFG has an option to purchase the property at the end of the lease term for ` 30 lacs. The first annual payment is ` 5 lacs with an increase of 3% every year thereafter. The implicit rate of interest is 9.04%. Entity H gives Company EFG an incentive of ` 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?

Solution:

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)	` 37,39,648
PV of purchase option at end of lease term (W.N. 2)	` 12,60,000
Total lease liability	**` 49,99,648 or ` 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 would record the following journal entry on the lease commencement date.

Right-of-use Asset	Dr.	` 50,00,000	
To Lease Liability			` 50,00,000

To record ROU asset and lease liability at the 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 ` 1,25,000 (` 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 paid at the beginning of the year	Interest paid	Interest expense	Lease Liability (end of the year
	a	b= a-c	c = (d of pvs. Year)	d = [(e of pvs. year-a) x 9.04%]	e = (e of pvs. Year + d – a
Commencement					50,00,000
Year 1	5,00,000	5,00,000	-	4,06,800	49,06,800
Year 2	3,15,000*	(91,800)	4,06,800	4,15,099	50,06,899
Year 3	5,30,450	1,15,351	4,15,099	4,04,671	48,81,120
Year 4	5,46,364	1,41,693	4,04,671	3,91,862	47,26,618
Year 5	5,62,754	1,70,892	3,91,862	3,76,413	45,40,277
Year 6	5,79,637	2,03,224	3,76,413	3,58,042	43,18,682
Year 7	5,97,026	2,38,984	3,58,042	3,36,438	40,58,094
Year 8	6,14,937	2,78,499	3,36,438	3,11,261	37,54,418
Year 9	6,33,385	3,22,124	3,11,261	2,82,141	34,03,174
Year 10	6,52,387	3,70,246	2,82,141	2,49,213*	30,00,000
Year 10	30,00,000	27,50,787	2,49,213*	-	-
Total	**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)
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)	Present value factor @ 9.04% (B)	Present value of lease payments (A*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	Payment on purchase option (A)	Present value factor @ 9.04% (B)	Present value of purchase option (A*B=C)
Year 10	30,00,000	0.42	12,60,000
Total			**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.

32- Remeasurement of a lease with variable lease payments

Entity W entered into a contract for lease of retail store with Entity J on January 01/01/20X1. The initial term of the lease is 5 years with a renewal option of further 3 years. The annual payments for initial term and renewal term is ` 100,000 and ` 110,000 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 01/01/20X2 will be based on the CPI available at 31/12/20X1.

Entity W's incremental borrowing rate at the lease inception date and as at 01/01/20X4 is 5% and 6% respectively and the CPI at lease commencement date and as at 01/01/20X4 is 120 and 125 respectively. At the lease commencement date, Entity W did not have a significant economic incentive to exercise the

renewal option. In the first quarter of 20X4, Entity W installed unique lease improvements into the retail store with an estimated five-year economic life. Entity W determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.
Is Entity W required to remeasure the lease in the first quarter of 20X4?
Solution:
Since Entity W is now reasonably certain that it will exercise its renewal option, it is required to remeasure the lease in the first quarter of 20X4.
The following table summarizes information pertinent to the lease remeasurement.

Remeasured lease term	**5 years; 2 years remaining in the initial term plus 3 years in the renewal period**
Entity W's incremental borrowing rate On the remeasurement date	6%
CPI available on the remeasurement date	125
Right-of-use asset immediately before the remeasurement	` 1,81,840 (Refer note 1)
Lease liability immediately before the remeasurement	` 1,95,244 (Refer note 1)

To remeasure the lease liability, Entity W would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 6%). The following table shows the present value of the future lease payments based on an updated CPI of 125. Since the initial lease payments were based on a CPI of 120, the CPI has increased by 4.167% approx. As a result, Entity W would increase the future lease payments by 4%. As shown in the table, the revised lease liability is ` 4,91,376.

Year	**4**	**5**	**6**	**7**	**8**	**Total**
Lease payment	1,04,167	1,04,167	1,14,583	1,14,583	1,14,583	5,52,083
Discount	1	0.943	0.890	0.840	0.792	
Present value	1,04,000	98,230	1,01,979	96,250	90,750	4,91,376

To calculate the adjustment to the lease liability, Entity W would compare the recalculated and original lease liability balances on the remeasurement date.
Entity W would record the following journal entry to adjust the lease liability.

ROU Asset	Dr.	2,96,132	
To Lease liability			2,96,132

Being lease liability and ROU asset adjusted on account of remeasurement.

Working Notes:
1 Calculation of ROU asset before the date of remeasurement

Year beginning	Lease Payment (A)	Present value factor @ 5% (B)	Present value of lease payments (A x B=C)
1	1,00,000	1.000	1,00,000
2	1,00,000	0.952	95,200
3	1,00,000	0.907	90,700
4	1,00,000	0.864	86,400
5	1,00,000	0.823	82,300
Lease liability as at commencement date		**4,54,600**	

2 Calculation of Lease Liability and ROU asset at each year end

Year	Lease Liability				ROU asset		
	Initial Value	**Lease payments**	**Interest expense@ 5%**	**Closing balance**	**Initial Value**	**Depreciation for 5 years**	**Closing balance**
1	4,54,600	1,00,000	17,730	3,72,330	4,54,600	90,920	3,63,680
2	3,72,330	1,00,000	13,617	2,85,947	3,63,680	90,920	2,72,760
3	2,85,947	1,00,000	9,297	1,95,244	2,72,760	90,920	1,81,840
4	1,95,244				1,81,840		

33 - Modification that is a separate lease
Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).
How should the said modification be accounted for?
Solution:
Lessee accounts for the modification as a separate lease, separate from the original 10-year lease because the modification grants Lessee an additional right to use an underlying asset,
and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract. In this example, the additional underlying asset is the new 3,000 square metres of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognises a ROU Asset and a lease liability relating to the lease of the additional 3,000 square metres of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square metres of office space as a result of this modification.

34 - Modification that increases the scope of the lease by extending the contractual lease term Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are ` 1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., ` 1,00,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7% p.a. How should the said modification be accounted for?

Solution:

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on:

(a) An eight-year remaining lease term

(b) Annual payments of ` 1,00,000 and

(c) Lessee's incremental borrowing rate of 7% p.a.

The modified lease liability equals ` 5,97,100 (W.N.1). The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is ` 3,46,355 (W.N.3). Lessee recognises the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (i.e., ` 2,50,745) (W.N. 4) as an adjustment to the ROU Asset.

Working Notes:

1. Calculation of modified lease liability:

Year	**Lease Payment (A)**	**Present value factor @ 7% (B)**	**Present value of lease payments (A*B=C)**
7	100,000	0.935	93,500
8	100,000	0.873	87,300
9	100,000	0.816	81,600
10	100,000	0.763	76,300
11	100,000	0.713	71,300
12	100,000	0.666	66,600
13	100,000	0.623	62,300
14	100,000	0.582	58,200
Modified lease liability		**5,97,100**	

2. Calculation of Lease liability as at commencement date:

Year	Lease payment (A)	Pv Factor @6% (b)	PV of Lease Payments (AxB=C)
1	100,000	0.943	94,300
2	100,000	0.890	89,000
3	100,000	0.840	84,000
4	100,000	0.792	79,200
5	100,000	0.747	74,700
6	100,000	0.705	70,500
7	100,000	0.665	66,500
8	100,000	0.627	62,700

9	100,000	0.592	59,200
10	100,000	0.558	55,800
Lease liability as at modification date		**7,35,900**	

3. Calculation of Lease liability immediately before modification date:

Year	Opening lease liability (A)	Interest @ 6% (B) = [A x 6%]	Lease payments (C)	Closing liability (D) = [A+B-C]
1	7,35,900	44,154	100,000	6,80,054
2	6,80,054	40,803	100,000	6,20,857
3	6,20,857	37,251	100,000	5,58,108
4	5,58,108	33,486	100,000	4,91,594
5	4,91,594	29,496	100,000	4,21,090
6	4,21,090	25,265	100,000	3,46,355
Lease liability as at modification date		3,46,355		

4. Adjustment to ROU asset:

Modified Lease liability	5,97,100
Original Lease liability as at modification date	(3,46,355)
Adjustment to ROU asset	**2,50,745**

The ROU asset will be increased by ` 2,50,745 on the date of modification

35 - Modification that decreases the scope of the lease
Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are ` 50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres 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 ` 30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5% p.a. How should the said modification be accounted for?

Solution:

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 @ 6%**	**Closing balance**	**Initial Value**	**Depreciation**	**Closing balance**
	a	**b**	**c = a x 6%**	**d = a-b + c**	**e**	**f**	**g**
1	3,67,950 *	50,000	22,077	3,40,027	3,67,950	36,795	3,31,155
2	3,40,027	50,000	20,402	3,10,429	3,31,155	36,795	2,94,360
3	3,10,429	50,000	18,626	2,79,055	2,94,360	36,795	2,57,565
4	2,79,055	50,000	16,743	2,45,798	2,57,565	36,795	2,20,770
5	2,45,798	50,000	14,748	2,10,546	2,20,770	36,795	1,83,975
6	2,10,546			1,83,975			

*(refer note 1)

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 ` 30,000 and

(c) Lessee's incremental borrowing rate of 5% p.a.

Year	Lease Payment(A)	Present value factor @ 5% (B)	Present value of lease payments (A x B = C)
6	30,000	0.952	28,560
7	30,000	0.907	27,210
8	30,000	0.864	25,920
9	30,000	0.823	24,690
10	30,000	0.784	23,520
Total		**1,29,900**	

basis of the remaining ROU Asset (i.e., 2,500 square metres corresponding to 50% of the original ROU Asset).

50% of the pre-modification ROU Asset (` 1,83,975) is ` 91,987.50.

50% of the pre-modification lease liability (` 2,10,546) is ` 1,05,273.

Consequently, Lessee reduces the carrying amount of the ROU Asset by ` 91,987.50 and the carrying amount of the lease liability by ` 1,05,273. Lessee recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (` 1,05,273 – ` 91,987.50 = ` 13,285.50) 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 ` 1,05,273 and the modified lease liability of ` 1,29,900 (which equals ` 24,627) as an adjustment to the ROU Asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Working Note:
Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment(A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	50,000	0.943	47,150
2	50,000	0.890	44,500
3	50,000	0.840	42,000
4	50,000	0.792	39,600
5	50,000	0.747	37,350
6	50,000	0.705	35,250
7	50,000	0.665	33,250
8	50,000	0.627	31,350
9	50,000	0.592	29,600
10	50,000	0.558	27,900
			3,67,950

36 - Modification that is a change in consideration only
Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from ` 1,00,000 per year to ` 95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a. The annual lease payments are payable at the end of each year. How should the said modification be accounted for?

Solution:
In the given case, Lessee calculates the ROU asset and the lease liabilities before modification as follows:

Year	Opening lease liability (A)	Interest @ 6% (B) = [A x 6%]	Lease payments (C)	Closing liability (D) = [A+B-C]
1	7,35,900	44,154	100,000	6,80,054
2	6,80,054	40,803	100,000	6,20,857
3	6,20,857	37,251	100,000	5,58,108
4	5,58,108	33,486	100,000	4,91,594
5	4,91,594	29,496	100,000	4,21,090
6	421090			

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 ` 95,000, and
(c) Lessee's incremental borrowing rate of 7% p.a.

Year	Lease Payments (A)	Present value @ 7% (B)	Present value of lease payments (A x B = C)
1	95,000	0.935	88,825
2	95,000	0.873	82,935
3	95,000	0.816	77,520
4	95,000	0.763	72,485
5	95,000	0.713	67,735
			3,89,500

Lessee recognises the difference between the carrying amount of the modified liability (` 3,89,500) and the lease liability immediately before the modification (` 4,21,090) of ` 31,590 as an adjustment to the ROU Asset

Working Note:
Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment (A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	1,00,000	0.943	94,300
2	1,00,000	0.890	89,000
3	1,00,000	0.840	84,000
4	1,00,000	0.792	79,200
5	1,00,000	0.747	74,700
6	1,00,000	0.705	70,500
7	1,00,000	0.665	66,500
8	1,00,000	0.627	62,700
9	1,00,000	0.592	59,200
10	1,00,000	0.558	55,800
Lease liability as at commencement date		**7,35,900**	

37 - Modification that both increases and decreases the scope of the lease
Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are ` 1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a.

At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to:
(a) include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and
(b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is ` 1,50,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a.
The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.
How should the said modification be accounted for?
Solution:
The pre-modification ROU Asset and the pre-modification lease liability in relation to the lease are as follows:

Year	Lease liability				ROU Asset		
	Opening balance	Interest expense @ 6%	Lease payment	Closing balance	Opening balance	Depreciation charge	Closing balance
1	7,35,900*	44,154	(1,00,000)	6,80,054	7,35,900	(73,590)	6,62,310
2	6,80,054	40,803	(1,00,000)	6,20,857	6,62,310	(73,590)	5,88,720
3	6,20,857	37,251	(1,00,000)	5,58,108	5,88,720	(73,590)	5,15,130
4	5,58,108	33,486	(1,00,000)	4,91,594	5,15,130	(73,590)	4,41,540
5	4,91,594	29,496	(1,00,000)	4,21,090	4,41,540	(73,590)	3,67,950
6	4,21,090				3,67,950		

*Refer Note 4.
At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of:
(a) A three-year remaining lease term (ie. till 8th year),
(b) Annual payments of ` 150,000 and
(c) Lessee's incremental borrowing rate of 7% p.a.

Year	**Lease Payments (A)**	**Present value @ 7% (B)**	**Present value of lease payments (A x B = C)**
1	1,50,000	0.935	1,40,250
2	1,50,000	0.873	1,30,950
3	1,50,000	0.816	1,22,400
Modified lease liability		**3,93,600**	

The modified liability equals ` 3,93,600, of which (a) ` 1,31,200 relates to the increase of ` 50,000 in the annual lease payments from Year 6 to Year 8 and (refer note 1) (b) ` 2,62,400 relates to the remaining three annual lease payments of ` 1,00,000 from Year 6 to Year 8 with reduction of lease term (Refer Note 3)

Decrease in the lease term:

At the effective date of the modification (at the beginning of Year 6), the pre-modification ROU Asset is ` 3,67,950. Lessee determines the proportionate decrease in the carrying amount of the ROU Asset based on the remaining ROU Asset for the original 2,000 square metres of office space (i.e., a remaining three-year lease term rather than the original five-year lease term). The remaining ROU Asset for the original 2,000 square metres of office space is ` 2,20,770 [i.e., ` (3,67,950 / 5) x 3 years].

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is ` 4,21,090. The remaining lease liability for the original 2,000 square metres of office space is ` 2,67,300 (i.e., present value of three annual lease payments of ` 1,00,000, discounted at the original discount rate of 6% p.a.) (refer note 2).

Consequently, Lessee reduces the carrying amount of the ROU Asset by ` 1,47,180 (` 3,67,950 – ` 2,20,770), and the carrying amount of the lease liability by ` 1,53,790 (` 4,21,090 – ` 2,67,300). Lessee recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (` 1,53,790 – ` 1,47,180 = ` 6,610) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lease Liability	Dr.	1,53,790	
To ROU Asset			1,47,180
To Gain			6,610

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7% p.a., which is ` 4,900 (` 2,67,300 – ` 2,62,400*), as an adjustment to the ROU Asset.

*(Refer note 3)

Lease Liability	Dr.	4,900	
To ROU Asset			4,900

Increase in the leased space:

At the commencement date of the lease for the additional 1,500 square metres of space (at the beginning of Year 6), Lessee recognises the increase in the lease liability related to the increase in leased space of ` 1,31,200 (i.e., present value of three annual lease payments of ` 50,000, discounted at the revised interest rate of 7% p.a.) as an adjustment to the ROU Asset.

ROU Asset	Dr.	1,31,200	
To Lease Liability			1,31,200

The modified ROU Asset and the modified lease liability in relation to the modified lease are as follows:

Year	Lease liability				ROU Asset		
	Opening balance	Interest expense @ 7%	Lease payment	Closing balance	Opening balance	Depreciation charge	Closing balance
6	3,93,600	27,552	(1,50,000)	2,71,152	3,47,070**	(1,15,690)	2,31,380

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7	2,71,152	18,981	(1,50,000)	1,40,133	2,31,380	(1,15,690)	1,15,690
8	1,40,133	9,867*	(1,50,000)	-	1,15,690	(1,15,690)	-

*Difference is due to approximation.

**Refer Note 5

Working Notes:

1 Calculation of lease liability on increased consideration:

Year	Lease Payments (A)	Present value @7% (B)	Present value of lease payments (A x B = C)
1	50,000	0.935	46,750
2	50,000	0.873	43,650
3	50,000	0.816	40,800
Modified lease liability			**1,31,200**

2 Calculation of remaining lease liability for the original contract of 2000 square meters at Original discount rate:

Year	Lease Payments (A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	1,00,000	0.943	94,300
2	1,00,000	0.890	89,000
3	1,00,000	0.840	84,000
Remaining lease liability			**2,67,300**

3 Calculation of remaining lease liability for the original contract of 2000 square meters at revised discount rate:

Year	Lease Payments (A)	Present value factor @ 7% (B)	Present value of lease payments (A x B = C)
1	1,00,000	0.935	93,500
2	1,00,000	0.873	87,300
3	1,00,000	0.816	81,600
Remaining lease liability			**2,62,400**

4 Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment (A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	100,000	0.943	94,300

2	100,000	0.890	89,000
3	100,000	0.840	84,000
4	100,000	0.792	79,200
5	100,000	0.747	74,700
6	100,000	0.705	70,500
7	100,000	0.665	66,500
8	100,000	0.627	62,700
9	100,000	0.592	59,200
10	100,000	0.558	55,800
Lease liability as at modification date			7,35,900

5 Calculation of opening balance of Modified ROU Asset at the beginning of 6th year:

The remaining ROU Asset for the original 2,000 square metres of office space after decrease in term	2,20,770
Less: Adjustment for increase in interest rate from 6% to 7%	(4,900)
Add: Adjustment for increase in leased space	1,31,200
	3,47,070

38 - Lessor accounting for a finance lease dealer-lessor case

A Lessor enters into a 10-year lease of equipment with Lessee. The equipment is not specialised in nature and is expected to have alternative use to Lessor at the end of the 10-year lease term. Under the lease:

- **Lessor receives annual lease payments of ` 15,000, payable at the end of the year**
- **Lessor expects the residual value of the equipment to be ` 50,000 at the end of the 10-year lease term**
- **Lessee provides a residual value guarantee that protects Lessor from the first ` 30,000 of loss for a sale at a price below the estimated residual value at the end of the lease term (i.e., ` 50,000)**
- **The equipment has an estimated remaining economic life of 15 years, a carrying amount of ` 1,00,000 and a fair value of ` 1,11,000**
- **The lease does not transfer ownership of the underlying asset to Lessee at the end of the lease term or contain an option to purchase the underlying asset**
- **The interest rate implicit in the lease is 10.078%.**

How should the Lessor account for the same in its books of accounts?

Solution:

Lessor shall classify the lease as a **FINANCE LEASE** because the sum of the present value of lease payments amounts to **substantially all** of the fair value of the underlying asset.

At lease commencement, Lessor accounts for the finance lease, as follows:

Net investment in the lease	₹ 1,11,000(a)	
Cost of goods sold	₹ 92,340(b)	
Revenue		₹ 1,03,340(c)
Property held for lease		₹ 1,00,000(d)

To record the net investment in the finance lease and derecognise the underlying asset.

(a) The net investment in the lease consists of:

(1) the present value of 10 annual payments of ` 15,000 plus the guaranteed residual value of ` 30,000, both discounted at the interest rate implicit in the lease, which equals ` 1,03,340 (i.e., the lease payment) (Refer note 1) **AND**

(2) the present value of unguaranteed residual asset of ` 20,000, which equals ` 7,660 (Refer note 2).
Note that the net investment in the lease is subject to the same considerations as other assets in classification as current or non-current assets in a classified balance sheet.
(b) Cost of goods sold is the carrying amount of the equipment of ` 1,00,000 (less) the present value of the unguaranteed residual asset of ` 7,660.
(c) Revenue equals the lease receivable.
(d) The carrying amount of the underlying asset.

At lease commencement, Lessor recognises selling profit of ` 11,000 which is calculated as = lease payment of ` 1,03,340 – [carrying amount of the asset (` 1,00,000) – net of any unguaranteed residual asset (` 7,660) ie which equals ` 92,340]

Year 1 Journal entry for a finance lease

Cash	₹ 15,000(e)	
Net investment in the lease		₹ 3,813(f)
Interest income		₹ 11,187(g)

(e) Receipt of annual lease payments at the end of the year.
(f) Reduction of the net investment in the lease for lease payments received of ` 15,000, net of interest income of ` 11,187
(g) Interest income is the amount that produces a constant periodic discount rate on the remaining balance of the net investment in the lease. Please refer the computation below:
The following table summarises the interest income from this lease and the related amortisation of the net investment over the lease term:

Year	Annual Rental Payment	Annual Interest Income (h)	Net investment at the end of the year
Initial net investment			1,11,000
1	15,000	11,187	1,07,187
2	15,000	10,802	1,02,989
3	15,000	10,379	98,368
4	15,000	9,914	93,282
5	15,000	9,401	87,683

6	15,000	8,837	81,520
7	15,000	8,216	74,736
8	15,000	7,532	67,268
9	15,000	6,779	59,047
10	15,000	5,953	50,000(i)

(h) Interest income equals 10.078% of the net investment in the lease at the beginning of each year. For e.g., Year 1 annual interest income is calculated as ` 1,11,000 (initial net investment) x 10.078%.
(i) The estimated residual value of the equipment at the end of the lease term.

Working Notes:
1 Calculation of net investment in lease:

Year	**Lease Payment (A)**	**Present value factor @ 10.078% (B)**	**Present value of lease payments (A x B = C)**
1	15,000	0.908	13,620
2	15,000	0.825	12,375
3	15,000	0.750	11,250
4	15,000	0.681	10,215
5	15,000	0.619	9,285
6	15,000	0.562	8,430
7	15,000	0.511	7,665
8	15,000	0.464	6,960
9	15,000	0.421	6,315
10	15,000	0.383	5,745
10	30,000	0.383	11,480*
1,03,340			

* Figure has been rounded off for equalization of journal entr

2 Calculation of present value of unguaranteed residual asset

Year	Lease Payment (A)	Present value factor @ 10.078% (B)	Present value of lease payments (A x B = C)
10	20,000	0.383	7,660

39- Deferral of lease payments not a lease modification

Lessor L leases retail space to Lessee Z and classifies the lease as an operating lease. The lease includes fixed lease payments of ` 10,000 per month.

Due to the COVID-19 pandemic, L and Z agree on a rent concession that allows Z to pay no rent in the period from July, 2020 to September 2020 but to pay rent of 20,000 per month in the period from January 2021 to March 2021. There are no other changes to the lease.

How this will be accounted for by lessor?

Solution:

L determines that the reduction in lease payments in July 2020 to September 2020 and the proportional increase in January 2021 to March 2021 does not result in an overall change in the consideration for the lease. L does not account for the change as a lease modification. L continues to recognise operating lease income on a straight-line basis, which is representative of the pattern in which Z's benefit from use of the underlying asset is diminished.

40 - Unamortised lease incentive: Lease modification

Lessor M enters into a 10-year lease of office space with Lessee K, which commences on 1 April 2015. The rental payments are 15,000 per month, payable in arrears. M classifies the lease as an operating lease. M reimburses K's relocation costs of K of 600,000, which M accounts for as a lease incentive. The lease incentive is recognised as a reduction in rental income over the lease term using the same basis as for the lease income – in this case, on a straight- line basis over 10 years.

On 1 April 2020, during the COVID-19 pandemic, M agrees to waive K's rental payments for May, June and July 2020.

This decrease in consideration is not included in the original terms and conditions of the lease and is therefore a lease modification.

How this will be accounted for by lessor?

Solution:

M accounts for this modification as a new operating lease from its effective date – i.e. 1 April 2020. M recognises the impact of the waiver on a straight-line basis over the five-year term of the new lease. M also takes into account the carrying amount of the unamortised lease incentive on 1 April 2020 of ` 3,00,000. M amortises this balance on a straight-line basis over the five-year term of the new lease.

41 - Modification that is not a separate lease and lease would have been classified as an operating lease
Lessor L enters into an eight-year lease of 40 lorries with Lessee M that commences on 1 January 2018. The lease term approximates the lorries' economic life and no other features indicate that the lease transfer or does not transfer substantially all of the risks and rewards incidental to ownership of the lorries. Assuming that substantially all of the risks and rewards incidental to ownership of the lorries are transferred, L classifies the lease as a finance lease.
During the COVID-19 pandemic, M's business has contracted. In June 2020, L and M amend the contract so that it now terminates on 31 December 2020.
Early termination was not part of the original terms and conditions of the lease and this is therefore a lease modification. The modification does not grant M an additional right to use the underlying assets and therefore cannot be accounted for as a separate lease.
How this will be accounted for by lessor?
Solution:
L determines that, had the modified terms been effective at the inception date, the lease term would not have been for the major part of the lorries' economic life. Furthermore, there are no other indicators that the lease would have transferred substantially all of the risks and rewards incidental to ownership of the lorries. Therefore, the lease would have been classified as an operating lease.
In June 2020, L accounts for the modified lease as a new operating lease. The lessor L:
a) derecognises the finance lease receivable and recognises the underlying assets in its statement of financial position according to the nature of the underlying asset – i.e. as property, plant and equipment in this case; and
b) measures the aggregate carrying amount of the underlying assets as the amount of the net investment in the lease immediately before the effective date of the lease modification

42 - Classification of a sublease in case of an Intermediate Lessor
Entity ABC (original lessee/intermediate lessor) leases a building for five years. The building has an economic life of 40 years. Entity ABC subleases the building for four years.
How should the said sublease be classified by Entity ABC?
Solution:
The sublease is classified with reference to the 'ROU Asset' in the head lease (and **NOT** the 'underlying building' of the head lease). Hence, when assessing the useful life criterion, the sublease term of four years is compared with five-year ROU Asset in the head lease (**NOT** compared with 40-year economic life of the building) and accordingly may result in the sublease being classified as a finance lease.

43 - Intermediate Lessor – Where the sublease is classified as a 'Finance Lease'
Head lease:
An intermediate lessor enters into a five-year lease for 10,000 square metres of office space (the head lease) with Entity XYZ (the head lessor).
Sublease:
At the beginning of Year 3, the intermediate lessor subleases the 10,000 square metres of office space for the remaining lease term i.e three years of the head lease to a sub-lessee.
How should the said sublease be classified and accounted for by the Intermediate Lessor?
Solution:
The intermediate lessor classifies the sublease by reference to the ROU Asset arising from the head lease (i.e., in this case, comparing the three-year sublease with the five-year ROU Asset in the head lease). The

intermediate lessor classifies the sublease as a finance lease, having considered the requirements of Ind AS 116 (i.e., one of the criteria of 'useful life' for a lease to be classified as a finance lease).
When the intermediate lessor **enters into** a sublease, the intermediate lessor:
(i) derecognises the ROU asset relating to the head lease that it transfers to the sublessee and recognises the net investment in the sublease;
(ii) recognises any difference between the ROU asset and the net investment in the sublease in profit or loss; **AND**
(iii) retains the lease liability relating to the head lease in its balance sheet, which represents the lease payments owed to the head lessor.
During the term of the sublease, the intermediate lessor recognises both
- finance income on the sublease **AND**
- interest expense on the head lease.

44 - Intermediate Lessor – Where the sublease is classified as a 'Operating Lease'
Head lease: An intermediate lessor enters into a five-year lease for 10,000 square metres of office space (the head lease) with Entity XYZ (the head lessor).
Sublease: At the commencement of the head lease, the intermediate lessor subleases the 10,000 square metres of office space for two years to a sub-lessee.
How should the said sublease be classified and accounted for by the Intermediate Lessor?
Solution:
The intermediate lessor classifies the sublease by reference to the ROU Asset arising from the head lease (i.e., in this case, comparing the two-year sublease with the five-year ROU Asset in the head lease). The intermediate lessor classifies the sublease as an operating lease, having considered the requirements of Ind AS 116 (i.e., one of the criteria of 'useful life' for a lease to be classified as a finance lease and since, it is not satisfied, classified the same as an operating lease).
When the intermediate lessor **enters into** the sublease, the intermediate lessor retains:
- the lease liability **AND**
- the ROU asset
both relating to the head lease in its balance sheet.
During the term of the sublease, the intermediate lessor:

(a) recognises a depreciation charge for the ROU asset and interest on the lease liability; **AND**
(b) recognises lease income from the sublease.
Sub-lessee Accounting:
A sub-lessee accounts for its lease in the same manner as any other lease (i.e., as a new lease subject to Ind AS 116's recognition and measurement provisions).

45 - Sale and leaseback transaction
An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of ` 30,00,000. Immediately before the transaction, the building is carried at a cost of ` 15,00,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with annual payments 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 Ind AS 115 Revenue from Contracts with Customers.
The fair value of the building at the date of sale is ` 27,00,000. 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.
Buyer-lessor classifies the lease of the building as an operating lease.
How should the said transaction be accounted by the Seller-lessee and the Buyer-lessor?
Solution:
Considering facts of the case, Seller-lessee and buyer-lessor account for the transaction as a sale and leaseback.
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:	30,00,000
Less: Fair Value (at the date of sale):	(27,00,000)
Additional financing provided by Buyer-lessor to Seller-lessee	**3,00,000**

Next step would be to calculate the present value of the annual payments which amounts to ` 14,94,000 (calculated considering 20 payments of ` 2,00,000 each, discounted at 12% p.a.) of which ` 3,00,000 relates to the additional financing (as calculated above) and balance ` 11,94,000 relates to the lease — corresponding to 20 annual payments of ` 40,164 and ` 1,59,836, respectively (refer calculations below).

Proportion of annual lease payments:

Present value of lease payments (as calculated above)	(A)	14,94,000
Additional financing provided (as calculated above)	(B)	3,00,000
Relating to the Additional financing provided	(C) = (E x B / A)	40,160
Relating to the Lease	(D) = (E – C)	1,59,840
Annual payments (at the end of each year)	(E)	2,00,000

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)	15,00,000
Fair Value (at the date of sale)	(B)	27,00,000
Discounted lease payments for the 20-year ROU asset	(C)	11,94,000
ROU Asset	**[(A / B) x C]**	**6,63,333**

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor, calculated as follows:

Fair Value (at the date of sale)	(A)	27,00,000
Carrying Amount	(B)	15,00,000
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) x C]	5,30,667
Relating to the rights transferred to Buyer-lessor	(D - E)	6,69,333

At the commencement date, Seller-lessee accounts for the transaction, as follows:

Cash	Dr.	30,00,000	
ROU Asset	Dr.	6,63,333	
To Building			15,00,000
To Financial Liability			14,94,000
To Gain on rights transferred			6,69,333

Buyer-Lessor:

At the commencement date, Buyer-lessor accounts for the transaction, as follows:

Building	Dr.	27,00,000	
Financial Asset (20 payments of ₹ 40,160 discounted @ 12% p.a.) (approx.)	Dr.	3,00,000	
To Cash			30,00,000

After the commencement date, Buyer-lessor accounts for the lease by treating ` 1,59,840 of the annual payments of ` 2,00,000 as lease payments. The remaining ` 40,160 of annual payments received from Seller-lessee are accounted for as:

(a) payments received to settle the financial asset of ` 3,00,000 **AND**

(b) interest revenue.

46 - Transition Approaches

A retailer (lessee) entered into 3-year lease of retail space beginning at 1 April 2017 with three annual lease payments of ` 2,00,000 due on 31 March 2018, 2019 and 2020, respectively. The lease is classified as an operating lease under Ind AS 17. The retailer initially applies Ind AS 116 for the first time in the annual period beginning at 1 April 2019. The incremental borrowing rate at the date of the initial application (i.e., 1

April 2019) is 10% p.a. and at the commencement of the lease (i.e., 1 April 2017) 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 lessee 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 using all the following transition approaches:
Full Retrospective Approach
Modified Retrospective Approach
- Alternative 1
- Alternative 2
Solution:
Full Retrospective Approach:

Under the full retrospective approach, the lease liability and the ROU asset are measured on the commencement date (i.e., 1 April 2017 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. Let us first calculate the Lease Liability and ROU Asset as follows:

Year	Payments (Cash flows)	Present Value Factor @12%	Discounted Cash flows / Present Value
31 Mar 2018	2,00,000	0.8929	1,78,580
31 Mar 2019	2,00,000	0.7972	1,59,440
31 Mar 2020	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 2018	4,80,380	57,646	(2,00,000)	3,38,026
31 Mar 2019	3,38,026	40,563	(2,00,000)	1,78,589
31 Mar 2020	1,78,589	21,411*	(2,00,000)	

*Difference is due to approximation

ROU Asset Schedule:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
01 Apr 2017	4,80,380	4,80,380	-	-	-
31 Mar 2018	3,20,254	3,38,026	-	-	-
01 Apr 2018	3,20,254	3,38,026			(17,772)
31 Mar 2019	1,60,127	1,78,589	40,563	1,60,127	-
01 Apr 2019	1,60,127	1,78,589	-	-	-
31 Mar 2020	-	-	21,411	1,60,127	-

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Ind AS 116 is applicable for the financial year beginning from 1st April 2019. Hence, 2019-20 is the first year of adoption and using Full retrospective method the comparative for 2018-19 needs to be restated and 1st April 2018 (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 1 April 2018 by taking values from the above table, with the difference between the ROU asset and lease liability going to retained earnings as of 1 April 2018 (assuming that only the 2018-19 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 2018.			

The following journal entries would be recorded during 2018-2019:

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 2019-2020:

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 (Alternative 1):
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., 01 April 2019 to 31 March 2020 in this case) discounted using the incremental borrowing rate as of the date of initial **application being 01 April 2019** (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., 01 April 2017 in this case) by using incremental borrowing rate as at transition date. Let us first calculate the Lease Liability and ROU Asset as follows:

Year	Payments (Cash flows)	Discounting Factor @10%	Discounted Cash flows / Present Value
31 Mar 2020	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 2020	1,81,820	18,182	(2,00,000)	-

ROU Asset Schedule:

Year	Opening Balance	Depreciation	Closing Balance
31 Mar 2020	1,65,790***	(1,65,790)	-

***(Refer note no 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
01 Apr 2017	4,97,360*	4,97,360**	-	-	-
31 Mar 2018	3,31,574	3,47,096	49,737	1,65,786	-
31 Mar 2019	1,65,787	1,81,806	34,710	1,65,787	(16,019)
01 Apr 2019	1,65,787	1,81,806	-	-	-
31 Mar 2020	-	-	18,194	1,65,787	-

*(Refer note no 1)

**(Refer note no 2)

At adoption, the lessee would record the ROU asset and lease liability at the 1 April 2019 by taking values from the above table, with the difference between the ROU asset and lease liability going to retained earnings as of 1 April 2019.

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 1 April 2019.			

The following journal entries would be recorded during 2019-2020:

Interest expense	Dr.	18,182	
To Lease Liability			18,182
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.			

Note 1:

Calculation of Present value of lease payments as at commencement date i.e., 01/04/2017

Year	*Payments (Cash flows)*	*Discounting Factor @10%*	*Discounted Cash flows / Present Value*
31 Mar 2018	2,00,000	0.9091	1,81,820
31 Mar 2019	2,00,000	0.8264	1,65,280
31 Mar 2020	2,00,000	0.7513	1,50,260
	6,00,000		**4,97,360**

Lease Liability Schedule:

Year	*Opening*	*Interest Expense @ 10%*	*Payments*	*Closing*
31 Mar 2018	4,97,360	49,736	(2,00,000)	3,47,096
31 Mar 2019	3,47,096	34,710	(2,00,000)	1,81,806
31 Mar 2020	1,81,806	18,194*	(2,00,000)	-

*Difference is due to approximation

Calculation of ROU asset as at transition date i.e., April 01, 2019

Year	Opening	Depreciation	Closing
31 Mar 2018	4,97,360	(1,65,786)	3,31,574
31 Mar 2019	3,31,574	(1,65,787)	1,65,787
31 Mar 2020	1,65,787	(1,65,787)	-

Modified Retrospective Approach (Alternative 2):

Under the modified retrospective approach (Alternative 2), the lease liability is also measured based on the remaining lease payments (i.e., from the date of transition to the lease end date, viz., 01 April 2019 to 31 March 2020 in this case) discounted using the incremental borrowing rate as of the date of initial **application being 01 April 2019** (i.e. 10% p.a. in this case). The carrying amount of the ROU asset is an amount equal to the carrying amount of the lease liability on the date of initial application as there are no prepayments or accrual items and hence, no impact on retained earnings as on the transition date.

Let us first calculate the Lease Liability and ROU Asset as follows:

Year	Payments (Cash flows)	Discounting Factor @ 10%	Discounted Cash flows / Present Value
31 Mar 2020	2,00,000	0.9091	1,81,820
	2,00,000		**1,81,820**

Lease Liability Schedule:

Year	Opening	Interest Expense	Payments	Closing
31 Mar 2020	1,81,820	18,182	(2,00,000)	-

ROU Asset Schedule:

Year	Opening	Depreciation	Closing
31 Mar 2020	1,81,820	(1,81,820)	-

The following table shows account balances under this method beginning at lease commencement:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
01 Apr 2019	1,81,820	1,81,820	-	-	-
31 Mar 2020	-	-	18,182	1,81,820	-

At adoption, the lessee would record the ROU asset and lease liability at the 1 April 2019 by taking values from the above table and there will be no impact on retained earnings on the transition date being 1 April 2019 since under this alternative, ROU Asset is equal to the Lease Liability.

ROU Asset	Dr.	1,81,820	
To Lease Liability			1,81,820
To initially recognise the lease-related asset and liability as of 1 April 2019.			

The following journal entries would be recorded during 2019-20:

Interest expense	Dr.	18,182	
To Lease Liability			18,182
To record interest expense and accrete the lease liability using the interest method.			
Depreciation expense	Dr.	1,81,820	
To ROU Asset			1,81,820
To record depreciation expense on the ROU asset.			

Lease Liability	Dr.	2,00,000	
To Cash			2,00,000
To record lease payment.			

A summary of the lease contract's accounting (assuming there are no changes due to reassessments) is, as follows:

Particulars	*Full Retrospective Approach*	*Modified Retrospective Approach (Alternative 1)*	*Modified Retrospective Approach (Alternative 2)*
Opening balance sheet impact as on 1 April 2019:			
ROU Asset	1,60,126	1,65,787	1,81,820
Lease Liability	1,78,589	1,81,806	1,81,820
Period ended 31 March 2020 activity:			
Cash lease payments	2,00,000	2,00,000	2,00,000
Lease payments recognised:			
Interest expense	21,411	18,194	18,182
Depreciation expense	1,60,127	1,65,787	1,81,820
Total periodic expense	1,81,538	1,83,981	2,00,002

47 Revised consideration is substantially the same as or less than the original consideration
Retailer Q leases a store in a large retail mall. The rent payable is ` 1,00,000 per month. As a result of the COVID-19 pandemic, Q agrees with the lessor to defer the rent originally due in the months April, 2020 to June, 2020.

As part of this agreement, the rent for the period January, 2021 to March 2021 will be increased by ` 1,10,000 per month, which compensates the lessor for the deferred rent as adjusted for the time value of money.
Whether the rent deferral is eligible for the practical expedient if the other conditions are met?
Solution:
The rent deferral satisfies the criteria to apply the practical expedient because:
(1) It is a rent concession occurring as a direct consequence of the pandemic;
(2) Increase in rentals during January, 2021 to March 2021 compensates for the time value of money;
(3) Rent deferral reduces lease payments originally due on or before 30 June 2021; and
(4) There is no substantive change to other terms and conditions of the lease.
Hence, Q considers applying the practical expedient.

48 - Consider only payments that were originally due on or before 30 June, 2021
Lessee P operates a chain of restaurants and leases several outlets. As a result of COVID-19 pandemic, P agrees a rent deferral with the lessor.
Under the terms of the rent deferral, rent originally due in the period July 2020 to December 2020 will be added to the rent due in the period July 2021 to December 2021.
Whether the rent deferral is eligible for the practical expedient if the other conditions are met?
Solution:
The rent deferral satisfies the criteria to apply the practical expedient because:
(1) It is a rent concession occurring as a direct consequence of the pandemic;
(2) Recovery of rentals during July, 2021 to December, 2021 is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
(3) Rent deferral reduces lease payments originally due on or before 30 June 2021; and
(4) There is no substantive change to other terms and conditions of the lease.
Therefore, P concludes that the rent deferral meets the ‘payments due’ eligibility criterion.

49 - Reduction in rent payments that extends beyond 30 June 2021
Lessee T leases office buildings from a lessor. As a result of the COVID-19 pandemic, in September 2020, T agrees a rent concession with the lessor, under which the monthly rent will be reduced by 50% per month for the 12 months commencing 1 October 2020.
Whether the rent deferral is eligible for the practical expedient if the other conditions are met?
Solution:
The rent deferral does not satisfies the criteria to apply the practical expedient because out of the listed eligibility criteria given in para 46B of Ind AS 116, rent deferral reduces lease

payments starting from October, 2020 and reduction will continue till September, 2021 which is beyond 30 June 2021.
Therefore, T is not permitted to apply the practical expedient.

50- Deferral of rent payments by extending the lease term
A lessee is granted a rent concession by the lessor whereby the lease payments for the period April 2020 to June 2020 are deferred. Three months are added to the end of the lease term at the same monthly rent, and

the lessee repays the deferred rent during those additional months. The rent concession is a direct consequence of COVID-19.
Whether the rent deferral is eligible for the practical expedient?
Solution:
The lessee considers applying the practical expedient. In considering whether this rent concession is eligible for the practical expedient, the lessee notes the following.
Firstly, the revised consideration in the lease is substantially the same as the original – i.e. the condition in paragraph 46B(a) of Ind AS 116 is met.
Secondly, the rent concession only reduces lease payments originally due in 2020 – i.e. before 30 June 2021 – so the condition in paragraph 46B(b) of Ind AS 116 is met.
Thirdly, there is a change in the lease term – an extension by three months.
There is no explicit guidance on what is considered 'substantive'. Judgement will need to be applied, considering both qualitative and quantitative factors. The lessee assesses that three-month extension at the end of the lease term with substantially the same lease payments, would not constitute a substantive change. Hence, the condition in paragraph 46B(c) of Ind AS 116 is met. Since, the rent concession is a direct consequence of COVID-19 and all three conditions in paragraph 46B of Ind AS 116 are met, the lessee concludes that the rent concession is eligible for application of practical expedient.

51- Forgiveness of lease payments
Lessee Z entered into a lease contract with Lessor L to lease 1,500 sqm of retail space for five years. The lease commenced on 1 April 2018 and the rental payments are 100,000 payable quarterly in advance on 1 April, 1 July, 1 October and 1 January. Z's incremental borrowing rate at commencement of the lease is 5% (assume that the interest rate implicit in the lease cannot be readily determined). There are no initial direct costs, lease incentives or dismantling costs. Z's business is severely impacted by the COVID-19 pandemic and L and Z negotiate a rent concession. On 1 June 2020, L agrees to provide Z with an unconditional rent concession that allows Z to forego payment of its rent due on 1 July – i.e. L forgives Z the rent payment of 100,000 due on 1 July.
What will be the accounting treatment in the books of lessee for rent concessions assuming that it is eligible for practical expedient?

Solution:
Z determines that the rent concession is eligible for the practical expedient.
Applying the practical expedient, Z should account for the forgiveness of rent as a negative variable lease payment. The rent concession is unconditional, so the event that triggers the variable lease payment is the agreement between Z and L for the rent concession on 1 June 2020.
Therefore, Z accounts for the rent concession as a negative variable lease payment on 1 June.
Assuming that there are no other changes to the lease, Z continues to use the retail space and the right-of-use asset is not impaired. The lease accounting entries will be as follows:
- recognise the rent concession as a variable lease payment in profit or loss (i.e. record a debit to the lease liability and a corresponding credit in the income statement); and
- continue to accrue interest on the lease liability at the unchanged incremental borrowing rate of 5% (i.e. record a debit to interest expense and a corresponding credit to the lease liability).

After accounting for the impact of the rent concession, Z's lease liability represents the present value of all future lease payments owing to L, discounted at the unchanged incremental borrowing rate. Z has effectively derecognised the portion of the lease liability that has been extinguished by the forgiveness of the quarterly lease payment due on 1 July 2020.
In addition, Z continues to depreciate the carrying amount of the right-of-use asset, which is unchanged as a result of the rent concession.

QUESTIONS

1. A lessee enters into a ten-year contract with a lessor (freight carrier) to transport a specified quantity of goods. Lessor uses rail wagons of a particular specification, and has a large pool of similar rail wagons that can be used to fulfil the requirements of the contract. The rail wagons and engines are stored at lessor's premises when they are not being used to transport goods. Costs associated with substituting the rail wagons are minimal for lessor.
Whether the lessor has substantive substitutions rights and whether the arrangement contains a lease?
Answer:
In this case, the rail wagons are stored at lessor's premises and it has a large pool of similar rail wagons and substitution costs to be incurred are minimal. Thus, the lessor has the practical ability to substitute the asset. If at any point, the same become economically beneficial for the lessor to substitute the wagons, he can do so and hence, the lessor's substitution rights are substantive and the arrangement does not contain a lease.

2. Customer M enters into a 20-year contract with Energy Supplier S to install, operate and maintain a solar plant for M's energy supply. M designed the solar plant before it was constructed – M hired experts in solar energy to assist in determining the location of the plant and the engineering of the equipment to be used. M has the exclusive right to receive and the obligation to take any energy produced. Whether it can be established that M is having the right to control the use of identified asset?
Answer:
In this case, the nature of the solar plant is such that all of the decisions about how and for what purpose the asset is used are predetermined because:
– the type of output (i.e. energy) and the production location are predetermined in the agreement; and
– when, whether and how much energy is produced is influenced by the sunlight and the design of the solar plant.
Because M designed the solar plant and thereby predetermined any decisions about how and for what purpose it is used, M is considered to have the right to direct the use. Although regular maintenance of the solar plant may increase the efficiency of the solar panels, it does not give the supplier the right to direct how and for what purpose the solar plant is used. Hence, M is having a right to control the use of asset.

3. A Customer enters into a ten-year contract with a Company (a ship owner) for the use of an identified ship. Customer decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent the company from sailing the ship into waters at a high risk of piracy or carrying explosive materials. The company operates and maintains the ship, and is responsible for safe passage.

Does the customer has the right to direct how and for what purpose the ship is to be used throughout the period of use and whether the arrangement contains a lease?

Answer:

The customer has the right to direct the use of the ship because the contractual restrictions are merely protective rights that protect the company's investment in the ship and its personnel. In the scope of its right of use, the customer determines how and for what purpose the ship is used throughout the ten-year period because it decides whether, where and when the ship sails, as well as the cargo that it will transport.

The customer has the right to change these decisions throughout the period of use and hence, the contract contains a lease.

4. A Lessee enters into a ten-year lease contract with a Lessor to use an equipment. The contract includes maintenance services (as provided by lessor). The Lessor obtains its own insurance for the equipment. Annual payments are ` 10,000 (` 1,000 relate to maintenance services and ` 500 to insurance costs).

The Lessee is able to determine that similar maintenance services and insurance costs are offered by third parties for ` 2,000 and ` 500 a year, respectively. The Lessee is unable to find an observable stand-alone rental amount for a similar equipment because none is leased without related maintenance services provided by the lessor.

How would the Lessee allocate the consideration to the lease component?

Answer:

The observable stand-alone price for maintenance services is ` 2,000. There is no observable stand-alone price for the lease. Further, the insurance cost does not transfer a good or service to the lessee and therefore, it is not a separate lease component.

Thus, the Lessee allocates ` 8,000 (` 10,000 – ` 2,000) to the lease component.

5. A Lessee enters into a non-cancellable lease contract with a Lessor to lease a building. Initially, the lease is for five years, and the lessee has the option to extend the lease by another five years at the same rental. To determine the lease term, the lessee considers the following factors:

Answer::

After considering all the stated factors, the lessee concludes that it has a significant economic incentive to extend the lease.

Thus, for the purpose of lease accounting under Ind AS 116, the lessee uses a lease term of ten years.

♦ Market rentals for a comparable building in the same area are expected to increase by 10% over the ten-year period covered by the lease. At inception of the lease, lease rentals are in accordance with current market rents.

♦ The lessee intends to stay in business in the same area for at least 20 years.

♦ The location of the building is ideal for relationships with suppliers and customers.

What should be the lease term for lease accounting under Ind AS 116?

6. A Lessee enters into a lease of a five-year-old machine. The non-cancellable lease term is 15 years. The lessee has the option to extend the lease after the initial 15-year period for optional periods of 12 months each at market rents.

To determine the lease term, the lessee considers the following factors:

♦ **The machine is to be used in manufacturing parts for a type of plane that the lessee expects will remain popular with customers until development and testing of an improved model are completed in approximately 15 years.**

♦ **The cost to install the machine in lessee's manufacturing facility is significant.**

♦ **The non-cancellable term of lessee's manufacturing facility lease ends in 19 years, and the lessee has an option to renew that lease for another twelve years.**

♦ **Lessee does not expect to be able to use the machine in its manufacturing process for other types of planes without significant modifications.**

♦ **The total remaining life of the machine is 30 years.**

What should be the lease term for lease accounting under Ind AS 116?
Answer:
The lessee notes that the terms for the optional renewal provide no economic incentive and the cost to install is significant. The lessee has no incentive to make significant modifications to the machine after the initial 15-year period. Therefore, the lessee does not expect to have a business purpose for using the machine after the non-cancellable lease term of 15 years.
Thus, the lessee concludes that the lease term consists of the 15-year non-cancellable period only.

7. A Company leases a manufacturing facility. The lease payments depend on the number of operating hours of the manufacturing facility, i.e., the lessee has to pay ` 2,000 per hour of use. The annual minimum payment is ` 2,00,00,000. The expected usage per year is 20,000 hours.
Whether the said payments be included in the calculation of lease liability under Ind AS 116?
Answer:
The said lease contains in-substance fixed payments of ` 2,00,00,000 per year, which are included in the initial measurement of the lease liability under Ind AS 116.
However, the additional ` 2,00,00,000 that the company expects to pay per year are variable payments that do not depend on an index or rate and, thus, are not included in the initial measurement of the lease liability but, are expensed when the over-use occurs.

PAST EXAMINATION PAPERS, MOCK TEST PAPERS (MTP) & REVISION TEST PAPER (RTP)

1. The following facts are given for the Sky Ltd:
-- A Lease which is non-cancellable was initiated on 1st April 2014 for equipment with an expected useful life of five years.
--- Three payments are due to the 'Lessor' of an amount of Rs. 1,02,000 per year beginning 31st March 2015. Included in the lease payments is a sum of Rs. 2,000 tobe paid annually by the 'Lessee' for insurance.
-- The 'Lessee' guarantees Rs. 20,000 residual value on 31st March 2017 to the Lessor.
--- Irrespective of the Rs. 20,000 residual value guarantee, the leased asset is expected to have only Rs. 2,000 residual value to the lessee at the end of the lease term.
-- The Lessee company depreciates similar equipment that it owns on a straight line basis.
--- The fair value of the equipment at 1st April 2014 is Rs. 2,64,000.

--- The Lessor's implicit rate is 10%. This fact is known to the Lessee company.
As per the provisions of Ind AS 17 'Leases' –
(i) How should Lessee Company classify and record the lease transaction at its inception on 1st April 2014? Indicate journal entry also.
(ii) What are the journal entries the Lessee is required to make to record the lease payments and the interest, insurance and depreciation expenses on 31st March 2015 through 31st March 2017?
(iii) What entry should the Lessee make on 31st March 2017 to record the guaranteed residual value payment (assuming estimated residual value of Rs. 2,000) and to clear the lease related accounts from the lessee's books?
(iv) What would be the Current and Non-current classification in the books of Lessee in the first year?
(Discount factor: 2015: 0.909; 2016: 0.826; 2017: 0.751)
[MAY 2018 ? 12 Marks]
Answer:
(i) The Lessee company should record the asset as a finance lease since the risk and reward is transferred. Lessee has guaranteed to the lessor, the residual value of Rs. 20,000, in spite of the fact that the estimated residual value of the asset will be Rs. 2,000. Further the lease payments substantially cover the fair value of leased asset as per calculation given below.

Calculation of Present value of Minimum Lease Payments (MLP) at implicit rate of 10%

Year	Discount Factor	Minimum Lease payments (see note below)	Present Value of MLP
Annual Lease Rentals			
31st March, 2015	0.909	1,00,000	90,900
31st March, 2016	0.826	1,00,000	82,600
31st March, 2017	0.751	1,00,000	75,100
Guaranteed Residual Value			
31st March, 2017	0.751	20,000	15,020
		Total	2,63,620

Note: The contingent rent, taxes, insurance, maintenance expenses etc. if paid by the lessee to the lessor, then it does not form part of the minimum lease payments and will be expensed when incurred. Insurance expense is a kind of reimbursement from lessee to lessor. Hence in the above case, for calculation of present value of minimum lease payments only lease rental of Rs. 1,00,000 has been considered. At the time of initial recognition, the lessee will recognise the leasehold asset at lower of below:

Present value of MLP	2,63,620
Fair value of leased asset	2,64,000
Hence, leasehold asset will be recognised at	2,63,620

Accounting entry for initial recognition would be :

Leasehold equipment Dr. 2,63,620
To Leasehold obligation 2,63,620
(ii) Lease rentals should split between principal portion of leasehold obligation and finance costs as follows:

Year	Opening balance	Payments	Finance costs @ 10%	Reduction in liability	Closing obligation
	(a)	(b)	(a) x 10% = (c)	(b)-(c)=(d)	(a)-(d) = (e)
1st April, 2014	-				2,63,620
31st March, 2015	2,63,620	1,00,000	26,362	73,638	1,89,982
31st March, 2016	1,89,982	1,00,000	18,998	81,002	1,08,980
31st March, 2017	1,08,980	1,00,000	11,020*	88,980	20,000

* Difference is due to approximation.

In the books of Lessee

Journal Entries (at the time of subsequent measurement)

Date	Particulars		Dr. ₹	Cr. ₹
31st March 2015	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	73,638	
	Interest Expenses	Dr.	26,362	
	Depreciation	Dr.	87,207	
	To Cash			1,02,000
	To Accumulated Depreciation			87,207
31st March 2016	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	81,002	
	Interest Expenses	Dr.	18,998	
	Depreciation	Dr.	87,207	
	To Cash			1,02,000
	To Accumulated Depreciation			87,207
31st March 2017	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	88,980	
	Interest Expenses	Dr.	11,020	
	Depreciation	Dr.	87,206	
	To Cash			1,02,000
	To Accumulated Depreciation			87,206

(iii) Entries at the end of lease period

Leasehold Obligation Account	Dr.	20,000	
Accumulated Depreciation Account	Dr.	2,61,620	
To Cash Account			18,000
To Leasehold Equipment Account			2,63,620

(iv) The Current and Non-current Classification at the end of year 1 in the books of Lessee

Balance Sheet (An extract)

	₹
ASSETS	
Non-current Asset	
Leasehold Asset	
Gross Block	2,63,620
Accumulated Depreciation	(87,207)
LIABILITIES	
Non-current Liability	
Leasehold Obligation (payable after 12 months from the reporting date)	1,08,980
Current Liability	
Leasehold Obligation (payable within 12 months from the reporting date)	81,002

2. 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*

[NOV 2019 - 4 Marks]

Answer:

The above security deposit is an interest free deposit redeemable at the end of lease term for Rs. 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

Particulars		Amount	Amount
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.

Following table shows the amortisation of security deposit based on discount rate:

Year	Opening balance (A)	Interest @ 12% (B)	Closing balance (A) = (A) + (B)
1	11,34,854	1,36,183	12,71,037
2	12,71,037	1,52,524	14,23,561
3	14,23,561	1,70,827	15,94,388
4	15,94,388	1,91,327	17,85,715
5	17,85,315	2,14,685*	20,00,000

*Difference is due to approximation.

For – Year 1

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,36,183	
To Interest income			1,36,183
Lease expense (8,65,146 / 5 years)	Dr.	1,73,029	
To Prepaid lease expenses			1,73,029

For – Year 2

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,52,524	
To Interest income			1,52,524
Lease expense (8,65,146 / 5 years)	Dr.	1,73,029	
To Prepaid lease expenses			1,73,029

For – Year 3

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,70,827	
To Interest income			1,70,827
Lease expense (8,65,146 / 5 years)	Dr.	1,73,029	
To Prepaid lease expenses			1,73,029

For – Year 4

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,91,327	
To Interest income			1,91,327
Lease expense (8,65,146 / 5 years)	Dr.	1,73,029	
To Prepaid lease expenses			1,73,029

For – Year 5

Particulars		Amount	Amount
Security deposit A/c	Dr.	2,14,685	
To Interest income			2,14,685
Lease expense (8,65,146 / 5 years)	Dr.	1,73,030	
To Prepaid lease expenses			1,73,030

Journal entry for realisation of security deposit at the end of 5th year

Particulars		Amount	Amount
Bank A/c	Dr.	20,00,000	
To Security deposit Ac			20,00,000

3. UK Ltd. has installed Wind Turbine Equipment at Rajasthan to generate electricity for which it has entered into a Power Purchase Agreement (PPA) with the State Government. The terms of the PPA are as follows:

- The PPA is for an initial period of 3 years, renewable at mutual terms and conditions. The Management estimates the useful life of such project around 20 years.

- The price per unit is fixed for a period of one year and is renewed every year as per the State Government policy.

- The Company's Management is of the view that the power generated by the project will be completely sold to the State Government and not to any third party. However, there is no such restriction prescribed in the PPA.
- Currently the Company has classified the Wind Turbine Equipment as part of the Property, Plant & Equipment and is charging depreciation on the same.

For the above PPA, which condition, as per the applicable Ind AS, is not relevant in determining whether an arrangement is or contains a lease?
(A) Use of Specific Assets;
(B) Right to Operate the assets;
(C) Right to control the Physical access;
(D) Price is contractually fixed by the purchaser;
UK Ltd. also wants you to give your suggestion on the accounting of the above arrangement under applicable Ind AS.
[MTP - OCTOBER 2018 - 10 MARKS]
Answer:
As per paragraph 6 of Appendix C to Ind AS 17, "Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:
(a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and
(b) the arrangement conveys a right to use the asset."
In the present case, the PPA with the State Government can be fulfilled by the use of the Wind Turbine Equipment which is a specific asset. Accordingly, condition (a) above is satisfied.
With respect to condition (b), paragraph 9 of Appendix C to Ind AS 17 provides as below:
"An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:
(a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
(b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
(c) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output." Accounting of the PPA with the State Government under applicable Ind AS:
Continuing the rationale to the above, in the present case, criteria (c) above is fulfilled since:
• The entire output of Wind Turbine Equipment is estimated to be consumed by the purchaser i.e. the State Government
• The price paid by the State Government includes an element of revision in price every year which makes the price for the output variable.
Accordingly, the PPA with the State Government contains an embedded lease arrangement.
Further to determine whether the lease arrangement is an operating lease or a finance lease, paragraph 10 of Ind AS 17 provides certain examples (that individually or in combination would normally lead to a lease being classified as a finance lease) which can be analysed as below:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term – Not fulfilled, as the ownership is not transferred to the State Government.
(b) the lessee has the option to purchase the asset after completion of the agreement – Not fulfilled, as the State Government doesn't have an option to purchase the Wind Turbine Equipment after the completion of PPA.

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred - Not fulfilled, as the PPA is for 3 years whereas the useful life of the Wind Turbine Equipment project is 20 years. (d)
(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset – Cannot be determined since the price per unit is not fixed for the entire tenure of the PPA. Definition of the 'inception of the lease' (given in para 4 of Ind AS 17) inter alia states that in the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined. This implies that the given PPA is not a finance lease.
(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications - Not fulfilled, as the asset is not specialised in nature.
Conclusion:
Based on the evaluation above, PPA with the State Government shall be accounted by UL Ltd. as "Property, plant and equipment under an operating lease arrangement".

4. QA Ltd. sold a property on 1st April, 2016 for Rs. 48 crores to raise cash for the future expansion of its business. The carrying value of the property on 1st April, 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. The estimated future life of the property as on 1st April, 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	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th
Rent in Rs. crores	1.00	1.20	1.30	1.40	1.50	1.60	1.70	1.80	1.90	2.00

The lease agreement is for the period of 10 years, however the same is cancellable after initial period of 5 years. The 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. The Company wants you to suggest the accounting treatment of the above lease transaction as per applicable Ind AS.
[MTP MARCH 2019 8 MARKS]
Answer:
First of all, one has to decide whether the sale and leaseback transaction results in an operating or finance lease. To determine whether the lease arrangement is an operating lease or a finance lease, paragraph 10 of Ind AS 17 provides certain examples (that individually or in combination would normally lead to a lease being classified as a finance lease) which can be analysed as below:
(a) the lease transfers ownership of the asset to the lessee by the end of the lease term - Not fulfilled, as the ownership is not transferred to QA Ltd. at the end of the lease.

(b) the lessee has the option to purchase the asset after completion of the agreement – Not fulfilled, as QA Ltd. doesn't have an option to purchase the property at the end of the lease.
(c) the lease term is for the major part of the economic life of the asset even if title is not transferred - Not fulfilled, as the lease is for 10 years whereas the useful life of the Property is 40 years.
(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset - Cannot be determined since the interest rate implicit in the lease is not given in the question. Since the rentals in absolutevalue is also not equal to fair value of the property, its fair value will definitely will be less.
(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications - Not fulfilled, as the asset is not specialised in nature.

Conclusion: Based on the evaluation above, Sale and leaseback transaction will result in an operating lease.
Suggested Accounting Treatment
When sale and leaseback transaction results in an operating lease, para 61 of Ind AS 17 will apply which inter alia states that if the sale price of sale and leaseback transaction is below fair value, any profit or loss shall be recognised immediately except that, if the loss is compensated for by future lease payments at below market price. If the loss is compensated for by future lease payments at below market price, the difference between carrying value and the sale price shall be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.
Here the market rentals are expected to be Rs. 8 crore for first 5 years and Rs. 11 crores while the lease rentals fixed as per the agreement is Rs. 6.4 crore for first 5 years and Rs. 9 crore for next five years. This implies that the loss in sale price is compensated for by future lease payments at below market price. Accordingly, the difference between carrying value and the sale price i.e. Rs. 2 crore (carrying value Rs. 50 crore – sale price Rs. 48 crore) shall be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.
Alternatively, the difference between carrying value and the sale price i.e. Rs. 2 crore (carrying value Rs. 50 crore – sale price Rs. 48 crore) shall be considered as prepayment which will compensated by the reduced rentals for the whole lease term. The amount will be considered as pre-payment.
The total lease rentals over the whole term are Rs. 15.4 crore (sum of annual rental from 1 to 10 years) Rental expenses of Rs. 1.54 crore (15.4 cr x 1/10) will be recognized in profit or loss for the year ended 31st March, 2017.
A proportion of the apparent loss on sale will be recognized in profit or loss for the year ended 31st March, 2017 The amount recognized will be Rs. 0.13 crore [Rs. 2 crore x (1/15.4)]
The closing pre-payment will be Rs. 1.33 crore (2 – 0.13 + 1 (rent paid) – 1.54 (rent charged).

5. **On 1st April, 2017, J Ltd. began to lease a property on a 20-year lease. J Ltd. paid a lease premium of Rs. 30,00,000 on 1st April, 2017. The terms of the lease required J Ltd. To make annual payments of Rs. 500,000 in arrears, the first of which was made on 31st March, 2018.**
On 1st April, 2017 the fair values of the leasehold interests in the leased property were as follows:
– Land Rs. 30,00,000.
– Buildings Rs. 45,00,000.
There is no opportunity to extend the lease term beyond 31st March, 2037. On 1st April, 2017, the estimated useful economic life of the buildings was 20 years.

The annual rate of interest implicit in finance leases can be taken to be 9.2%. The present value of 20 payments of 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 J Ltd. for the year ended 31st March, 2018.
[MTP - APRIL 2019 - 12 MARKS]
Answer:

Statement of Profit and Loss

	Rs. '000
Operating lease rental	(260)
Amortisation of asset leased on finance lease	(225)
Finance cost relating to finance leases	(248·4)

Balance Sheet

	Rs. '000
Property, plant and equipment	4,275
Prepaid operating lease rentals:	
In non-current assets	1,080
In current assets	60
Lease liability:	
In non-current liabilities	(2,592·1)
In current liabilities	(56·3)

Explanation and supporting calculations:
Separate decisions are made for the land and buildings elements of the lease.
1) The land lease is an operating lease because land has an indefinite useful economic life and the lease term is 20 years.
The lease premium and annual rentals are apportioned 40% (3/7·5) to the land element.
Therefore, the premium for the land element is Rs. 12,00,000 (Rs. 30,00,000 x 40%) and the annual rentals for the land element Rs. 200,000 (Rs. 500,000 x 40%). This makes the total lease payments Rs. 52,00,000 (Rs. 12,00,000 + 20 x Rs. 200,000).
The rental expense for the current period is Rs. 2,60,000 (Rs. 52,00,000 x 1/20).
The amount paid in the current period regarding the land element is Rs. 14,00,000 (Rs. 12,00,000 + Rs. 200,000). Therefore, there is a prepayment of Rs. 1,140,000 (Rs. 14,00,000 –Rs. 2,60,000) at the year end. In the next 19 periods, the rental expense will be Rs. 260,000 and the rental payment will be Rs. 200,000. Therefore Rs. 60,000 of the rental prepayment will reverse in each period. This means that Rs. 60,000 of the prepayment will be a current asset, and the balance a noncurrent asset.
2) The buildings element of the lease will be a finance lease because the lease term is for substantially all of the useful life of the buildings.
The premium apportioned to the buildings element is Rs. 18,00,000 (Rs. 30,00,000 x 60%) and the annual rental apportioned to the buildings is Rs. 300,000 (Rs. 500,000 x 60%).
The initial carrying value of the leased asset in PPE is Rs. 45,00,000 (Rs. 18,00,000 + Rs. 300,000 x 9).

Therefore, the annual depreciation charge is Rs. 2,25,000 (Rs. 45,00,000 x 1/20) and the closing PPE = Rs. 42,75,000 (Rs. 45,00,000 – Rs. 2,25,000).

The finance cost in respect of the finance lease and the closing non-current liability is shown in the working below.
The closing current liability is Rs. 56,300 (Rs. 26,48,400 – Rs. 25,92,100).
Lease liability profile – working

Year ended 31st March	Bal b/f Rs.'000	Finance Cost @ 9.2% Rs. '000	Lease rental payment Rs. '000	Bal c/f Rs. '000
2018	*2,700	248·4	(300)	2,648·4
2019	2,648·4	243·7	(300)	2,592·1

* Balance brought forward is equal to net of lease premium of Rs. 18,00,000 ie. Rs. 45,00,000 – Rs. 18,00,000 = Rs. 27,00,000.

6. X Ltd. sold JCB Machine having WDV of Rs. 50 Lakhs to Y Ltd. for Rs. 60 Lakhs and the same JCB was leased back by Y Ltd. to X Ltd. The lease is operating lease. Comment according to relevant Ind AS if:
(a) Sale price of Rs. 60 Lakhs is equal to fair value.
(b) Fair value is Rs. 50 Lakhs and sale price is Rs. 45 Lakhs.
(c) Fair value is Rs. 55 Lakhs and sale price Rs. 62 Lakhs.
(d) Fair value is Rs. 45 Lakhs and sale price is Rs. 48 Lakhs.
[MTP OCTOBER 2019 5 MARKS]
Answer:
As per Ind AS 17, Leases:
(a) Since sale price is equal to fair value, profit of Rs. 10 lakhs (i.e., Rs. 60 lakhs – Rs. 50 lakhs) is to be recognised as income immediately.
(b) Assuming, the loss is not compensated by future lease payments at below market price, the loss of Rs. 5 lakhs (i.e., Rs. 50 lakhs – Rs. 45 lakhs) should be recognised immediately in the profit and loss account. In case, the loss is compensated by future lease payments at below market price, then the loss of Rs. 5 lakhs should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.
(c) Profit of Rs. 7 lakhs (i.e., Rs. 62 lakhs – Rs. 55 lakhs) should be deferred and amortised over the period for which the asset is expected to be used. Profit of Rs. 5 lakhs (i.e., Rs. 55 lakhs – Rs. 50 lakhs) should be recognised immediately.
(d) Rs. 3 lakhs (i.e., Rs. 48 lakhs – Rs. 45 lakhs) should be deferred and amortised over the period for which the asset is expected to be used. Loss of Rs. 5 lakhs (i.e., Rs. 50 lakhs – Rs. 45 lakhs) should be recognised immediately in the profit and loss account.

7. ABC Ltd. has entered into an operating lease agreement for 5 year, for taking a building on lease for Rs. 5,00,000 p.a. As per the agreement the lessor will charge escalation in the lease @ 20% p.a. However, the general inflation in the country expected for the aforesaid period is around 7% p.a.
Examine whether the lease payment will be straight lined or not as per Ind AS 17 in the book of ABC Ltd.? If yes, should the entire 20% p.a. escalation in lease rent be straightlined over a period of 5 years or only the difference which exceeds the expected inflation rate will be straight-lined?
[RTP MAY 2018]

Answer:
As per paragraph 33 of Ind AS 17, lease payments shall be straight-lined over the period of lease unless
Either another systematic basis is more representative of the time pattern of the user's benefit even if the payments to the lessors are not on that basis
or
the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then lease payments shall be straight-lined. Judgement would be required to be made as per the facts and circumstances of each case to determine whether the payments to the lessor are structured to increase in line with expected general inflation. Therefore, it is required to evaluate the lease agreement to ascertain the real intention and attributes of escalation in lease payments, i.e., whether the intention of such escalation is to compensate for expected general inflation or any other factors. It is not necessary that the rate of the escalation of lease payments should exactly be equal to the expected general inflation. If the actual increase or decrease in the rate of inflation is not materially different as compared to the expected rate of inflation under the lease agreement, it is not required to straight-line the lease payments. However, the purpose of such escalation should only be to compensate the expected general inflation rate.
In the given case, the increase of 20% p.a. in lease rentals does not appear to have any link with general inflation which is expected to be 7%. Accordingly, the entire lease payments should be straight-lined since the increase is not a compensation for inflation.

8. A Ltd. prepares its financial statements for the period ending on 31st March each year. The financial statements for the year ended 2017-2018 is under preparation. The following events are relevant to these financial statements: On 1st April, 2016, A Ltd. purchased an asset for Rs. 20,00,000. The estimated useful life of the asset was 10 years, with an estimated residual value of zero. A Ltd. Immediately leased the asset to B Ltd. The lease term was 10 years and the annual rental payable in advance by B Ltd., was Rs. 27,87,000. A Ltd. incurred direct costs of Rs. 2,00,000 in arranging the lease. The lease contained no early termination clauses and responsibility for repairs and maintenance of the asset rest with B Ltd. for the duration of the lease. The annual rate of interest implicit in the lease is 8%. At an annual discount rate of 8% the present value of Rs. 1 receivable at the start of years 1–10 is Rs. 7.247. Examine and show how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 2018 as per Ind AS. [RTP NOV 2018]
Answer:
All numbers in Rs. in 000.
The lease of the asset by A Ltd. to B Ltd. would be regarded as a finance lease because the risks and rewards of ownership have been transferred to B Ltd. Evidence of this includes the lease is for the whole of the life of the asset and B Ltd. being responsible for repairs and maintenance. As per para 36 of Ind AS 17, since the lease is a finance lease and A Ltd. is the lessor, A Ltd. Will recognise a financial asset ie. as a receivable at an amount equal to the 'net investment in finance leases'. The amount recognised will be the present value of the minimum lease payments which will be 20,197.39 ie. 2,787 x 7.247.
The impact of the lease on the financial statements for the year ended 31st March, 2018 can best be seen by preparing a profile of the net investment in the lease for the first three years of the lease and shown below:

Year to 31st March	Opening Balance	Finance income	Rental	Closing Balance
2017	20,197.39	1,615.79	(2,787)	19,026.18
2018	19,026.18	1,522.09	(2,787)	17,761.27
2019	17,761.27	1,420.90	(2,787)	16,395.17

During the year ended 31st March, 2018, A Ltd. will recognise income from finance leases of 1,522.09. The net investment on 31st March, 2018 will be 17,761.27.
Of the closing net investment of 17,761.27, current asset will be shown for 2,787 and 14,974.27 as a non-current asset.

9. The building, if purchased outright, would have a useful economic life of 50 years. The lease term, which would commence on 1 January 2019, is for 30 years. D Ltd would pay 40% of the asset's value upfront. At the end of each of the 30 years, there is also an annual rental payment due. This is equivalent to 6% of the asset's value as at 1 January 2019 or a contingent rent, if higher, at the year end. Legal title at the end of the lease remains with the lessor, but D Ltd can continue to lease the asset indefinitely at a rental that is substantially below its market value. If D Ltd cancels the lease, it must make a payment to the lessor to recover their remaining investment. As per Ind AS 17 Leases, should the lease be classified as an operating lease or a finance lease?
[RTP MAY 2019]
Answer:
A finance lease is a lease where the risks and rewards of ownership transfer from the lessor to the lessee.
Key indications that a lease is a finance lease are:
• The lease transfers ownership of the asset to the lessee by the end of the lease term.

• The lease term is for the major part of the asset's economic life.
• At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.
• If the lessee can cancel the lease, the lessor's losses are borne by the lessee.
• The lessee has the ability to lease the asset for a secondary period at a rent that is substantially lower than market rent.
The lease term is only for 60% (30 years/50 years) of the asset's useful life. Legal title also does not pass at the end of the lease. These factors suggest that the lease is an operating lease. However, D Ltd can continue to lease the asset at the end of the lease term for a value that is substantially below market value. This suggests that D Ltd will benefit from building over its useful life and is therefore an indication of a finance lease. D Ltd is also unable to cancel the lease without paying the lessor. This is an indication that the lessor is guaranteed to recoup their investment and therefore that they have relinquished the risks of ownership: It also seems likely that the present value of the minimum lease payments will be substantially all of the asset's fair value. Contingent rentals should be excluded from minimum lease payments - the impact of the potential rental increase should be ignored as this is contingent upon a future event. The minimum lease payments (ignoring discounting) equate to 40% of the fair value, payable upfront, and then another 180% (30 years x 6%) of the fair value over the lease term. Therefore, this again suggests that the lease is a finance lease.

The fact that there is a contingent rental can be suggestive of an operating or a finance lease. This must be examined more closely to see whether it suggests a transfer of the risks and rewards of ownership. "In this particular case, an increase in the value of the building will mean that the lessor receives greater payments from the lessee. However, a decrease in the value of the building will mean that the rent is fixed at 6% of the fair value at inception. This appears to be guaranteeing the lessor their required return on the investment, suggesting that the risks of ownership have been transferred to the lessee.
All things considered, it appears that the lease is a finance lease.

10. 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 2020)
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 noted that 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

11. 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 rent of ` 70,000 is 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 2020)
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	1,20,000	60%	1,02,000
Service charge	80,000	40%	68,000
Total	**2,00,000**	**100%**	**1,70,000**

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 (A)	Present value factor @ 10% (B)	Present value of lease payments (A X B = C)
Year 1	1,02,000	.909	92,718
Year 2	1,02,000	.826	84,252
Year 3	1,02,000	.751	76,602
Year 4	1,02,000	.683	69,666
Year 5	1,02,000	.621	63,342
Year 6	1,02,000	.564	57,528
Year 7	1,02,000	.513	52,326
Year 8	1,02,000	.467	47,634
Year 9	1,02,000	.424	43,248
Lease Liability at commencement date			**5,87,316**

Further, ₹ 68,000 allocated to the non-lease component of facility used will be recognised in profit or loss as and when incurred.

UNIT 4: INDAS 23: BORROWING COSTS

Illustrations

1 A company deals in production of dairy products. It prepares and sells various milk products like ghee, butter and cheese. The company borrowed funds from bank for manufacturing operation. The cheese takes substantial longer period to get ready for sale.
State whether borrowing costs incurred to finance the production of inventories (cheese) that have a long production period, be capitalised?
Solution
Ind AS 23 does not require the capitalisation of borrowing costs for inventories that are manufactured in large quantities on a repetitive basis. However, interest capitalisation is permitted as long as the production cycle takes a 'substantial period of time', as with cheese.

2 A company is in the process of developing computer software. The asset has been qualified for recognition purposes. However, the development of computer software will take substantial period of time to complete.
(i) Can computer software be termed as a 'qualifying asset' under Ind AS 23?
(ii) Is management intention considered when assessing whether an asset is a qualifying asset?
Solution
(i) Yes. An intangible asset that takes a substantial period of time to get ready for its intended use or sale is a 'qualifying asset'. This would be the case for an internally generated computer software in the development phase when it takes a 'substantial period of time' to complete.
(ii) Yes. Management should assess whether an asset, at the date of acquisition, is 'ready for its intended use or sale'. The asset might be a qualifying asset, depending on how management intends to use it. For example, when an acquired asset can only be used in combination with a larger group of fixed assets or was acquired specifically for the construction of one specific qualifying asset, the assessment of whether the acquired asset is a qualifying asset is made on a combined basis.

3
A telecom company has acquired a 3G license. The licence could be sold or licensed to a third party. However, management intends to use it to operate a wireless network. Development of the network starts when the license is acquired.

Should borrowing costs on the acquisition of the 3G license be capitalised until the network is ready for its intended use?
Solution
Yes. The license has been exclusively acquired to operate the wireless network. The fact that the license can be used or licensed to a third party is irrelevant. The acquisition of the license is the first step in a wider investment project (developing the network). It is part of the network investment, which meets the definition of a qualifying asset under Ind AS 23.

4

A real estate company has incurred expenses for the acquisition of a permit allowing the construction of a building. It has also acquired equipment that will be used for the construction of various buildings.
Can borrowing costs on the acquisition of the permit and the equipment be capitalised until the construction of the building is complete?

Solution

With respect to Permit

Yes, since permit is specific to one building. It is the first step in a wider investment project. It is part of the construction cost of the building, which meets the definition of a qualifying asset.

With respect to Equipment

No, since the equipment will be used for other construction projects. It is ready for its 'intended use' at the acquisition date. Hence, it does not meet the definition of a qualifying asset.

5

ABC Ltd. has taken a loan of USD 20,000 on 1st April, 20X1 for constructing a plant at an interest rate of 5% per annum payable on annual basis.
On 1st April, 20X1, the exchange rate between the currencies i.e. USD vs Rupees was ` 45 per USD. The exchange rate on the reporting date i.e. 31st March, 20X2 is ` 48 per USD.
The 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 1st April, 20X1.
Compute the borrowing cost to be capitalized for the construction of plant by ABC Ltd. for the period ending 31st March,20X2.

Solution

In the above situation, the borrowing cost needs to determine for interest cost 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 `: USD 1,000 x ` 48/USD = ` 48,000
Increase in liability due to change in exchange difference: USD 20,000 x (48 - 45) = ` 60,000

(b) Interest that would have resulted if the loan was taken in Indian Currency:

USD 20,000 x ` 45/USD x 11% = ` 99,000

(c) Difference between interest on foreign currency borrowing and local currency borrowing:

` 99,000 - 48,000 = ` 51,000

Hence, out of exchange loss of ` 60,000 on principal amount of foreign currency loan, only exchange loss to the extent of ` 51,000 is considered as borrowing costs.

Total borrowing cost to be capitalized is as under:

(a) Interest cost on borrowing ` 48,000

(b) Exchange difference to the extent considered to be
an adjustment to Interest cost ` 51,000
` 99,000

The exchange difference of ` 51,000 has been capitalized as borrowing cost and the remaining ` 9,000 will be expensed off in the Statement of Profit and loss.

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

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

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

Solution:

Particulars	Factory Building	Office Building
Borrowing Costs	(10,00,000 x 9%) 90,000	(20,00,000 x 9%) 1,80,000
Less: Investment Income	(5,00,000 x 7% x 6/12) (17,500)	(10,00,000x7% x 6/12) (35,000)
	72,500	1,45,000

Cost of the asset:		
Expenditure incurred	10,00,000	20,00,000
Borrowing Costs	72,500	1,45,000
Total	10,72,500	21,45,000

7 On 1st April, 20X1, A Ltd. took a 8% loan of ` 50,00,000 for construction of building A which is repayable after 6 years ie on 31st March 20X7. The construction of building was completed on 31st March 20X3. A Ltd. started constructing a new building B in the year 20X3-20X4, for which he used his existing borrowings. He has outstanding general purpose loan of ` 25,00,000, interest on which is payable @ 9% and ` 15,00,000, interest on which is payable @ 7%.

Is the specific borrowing transferred to the general borrowings pool once the respective qualifying asset is completed? Why

Solution

Yes. If specific borrowings were not repaid once the relevant qualifying asset was completed, they become general borrowings for as long as they are outstanding.

The borrowing costs that are directly attributable to obtaining qualifying assets are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. If cash was not spent on other qualifying assets, it could be directed to repay this specific loan. Thus, borrowing costs could be avoided (that is, they are directly attributable to other qualifying assets).

When general borrowings are used for qualifying assets, Ind AS 23 requires that, borrowing costs eligible for capitalisation is calculated by applying a capitalisation rate to the expenditures on qualifying assets.

The amount of borrowing costs eligible for capitalisation is always limited to the amount of actual borrowing costs incurred during the period.

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

(Amounts in ₹ 000s)

Loan	1st April, 20X1	31st March, 20X2
18% Bank Loan	1,000	1,000
16% Term Loan	3,000	3,000
14% Debentures	-	2,000

14% debenture was issued to fund the construction of Office building on 1st July, 20X1 but the development activities has yet to be started.
On 1st April, 20X1, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: ` 500,000 on 1st April, 20X1 and ` 2,500,000 on 1st January, 20X2.
Calculate the borrowing cost that can be capitalised for the plant.
Solution

Capitalisation rate	$\frac{(18\% \times 1,000)}{1,000+3,000}+\frac{(16\% \times 3,000)}{1,000+3,000}$	16.5%
Borrowing Costs	(500,000 x 16.5%)+(2,500,000 x16.5% x 3/12)	₹ 1,85,625

Capitalisation rate for above illustration could also be calculated with the following approach by assigning weights to the borrowings:

Particulars	Loan	Weighted average (a)	Interest rate (b)	Capitalisation rate (a*b)
18% Bank Loan	1,000	25%	18%	4.5%
16% Term Loan	3,000	75%	16%	12%
Total	**4,000**	**100%**		**16.5%**

Answer in both the approaches would be same as can be seen from the above two solutions.

9 : Commencement Date
X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:
(i) 15th May, 20X1: Loan interest relating to the project starts to be incurred
(ii) 2nd June, 20X1 : Technical site planning commences
(iii) 19th June, 20X1 : Expenditure on the project started to be incurred
(iv) 18th July, 20X1 : Construction work commences

Identify commencement date.
Solution
In the above case, the three conditions to be tested for commencement date would be:
Borrowing cost has been incurred on : 15th May, 20X1
Expenditure has been incurred for the asset on : 19th June, 20X1
Activities necessary to prepare asset for its intended use or sale: 2nd June, 20X1
Commencement date would be the date when the above three conditions would be satisfied in all i.e. 19th June, 20X1

Questions
1. Marine Transport Limited ordered 3 ships for its fleet on 1st April, 20X0. It pays a down payment of 25% of the contract value of each of the ship out of long term borrowings from a scheduled bank. The delivery has to commence from the financial year 20X7. On 1st March, 20X2, the ship builder informs that it has commenced production of one ship. There is no progress on other 2 ships. Marine Transport Limited prepares its financial statements on financial year basis.
Is it permissible for Marine Transport Limited to capitalise any borrowing costs for the financial year ended 31st March, 20X1 or 31st March, 20X2.
Answer:
As per paragraph 5 of Ind AS 23, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. As per paragraph 17 of Ind AS 23, an entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:
(a) It incurs expenditures for the asset.
(b) It incurs borrowing costs.
(c) It undertakes activities that are necessary to prepare the asset for its intended use or sale.
The ship is a qualifying asset as it takes substantial period of time for its construction. Thus the related borrowing costs should be capitalised.
Marine Transport Limited borrows funds and incurs expenditures in the form of down payment on 1st April, 20X0. Thus condition (a) and (b) are met. However, condition (c) is met only on 1st March, 20X2, and that too only with respect to one ship. Thus there is no capitalisation of borrowing costs during the financial year ended 31st March, 20X1. Even during the financial year ended 31st March, 20X2, borrowing costs relating to the 'one' ship whose construction had commenced from 1st March, 20X2 will be capitalised from 1st March, 20X2 to 31st March, 20X2. All other borrowing costs are expensed.

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

Date	Amount (`)
1st July, 20X1	**2,50,000**
1st December, 20X1	**3,00,000**

The details of borrowings and interest thereon are as under:

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

Compute the borrowing costs that need to be capitalised.
Answer:
The capitalisation rate is calculated as below:
Total borrowing costs / Weighted average total borrowings: 1,65,000/15,00,000 = 11%.
Interest to be capitalised is calculated as under:
— On ` 2,50,000 @ 11% p.a. for 9 months = ` 20,625
— On ` 3,00,000 @ 11% p.a. for 4 months = ` 11,000
Total interest capitalised for year ended 31 March 2002 is ` 31,625

3. An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1. Directly attributable expenditure at the beginning of the month on this asset are ` 100,000 in September 20X1 and ` 250,000 in each of the months of October to December 20X1.
The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 10% debentures with a face value of ` 20 lacs and had an overdraft of ` 500,000, which increased to ` 750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%. Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'.
Answer:
Since the entity has only general borrowing hence first step will be to compute the capitalisation rate. The capitalisation rate of the general borrowings of the entity during the period of construction is calculated as follows:

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

Weighted average borrowings during period

$$= \frac{(20,00,000 \times 4) + (500,000 \times 3) + (750,000 \times 1)}{4} = ₹\ 25,62,500$$

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

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

4. K Ltd. began construction of a new building at an estimated cost of ` 7 lakh on 1st April, 20X1. To finance construction of the building it obtained a specific loan of ` 2 lakh from a financial institution at an interest rate of 9% per annum.
The company's other outstanding loans were:

Amount	Rate of Interest per annum
₹ 7,00,000	12%
₹ 9,00,000	11%

The expenditure incurred on the construction was:

April, 20X1	₹ 1,50,000
August, 20X1	₹ 2,00,000
October, 20X1	₹ 3,50,000
January, 20X2	₹ 1,00,000

The construction of building was completed by 31st January, 20X2. Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entry for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 20X2.
Answer:

(i) Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (₹)	*Rate of interest*		*Amount of interest (₹)*
7,00,000	12%	=	84,000
9,00,000	11%	=	99,000
16,00,000			1,83,000
Weighted average rate of interest (1,83,000/16,00,000) x 100		=	11.4375%

(ii) Computation of borrowing cost to be capitalized for specific borrowings and general borrowings based on weighted average accumulated expenses

Date of incurrence of expenditure	*Amount spent*	*Financed through*	*Calculation*	₹
1st April, 20X1	1,50,000	Specific borrowing	1,50,000 x 9% x 10/12	11,250
1st August, 20X1	2,00,000	Specific borrowing	50,000 x 9% x 10/12	3,750
		General borrowing	1,50,000 x 11.4375% x 6/12	8,578.125
1st October, 20X1	3,50,000	General borrowing	3,50,000 x 11.4375% x 4/12	13,343.75
1st January, 20X2	1,00,000	General borrowing	1,00,000 x 11.4375% x 1/12	953.125
				37,875

Note: Since construction of building started on 1st April, 20X1, it is presumed that all the later expenditures on construction of building had been incurred at the beginning of the respective month.

(iii) Total expenses to be capitalized for building

	₹
Cost of building ₹ (1,50,000 + 2,00,000 + 3,50,000 + 1,00,000)	8,00,000
Add: Amount of interest to be capitalized	37,875
	8,37,875

(iv) Journal Entry

Date	*Particulars*		₹	₹
31.1.20X2	Building account	Dr.	8,37,875	
	To Bank account			8,00,0000
	To Interest payable (borrowing cost)			37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Note: In the above journal entry, it is assumed that interest amount will be paid at the year end. Hence, entry for interest payable has been passed on 31.1.20X2.

Alternatively, following journal entry may be passed if interest is paid on the date of capitalization:

Date	*Particulars*		₹	₹
31.1.20X2	Building account	Dr.	8,37,875	
	To Bank account			8,37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

5. On 1st April, 20X1, entity A contracted for the construction of a building for ` 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor:

Payment date	Amount (₹ '000)
1st April, 20X1	200
30th June, 20X1	600
31st December, 20X1	1,200
31st March, 20X2	200
Total	2,200

Entity A's borrowings at its year end of 31st March, 20X2 were as follows:
a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to ` 7,00,000. Interest of ` 65,000 was incurred on these borrowings during the year, and interest income of ` 20,000 was earned on these funds while they were held in anticipation of payments.
b. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ` 1,000,000 and remained unchanged during the year; and
c. 10% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ` 1,500,000 and remained unchanged during the year.
What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?
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 capitalisation rate and expenditure incurred in obtaining a qualifying asset. The costs incurred should first be allocated to the specific borrowings.
Analysis of expenditure:

Date	Expenditure (₹ '000)	Amount allocated in general borrowings (₹ '000)	Weighted for period outstanding (₹ '000)
1st April 20X1	200	0	0
30th June 20X1	600	100*	100 × 9/12 = 75
31st Dec 20X1	1,200	1,200	1,200 × 3/12 = 300
31st March 20X2	200	200	200 × 0/12 = 0
Total	2,200		375

*Specific borrowings of ` 7,00,000 fully utilized on 1st April & on 30th June to the extent of ` 5,00,000 hence remaining expenditure of ` 1,00,000 allocated to general borrowings.
The capitalisation 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.

$$\text{Capitalisation rate} = \frac{(10,00,000 \times 12.5\%) + (15,00,000 \times 10\%)}{10,00,000 + 15,00,000} = 11\%$$

Borrowing cost to be capitalized:	Amount
	(₹)
On specific loan	65,000
On General borrowing (3,75,000 × 11%)	41,250
Total	1,06,250
Less: interest income on specific borrowings	(20,000)
Amount eligible for capitalization	86,250
Therefore, the borrowing costs to be capitalized are ₹ 86,250.	

6. In a group with Parent Company "P" there are 3 subsidiaries with following business:
"A" – Real Estate Company
"B" – Construction Company
"C" – Finance Company

- **Parent Company has no operating activities of its own but performs management functions for its subsidiaries.**
- **Financing activities and cash management in the group are coordinated centrally.**
- **Finance Company is a vehicle used by the group solely for raising finance.**
- **All entities in the group prepare Ind AS financial statements.**

The following information is relevant for the current reporting period 20X1-20X2:
Real Estate Company

- **Borrowings of ` 10,00,000 with an interest rate of 7% p.a.**
- **Expenditures on qualifying assets during the period amounted to ` 15,40,000.**
- **All construction works were performed by Construction Company. Amounts invoiced to Real Estate Company included 10% profit margin.**

Construction Company

- **No borrowings during the period.**
- **Financed ` 10,00,000 of expenditures on qualifying assets using its own cash resources.**

Finance Company

- **Raised ` 20,00,000 at 7% p.a. externally and issued a loan to Parent Company for general corporate purposes at the rate of 8%.**

Parent Company

? Used loan from Finance Company to acquire a new subsidiary.

? No qualifying assets apart from those in Real Estate Company and Construction Company.

? Parent Company did not issue any loans to other entities during the period.

What is the amount of borrowing costs eligible for capitalisation in the financial statements of each of the four entities for the current reporting period 20X1-20X2?

Answer:

Following is the treatment as per Ind AS 23:

Finance Company

No expenditure on qualifying assets have been incurred, so Finance Company cannot capitalise anything.

Real Estate Company

Total interest costs in the financial statements of Real Estate Company is ` 70,000. Expenditures on qualifying assets exceed total borrowings, so the total amount of interest can be capitalised.

Construction Company

No interest expense has been incurred, so Construction Company cannot capitalise anything.

Consolidated financial statements of Parent Company:

Total general borrowings of the group: ` 10,00,000 + ` 20,00,000 = ` 30,00,000

Although Parent Company used proceeds from loan to acquire a subsidiary, this loan cannot be excluded from the pool of general borrowings.

Total interest expenditures for the group = ` 30,00,000 x 7% = ` 2,10,000

Total expenditures on qualifying assets for the group are added up. Profit margin charged by Construction Company to Real Estate Company is eliminated:

Real Estate Company – ` 15,40,000/1.1 = ` 14,00,000

Construction Co – ` 10,00,000

Total consolidated expenditures on qualifying assets:

` (14,00,000 + 10,00,000) = ` 24,00,000

Capitalisation rate = 7%

Borrowing costs eligible for capitalisation = ` 24,00,000 x 7% = ` 1,68,000

Total interest expenditures of the group are higher than borrowing costs eligible for capitalisation calculated based on the actual expenditures incurred on the qualifying assets. Therefore, only ` 1,68,000 can be capitalised.

PAST PAPERS ,MOCK TEST PAPERS (MTP) , REVISION TEST PAPERS (RTP)

1. An entity constructs a new office building commencing on 1st September, 2018, which continues till 31st December, 2018 (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 2018 and Rs. 4 lakh in each of the months of October to December 2018. 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 2018. Interest was paid on the overdraft at 12% until 1st October, 2018 and then the rate was increased to 15%. Calculate the capitalization rate for computation of borrowing cost in accordance with

Ind AS 'Borrowing Cost'.
[NOV 2019 8 MARKS]
OR
An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1. Directly attributable expenditure at the beginning of the month on this asset are Rs. 100,000 in September 20X1 and Rs. 250,000 in each of the months of October to December 20X1.
The entity has not taken any specific borrowings to finance the construction of the asset, but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 10% debentures with a face value of Rs. 20 lacs and had an overdraft of Rs. 500,000, which increased to Rs. 750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%.
Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'.
[RTP MAY 2018]
Answer:

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding balance	Amount of loan (₹)	Rate of interest p.a.	Weighted average amount of interest (₹)
	a	b	c	d = [(b x c) x (a/12)]
9% Debentures	12 months	30,00,000	9%	2,70,000
Bank overdraft	9 months	4,00,000	12%	36,000
	2 months	4,00,000	15%	10,000
	1 month	8,00,000	15%	10,000
		46,00,000		3,26,000

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

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

Weighted average borrowings during period

$$= \frac{(20,00,000 \times 4) + (500,000 \times 3) + (750,000 \times 1)}{4} = ₹\ 25,62,500$$

Capitalisation rate = Total finance costs during the construction period / Weighted average borrowings during the construction period = 96,250 / 25,62,500 = 3.756%

2. 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. The exchange rate on the reporting date i.e March 31, 20X2 is Rs. 48 per USD.
The 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 8 MARKS]
Answer:
In the above situation, the Borrowing cost needs to determine for interest cost 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.

3. K Ltd. began construction of a new building at an estimated cost of Rs. 7 lakh on 1 st April, 2017. To finance construction of the building it obtained a specific loan of Rs. 2 lakh from a financial institution at an interest rate of 9% per annum. The company's other outstanding loans were:

Amount	Rate of Interest per annum
₹ 7,00,000	12%
₹ 9,00,000	11%

The expenditure incurred on the construction was:

April, 2017	₹ 1,50,000
August, 2017	₹ 2,00,000
October, 2017	₹ 3,50,000
January, 2018	₹ 1,00,000

The construction of building was completed by 31st January, 2018. Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entry for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 2018.
[RTP NOV 2018]
Answer:

(i) Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (₹)	*Rate of interest*		*Amount of interest (₹)*
7,00,000	12%	=	84,000
9,00,000	11%	=	99,000
16,00,000			1,83,000
Weighted average rate of interest (1,83,000/16,00,000) x 100		=	11.4375%

(ii) Computation of borrowing cost to be capitalized for specific borrowings and general borrowings based on weighted average accumulated expenses

Date of incurrence of expenditure	*Amount spent*	*Financed through*	*Calculation*	₹
1st April, 2017	1,50,000	Specific borrowing	1,50,000 x 9% x 10/12	11,250
1st August, 2017	2,00,000	Specific borrowing	50,000 x 9% x 10/12	3,750
		General borrowing	1,50,000 x 11.4375% x 6/12	8,578.125
1st October, 2017	3,50,000	General borrowing	3,50,000 x 11.4375% x 4/12	13,343.75
1st January, 2018	1,00,000	General borrowing	1,00,000 x 11.4375% x 1/12	953.125
				37,875

Note: Since construction of building started on 1st April, 2017, it is presumed that all the later expenditures on construction of building had been incurred at the beginning of the respective month.

(iii) Total expenses to be capitalized for building

	₹
Cost of building ₹ (1,50,000 + 2,00,000 + 3,50,000 + 1,00,000)	8,00,000
Add: Amount of interest to be capitalized	37,875
	8,37,875

(iv) Journal Entry

Date	*Particulars*		₹	₹
31.1.2018	Building account	Dr.	8,37,875	
	To Bank account			8,00,0000
	To Interest payable (borrowing cost)			37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Note: In the above journal entry, it is assumed that interest amount will be paid at the year end. Hence, entry for interest payable has been passed on 31.1.2018.

Alternatively, following journal entry may be passed if interest is paid on the date of capitalization:

Date	*Particulars*		₹	₹
31.1.2018	Building account	Dr.	8,37,875	
	To Bank account			8,37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

4. On 1st April 2017 Alpha Ltd. commenced joint construction of a property with Gama Ltd. For this purpose, an agreement has been entered into that provides for joint operation and ownership of the property. All the ongoing expenditure, comprising maintenance plus borrowing costs, is to be shared equally. The construction was completed on 30th September 2017 and utilisation of the property started on 1st January 2018 at which time the estimated useful life of the same was estimated to be 20 years.
Total cost of the construction of the property was Rs. 40 crores. Besides internal accruals, the cost was partly funded by way of loan of Rs. 10 crores taken on 1st January 2017. The loan carries interest at an annual rate of 10% with interest payable at the end of year on 31st December each year. The company has spent Rs. 4,00,000 on the maintenance of such property.
The company has recorded the entire amount paid as investment in Joint Venture in the books of accounts. Suggest the suitable accounting treatment of the above transaction as per applicable Ind AS.
[RTP – NOV 2018]

Answer:

As provided in Ind- AS 111 - Joint Arrangements - this is a joint arrangement because two or more parties have joint control of the property under a contractual arrangement. The arrangement will be regarded as a joint operation because Alpha Ltd. and Gama Ltd. have rights to the assets and obligations for the liabilities of this joint arrangement. This means that the company and the other investor will each recognise 50% of the cost of constructing the asset in property, plant and equipment.

The borrowing cost incurred on constructing the property should under the principles of Ind AS 23 'Borrowing Costs', be included as part of the cost of the asset for the period of construction.

In this case, the relevant borrowing cost to be included is Rs. 50,00,000 (Rs. 10,00,00,000 x 10% x6/12).

The total cost of the asset is Rs. 40,50,00,000 (Rs. 40,00,00,000 + Rs. 50,00,000) Rs. 20,25,00,000 crores is included in the property, plant and equipment of Alpha Ltd. and the same amount in the property, plant and equipment of Gama Ltd.

The depreciation charge for the year ended 31 March 2018 will therefore be Rs. 1,01,25,000 (Rs.40,50,00,000 x 1/20 x 6/12) Rs. 50,62,500 will be charged in the statement of profit or loss of the company and the same amount in the statement of profit or loss of Gama Ltd.

The other costs relating to the arrangement in the current year totalling Rs. 54,00,000 (finance cost for the second half year of Rs. 50,00,000 plus maintenance costs of Rs. 4,00,000) will be charged to the statement of profit or loss of Alpha Ltd. and Gama Ltd. in equal proportions- Rs.27,00,000 each.

5. On 1st April, 20X1, entity A contracted for the construction of a building for Rs. 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor:

Payment date	Amount (₹ '000)
1st April, 20X1	200
30th June, 20X1	600
31st December, 20X1	1,200
31st March, 20X2	200
Total	2,200

Entity A's borrowings at its year end of 31st March, 20X2 were as follows:

a) 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to Rs. 7,00,000. Interest of Rs. 65,000 was incurred on these borrowings during the year, and interest income of Rs. 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 st April, 20X1 amounted to Rs. 1,000,000 and remained unchanged during the year; and

c) 10% 10-year note with simple interest payable annually; debt outstanding at 1 st April, 20X1 amounted to Rs. 1,500,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

[RTP ⍰ NOV 2019]

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 (₹'000)	Amount allocated in general borrowings (₹'000)	Weighted for period outstanding (₹'000)
1st April 20X1	200	0	0
30th June 20X1	600	100*	100 × 9/12 = 75
31st Dec 20X1	1,200	1,200	1,200 × 3/12 = 300
31st March 20X2	200	200	200 × 0/12 = 0
Total	2,200		375

*Specific borrowings of Rs. 7,00,000 fully utilized on 1st April & on 30th June to the extent of Rs. 5,00,000 hence remaining expenditure of Rs. 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.

$$\text{Capitalisation rate} = \frac{(10,00,000 \times 12.5\%) + (15,00,000 \times 10\%)}{10,00,000 + 15,00,000} = 11\%$$

Borrowing cost to be capitalized:	Amount (₹)
On specific loan	65,000
On General borrowing (3,75,000 × 11%)	41,250
Total	1,06,250
Less interest income on specific borrowings	(20,000)
Amount eligible for capitalization	86,250
Therefore, the borrowing costs to be capitalized are ₹ 86,250.	

6. 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 asset. 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 2019 amounted 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 2019 amounted 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)

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 April 2019	2,00,000	0	0
30 June 2019	6,00,000	1,00,000*	1,00,000 × 9/12 = 75,000
31 Dec 2019	12,00,000	12,00,000	12,00,000 × 3/12 = 3,00,000
31 March 2020	2,00,000	2,00,000	2,00,000 × 0/12 = 0
Total	22,00,000		3,75,000

*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.

$$\text{Capitalisation rate} = \frac{(10,00,000 \text{ x } 12.5\%) + (15,00,000 \text{ x } 10\%)}{10,00,000 + 15,00,000} = 11\%$$

Borrowing cost to be capitalized:	Amount (₹)
On specific loan	65,000
On General borrowing (₹ 3,75,000 × 11%)	41,250
Total	1,06,250
Less: Interest income on specific borrowings	(20,000)
Amount eligible for capitalization	86,250
Therefore, the borrowing costs to be capitalized are ₹ 86,250.	

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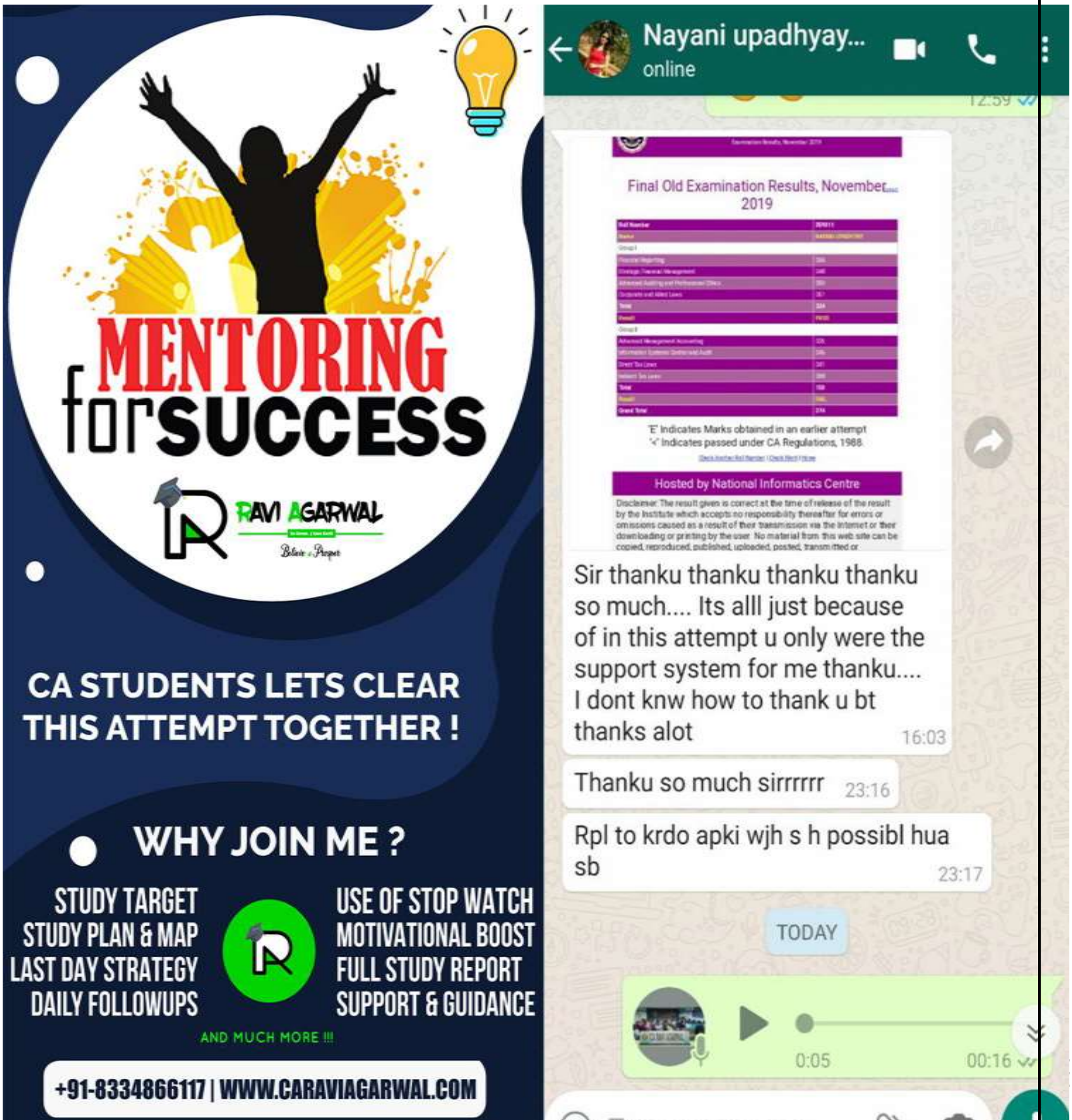
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Sir thanku thanku thanku thanku so much.... Its alll just because of in this attempt u only were the support system for me thanku.... I dont knw how to thank u bt thanks alot
16:03
Thanku so much sirrrrrr
23:16
Rpl to krdo apki wjh s h possibl hua sb
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UNIT 5: INDAS 36: IMPAIRMENT OF ASSETS

1

The carrying value of a building in the books of Sun Ltd. as at 31st March, 20X1 is ` 300 lakh. As on that date the value in use is ` 250 lakh and fair value less cost of disposal is ` 238 lakh. Calculate the Recoverable Amount.

Solution

Recoverable Amount : Higher of Fair Value less Costs of disposal and Value in Use
Fair Value less costs of disposal : ` 250 lakh
Value in Use : ` 238 lakh
Therefore, Recoverable value will be ` 250 lakh

2

Saturn India Ltd is reviewing one of its business segments for impairment. The carrying value of its net assets is 40 million. Management has produced two computations for the value-in-use of the business segment. The first value of ` 36 million excludes the benefit to be derived from a future reorganization, but the second value of ` 44 million includes the benefits to be derived from the future reorganization. There is not an active market for the sale of the business segments.

Whether the business segment needs to be Impaired?

Solution

The benefit of the future reorganization should not be taken into account in calculating value-in-use. Therefore, the net assets of the business segment will be impaired by ` 4 million because the value-in-use of ` 36 million is lower than the carrying value of ` 40 million. The value-in-use can be used as the recoverable amount as there is no active market for the sale of the business segment

3

Mars Ltd. gives the following estimates of cash flows relating to property, plant and equipment on 31st March, 20X4. The discount rate is 15%

Year	Cash Flow(₹ in lakh)
20X4-20X5	2,000
20X5-20X6	3,000
20X6-20X7	3,000
20X7-20X8	4,000
20X8-20X9	2,000
Residual Value at 31st March, 20X9	500

Property, plant & equipment was purchased on 1st April, 20X1 for ` 20,000 lakh

Useful Life was 8 Years

Residual Value estimated at the end of 8 years ` 500 lakh

Fair value less cost to disposal ` 10,000 lakh

Calculate impairment loss, if any on the property, plant and equipment. Also calculate the revised carrying amount and revised depreciation of property, plant and equipment.

Solution

(a) Calculation of Carrying Amount on 31st March, 20X4 (` in lakh)

Particular	Amount
Original Cost on 1st April, 20X1	20,000
Less: Depreciation $\frac{(20,000-500)}{8}\times 3$	(7,313)
Carrying Amount	12,687

(b) Calculation of Value in Use

Year	Cash Flows	*P.V.*	Amount
20X4-20X5	2,000	.870	1,740
20X5-20X6	3,000	.756	2,268
20X6-20X7	3,000	.658	1,974
20X7-20X8	4,000	.572	2,288
20X8-20X9 (including residual value)	2,500	.497	1,243
Total			9,513

(c) Calculation of Recoverable Amount

Particular	Amount
Value in Use	9,513
Fair value less costs of disposal	10,000
Recoverable Amount	10,000

(d) Calculation of Impairment Loss

Carrying Amount – Recoverable Amount

12,687 – 10,000 = 2,687

(e) Calculation of Revised Carrying Amount

Particular	Amount
Carrying Amount	12,687
Less: Impairment Loss	(2,687)
Revised Carrying Amount	10,000

(f) Calculation of Revised Depreciation

$$\frac{\text{Revised Carrying Amount – Residual Value}}{\text{Remaining Life}}$$

$$\frac{10{,}000 - 500}{5} = 1{,}900$$

4: Impairment Loss

Jupiter Ltd, a leading manufacturer of steel is having a furnace, which is carried in the balance sheet on 31st March, 20X1 at ₹ 250 lakh. As at that date the value in use and fair value is ₹ 200 lakh. The cost of disposal is ₹ 13 lakh. Calculate the Impairment Loss to be recognised in the books of the Company?

Solution

Calculation of Impairment Loss:

Calculation of Impairment Loss	₹ in lakh
Recoverable Amount =	200
Higher of ,	
Fair Value less Cost of Disposal (200 -13)	187
Or	
Value in Use	200
Impairment Loss = Carrying Amount – Recoverable Amount	
= 250 – 200	50

- An impairment loss shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Standard (for example, in accordance with the revaluation model in Ind AS 16).
- Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with that other Standard. Impairment loss on a revalued asset is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount in the revaluation surplus for that same asset. Such an impairment loss on a revalued asset reduces the revaluation surplus for that asset.
- When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognise a liability if, and only if, that is required by another Standard.
- After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset is adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.
- If an impairment loss is recognised, any related deferred tax assets or liabilities are determined in accordance with Ind AS 12 by comparing the revised carrying amount of the asset with its tax base.

5

Mercury Ltd. has an identifiable asset with a carrying amount of ₹ 1,000. Its recoverable amount is ₹ 650. The tax rate is 30% and the tax base of the asset is ₹ 800. Impairment losses are not deductible for tax purposes. What would be the impact of impairment loss on related deferred tax asset / liability against the revised carrying amount of asset?

Solution

The effect of impairment loss is as follows:

	Identifiable assets before impairment loss	*Impairment loss*	*Identifiable assets after impairment loss*
	₹	₹	₹
Carrying amount	1,000	(350)	650
Tax Base	800	-	800
Taxable (deductible) temporary difference	200	(350)	(150)
Deferred tax liability (asset) at 30%	60	(105)	(45)

In accordance with Ind AS 12, the entity recognises the deferred tax asset to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

6

A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is ` 500, which is equal to the present value of the restoration costs.

The entity is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The entity has received various offers to buy the mine at a price of around ` 800. This price

reflects the fact that the buyer will assume the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately ` 1,200, excluding restoration costs. The carrying amount of the mine is ` 1,000. How the impairment loss is to be accounted for?

Solution

The cash-generating unit's fair value less costs of disposal is ` 800. This amount considers restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be ` 700 (` 1,200 less ` 500). The carrying amount of the cash-generating unit is ` 500, which is the carrying amount of the mine (` 1,000) less the carrying amount of the provision for restoration costs (` 500). Therefore, the recoverable amount of the cash-generating unit exceeds its carrying amount. Thus, there is no impairment loss.

7

Entity A acquires Entity B for ` 50 million, of which ` 35 million is the fair value of the identifiable assets acquired and liabilities assumed. The acquisition of B Ltd. is to be integrated into two of Entity A's CGUs with the net assets being allocated as follows: ` in million

	CGU 1	CGU 2	Total
Fair value of acquired identifiable tangible and intangible assets	25	10	35

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In addition to the net assets acquired that are assigned to CGU 2, the acquiring entity expects CGU 2 to benefit from certain synergies related to the acquisition (e.g. CGU 2 is expected to realise higher sales of its products because of access to the acquired entity's distribution channels). There is no synergistic goodwill attributable to other CGUs. Entity A allocated the purchase consideration of the acquired business to CGU 1 and CGU 2 as ` 33 million and ` 17 million respectively.
Determine the allocation of goodwill to each CGU?
Solution:
If goodwill is allocated to the CGUs based on the difference between the purchase consideration and the fair value of net assets acquired ie direct method, the allocation would be as follows: (All figures are ` in million, unless otherwise specified)

	CGU 1	CGU 2	Total
Allocation of Purchase consideration	33	17	50
Less: Acquired identifiable tangible and intangible assets	(25)	(10)	(35)
Goodwill assigned to CGUs	8	7	15

8
Earth Infra Ltd has two cash-generating units, A and B. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for ` 20 million and CGU B for ` 30 million. The company has an office building which it is using as an office headquarter and has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of ` 10 million. The recoverable amounts are based on value-in-use of ` 18 million for CGU A and ` 38 million for CGU B.
Determine whether the carrying values of CGU A and B are impaired.
Solution
The office building is a corporate asset which needs to be allocated to CGU A and B on a reasonable and consistent basis:

	A	B	Total
Carrying value of CGUs	20	30	50
Allocation of office building	4	6	10
(office building is allocated in the ratio of Carrying value of CGU's)			
Carrying value of CGU after Allocation of corporate asset	24	36	60
Recoverable Amount	18	38	56
Impairment Loss	6	-	

The impairment loss will be allocated on the basis of 4/24 against the building (` 1 million) and 20/24 against the other assets (` 5 million).

9
A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's fair value less costs of disposal is less than its carrying amount. The machine does not generate independent cash inflows. The smallest identifiable group of assets that includes the machine and generates cash inflows that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. The recoverable amount of the production line shows that the production line taken as a whole is not impaired.
Assumption 1: budgets/forecasts approved by management reflect no commitment of management to replace the machine.
Assumption 2: budgets/forecasts approved by management reflect a commitment of management to replace the machine and sell it in the near future. Cash flows from continuing use of the machine until its disposal are estimated to be negligible.
How to account for the impairment loss of machine in above scenarios?
Solution
1. The recoverable amount of the machine alone cannot be estimated because the machine's value in use:
a) may differ from its fair value less costs of disposal; and
b) can be determined only for the cash-generating unit to which the machine belongs (the production line).

The production line is not impaired. Therefore, no impairment loss is recognised for the machine. Nevertheless, the entity may need to reassess the depreciation period or the depreciation method for the machine. Perhaps a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the machine or the pattern in which economic benefits are expected to be consumed by the entity.
2. The machine's value in use can be estimated to be close to its fair value less costs of disposal. Therefore, the recoverable amount of the machine can be determined and no consideration is given to the cash-generating unit to which the machine belongs (i.e. the production line). Because the machine's fair value less costs of disposal is less than its carrying amount, an impairment loss is recognised for the machine.
After the allocation procedures have been applied, a liability is recognised for any remaining amount of an impairment loss for a cash-generating unit if, and only if, that is required by another Indian Accounting Standard.

10: Reversal of Impairment Loss
On 1st April 20X1, Venus Ltd acquired 100% of Saturn Ltd for ` 4,00,000. The fair value of the net identifiable assets of Saturn Ltd was ` 3,20,000 and goodwill was ` 80,000. Saturn Ltd is in coal mining business. On 31st March, 20X3, the government has cancelled licenses given to it in few states.
As a result Saturn's Ltd revenue is estimated to get reduce by 30%. The adverse change in market place and regulatory conditions is an indicator of impairment. As a result, Venus Ltd has to estimate the recoverable amount of goodwill and net assets of Saturn Ltd on 31st March, 20X3.
Venus Ltd uses straight line depreciation. The useful life of Saturn's Ltd assets is estimated to be 20 years with no residual value. No independent cash inflows can be identified to any individual assets. So the entire operation of Saturn Ltd is to be treated as a CGU. Due to the regulatory entangle it is not possible to determine the selling price of Saturn Ltd as a CGU. Its value in use is estimated by the management at ` 2,12,000. Suppose by 31st March, 20X5 the government reinstates the licenses of Saturn Ltd. The management expects a favourable change in net cash flows. This is an indicator that an impairment loss may have reversed. The recoverable amount of Saturn's Ltd net asset is re-estimated. The value in use is expected to be ` 3,04,000 and fair value less cost to disposal is expected to be ` 2,90,000.
Calculate the impairment loss, if any. Also show the accounting treatment for reversal of impairment loss and the subsequent depreciation thereon.

Solution

Since the fair value less costs of disposal is not determinable the recoverable amount of the CGU is its value in use. The carrying amount of the assets of the CGU on 31st March, 20X3 is as follows:

Calculation of Impairment loss

			₹
	Goodwill	Other assets	Total
Historical Cost	80,000	3,20,000	4,00,000
Accumulated Depreciation (3,20,000/20) x 2	-	(32,000)	(32,000)
Carrying Amount	80,000	2,88,000	3,68,000
Impairment Loss	(80,000)	(76,000)	(1,56,000)

Revised Carrying Amount

- Impairment Loss = Carrying Amount – Recoverable Amount (` 3,68,000 - ` 2,12,000) = ` 1,56,000 is charged in statement of profit and loss for the period ending 31st March, 20X3 as impairment loss.
- Impairment loss is allocated first to goodwill ` 80,000 and remaining loss of ` 76,000 (` 1,56,000 – ` 80,000) is allocated to the other assets.

Reversal of Impairment loss

Reversal of impairment loss is recognised subject to:-

- The impairment loss on goodwill cannot be reversed.
- The increased carrying amount of an asset after reversal of an impairment loss not to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

Calculation of carrying amount of identifiable assets had no impairment loss is recognised

	₹
Historical Cost	3,20,000
Accumulated Depreciation for 4 years (3,20,000/20) x 4	(64,000)
Carrying amount had no impairment loss is recognised on 31st March, 20X5	2,56,000

Carrying amount of other assets after recognition of impairment loss

	₹
Carrying amount on 31st March, 20X3	2,12,000
Accumulated Depreciation for 2 years (2,12,000/18) x 2 [rounded off to nearest thousand for ease of calculation]	(24,000)
Carrying amount on 31st March, 20X5	1,88,000

The impairment loss recognised previously can be reversed only to the extent of lower of re-estimated recoverable amount is ` 2,56,000 (higher of fair value less costs of disposal ` 2,90,000 and value in use ` 3,04,000)

Impairment loss reversal will be ` 68,000 i.e. (` 2,56,000 – ` 1,88,000). This amount is recognised as income in the statement of profit and loss for the year ended 31st March, 20X5.

The carrying amount of other assets at 31st March, 20X5 after reversal of impairment loss will be ` 2,56,000.

From 1st April, 20X5 the depreciation charge will be ` 16,000 i.e. (` 2,56,000/16)

11 - NCI measurement and Goodwill impairment

A Ltd acquires 80% shares of a subsidiary B Ltd. for ` 3,200 thousand. At the date of acquisition, B Ltd.'s identifiable net assets is ` 3,000 thousand. A elects to measure NCI at proportionate share of net identifiable assets. It recognizes

	` in thousand
Purchase Consideration	**3,200**
NCI (3,000 x 20%)	**600**
	3,800
Less: Net Assets	**(3,000)**
Goodwill	**800**

At the end of next financial year, B Ltd.'s carrying amount is reduced to ` 2,700 thousand (excluding goodwill). Recoverable amount of B Ltd.'s assets is
Case (i) ` 2,000 thousand,
Case (ii) ` 2,800 thousand
Calculate impairment loss allocable to Parent and NCI in both the cases.
Solution

Case (i) ₹ in thousand

Particulars	Goodwill	Other Asset	Total
Carrying amount	800	2,700	3,500
Unrecognised NCI (notional) [(800 / 80%) x 20%]	200	-	200

Notional Total	1,000	2,700	**3,700**
Recoverable amount	-	-	**2,000**
Total Impairment loss	-	-	**(1,700)**
Impairment loss recognised in CFS	(800)	(700)	**(1,500)**
Carrying amount after impairment	-	2,000	**2,000**

Impairment loss on:	Parent	NCI
Goodwill	(800)	-
Other assets	(560)	(140)
Total	**(1,360)**	**(140)**

Case (ii)

Particulars	Goodwill	Other Asset	Total
Carrying amount	800	2,700	**3,500**
Unrecognised NCI (notional) (800 / 80% x 20%)	200	-	**200**
Notional Total	**1,000**	**2,700**	**3,700**
Recoverable amount	-	-	**2,800**
Total Impairment loss	-	-	**(900)**
Impairment loss recognised in CFS (900 x 80%)	(720)	-	**(720)**
Carrying amount after impairment (800 – 720)	80	2,700	**2,780**

Impairment loss on:	Parent	NCI
Goodwill	(720)	-
Other assets	-	-
Total	(720)	-

It is to be noted that since an entity measures NCI at its proportionate interest in the net identifiable assets of a subsidiary at the acquisition date, rather than at fair value, goodwill attributable to NCI is not recognised in the parent's consolidated financial statements and so the impairment loss on such goodwill not recognised.

12
From the following details of an asset, find out:
(a) Impairment loss and its treatment.
(b) Current year depreciation for the year end.
Particulars of assets:

Cost of asset	**` 56 lakh**
Useful life	**10 years**
Salvage value	**Nil**
Carrying value at the beginning of the year	**` 27.30 lakh**
Remaining useful life	**3 years**
Recoverable amount at the beginning of the year	**` 12 lakh**
Upward revaluation done in last year	**` 14 lakh**

Solution
Impairment loss
Impairment loss = Carrying amount of the asset – Recoverable amount
= ` 27.30 lakh – ` 12 lakh
= ` 15.30 lakh
Treatment of impairment loss
As per Ind AS 36, impairment loss (whether of an individual asset of a CGU) is recognised in the following manner:
(a) Impairment loss of a revalued asset: It is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. The balance, if any, is recognised as an expense in the statement of profit and loss.
(b) Impairment loss of other assets: Impairment loss of any other asset should be recognised as an expense in the statement of profit and loss.
Since, the asset in question has been revalued upwards, the impairment loss will be adjusted first against the revaluation surplus of ` 14 lakh. The balance amount of ` 1.30 lakh will be recognised as an expense in the profit and loss account.
Current year depreciation
Revised carrying amount (after recognising impairment loss) ` 12 lakh
Remaining useful life 3 years
Salvage value Nil
Annual depreciation (12/3) ` 4 lakh

13
Venus Ltd. has an asset, which is carried in the Balance Sheet on 31st March, 20X1 at ` 500 lakh. As at that date the value in use is ` 400 lakh and the fair value less costs to sells is ` 375 lakh.
From the above data:
(a) Calculate impairment loss.
(b) Prepare journal entries for adjustment of impairment loss.

Solution

According to Ind AS 36, Impairment of Assets, impairment loss is the excess of 'Carrying amount of the asset' over 'Recoverable Amount'.
In the present case, the impairment loss can be computed in the following manner: Step 1: Fair value less costs to sell: ` 375 lakh
Step 2: Value in use: ` 400 lakh
Step 3: Recoverable amount, i.e., higher of 'fair value less costs to sell' & 'value in use'.
Thus, recoverable amount is ` 400 lakh
Step 4: Carrying amount of the asset ` 500 lakh
Step 5: Impairment loss, i.e., excess of amount computed in step 4 over amount computed in Step 3.
` 100 lakh (being the difference between ` 500 lakh and ` 400 lakh).
According to Ind AS 36, an impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at revalued amount in accordance with another Accounting Standard. Assuming, that the asset is not carried at revalued amount, the impairment loss of ` 100 lakh will be charged to Profit & Loss Account.

Journal Entries

Date	Particulars		Dr. Amt.	Cr. Amt.
				₹ in lakh
31.3.20X1	Impairment Loss A/c	Dr.	100	
	To Assets A/c			100
	(Being impairment loss on an asset recognised)			
31.3.20X1	Statement of Profit & Loss	Dr.	100	
	To Impairment Loss A/c			100
	(Being impairment loss transferred to statement of profit and loss)			

14

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

Solution

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis. Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent of each other and that each magazine title is a separate cash-generating unit.

15

A mining entity owns a private railway to support its mining activities. The private railway could be sold only for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the mine. Should the entity determine the recoverable amount for the private railway or for the mining business as a whole?

Solution

It is not possible to estimate the recoverable amount of the private railway because its value in use cannot be determined and is probably different from scrap value. Therefore, the entity estimates the recoverable amount of the cash-generating unit to which the private railway belongs, i.e., the mine as a whole.

16

A bus company provides services under contract with a municipality that requires minimum service on each of seven separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss. Should the company determine the recoverable amount for an individual asset or for a cash generating unit?

Solution

Because the entity does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the seven routes together. The cash- generating unit for each route is the bus company as a whole.

17

A significant raw material used for plant Y's final production is an intermediate product bought from plant X of the same entity. X's products are sold to Y at a transfer price that passes all margins to X. 80% of Y's final production is sold to customers outside of the entity.

60% of X's final production is sold to Y and the remaining 40% is sold to customers outside of the entity. For each of the following cases, what are the cash-generating units for X and Y?

(a) If X could sell the products it sells to Y in an active market and internal transfer prices are higher than market prices, what are the cash-generating units for X and Y?

(b) If there is no active market for the products X sells to Y, what are the cash-generating units for X and Y?

Solution

(a) Cash-generating unit for X: X could sell its products in an active market and, so, generate cash inflows that would be largely independent of the cash inflows from Y. Therefore, it is likely that X is a separate cash-generating unit, although part of its production is used by Y.

Cash-generating unit for Y: It is likely that Y is also a separate cash-generating unit. Y sells 80% of its products to customers outside of the entity. Therefore, its cash inflows can be regarded as largely independent.

Effect of internal transfer pricing: Internal transfer prices do not reflect market prices for X's output.

Therefore, in determining value in use of both X and Y, the entity adjusts financial budgets/forecasts to reflect management's best estimate of future prices that could be achieved in arm's length transactions for those of X's products that are used internally.

(b) Cash-generating units for X and Y: It is likely that the recoverable amount of each plant cannot be assessed independently of the recoverable amount of the other plant because:

(i) the majority of X's production is used internally and could not be sold in an active market. So, cash inflows of X depend on demand for Y's products. Therefore, X cannot be considered to generate cash inflows that are largely independent of those of Y.

(ii) the two plants are managed together.

As a consequence, it is likely that X and Y together are the smallest group of assets that generates cash inflows that are largely independent.

18

XYZ Limited produces a single product and owns plants 1, 2 and 3. Each plant is located in a different country. Plant 1 produces a component that is assembled in either Plant 2 or Plant 3. The combined capacity of Plant 2 and Plant 3 is not fully utilised. XYZ Limited's products are sold worldwide from either Plant 2 or Plant 3, e.g., Plant 2's production can be sold in Plant 3's country if the products can be delivered faster from Plant 2 than from Plant 3. Utilisation levels of Plant 2 and Plant 3 depend on the allocation of sales between the two sites. If there is no active market for Plant 1's products, what are the cash-generating units for Plant 1, Plant 2 and Plant 3?

Solution

It is likely that the recoverable amount of each plant cannot be assessed independently because:

(a) There is no active market for Plant 1's products. Therefore, Plant 1's cash inflows depend on sales of the final product by Plant 2 and Plant 3.

(b) Although there is an active market for the products assembled by Plant 2 and Plant 3, cash inflows for Plant 2 and Plant 3 depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for Plant 2 and Plant 3 can be determined individually.

As a consequence, it is likely that Plant 1, Plant 2 and Plant 3 together (i.e., XYZ Limited as a whole) are the smallest identifiable group of assets that generates cash inflows that are largely independent.

19

Goodwill had previously been allocated to cash-generating unit A. The goodwill allocated to A cannot be identified or associated with an asset group at a level lower than A, except arbitrarily. A is to be divided and integrated into three other cash-generating units, B, C and D. How the goodwill should be reallocated to B, C and D?

Solution

Since goodwill allocated to A cannot be non-arbitrarily identified or associated with an asset group at a level lower than A, it is reallocated to units B, C and D on the basis of the relative values of the three portions of A before those portions are integrated with B, C and D.

20

XYZ Limited has a cash-generating unit 'Plant A' as on 1st April, 20X1 having a carrying amount of ` 1,000 crore. Plant A was acquired under a business combination and goodwill of ` 200 crore was allocated to it. It is depreciated on straight line basis. Plant A has a useful life of 10 years with no

residual value. On 31st March, 20X2, Plant A has a recoverable amount of ` 600 crore. Calculate the impairment loss on Plant A. Also, prescribe its allocation as per Ind AS 36.

Solution

Particulars	Goodwill (₹ in crore)	Identifiable assets (₹ in crore)	Total (₹ in crore)
Historical cost	200	1,000	1,200
Depreciation (20X1-20X2)	-	(100)	(100)
Carrying amount	200	900	1,100

Since, the recoverable amount is ` 600 crore, there is an impairment loss of ` 500 crore. The impairment loss of ` 500 crore should be allocated to goodwill first, and then to the other identifiable assets, i.e., ` 200 crore to goodwill and ` 300 crore to identifiable assets of Plant A.

(₹ in crore)			
Particulars	Goodwill	Identifiable assets	Total
Impairment loss	(200)	(300)	(500)
Carrying amount after impairment loss	-	600	600

21

Sun Ltd is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31st March. On 1st July, 20X1, Sun Ltd acquired an 80% interest in Pluto Ltd. Details of the acquisition were as follows:

– Sun ltd acquired 800,000 shares in Pluto Ltd by issuing two equity shares for every five acquired. The fair value of Sun Ltd's share on 1st July, 20X1 was ` 4 per share and the fair value of a Pluto's share was ` 1.40 per share. The costs of issue were 5% per share.

– Sun Ltd incurred further legal and professional costs of ` 100,000 that directly related to the acquisition.

– The fair values of the identifiable net assets of Pluto Ltd at 1st July, 20X1 were measured at ` 1.3 million. Sun Ltd initially measured the non-controlling interest in Pluto Ltd at fair value. They used the market value of a Pluto Ltd share for this purpose. No impairment of goodwill arising on the acquisition of Pluto Ltd was required at 31st March, 20X2 or 20X3.

– Sun ltd acquired 800,000 shares in Pluto Ltd by issuing two equity shares for every five acquired. The fair value of Sun Ltd's share on 1st July, 20X1 was ` 4 per share and the fair value of a Pluto's share was ` 1.40 per share. The costs of issue were 5% per share.

– Sun Ltd incurred further legal and professional costs of ` 100,000 that directly related to the acquisition.

– The fair values of the identifiable net assets of Pluto Ltd at 1st July, 20X1 were measured at ` 1.3 million. Sun Ltd initially measured the non-controlling interest in Pluto Ltd at fair value. They used the market value of a Pluto Ltd share for this purpose. No impairment of goodwill arising on the acquisition of Pluto Ltd was required at 31st March, 20X2 or 20X3.

Pluto Ltd comprises three cash generating units A, B and C. When Pluto Ltd was acquired the directors of Sun Ltd estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	Carrying value (before goodwill allocation) ` '000	Recoverable amount ` '000	
A	600	740	
B	550	650	
C	450	400	

Required:

(i) Compute the carrying value of the goodwill arising on acquisition of Pluto Ltd in the consolidated Balance Sheet of Sun ltd at 31st March, 20X4 following the impairment review.

(ii) Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Pluto ltd.

Solution

1. Computation of goodwill on acquisition

Particular	**Amount (` '000)**
Cost of investment (8,00,000 x 2/5 x ` 4)	1,280
Fair value of non-controlling interest (2,00,000 x ` 1·4)	280
Fair value of identifiable net assets at date of acquisition	(1,300)
So goodwill equals	260

Acquisition costs are not included as part of the fair value of the consideration given under Ind AS 103, Business Combination

2. Calculation of impairment loss

Unit	Carrying value			Recoverable Amount	Impairment Loss
	Before Allocation	Allocation of goodwill (2:2:1)	After Allocation		
A	600	104	704	740	Nil
B	550	104	654	650	4
C	400*	52	452	400	52

* After writing down assets in the individual CGU to recoverable amount.

3. Calculation of closing goodwill

Goodwill arising on acquisition (W1)	260
Impairment loss (W2)	(56)
So closing goodwill equals	204

4. Calculation of overall impairment loss

on goodwill (W3)	56
on assets in unit C (450 – 400)	50
So total loss equals	106

` 21.2 (20%) of the above is allocated to the NCI with the balance allocated to the shareholders of Sun ltd.

Questions

1. Apex Ltd. is engaged in manufacturing of steel utensils. It owns a building for its headquarters. The building used to be fully occupied for internal use. However, recently the company has undertaken a massive downsizing exercise as a result of which 1/3rd of the building became vacant. This vacant portion has now been given for on lease for 6 years. Determine the CGU of the building.

Answer:
CGU of the building is Apex Ltd. as a whole as the primary purpose of the building is to serve as a corporate asset.

2. ABC Ltd. has three cash-generating units: A, B and C, the carrying amounts of which as on 31st March, 20X1 are as follows:

Cash-generating units	Carrying amount	(` in crore) Remaining useful life
A	500	10
B	750	20
C	1,100	20

ABC Ltd. also has two corporate assets having a remaining useful life of 20 years.

		(₹ in crore)
Corporate asset	Carrying amount	Remarks
X	600	The carrying amount of X can be allocated on a reasonable basis (i.e., pro rata basis) to the individual cash-generating units.
Y	200	The carrying amount of Y cannot be allocated on a reasonable basis to the individual cash-generating units.

Recoverable amount as on 31st March, 20X1 is as follows:

Cash-generating units	Recoverable amount (` in crore)
A	600
B	900
C	1,400
ABC Ltd.	3,200

Calculate the impairment loss, if any. Ignore decimals.
Answer:
Allocation of corporate assets
The carrying amount of X is allocated to the carrying amount of each individual cash- generatingunit. A weighted allocation basis is used because the estimated remaining useful life of A'scash-generating unit is 10 years, whereas the estimated remaining useful lives of B and C'scash-generating units are 20 years.

(₹ in crore)				
Particulars	A	B	C	Total
Carrying amount	500	750	1,100	2,350
Useful life	10 years	20 years	20 years	—
Weight based on useful life	1	2	2	—
Carrying amount (after assigning weight)	500	1,500	2,200	4,200
Pro-rata allocation of X	12% (500/4,200)	36% (1,500/4,200)	52% (2,200/4,200)	100%
Allocation of carrying amount of X	72	216	312	600
Carrying amount (after allocation of X)	572	966	1,412	2,950

Calculation of impairment loss

Step I: Impairment losses for individual cash-generating units and its allocation

(a)Impairment loss of each cash-generating units

(₹ in crore)			
Particulars	A	B	C
Carrying amount (after allocation of X)	572	966	1,412
Recoverable amount	600	900	1400
Impairment loss	-	66	12

(b)Allocation of the impairment loss

(₹ in crore)				
Allocation to	B		C	
X	15	(66 x 216/966)	3	(12 x 312/1,412)
Other assets in cash- generating units	51	(66 x 750/ 966)	9	(12 x 1,100/ 1,412)
Impairment loss	66		12	

Step II: Impairment losses for the larger cash-generating unit, i.e., ABC Ltd. as a whole

(₹ in crore)						
Particulars	A	B	C	X	Y	ABC Ltd.
Carrying amount	500	750	1,100	600	200	3,150
Impairment loss (Step I)	-	(51)	(9)	(18)	-	(78)
Carrying amount (after Step I)	500	699	1,091	582	200	3,072
Recoverable amount						3,200
Impairment loss for the 'larger' cash-generating unit					Nil	

3. Parent acquires an 80% ownership interest in Subsidiary for ` 2,100 on 1st April, 20X1. At that date, Subsidiary's net identifiable assets have a fair value of ` 1,500. Parent chooses to measure the non-controlling interests as the proportionate interest of Subsidiary's net identifiable assets. The assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Since other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of ` 500 related to those synergies has been allocated to other cash-generating units within Parent. On 31st March, 20X2, Parent determines that the recoverable amount of cash-generating unit Subsidiary is ` 1,000. The carrying amount of the net assets of Subsidiary, excluding goodwill, is ` 1,350. Allocate the impairment loss on 31st March, 20X2.

Answer:

Non-controlling interests is measured as the proportionate interest of Subsidiary's net identifiable assets, i.e., ` 300 (20% of ` 1,500). Goodwill is the difference between the aggregate of the consideration transferred and the amount of the non-controlling interests (` 2,100 + ` 300) and the net identifiable assets (` 1,500), i.e., ` 900.

Since, the assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets, therefore, Subsidiary is a cash-generating unit. Since other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of ` 500 related to those synergies has been allocated to other cash-generating units within Parent. Because the cash-generating unit comprising Subsidiary includes goodwill within its carrying amount, it should be tested for impairment annually, or more frequently if there is an indication that it may be impaired.

Testing Subsidiary (cash-generating unit) for impairment

Goodwill attributable to non-controlling interests is included in Subsidiary's recoverable amount of ` 1,000 but has not been recognised in Parent's consolidated financial statements. Therefore, the carrying amount of Subsidiary should be grossed up to include goodwill attributable to the non-controlling interests, before being compared with the recoverable amount of ` 1,000. Goodwill attributable to Parent's 80% interest in Subsidiary at the acquisition date is ` 400 after allocating ` 500 to other cash-generating units within Parent. Therefore, goodwill attributable to the 20% non-controlling interests in Subsidiary at the acquisition date is ` 100.

Testing subsidiary for impairment on 31st March, 20X2

On 31st March, 20X2	Goodwill of subsidiary (₹)	Net identifiable assets (₹)	Total (₹)
Carrying amount	400	1,350	1,750
Unrecognised non-controlling interests	100	-	100
Adjusted carrying amount	500	1,350	1,850
Recoverable amount			1,000
Impairment loss			850

Allocating the impairment loss

The impairment loss of ` 850 should be allocated to the assets in the unit by first reducing the carrying amount of goodwill.

Therefore, ` 500 of the ` 850 impairment loss for the unit is allocated to the goodwill. If the partially-owned subsidiary is itself a cash-generating unit, the goodwill impairment loss should be allocated to the controlling and non-controlling interests on the same basis as that on which profit or loss is allocated. In this case, profit or loss is allocated on the basis of relative ownership interests. Because the goodwill is recognised only to the extent of Parent's 80% ownership interest in Subsidiary, Parent recognises only 80% of that goodwill impairment loss (i.e., ` 400).

The remaining impairment loss of ` 350 is recognised by reducing the carrying amounts of Subsidiary's identifiable assets.

Allocation of the impairment loss for Subsidiary on 31st March, 20X2

On 31st March, 20X2	Goodwill of subsidiary (₹)	Net identifiable assets (₹)	Total (₹)
Carrying amount	400	1,350	1,750
Impairment loss	(400)	(350)	(750)
Carrying amount after impairment loss	-	1,000	1,000

4. A Ltd. purchased a machinery of ` 100 crore on 1st April, 20X1. The machinery has a useful life of 5 years. It has nil residual value. A Ltd. adopts straight line method of depreciation for depreciating the machinery. Following information has been provided as on 31st March, 20X2:

Financial year	Estimated future cash flows (` in crore)
20X2-20X3	**15**
20X3-20X4	**30**

20X4-20X5 **40**

20X5-20X6 **10**

Discount rate applicable : 10%
Fair value less costs to sell as on 31st March, 20X2 : ` 70 crore
Calculate the impairment loss, if any.
Answer:

Financial year	Estimated cash flows (₹ in crore)	Present value factor @ 10%	Present value
20X2-20X3	15	0.9091	13.64
20X3-20X4	30	0.8264	24.79
20X4-20X5	40	0.7513	30.05
20X5-20X6	10	0.6830	6.83
			75.31

The recoverable amount of the machinery is ` 75.31 crore (higher of value in use of ` 75.31 crore and fair value less costs to sell of ` 70 crore). Carrying amount of the machinery is ` 80 crore (after providing for one year depreciation @ ` 20 crore). Therefore, the impairment loss of ` 4.69 crore should be provided in the books.

5. Assuming in the above question, as on 31st March, 20X3, there is no change in the estimated future cash flows and discount rate. Fair value less costs to sell as on 31st March, 20X3 is ` 40 crore. How should it be dealt with under Ind AS 36?
Answer:

Value in use of the machinery as on March 31,20X3 can be calculated as follows:

Financial year	Estimated cash flows (₹ in crore)	Present value factor @ 10%	Present value
20X3-20X4	30	0.9091	27.27
20X4-20X5	40	0.8264	33.06
20X5-20X6	10	0.7513	7.51
			67.84

The recoverable amount of the machinery is ` 67.84 crore (higher of value in use of ` 67.84 crore and fair value less costs to sell of ` 40 crore). Carrying amount of the machinery at the end of the year 20X2 is ` 56.48 crore (after providing for two years depreciation (100-20-4.69)-18.83).
However, as per paragraph 116 of Ind AS 36, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.
Therefore, the impairment loss of ` 4.69 crore should not be reversed.

6. A Ltd. purchased an asset of ` 100 lakh on 1st April, 20X0. 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, 20X1	**` 60 lakh**
31st March, 20X2	**` 40 lakh**
31st March, 20X3	**` 28 lakh**

Calculate the amount of impairment loss or its reversal, if any, on 31st March, 20X1, 31st March, 20X2 and 31st March, 20X3.

Answer:

As on 31st March, 20X1

Carrying amount of the asset (opening balance)	₹ 100 lakh
Depreciation (₹ 100 lakh /4 years)	₹ 25 lakh
Carrying amount of the asset (closing balance)	₹ 75 lakh
Recoverable amount (given)	₹ 60 lakh

Therefore, an impairment loss of ` 15 lakh should be recognised as on 31st March, 20X1. Depreciation for subsequent years should be charged on the carrying amount of the asset (after providing for impairment loss), i.e., ` 60 lakh.

As on 31st March, 20X2

Carrying amount of the asset (opening balance)	` 60 lakh
Depreciation (` 60 lakh /3 years)	` 20 lakh
Carrying amount of the asset (closing balance)	` 40 lakh

Therefore, no impairment loss should be recognised as on 31st March, 20X2.

As on 31st March, 20X3

Carrying amount of the asset (opening balance)	` 40 lakh
Depreciation (` 40 lakh / 2 years)	` 20 lakh
Carrying amount of the asset (closing balance)	` 20 lakh
Recoverable amount (given)	` 28 lakh

Since, the recoverable amount of the asset exceeds the carrying amount of the asset by ` 8 lakh, impairment loss recognised earlier should be reversed. However, reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

Carrying amount as on 31st March, 20X3 had no impairment loss being recognised would have been ` 25 lakh. Therefore, the reversal of an impairment loss of ` 5 lakh should be done as on 31st March, 20X3.

7. On 31st March, 20X1, XYZ Ltd. makes following estimate of cash flows for one of its asset located in USA:

Year	Cash flows
20X1-20X2	US $ 80
20X2-20X3	US $ 100
20X3-20X4	US $ 20

Following information has been provided

Particulars	India	USA
Applicable discount rate	15%	10%

Exchange rates are as follows:

As on	Exchange rate
31st March, 20X1	` 45/US $

As on	Expected Exchange rate
31st March, 20X2	` 48/US $
31st March, 20X3	` 51/US $
31st March, 20X4	` 55/US $

Calculate value in use as on 31st March, 20X1.

Answer:

Year	Cash flows (US $)	Present value factor @ 10%	Discounted cash flows (US $)
20X1-20X2	80	0.9091	72.73
20X2-20X3	100	0.8264	82.64
20X3-20X4	20	0.7513	15.03
Total Discounted cash flows in US $			170.40
Exchange rate as on 31st March, 20X1, i.e., date of calculating value in use			₹ 45/US $
Value in use as on 31st March, 20X1			₹ 7,668

9. Cash flow of ` 1,000 may be received in one year, two years or three years with probabilities of 10%, 60% and 30%, respectively. Calculate expected cash flows assuming applicable discount rate of 5%, 5.25% and 5.5% in year 1, 2 and 3, respectively.

Answers:

Years	Cash flow	P.V.F.	Present value	Probability	Expected cash flow
1	1,000	0.95238	952.38	10%	95.24
2	1,000	0.90273	902.73	60%	541.64
3	1,000	0.85161	851.61	30%	255.48
Total					892.36

The expected present value is ` 892.36.

10. Calculate expected cash flows in each of the following cases:
(a) the estimated amount falls somewhere between ` 50 and ` 250, but no amount in the range is more likely than any other amount.
(b) the estimated amount falls somewhere between ` 50 and ` 250, and the most likely amount is ` 100. However, the probabilities attached to each amount are unknown.
(c) the estimated amount will be ` 50 (10 per cent probability), ` 250 (30 per cent probability), or ` 100 (60 per cent probability).

Answer:

(a) the estimated expected cash flow is ` 150 [(50 + 250)/2].
(b) the estimated expected cash flow is ` 133.33 [(50 + 100 + 250)/3].
(c) the estimated expected cash flow is ` 140 [(50 × 0.10) + (250 × 0.30) + (100 × 0.60)].

11. 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 o
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%.
f 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.

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. [ALSO IN RTP MAY 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.

Answer:

(a) Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss

(i) Calculation of carrying value of Machinery A and B before impairment

Machinery A		
Cost	(A)	₹ 10,00,000
Residual Value		₹ 50,000
Useful life		10 years
Useful life already elapsed		5 years
Yearly depreciation	(B)	₹ 95,000
WDV as at 31st March, 2018 [A- (B x 5)]		**₹ 5,25,000**
Machinery B		
Cost	(C)	₹ 5,00,000
Residual Value		-
Useful life		10 years
Useful life already elapsed		3 years
Yearly depreciation	(D)	₹ 50,000
WDV as at 31st March, 2018 [C- (D x 3)]		**₹ 3,50,000**

(ii) Calculation of Value-in-use of Machinery A

Period	Cash Flows (`)	PVF	PV
1	1,50,000	0.909	1,36,350
2	1,00,000	0.826	82,600
3	1,00,000	0.751	75,100
4	1,50,000	0.683	1,02,450
5	1,00,000	0.621	62,100
5	50,000	0.621	31,050
Value in use			**4,89,650**

(iii) Calculation of Fair Value less cost of disposal of Machinery A

	₹
Fair Value	7,00,000
Less: Dismantling cost	(1,50,000)
Packaging cost	(25,000)
Legal Fees	(75,000)
Fair value less cost of disposal	4,50,000

(iv) Calculation of Impairment loss on Machinery A

	₹
Carrying Value	5,25,000
Less: Recoverable Value ie higher of Value-in-use and Fair value less cost of disposal	4,89,650
Impairment Loss	**35,350**

(v) Calculation of Impairment loss of CGU

1. First goodwill will be impaired fully and then the remaining impairment loss of ` 75,000 will be allocated to Machinery A and B.
2. If we allocate remaining impairment loss to Machinery A and B on pro-rata basis, it would come to ` 45,000 on Machinery A. However, the impairment loss of Machinery A cannot exceed ` 35,350. Hence, impairment to CGU will be as follows:

	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	₹	₹	₹
Machinery A	5,25,000	35,350	4,89,650
Machinery B	3,50,000	39,650*	3,10,350
Inventory	2,00,000	-	2,00,000
Goodwill	1,50,000	1,50,000	-
Total	**12,25,000**	**2,25,000**	**10,00,000**

* Balancing figure.

(b) Carrying value after adjustment of depreciation

	₹
Machinery A [4,89,650 – {(4,89,650-50,000)/5}]	4,01,720
Machinery B [3,10,350 – (3,10,350/7)]	2,66,014
Inventory	2,00,000
Goodwill	-
Total	**8,67,734**

(c) Calculation of carrying value of CGU as on 31st March, 2019

The revised value of CGU is ` 11 Lakh. However, impaired goodwill cannot be reversed. Further, the individual assets cannot be increased by lower of recoverable value or Carrying Value as if the assets were never impaired. Accordingly, the carrying value as on 31st March, 2019 assuming that the impairment loss had never incurred, will be:

	Carrying Value	Recoverable Value	Final CV as at 31st Mar 2019
Machinery A	4,30,000	4,50,000	4,30,000
Machinery B	3,00,000	(7,60,000 – 4,50,000) 3,10,000	3,00,000
Inventory	2,00,000	2,00,000	2,00,000
Goodwill	-		
Total	9,30,000	9,60,000	9,30,000

12. E Ltd. 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 ` 5,00,000 through a vendor financing arrangement on which interest is being charged at the rate of 10% per annum.

During the year ended 31st March, 20X3, E Ltd. sold 10,000 steering wheels at a selling price of ` 190 per wheel.

• The most recent financial budget approved by E Ltd.'s management, covering the period 1st April, 20X3 – 31st March, 20X8, including that the company expects to sell each steering wheel for ` 200 during 20X3-20X4, the price rising in later years in line with a forecast inflation of 3% per annum.

• During the year ended 31st March, 20X4, E Ltd. expects to sell 10,000 steering wheels. The number is forecast to increase by 5% each year until 31st March, 20X8.

• E Ltd. estimates that each steering wheel costs ` 160 to manufacture, which includes ` 110 variable costs, ` 30 share of fixed overheads and ` 20 transport costs.

• Costs are expected to rise by 1% during 20X4-20X5, and then by 2% per annum until 31st March, 20X8.

• During 20X5-20X6, the machine will be subject to regular maintenance costing ` 50,000.

• In 20X3-20X4, E Ltd. expects to invest in new technology costing ` 1,00,000. This technology will reduce the variable costs of manufacturing each steering wheel from ` 110 to ` 100 and the share of fixed overheads from ` 30 to ` 15 (subjec t to the availability of technology, which is still under development).

• E Ltd. is depreciating the machine using the straight line method over the machine's 10 year estimated useful life. The current estimate (based on similar assets that have reached the end of their useful lives) of the disposal proceeds from selling the machine is ` 80 000 net of disposal costs. E Ltd. expects to dispose of the machine at the end of March, 20X8.

• E Ltd. has determined a pre-tax discount rate of 8%, 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?

Answer:

Calculation of the value in use of the machine owned by E Ltd. includes the projected cash inflow (i.e. sales income) from the continued use of the machine and projected cash outflows that are necessarily incurred to generate those cash inflows (i.e cost of goods sold). Additionally, projected cash inflows include ` 80,000 from the disposal of the asset in March, 20X8. Cash outflows include routing capital expenditures of ` 50,000 in 20X5-20X6

As per Ind AS 36, estimates of future cash flows shall not include:

- Cash inflows from receivables
- Cash outflows from payables
- Cash inflows or outflows expected to arise from future restructuring to which an entity is not yet committed
- Cash inflows or outflows expected to arise from improving or enhancing the asset's performance
- Cash inflows or outflows from financing activities
- Income tax receipts or payments.

Hence in this case, cash flows do not include financing interest (i.e. 10%), tax (i.e. 30%) and capital expenditures to which E Ltd. has not yet committed (i.e. ` 1,00,000). 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	20X3-20X4	20X4-20X5	20X5-20X6	20X6-20X7	20X7-20X8	Value in use
Quantity (A)	10,000	10,500	11,025	11,576	12,155	
Price per unit (B)	₹ 200	₹ 206	₹ 212	₹ 219	₹ 225	
Estimated cash inflows (C=A x B)	₹ 20,00,000	₹ 21,63,000	₹ 23,37,300	₹ 25,35,144	₹ 27,34,875	
Misc. cash inflow disposal proceeds (D)					₹ 80 000	
Total estimated cash inflows (E=C+D)	₹ 20,00,000	₹ 21,63,000	₹ 23,37,300	₹ 25,35,144	₹ 28,14,875	
Cost per unit (F)	₹ 160	₹ 162	₹ 165	₹ 168	₹ 171	
Estimated cash outflows (G = A x F)	(₹ 16,00,000)	(₹ 17,01,000)	(₹ 18,19,125)	(₹ 19,44,768)	(₹ 20,78,505)	
Misc. cash outflow: maintenance costs (H)			(₹ 50,000)			
Total estimated cash outflows (I=G+H)	(₹ 16,00,000)	(₹ 17,01,000)	(₹ 18,69,125)	(₹ 19,44,768)	(₹ 20,78,505)	
Net cash flows (J=E-I)	₹ 4,00,000	₹ 4,62,000	₹ 4,68,175	₹ 5,90,376	₹ 7,36,370	
Discount factor 8% (K)	0.9259	0.8573	0.7938	0.7350	0.6806	
Discounted future cash flows (L=J x K)	₹ 3,70,360	₹ 3,96,073	₹ 3,71,637	₹ 4,33,926	₹ 5,01,173	₹ 20,73,169

13. 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 31st March 20X6, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for PQR Ltd. has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. CFO thought that the

projections were too conservative, and he intended to use the highest figures each year. These were as follows:

	` '000
Year ended 31st March 20X7	**276**
Year ended 31st March 20X8	**192**
Year ended 31st March 20X9	**120**
Year ended 31st March 20Y0	**114**

The above cash inflows should be assumed to occur on the last day of each financial year. The pre-tax discount rate is 9%. The machine could have been sold at 31st March 20X6 for ` 6,00,000 and related selling expenses in this regard could have been ` 96,000. The machine had been revalued previously, and at 31st March 20X6 an amount of ` 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 31st March 20X6 was ` 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.
Calculate impairment loss, if any and revised depreciation of asset. Also suggest how Impairment loss, if any would be set off and how compensation from government be accounted for? [ALSO IN RTP MAY 2020/MTP-OCT 2020S]

Answer:

Carrying amount of asset on 31st March 20X6 = ` 6,60,000

Calculation of Value in Use:

Year ended	**Cash flow `**	**Discount factor @ 9%**	**Amount `**
31st March, 20X7	2,76,000	0.9174	2,53,202
31st March, 20X8	1,92,000	0.8417	1,61,606
31st March, 20X9	1,20,000	0.7722	92,664
31st March, 20Y0	1,14,000	0.7084	80,758
		Total (Value in Use)	**5,88,230**

Calculation of Recoverable amount:

Particulars	**Amount (`)**
Value in use	5,88,230
Fair value less costs of disposal (6,00,000 – 96,000)	5,04,000
Recoverable amount (Higher of value in use and fair value less costs of disposal)	5,88,230

Calculation of Impairment loss:

Particulars	**Amount (`)**
Carrying amount	6,60,000
Less: Recoverable amount	(5,88,230)
Impairment loss	71,770

Calculation of Revised carrying amount:

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.

14. On 1 January Year 1, Entity Q purchased a machine costing ` 2,40,000 with an estimated useful life of 20 years and an estimated zero residual value. Depreciation is computed on straight-line basis. The asset had been re-valued on 1 January Year 3 to ` 2,50,000, but with no change in useful life at that date. On 1 January Year 4 an impairment review showed the machine's recoverable amount to be ` 1,00,000 and its estimated remaining useful life to be 10 years.

Calculate:

a) The carrying amount of the machine on 31 December Year 2 and the revaluation surplus arising on 1 January Year 3.

b) The carrying amount of the machine on 31 December Year 3 (immediately before the impairment).

c) The impairment loss recognised in the year to 31 December Year 4 and its treatment thereon

d) The depreciation charge in the year to 31 December Year 4.

Note: During the course of utilization of machine, the company did not opt to transfer part of the revaluation surplus to retained earnings.

Answer:

(a) Calculation of Carrying amount of machine at the end of Year 2 `

Cost of machine 2,40,000

Accumulated depreciation for 2 years [2 years × (2,40,000 ÷ 20)] (24,000)

Carrying amount of the machine at the end of Year 2 2,16,000

(b) Calculation of carrying amount of the machine on 31 December Year 3 `

Carrying amount at the beginning of Year 3 2,16,000

Revaluation done at the beginning of Year 3 2,50,000

Revaluation surplus 34,000

(c) Calculation of Impairment loss at the end of Year 4

When machine is revalued on 1 January Year 3, depreciation is charged on the revalued amount over its remaining expected useful life.

Valuation at 1 January (re-valued amount) 2,50,000

Accumulated depreciation in Year 3 (2,50,000 / 18) (13,889)

Carrying amount of the asset at the end of Year 3 2,36,111

On 1 January Year 4, recoverable amount of the machine 1,00,000

Impairment loss (2,36,111 – 1,00,000) 1,36,111

An impairment loss of ` 34,000 will be taken to other comprehensive income (reducing the revaluation surplus for the asset to zero)

The remaining impairment loss of ` 1,02,111 (1,36,111 – 34,000) is recognised in the Statement of Profit and Loss for the Year 4.

(d) Calculation of depreciation charge in the Year 4

Carrying value of the machine at the beginning of Year 4 ` 1,00,000

Estimated remaining useful life 10 years

Depreciation charge is (` 1,00,000 / 10 years) ` 10,000

PAST PAPERS, MOCK TEST PAPERS (MTP) , REVISION TEST PAPERS (RTP)

1. 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	The 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.
[NOV 2018 10 MARKS]
Answer:
(i) Allocation of corporate assets to CGU
The carrying amount of AU is allocated to the carrying amount of each individual cashgenerating 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.

					(₹ in lakh)
	Particulars	X	Y	Z	Total
(a)	Carrying amount	800	1000	1,200	3,000
(b)	Useful life	20 years	10 years	20 years	
(c)	Weight based on useful life	2	1	2	
(d)	Carrying amount (after assigning weight) (a x c)	1,600	1,000	2,400	5,000
(e)	Pro-rata allocation of AU	32% (1,600/5,000)	20% (1,000/5,000)	48% (2,400/5,000)	100%
(f)	Allocation of carrying amount of AU (32: 20: 48)	256	160	384	800
(g)	Carrying amount (after allocation of AU) (a+f)	1,056	1,160	1,584	3,800

(ii) Calculation of impairment loss
Step 1: Impairment losses for individual cash-generating units and its allocation

(a) Impairment loss of each cash-generating units

			(₹ in lakh)
Particulars	X	Y	Z
Carrying amount (after allocation of AU)	1,056	1,160	1,584
Recoverable amount	1,000	1,200	1,400
Impairment loss	56	Nil	184

(b) Allocation of the impairment loss (after rounding off)

				(₹ in lakh)
Allocation to	X		Z	
AU	14	(56x256/1,056)	45	(184x384/1,584)
Other assets in cash-generating units	42	(56x800/1056)	139	(184x1,200/ 1,584)
Impairment loss	56		184	

Step 2: Impairment loss for the larger cash-generating unit, i.e., XYZ Ltd. as a whole

						(₹ in lakh)
Particulars	X	Y	Z	AU	BU	XYZ Ltd.
Carrying amount	800	1,000	1,200	800	400	4,200
Impairment loss (Step I)	(42)	-	(139)	(59)*	-	(240)
Carrying amount (after Step I)	758	1,000	1,061	741	400	3,960
Recoverable amount						3,900
Impairment loss for the 'larger' cash-generating unit						60

2. A machine was acquired by ABC Ltd. 15 years ago at a cost of Rs. 20 crore. Its accumulated depreciation as at 31st March, 2018 was Rs. 16.60 crore. Depreciation estimated for the financial year 2018-19 is Rs. 1 crore. Estimated Net Selling Price of the machine as on 31st March, 2018 was Rs. 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 Rs. 1.40 crore as 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 Rs. 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 Rs. 8 lakh to dispose of the plant, what would be your response to questions (i) and (ii) above?
[NOV 2018 – 5 MARKS]
Answer:
As per the requirement of the question, the following solution has been drawn on the basis of AS 28

		(₹ in crore)
(i)	Carrying amount of plant (before impairment) as on 31st March, 2019	2.40
	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

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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 Price on 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. (2.40 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:

	₹ in crore
Carrying amount before impairment on 1.4.2018 (20 - 16.60)	3.40
Recoverable amount ie. higher of NSP (1.20 cr) and Value in use (1.40 cr)	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 4 above)	0.98
Impairment Loss as on 31.3.2019 (since carrying amount is less than recoverable amount)	NIL

3. Great Ltd., acquired a machine on 1st April, 2012 for Rs. 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2016, the carrying value of the machine was reassessed at Rs. 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March 2018, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs. 79 lakhs. Calculate the loss on impairment of the machine and show how this loss is to be treated in the books of Great Ltd. Great Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

[MTP – AUGUST 2018 – 10 MARKS]

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. 2012-2013 to 2015-2016 $\left[\frac{7 \text{ crores}}{7 \text{ years}} \times 4 \text{ years}\right]$		(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 $\left[\frac{5.10 \text{ crores}}{3 \text{ years}} \times 2 \text{ years}\right]$		(3.40)
Carrying amount as on 31.03.2018		1.70
Less: Recoverable amount		(0.79)
Impairment loss		0.91
Less: Balance in revaluation reserve as on 31.03.2018:		
Balance in revaluation reserve as on 31.03.2016	2.10	
Less: Enhanced depreciation met from revaluation reserve 2016-2017 & 2017-2018 = [(1.70 – 1.00) x 2 years]	(1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"		(0.70)
Impairment Loss to be debited to profit and loss account		0.21

4. X Ltd. purchased a Property, Plant and Equipment four years ago for Rs. 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at Rs. 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is Rs. 67.50 lakhs and expected disposal costs are Rs. 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at Rs. 60 lakhs?
[MTP MARCH 2019 5 MARKS]
Answer:
Treatment of Impairment Loss
As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is Rs. 64.50 lakhs (Rs. 67.50 lakhs – Rs. 3 lakhs) and value in use is Rs. 60 lakhs. Therefore, recoverable amount will be Rs. 64.50 lakhs. Impairment loss will be calculated as Rs. 10.50 lakhs [Rs. 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less

Rs. 64.50 lakhs (Recoverable Amount)].
Thus impairment loss of Rs.10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.
Working Note:
Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year on revaluation

	(Rs. in lakhs)
Purchase price of a Property, Plant and Equipment	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years]	(60.00)
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

5. 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. The difference is treated as goodwill. The useful life of identifiable assets is 15 years and depreciated on straight line basis. When Government put the restriction at the end of 2016 the 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.
reestimate recoverable amount, which was estimated at Rs. 3,420 lakh.
Required:
(i) Calculation and allocation of impairment loss in 2016.
(ii) Reversal of impairment loss and its allocation as per AS 28 in 2018.

[RTP MAY 2019 | MTP ▯ APRIL 2019 ▯ 12 MARKS]

Answer:

(i) Calculation and allocation of impairment loss in 2016 *(Amount in Rs. lakhs)*

	Goodwill	Identifiable assets	Total
Historical cost	2,000	4,000	6,000
Accumulated depreciation/amortisation (4 yrs.)	(1,600)	(1,067)	(2,667)
Carrying amount before impairment	400	2,933	3,333
Impairment loss*	(400)	(213)	(613)
Carrying amount after impairment loss	0	2,720	2,720

*** Notes:**

1. As per para 87 of AS 28, an impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:
   (a) first, to goodwill allocated to the cash-generating unit (if any); and
   (b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

   Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value.
2. Since the goodwill has arisen on acquisition of assets, AS 14 comes into the picture. As per para 19 of AS 14, goodwill shall amortise over a period not exceeding five years unless a somewhat longer period can be justified. Therefore, the amortization period of goodwill is considered as 5 years.

(ii) Carrying amount of the assets at the end of 2018 *(Amount in Rs. lakhs)*

End of 2018	Goodwill	Identifiable assets	Total
Carrying amount in 2018	0	2,225	2,225
Add: Reversal of impairment loss (W.N.2)	-	175	175
Carrying amount after reversal of impairment loss	-	2,400	2,400

Working Note:

1. Calculation of depreciation after impairment till 2018 and reversal of impairment loss in 2018.

			(Amount in Rs. lakhs)
	Goodwill	Identifiable assets	Total
Carrying amount after impairment loss in 2016	0	2,720	2,720
Additional depreciation (i.e. (2,720/11) x 2)	–	(495)	(495)
Carrying amount	0	2,225	2,225
Recoverable amount			3,420
Excess of recoverable amount over carrying amount			1,195

Note: It is assumed that the restriction by the Government has been lifted at the end of the year 2018.

2. Determination of the amount to be impaired by calculating depreciated historical cost of the identifiable assets without impairment at the end of 2018

(Amount in Rs. lakhs)

End of 2018	*Identifiable assets*
Historical cost	4,000
Accumulated depreciation	(266.67 x 6 years) = (1,600)
Depreciated historical cost	2,400
Carrying amount (in W.N. 1)	2,225
Amount of reversal of impairment loss	175

Notes:

1. As per para 107 of AS 28, in allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset should not be increased above the lower of:
   (a) its recoverable amount (if determinable); and
   (b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.

   Hence impairment loss reversal is restricted to Rs. 175 lakhs only.
2. The reversal of impairment loss took place in the 6th year. However, goodwill is amortised in 5 years. Therefore, there would be no balance in the goodwill account in the 6th year even without impairment loss. Hence in W.N. 2 above there is no column for recalculation of goodwill.

6. ABC Ltd. prepares consolidated financial statements upto 31st March each year. On 1 st July 2017, ABC Ltd. acquired 75% of the equity shares of JKL Ltd. and gained control of JKL Ltd. the issued shares of JKL Ltd. is 1,20,00,000 equity shares. Details of the purchase consideration are as follows:

− On 1st July, 2017, ABC Ltd. issued two shares for every three shares acquired in JKL Ltd. On 1st July, 2017, the market value of an equity share in ABC Ltd. was Rs. 6.50 and the market value of an equity share in JKL Ltd. was Rs. 6.

− On 30th June, 2018, ABC Ltd. will make a cash payment of Rs. 71,50,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 2017. On 1 st July, 2017, ABC Ltd. would have to pay interest at an annual rate of 10% on borrowings.

− On 30th June, 2019, ABC Ltd. may make a cash payment of Rs. 3,00,00,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 2017. This payment is contingent upon the revenues of ABC Ltd. growing by 15% over the two-year period from 1st July, 2017 to 30th June, 2019. On 1st July, 2017, the fair value of this contingent consideration was Rs. 2,50,00,000. On 31st March, 2018, the fair value of the contingent consideration was Rs. 2,20,00,000.

On 1st July, 2017, the carrying values of the identifiable net assets of JKL Ltd. in the

books of that company was Rs. 6,00,00,000. On 1st July, 2017, the fair values of these net assets was Rs. 7,00,00,000. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 31st March, 2018, JKL Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 2018 it was necessary for ABC Ltd. to recognise an impairment of the goodwill arising on acquisition of JKL Ltd., amounting to 10% of its total computed value.

Compute the impairment of goodwill in the consolidated financial statements of ABC Ltd. under both the methods permitted by Ind AS 103 for the initial computation of the noncontrolling interest in JKL Ltd. at the acquisition date.

[RTP NOV 2018]

Answer:

Computation of goodwill impairment

	NCI at fair value	NCI at of net assets
	₹ in '000	₹ in '000
Cost of investment		
Share exchange (12,000 x 75% x 2/3 x ₹ 6.50)	39,000	39,000
Deferred consideration (7,150 / 1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Non-controlling interest at date of acquisition:		
Fair value – 3000 x ₹ 6	18,000	
% of net assets – 68,000 (Refer W.N.) x 25%		17,000
Net assets on the acquisition date (Refer W.N.)	(68,000)	(68,000)
Goodwill on acquisition	20,500	19,500
Impairment @ 10%	2,050	1,950

Working Note:

Net assets on the acquisition date	₹ '000
Fair value at acquisition date	70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]	(2,000)
	68,000

7. M Ltd. has three cash-generating units: A, B and C. Due to adverse changes in the technological environment, M Ltd. conducted impairment tests of each of its cash - generating units. On 31st March, 2018, the carrying amounts of A, B and C are Rs. 100 lakhs, Rs. 150 lakhs and Rs. 200 lakhs respectively.

The operations are conducted from a headquarter. The carrying amount of the headquarter assets is Rs. 200 lakhs: a headquarter building of Rs. 150 lakhs and a research centre of Rs. 50 lakhs. The relative carrying amounts of the cash-generating units are a reasonable indication of the proportion of the head-quarter building devoted to each cash-generating unit. The carrying amount of the research centre cannot be

allocated on a reasonable basis to the individual cash-generating units.
Following is the remaining estimated useful life of:

	A	B	C	Head quarter assets
Remaining estimated useful life	10	20	20	20

The headquarter assets are depreciated on a straight-line basis.
The recoverable amount of each cash generating unit is based on its value in use since net selling price for each CGU cannot be calculated. Therefore, Value in use is equal to

	A	B	C	M Ltd. as a whole
Recoverable amount	199	164	271	720*

***The research centre generates additional future cash flows for the enterprise as a whole. Therefore, the sum of the value in use of each individual CGU is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarter building.**
Calculate and show allocation of impairment loss as per AS 28. Ignore tax effects.
[RTP NOV 2018]
Answer:
1. Identification of Corporate Assets of M Ltd.
Here, the corporate assets are the headquarter building and the research centre.
For corporate building
Since, the carrying amount of the headquarter building can be allocated on a reasonable and consistent basis to the cash-generating units under review. Therefore, only a 'bottom-up' test is necessary.
For research centre
Since the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual CGU under review. Therefore, a 'top-down' test will be applied in addition to the 'bottom-up' test.
2. Allocation of Corporate Assets
Since the estimated remaining useful life of A's CGU is 10 years, whereas the estimated remaining useful lives of B and C's CGU are 20 years, the carrying amount of the headquarter building is allocated to the carrying amount of each individual cash-generating unit on weight basis.

3. Calculation of a weighted allocation of the carrying amount of the headquarter building (Amount in Rs. lakhs rounded off)

On 31st March, 2018	A	B	C	Total
Carrying amount (A)	100	150	200	450
Useful life	10 years	20 years	20 years	
Weighting based on useful life	1	2	2	
Carrying amount after weighting	100	300	400	800
Pro-rata allocation of the building	12.5% (100/800)	37.5% (300/800)	50% (400/800)	100%
Allocation of the carrying amount of the building (based on pro-rata above) (B)	19	56	75	150
Carrying amount (after allocation of the building)	119	206	275	600

4. Calculation of Impairment Losses

(i) Application of 'bottom-up' test (Amount in Rs. lakhs)

31st March, 2018	A	B	C
Carrying amount (after allocation of the building) (Refer Point 3 above)	119	206	275
Recoverable amount (given in the question)	199	164	271
Impairment loss	0	(42)	(4)

(ii) Allocation of the impairment losses for cash-generating units B and C (Amount in Rs. lakhs)

Cash-generating unit	B	C
To headquarter building	(12) (42*56/206)	(1) (4*75/275)
To assets in cash-generating unit	(30) (42*150/206)	(3) (4*200/275)
	(42)	(4)

Since the research centre could not be allocated on a reasonable and consistent basis to A, B and C's CGU, M Ltd. compares the carrying amount of the smallest CGU to which the carrying amount of the research centre can be allocated (i.e., M as a whole) to its recoverable amount, in accordance with the 'top-down' test.

(iii) Application of the 'top-down' test (Amount in Rs. lakhs)

31st March, 2018	A	B	C	Building	Research centre	M Ltd.
Carrying amount	100	150	200	150	50	650
Impairment loss arising from the 'bottom-up' test	–	(30)	(3)	(13)	–	(46)
Carrying amount after the 'bottom-up' test	100	120	197	137	50	604
Recoverable amount						720

Since recoverable amount is more than the carrying amount of M Ltd., no additional impairment loss has been resulted from the application of the 'topdown' test. Only an impairment loss of Rs. 46 lakhs will be recognized as a result of the application of the 'bottom-up' test.

8. 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. 500 000 through a vendor financing arrangement on which interest is being charged at the rate of 10 per cent per annum.

▯ During the year ended 31st March, 20X3, East sold 10 000 steering wheels at a selling price of 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. 100 000. 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?

[RTP NOV 2019]

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 flows shall not include:
• Cash inflows from receivables
• Cash outflows from payables
• Cash inflows or outflows expected to arise from future restructuring to which an entity is not yet committed
• Cash inflows or outflows expected to arise from improving or enhancing the asset's

Performance • Cash inflows or outflows from financing activities
• Income tax receipts or payments.

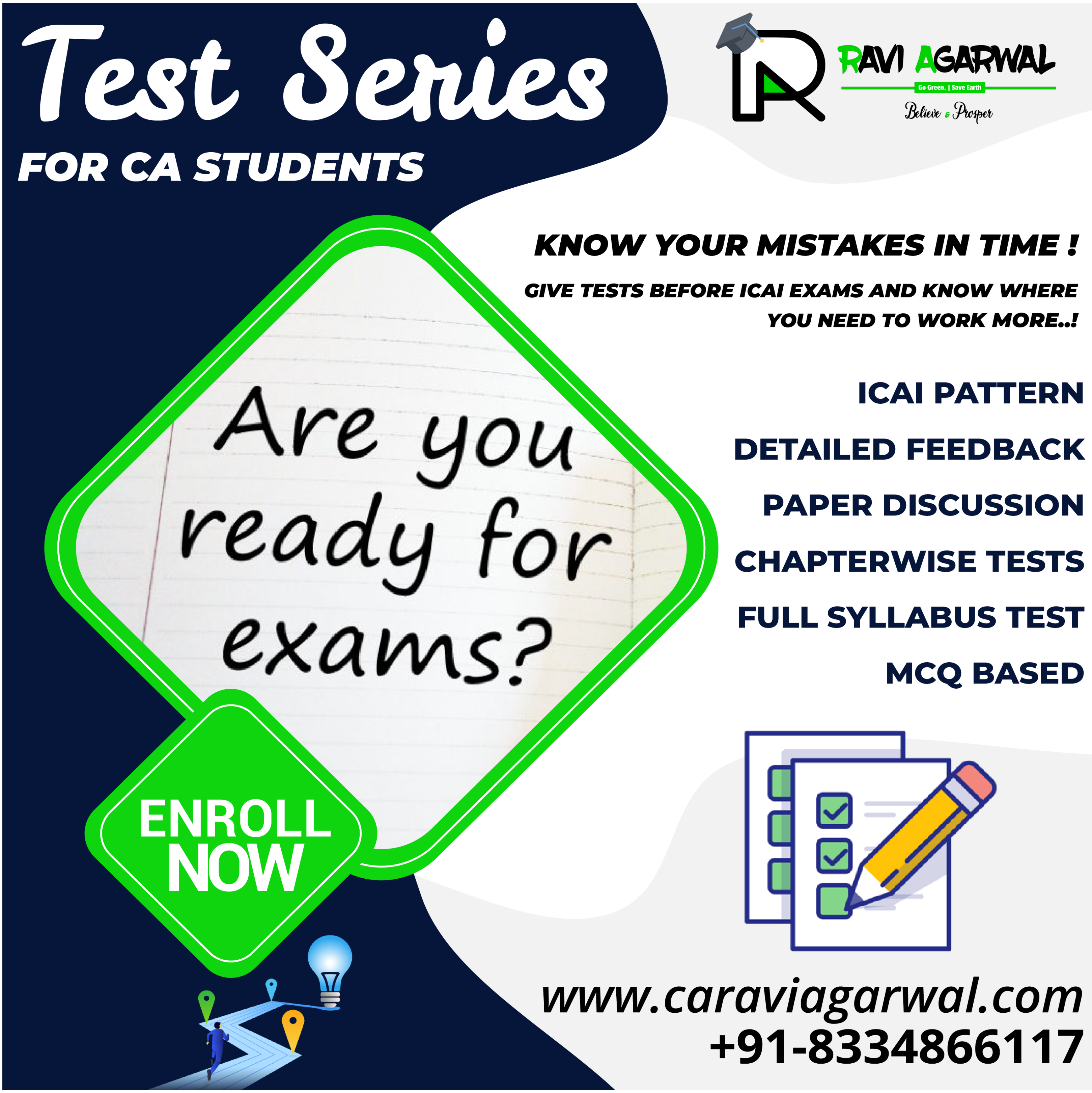
Hence in this case, cash flows do not include financing interest (i.e. 10%), tax (i.e. 30%) and capital expenditures to which East has not yet committed (i.e. Rs. 100 000). They also do not include any savings in cash outflows from these capital expenditure, as required by Ind AS 36. The cash flows (inflows 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	20X5-20X6	20X6-X7	20X7-X8	Value in use
Quantity (A)	10,000	10,500	11,025	11,576	12,155	
Price per unit(B)	₹ 200	₹ 206	₹ 212	₹ 219	₹ 225	
Estimated cash inflows (C=A x B)	₹ 20,00,000	₹ 21,63,000	₹ 23,37,300	₹ 25,35,144	₹ 27,34,875	
Misc. cash inflow disposal proceeds (D)					₹ 80 000	
Total estimated cash inflows (E=C+D)	₹ 20,00,000	₹ 21,63,000	₹ 23,37,300	₹ 25,35,144	₹ 28,14,875	
Cost per unit (F)	₹ 160	₹ 162	₹ 165	₹ 168	₹ 171	
Estimated cash outflows (G = A x F)	(₹ 16,00,000)	(₹ 17,01,000)	(₹ 18,19,125)	(₹ 19,44,768)	(₹ 20,78,505)	
Misc. cash outflow: maintenance costs (H)			(₹ 50,000)			
Total estimated cash outflows (I=G+H)	(₹ 16,00,000)	(₹ 17,01,000)	(₹ 18,69,125)	(₹ 19,44,768)	(₹ 20,78,505)	
Net cash flows (J=E-I)	₹ 4,00,000	₹ 4,62,000	₹ 4,68,175	₹ 5,90,376	₹ 7,36,370	
Discount factor 8% (K)	0.9259	0.8573	0.7938	0.7350	0.6806	
Discounted future cash flows (L=J x K)	₹ 3,70,360	₹ 3,96,073	₹ 3,71,637	₹ 4,33,926	₹ 5,01,173	₹ 20,73,169

9. 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. Investor Ltd. 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. XYZ Ltd. paid a dividend of ` 12,00,000 on 31st March, 2020. XYZ Ltd. 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 31st March, 2020 as per the relevant Ind AS. (RTP- NOV 2020)
Answer:
Calculation of Investor Ltd.'s investment in XYZ Ltd. under equity method:

	₹	₹
Acquisition of investment in XYZ Ltd.		
Share in book value of XYZ Ltd.'s net assets (35% of ₹ 90,00,000)	31,50,000	
Share in fair valuation of XYZ Ltd.'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 Investor Ltd.		**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 Investor Ltd.'s investment in XYZ Ltd.		**46,10,000**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UNIT 6: INDAS 38: INTANGIBLE ASSETS

Illustrations

1: Identifiability

Sun Ltd has an expertise in the consulting business. In years gone by, the Company gained a 30% market share for its services business and intends to recognise it as an intangible asset. Is the action by Company justified? **Solution** Market share does not meet the definition of intangible assets as is not identifiable i.e. it is neither separable and nor has arisen from contractual or legal rights.

2 : Control

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

Solution

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

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

3: Identifiability of Intangible assets

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

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

Solution

Under Ind AS 38 – Intangible Assets – intangible assets can only be recognised if they are **identifiable** and have a **cost** which can be reliably measured.

These criteria are very difficult to satisfy for internally developed intangibles.

For these reasons, Ind AS 38 specifically prohibits recognising advertising expenditure as an intangible asset.

The issue of how successful the store is likely to be does not affect this prohibition. Therefore, such costs should be recognised as expenses.

However, the costs would be recognised on accrual basis. Therefore, of the advertisements paid for before 31st March, 20X1, ` 7,00,000 would be recognised as an expense and ` 1,00,000 as a pre-payment in the year ended 31st March, 20X1. The ` 4,00,000 cost of advertisements paid for since 31st March, 20X1 would be charged as expenses in the year ended 31st March, 20X2

4: Separate Acquisition

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

Purchase tax : ` 1,00,000

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

Legal fees: ` 87,000

Consultancy fees for implementation : ` 1,20,000

Cost of capital of the company is 10%.

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

Solution

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

5: Business Combination

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

- **Trade Mark named "GRAND" – valued at ` 180,000 using a discounted cash flow technique.**
- **Sole distribution rights to an electronic product; future cash flows from which are estimated to be ` 150,000 per annum for the next 6 years.**

10% is considered an appropriate discount rate.

The 6 year, 10% annuity factor is 4.36.

Calculate goodwill and other Intangible assets arising on acquisition

Solution

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

6: Exchange of Asset
Sun Ltd acquired a software from Earth Ltd. in exchange for a telecommunication license. The telecommunication license is carried at ` 5,00,000 in the books of Sun Ltd. The Software is carried at ` 10,000 in the books of the Earth Ltd which is not the fair value.
Advise journal entries in the following situations in the books of Sun Ltd and Earth Ltd:
1) Fair value of software is ` 5,20,000 and fair value of telecommunication license is ` 5,00,000.
2) Fair Value of Software is not measurable. However similar Telecommunication license is transacted by another company at ` 4,90,000.
3) Neither Fair Value of Software nor Telecommunication license could be reliably measured.
Answer;

		₹ in '000
Situation	Sun Ltd.	Earth Ltd.
1	Software Dr. 500 To Telecommunication license 500 To Profit on Exchange Nil	Telecommunication license Dr. 520 To Software 10 To Profit on Exchange 510
2	Software Dr. 490 Loss on Exchange Dr. 10 To Telecommunication license 500 **Note:** The company may first recognise Impairment loss and then reccord an entry. The effect is the same as impairment loss will also be charged to Income Statement.	Telecommunication license Dr. 490 To Software 10 To Profit on Exchange 480
3	Software Dr. 500 To Telecommunication license 500	Telecommunication license Dr. 10 To Software 10

7
Venus Ltd. is preparing its accounts for the year ended 31st March, 20X2 and is unsure how to treat the following items.
1. Company has completed a big marketing and advertising campaign costing ` 2,40,000. The finance director had authorised this campaign on the basis that it would create ` 5,00,000 of additional profits over the next three years.
2. A new product was developed during the year. The expenditure aggregated ` 1,50,000 of which ` 1,00,000 was incurred prior to 30th September, 20X1, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at ` 70,000.
3. Staff participated in a training programme which cost the company ` 300,000. The training organisation had made a presentation to the directors of Baxter outlining that incremental profits to the business over the next twelve months would be ` 500,000.
What amounts should appear as assets in Venus Ltd. Balance sheet as at 31st March, 20X2?
Solution
The treatment in Venus Ltd's balance sheet as at 31st March, 20X2 will be as follows:

1. Marketing and advertising campaign: no asset will be recognised because it is not possible to identify future economic benefits that are attributable only to this campaign. All of the expenditure should be expensed in the statement of profit and loss account.
2. New product: development expenditure appearing in the statement of financial position will be valued at ` 50,000. The expenditure prior to the date on which the product becomes technically feasible is recognised in the statement of profit and loss account as an expense.
3. Training programme: no intangible asset will be recognised, because staff are not under the control of Venus Ltd. and when staff leave the benefits of the training, whatever they may be, also leave.

: Development Phase

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

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

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

Expenditure incurred for development of the process in FY 20X2-20X3 is ` 6,000. Asset was brought into use on 31st March, 20X3 and is expected to be useful for 6 years.

What is the carrying amount of the intangible asset at 31st March, 20X2 and 31st March, 20X3. Also determine the charge to profit or loss for 20X1-20X2?

At 31st March, 20X4, the amount estimated to be recoverable from the process is ` 5,000.

What is the carrying amount of the intangible asset at 31st March, 20X4 and the charge to profit or loss for 20X3-20X4 on account of impairment loss?

Solution

1) Expenditure to be transferred to profit or loss in 20X1-20X2 `

Total Expenditure	3,600
Less: Expenditure during development phase	(900)
Expenditure to be transferred to profit or loss	2,700

2) Carrying amount of intangible asset on 31st March, 20X2

Expenditure during Development Phase will be capitalised ` 900

(Recoverable amount is higher being ` 1,000, hence no impairment)

3) Carrying amount of intangible asset on 31st March, 20X3

Carrying amount of intangible asset on 31st March, 20X2	` 900
Add: Further expenditure during development phase	6,000
Total capital expenditure on development phase	6,900

4) Expenditure to be charged to profit or loss in 20X3-20X4

Opening balance of Intangible Asset	6,900	
Add: Amortisation for the year (6,900 / 6)	(1,150)	
Carrying amount of intangible asset	5,750	
Less: Recoverable Amount (5,000)		
Amount charged to profit or loss (Impairment Loss)		750

5) Carrying Amount of Intangible Asset on 31st March, 20X4

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

9 : Revaluation Model

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

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

Assuming that the year-end for both companies is 31st March, and that they both use the revaluation model, show how each of these transactions should be dealt with in the financial statements. Explain the treatment for revaluation of intangible asset. Ignore computation of amortization on them for ease of understanding.

Solution

Saturn Ltd.

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

Jupiter Ltd.

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

Note: The above amount will be different if amortization of intangible asset is taken into consideration

10

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

Year	(In metric tons)
1	50,000
2	70,000
3	1,00,000
4	1,20,000
5	1,10,000

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

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

Solution

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

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

The first year charge should be a proportion of 50,000/4,50,000 on ` 10,00,00,000 = ` 1,11,11,111.

At the end of 2nd year, as per revised estimate the total number of units to be produced in future are 3,70,000 MT (ie 65,000 + 85,000 + 1,05,000 + 1,15,000).

The amortisation for second year will be 65,000 / 3,70,000 on (10,00,00,000 – 1,11,11,111) ie 1,56,15,615.

Amortisation for remaining years (unless the estimates are again revised) :

Year 3 = 85,000 / 3,70,000 on (10,00,00,000 – 1,11,11,111) ie. ` 2,04,20,420

Year 4 = 1,05,000 / 3,70,000 on (10,00,00,000 – 1,11,11,111) ie. ` 2,52,25,225

Year 5 = 1,15,000 / 3,70,000 on (10,00,00,000 – 1,11,11,111) ie. ` 2,76,27,629

11

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

Solution

Value as on 31st March, 20X2

Original cost ` 3,00,000
Less: amortisation (` 60,000)

Net Value ` 2,40,000

Value as on 31st March, 20X3

On 1st April, 20X2, the impairment is recorded by writing down the asset to the estimated value of ` 1,50,000, which necessitates a ` 90,000 charge to profit & loss (carrying value, ` 2,40,000 less fair value ` 1,50,000).
Amortisation provided for the financial year 20X2-20X3 is ` 75,000 (` 1,50,000/2)
Net value is = ` 1,50,000 – ` 75,000 = ` 75,000.

Value as on 31st March, 20X4

As of 1st April, 20X3, the carrying value of the patent is ` 75,000.
Revalued amount of patent is ` 3,00,000.
Out of total revaluation gain of ` 2,25,000, ` 90,000 will be charged to profit & loss and balance amount of ` 1,35,000 (` 2,25,000 – ` 90,000) will be credited to revaluation reserve.
Amortisation provided for the financial year 20X3-20X4 is ` 75,000 (` 3,00,000/4)
Net value is = ` 3,00,000 – ` 75,000 = ` 2,25,000.
Similarly, Value as on March 31, 20X5 = ` 2,25,000 – `75,000 = ` 1,50,000
Value as on March 31, 20X6 = ` 1,50,000 – `75,000 = ` 75,000
Value as on March 31,20X5 = ` 75,000 – `75,000 = ` Nil

12

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

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

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

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

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

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

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

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

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

Solution

X Pharmaceutical Ltd. is advised as under:

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

The drug license should be recorded at ` 1,00,00,000.
2. It should recognise the brand as an intangible asset because it is purchased as part of acquisition and it is separately identifiable. The brand should be amortised over a period of 15 years.
The brand will be recorded at ` 3,00,00,000.

3. The advertisement expenses of ` 1,00,00,000 should be expensed off.
4. The development cost incurred during the financial year 20X1-20X2 should be capitalised.
Cost of intangible asset (Drug A) as on 31st March, 20X2

Opening cost	` 5,00,00,000
Development cost	` 5,00,00,000
Total cost	` 10,00,00,000

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

Questions

1. X Ltd. is engaged in the business of publishing Journals. They acquired 100% stake in Y Ltd., a company in the same industry. X Ltd. paid purchase consideration of ` 10,00,00,000 and fair value of net assets acquired is ` 8,50,00,000. The purchase consideration includes payment for the following as well:
(a) ` 30,00,000 for obtaining the skilled staff of Y Ltd.
(b) ` 50,00,000 by way of payment towards 'Non-compete Fee' so as to restrict Y Ltd. to compete in the same line of business for next 5 years.
However, the above items (a) and (b) are not forming part of the net assets acquired of ` 8,50,00,000.
How should the above transactions be accounted for by X Ltd?
Answer:
X Ltd. should recognise an intangible asset in respect of the consideration paid towards 'Non-Compete Fee'.
However, amount paid for obtaining skilled staff amounting to ` 30,00,000 does not meet the definition of intangible asset since X Ltd. has not established any right over the resource and the same should be expensed. The entity has insufficient control over the expected future economic benefits arising from the team of skilled staff.
Therefore, ` 50,00,000 will be separately recognised as an intangible asset, whereas amount paid for obtaining skilled staff does not meet the recognition criteria for being identified as a separate intangible asset. However, since it is acquired as part of a business combination, it forms part of the goodwill recognised at the acquisition date.
The value of goodwill would be ` 1,00,00,000 (` 1,50,00,000 – ` 50,00,000).

2. X Ltd. purchased a franchise from a restaurant chain at a cost of ` 1,00,00,000 and the franchise has 10 years life. In addition, the franchise agreement mentions that the franchisee would also pay the franchisor royalty as a percentage of sales made. Can the franchise rights be treated as an intangible asset under Ind AS 38?
Answer:
The franchise rights meets the identification criterion of an intangible asset since it arises from the contractual rights. It is acquired separately and it's cost can be measured reliably. In addition, X Ltd. will have future economic benefits and control over them from the franchise rights.
X Ltd. should recognise the franchise right as intangible asset and amortise it over 10 years. Royalty as a percentage of sales paid to the franchisor would be a charge to the profit and loss in the books of the X Ltd.

3. An entity regularly places advertisements in newspapers advertising its products and includes a reply slip that informs individuals replying to the advertisement that the entity may pass on the individual's details to other sellers of similar products, unless the individual ticks a box in the advertisement.
Over a period of time the entity has assembled a list of customers' names and addresses. The list is provided to other entities for a fee. The entity would like to recognise an asset in respect of the expected future economic benefits to be derived from the list. Can the customer list be treated as an intangible asset under Ind AS 38?
Answer:
In this situation, the entity has no legal rights to the customer relationship, but exchange transactions have taken place that evidence separability of the asset and the control that the entity is able to exercise over the asset. Therefore, the list is an intangible asset. However, the entity may not recognise the asset because the cost of generating the customer list internally cannot be distinguished from the cost of developing the business as a whole. It does not meet the conditions specified to recognize an internally generated intangible asset.

4. A software company X Ltd. is developing new software for the telecom industry. It employs 100 employs engineers trained in that particular discipline who are engaged in the development of the software. X Ltd. feels that it has an excellent HR policy and does not expect any of its employees to leave in the near future. It wants to recognise these set of engineers as a human resources asset in the form of an intangible asset. What would be your advice to X Ltd?
Answer;
Although, without doubt the skill sets of the employees make them extremely valuable to the company, however it does not have control over them. Merely having good HR policies would not make them eligible to be recognised as an intangible asset.

5. X Ltd. has acquired a telecom license from Government to operate mobile telephony in two states of India. Can the cost of acquisition be capitalised as an intangible asset under Ind AS 38?
Answer:
Cost of acquisition of the telecom license can be capitalised as an intangible asset under the head Licenses, as it will lead to future economic benefits for X Ltd.

6. X Ltd. purchased a standardised finance software at a list price of ` 30,00,000 and paid ` 50,000 towards purchase tax which is non-refundable. In addition to this, the entity was granted a trade discount of 5% on the initial list price. X Ltd. incurred cost of ` 7,00,000 towards contract with the vendor company of ` 2,00,000. At what cost the intangible asset will be recognised?
Answer;

List price	30,00,000
Less: Trade discount (5%)	(1,50,000)
	28,50,000
Non-refundable purchase tax	50,000
Customisation cost	7,00,000
Total cost	36,00,000

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

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

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

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

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

Answer:

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

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

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

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

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

(a) ` 5,00,000 – as research expenses

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

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

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

Answer:

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

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

9. X Ltd. acquired a patent right of manufacturing drug from Y Ltd. In exchange X Ltd. gives its intellectual property right to Y Ltd. Current market value of the patent and intellectual property rights are ` 20,00,000 and ` 18,00,000 respectively. At what value patent right should be initially recognised in the books of X Ltd. in following two situations?
(a) X Ltd. did not pay any cash to Y Ltd.
(b) X Ltd. pays ` 2,00,000 to Y Ltd.
Answer;
If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.
The transaction at the fair value of the asset received adjusted for any cash received or paid. Therefore, in case (a) patent is measured at ` 18,00,000, in case (b) it is measured at ` 20,00,000 (18,00,000 + 2,00,000).

10. X Garments Ltd. spent ` 1,00,00,000 towards promotions for a fashion show by way of various on-road shows, contests etc.
After that event, it realised that the brand name of the entity got popular and resultantly, subsequent sales have shown a significant improvement. It is further expected that this hike will have an effect over the next 2-3 years.
How the entity should account for the above cost incurred on promoting such show?
Answer;
Expenditure of ` 1,00,00,000 though increased future economic benefits, but it does not result in creation of an intangible asset.
Such promotional cost should be expensed off.

11. An entity is developing a new production process. During 20X1-20X2, expenditure incurred was ` 1,000, of which ` 900 was incurred before 1st March, 20X2 and ` 100 was incurred between 1st March, 20X2 and 31st March, 20X2. The entity is able to demonstrate that at 1st March, 20X2, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be ` 500. Explain the accounting treatment of expenditure incurred in 20X1-20X2 and 20X2-20X3 as per relevant Ind AS.
During 20X2-20X3, expenditure incurred is ` 2,000. At the end of 20X3, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be ` 1,900.
Answer:
At the end of the financial year 20X2, the production process is recognised as an intangible asset at a cost of ` 100 (expenditure incurred since the date when the recognition criteria were met, i.e., 1st March, 20X2). ` 900 expenditure incurred before 1st March, 20X2 is recognised as an expense because the recognition criteria were not met until 1st March, 20X2. This expenditure does not form part of the cost of the production process recognised in the balance sheet.
At the end of 20X3, the cost of the production process is ` 2,100 (` 100 expenditure recognised at the end of 20X2 plus ` 2,000 expenditure recognised in 20X3). The entity recognises an impairment loss of ` 200 to adjust the carrying amount of the process before impairment loss (` 2,100) to its recoverable amount (` 1,900). This

impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in Ind AS 36 are met.

12. X Ltd. is engaged is developing computer software. The expenditures incurred by X Ltd. in pursuance of its development of software is given below:
(a) Paid ` 2,00,000 towards salaries of the program designers.
(b) Incurred ` 5,00,000 towards other cost of completion of program design.
(c) Incurred ` 2,00,000 towards cost of coding and establishing technical feasibility.
(d) Paid ` 7,00,000 for other direct cost after establishment of technical feasibility.
(e) Incurred ` 2,00,000 towards other testing costs.
(f) A focus group of other software developers was invited to a conference for the introduction of this new software. Cost of the conference aggregated to ` 70,000.
On 15th March, 20X1, the development phase was complete and a cash flow budget was prepared.
Net profit for the year was estimated to be equal ` 40,00,000. How X Ltd. should account for the above mentioned cost?
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, ` 9,00,000 (salary cost of ` 2,00,000, program design cost of ` 5,00,000 and coding and technical feasibility cost of ` 2,00,000) would be recorded as expense 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 ` 70,000 would be expensed off.
In this situation, direct cost after establishment of technical feasibility of ` 7,00,000 and testing cost of ` 2,00,000 will be capitalised.
The cost of software capitalised is = ` (7,00,000 + 2,00,000) = ` 9,00,000.

13. X Ltd. has started developing a new production process in financial year 20X1-20X2. Total expenditure incurred till 30th September, 20X1, was ` 1,00,00,000. The expenditure on the development of the production process meets the recognition criteria on 1st July, 20X1. The records of X Ltd. show that, out of total ` 1,00,00,000, ` 70,00,000 were incurred during July to September, 20X1. X Ltd. publishes its financial results quarterly. How X Ltd. should account for the development expenditure?
Answer;
X Ltd. should recognise the intangible asset at ` 70,00,000 and ` 30,00,000 which was already recognised as an expense in first quarter should not be capitalised

14. X Ltd. decides to revalue its intangible assets on 1st April, 20X1. On the date of revaluation, the intangible assets stand at a cost of ` 1,00,00,000 and accumulated amortisation is ` 40,00,000. The

intangible assets are revalued at ` 1,50,00,000. How should X Ltd. account for the revalued intangible assets in its books of account?

Answer:

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

PAST PAPERS, MOCK TEST PAPERS & REVISION TEST PAPER

1. 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 Rs. 1,50,000 towards salaries of the program designers.
(ii) Incurred Rs. 3,00,00 0 towards other cost of completion of program design.
(iii) Incurred Rs. 80,000 towards cost of coding and establishing technical feasibility.
(iv) Paid Rs. 3,00,000 for other direct cost after establishment of technical feasibility.
(v) Incurred Rs. 90,000 towards other testing costs.
(vi) A focus group of other software develop ers was invited to a conference for the introduction of this new software. Cost of the conferen ce aggre gated to Rs. 60,000.
(vii) On March 15, 2018, the development phase was completed and a cash flow budget was prepared.
Net profit for the year 2017-18 was estimated to be equal Rs. 30,00,000.
How CARP Ltd. should account for the above mentioned cost as per relevant Ind AS?
[MAY 2019 5 MARKS/MTP-OCT 2020]
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, Rs. 5,30,000 (salary cost of Rs. 1,50,000, program design cost of Rs. 3,00,000 and coding and technical feasibility cost of Rs. 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 Rs. 60,000 would be expensed off.
In this situation, direct cost after establishment of technical feasibility of Rs. 3,00,000 and testing cost of Rs. 90,000 will be capitalised.
The cost of software capitalised is = Rs. (3,00,000 + 90,000) = Rs. 3,90,000.

2. 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. Examine and justify the treatment of these costs of Rs. 12,00,000 in the financial statements for the year ended 31st March, 2018 as per Ind AS.
[RTP NOV 2018 | MTP OCTOBER 2019 6 MARKS]

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. Therefore, the treatment given by the accountant is correct since such costs should be recognised as expenses.
However, the costs should be recognised on an accruals basis.
Therefore, of the advertisements paid for before 31 st 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, 20X2 would be charged as expenses in the year ended 31st March, 20X3.

3. 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 Rs. 35 crores. The fair value of ABR Ltd.' s net assets was Rs. 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 Rs. 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 Rs. 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 Rs. 12 crores. Based on early assessment of its sales success, the valuer has estimated its market value at Rs. 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 Rs. 10 crores.
KK Ltd. has requested you to suggest the accounting treatment of the above transaction under applicable Ind AS.
[RTP MAY 2019]

Answer:

As per para 13 of Ind AS 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. Even though 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 Rs. 15 crore and the extra Rs. 5 crore should only be disclosed as a Contingent Asset and not recognised.

(ii) Patent internally developed by ABR Ltd.: Further as per para 75 of Ind AS 38 'Intangible Assets', after initial recognition, an intangible asset shall be carried at revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market. From the information given in the question, it appears that there is no active market for patents since the fair value is based on early assessment of its sale success. Hence it is suggested to use the cost model and recognise the patent at the actual development cost of Rs. 12 crore

(iii) Grant of Licence to ABR Ltd. by the Government: As regards to the five-year license, para 44 of Ind AS 38 requires to recognize grant asset at fair value. KK Ltd. can recognize both the asset (license) and the grant at Rs. 10 crore to be amortised over 5 years.

Hence the revised working would be as follows:

Fair value of net assets of ABR Ltd.	₹ 15 crore
Add: Patent (10 + 12)	₹ 22 crore
Add: License	₹ 10 crore
Less: Grant for License	(₹ 10 crore)
	₹ 37 crores
Purchase Consideration	₹ 35 crores
Bargain purchase	₹ 2 crore

4. One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors. The senior engineer believes that the cost reductions will exceed the project costs within twenty four months of their implementation. Regulatory testing and health and safety approval was obtained on 1 June 20X5. This removed uncertainties concerning the project, which was finally completed on 20 April 20X6. Costs of Rs. 18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset. An offer of Rs. 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 Rs. 12,00,000 in perpetuity. Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long term prospects of the new process and she is of the opinion that competitors would have developed new technology at some time which would require to replace the new process within four years. She estimates that the present value of future cost savings will be Rs. 9,60,000 over this period. After that, she thinks that there is no certainty about its future. What would be the appropriate accounting treatment of aforesaid issue?
[RTP MAY 2020]

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 criterion to be met, the other criteria have been met as follows:

- Intention to complete the asset is apparent as it is a major project with full support from board
- Finance is available as resources are focused on project
- Costs can be reliably measured
- Benefits are expected to exceed costs – (in 2 years)

Amount of Rs. 15,00,000 (Rs. 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 Rs. 3,00,000 (2/12 x Rs. 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 Rs. 12,00,000 in perpetuity would clearly have a present value in excess of Rs. 12,00,000 and hence there would be no impairment. However, the research director is technically qualified, so impairment tests should be based on her estimate of a four-year remaining life and so present value of the future cost savings of Rs. 9,60,000 should be considered in that case. Rs. 9,60,000 is greater than the offer received (fair value less costs to sell) of Rs. 7,80,000 and so Rs. 9,60,000 should be used as the recoverable amount.
So, the carrying amount should be consequently reduced to Rs. 9,60,000. Calculation of Impairment loss:

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 Rs. 5,40,000 is to be recognised in the profit and loss for the year 20X5-20X6.
Necessary adjusting entry to correct books of account will be:

		₹	₹
Operating expenses- Development expenditure	Dr.	3,00,000	
Operating expenses–Impairment loss of intangible assets	Dr.	5,40,000	
To Intangible assets – Development expenditure			8,40,000

5. ABC Pvt. Ltd., recruited a player. As per the terms of the contract, the player is prohibited from playing for any other entity for coming 5 years and have to in the employment with the company and cannot leave the entity without mutual agreement. The price the entity paid to acquire this right is derived from the skills and fame of the said player. The entity uses and develops the player through participation in matches. State whether the cost incurred to obtain the right regarding the player can be recognised as an intangible asset as per Ind AS 38?(RTP- NOV 2020)

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 an entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.
Further, paragraph 15 of Ind AS 38 provides that an entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.
Since the right in the instant case is contractual, identifiability criterion is satisfied. Based on the facts provided in the given case, the player is prohibited from playing in other teams by the terms of the contract which legally binds the player to stay with ABC Ltd for 5 years.
Accordingly, in the given case, the company would be able to demonstrate control. Future economic benefits are expected to arise from use of the player in matches. Further, cost of obtaining rights is also reliably measurable. Hence, it can recognise the costs incurred to obtain the right regarding the player as an intangible asset. However, careful assessment of relevant facts and circumstances of each case is required to be made.

UNIT 7 : INDIAN ACCOUNTING STANDARD 40 : INVESTMENT PROPERTY

Illustrations

1

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

Solution

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

So, X Limited should add the cost of new walls and remove the carrying amount of old walls.

The new carrying amount of the building = ` 50,00,000 + ` 5,00,000 – ` 1,00,000 = ` 54,00,000.

2

Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for ₹ 5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying ₹ 6,25,000 as a one-time joining fee. Netravati Ltd. wants to write off the one-time joining fees paid as an expense under Membership and Subscription Charges and value the investment property at ₹ 5 crores. Advise.

Would you answer change if the office space was purchased with the intention of using it as an administrative centre of the company?

Solution

Cost of Investment Property

As per Ind AS 40, the cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs). Accordingly, on initial recognition, the one-time joining fee of ₹ 6,25,000 should be added to the purchase price. Therefore, the investment property should be measured at ₹ 5,06,25,000 (i.e. cost of the commercial office space + one-time joining fee). Writing off the amount of ₹ 6,25,000 to the P&L is not appropriate.

Use as Administrative Office

If the property is used as an administrative centre, it is not an investment property, but rather an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

Even under Ind AS 16, all direct costs relating to the acquisition of the asset should be added to the purchase price. Hence, cost of the asset under Ind AS 16 would be ₹ 5,06,25,000

3

X Limited purchased a building for ₹ 30,00,000 on 1st May, 20X1 with an intention to earn rentals. The purchase price was funded by a loan, interest on which is payable @ 5%. Property transfer taxes and direct legal costs of ₹ 1,00,000 and ₹ 20,000 respectively were incurred in acquiring the building. X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

(a) ₹ 2,00,000 planning permission.

(b) ₹ 7,00,000 construction costs (including ₹ 40,000 refundable purchase taxes)

What is the cost of the Building as per Ind AS 40?
Solution
As per Ind AS 40, the cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs).
Accordingly, cost of the Building is arrived at as under:

Particulars		Amount in ₹	Total ₹
Purchase price			30,00,000
Add:	Property transfer taxes		1,00,000
	Direct legal costs		20,000
	Fee for planning permission		2,00,000
	Construction costs	7,00,000	
	Less: Refundable purchase taxes	40,000	6,60,000
Cost of the Building as per Ind AS 40			39,80,000

Note: The building does not qualify the substantial period criteria for redevelopment of property. Hence, borrowing cost of loan fund has not been capitalised.

4
X Limited purchased a land worth of ₹ 1,00,00,000. It has option either to pay full amount at the time of purchases or pay for it over two years for a total cost of ₹ 1,20,00,000. What should be the cost of the building under both the payment methods?
Solution
Using either payment method, the cost will be ₹ 1,00,00,000. If the second payment option is used, ₹ 20,00,000 will be treated as interest expenses over the credit period of 2 years.

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

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

Questions

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

Answer:

Cost of the asset is ₹ 40,00,000.
Depreciable amount = Cost less Residual value = ₹ (40,00,000 - 2,00,000) = ₹ 38,00,000
Depreciation for the year = Depreciable amount/useful life
= ₹ 38,00,000/20
= ₹ 1,90,000.
Carrying amount = Cost less accumulated depreciation
= ₹ (40,00,000 - 1,90,000) = ₹ 38,10,000.

2. X Limited has an investment property (building) which is carried in Balance Sheet on 31st March, 20X1 at ₹ 15,00,000. During the year X Limited has stopped letting out the building and used it as its office premise. On 31st March, 20X1, management estimates the recoverable amount of the building as ₹ 10,00,000 and its remaining useful life as 20 years and residual value is nil. How should X Limited account for the above investment property as on 31st March, 20X1?

Answer:

At 31st March, 20X1, X Limited must transfer the property from investment property to property, plant and equipment since there is a change in use of the said building.
The transfer should be made at its carrying amount i.e., ₹ 15,00,000.
Since recoverable amount of the property as on 31st March, 20X1 is ₹ 10,00,000, impairment loss ₹ 5,00,000 should be recognised in the Statement of Profit and Loss. So, the carrying amount of Investment property at 31st March,20X1 would be ₹ 10,00,000.
The entity must disclose the reclassification.
From April, 20X1, X Limited will depreciate the building over its remaining useful life of 20 years.

3. In financial year 20X1-20X2, X Limited incurred the following expenditure in acquiring property consisting of 6 identical houses each with separate legal title including the land on which it is built.
The expenditure incurred on various dates is given below:
On 1st April, 20X1 - Purchase cost of the property ₹ 1,80,00,000.
On 1st April, 20X1 – Non-refundable transfer taxes ₹ 20,00,000 (not included in the purchase cost).
On 2nd April, 20X1- Legal cost related to property acquisition ₹ 5,00,000.
On 6th April, 20X1- Advertisement campaign to attract tenants ₹ 3,00,000.
On 8th April, 20X1 - Opening ceremony function for starting business ₹ 1,50,000.
Throughout 20X1-20X2, incurred ₹ 1,00,000 towards day-to-day repair maintenance and other administrative expenses.
X Limited uses one of the six houses for office and accommodation of its few staffs. The other five houses are rented to various independent third parties.
How X Limited will account for all the above-mentioned expenses in the books of account?
Answer:

The cost of the property = ₹ (1,80,00,000 + 20,00,000 + 5,00,000) = ₹ 2,05,00,000.
Since five houses out of six are being rented, so 5/6th of the property cost will be accounted for as an investment property and 1/6th of the property cost will be accounted for as owner-occupied property.
Cost of the investment property = ₹ 2,05,00,000 x 5/6 = ₹ 1,70,83,333
Cost of the owner-occupied property = ₹ (2,05,00,000 - 1,70,83,333) = ₹ 34,16,667.
All other costs, i.e., advertisement expenses, ceremony expenses and repair maintenance expenses will be expensed off as and when incurred.

4. X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 20X1, X Ltd. purchased a large property (consisting of land) for ₹ 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were ₹ 20,00,000. On 31st March, 20X5, the fair value of the property was ₹ 2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 20X5 and vacated the property on 30th September, 20X5. On 30th September, 20X5, the fair value of the property was ₹ 2,90,00,000. On 1st October, 20X5, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of ₹ 60,00,000 on this conversion project between 30th September, 20X5 to 31st March, 20X6. The project was incomplete at 31st March, 20X6 and the directors of X Ltd. estimate that they need to spend a further ₹ 40,00,000 to complete the project, after which each flat could be sold for ₹ 50,00,000.
Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 20X6 as per Ind AS. [RTP ⍰ NOV 2018]
Answer:
From 1st April, 20X1, the property would be regarded as an investment property since it is being held for its investment potential rather than being owner occupied or developed for sale.
The property would be measured under the cost model. This means it will be measured at ₹ 2,00,00,000 at each year end.
On 30th September, 20X5, the property ceases to be an investment property. X Ltd. begins to develop it for sale as flats. As per para 59 of Ind AS 40, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes. Hence, the carrying value of the reclassified property will be ₹ 2,00,00,000.
Since the lease of the property is an operating lease, rental income of ₹ 10,00,000 (₹ 20,00,000 x 6/12) would be recognised in P/L for the year ended 31st March, 20X6.
The additional costs of ₹ 60,00,000 for developing the flats which were incurred up to and including 31st March, 20X6 would be added to the 'cost' of inventory to give a closing cost of ₹ 2,60,00,000.
The total selling price of the flats is expected to be ₹ 5,00,00,000 (10 x ₹ 50,00,000). Since the further costs to develop the flats total ₹ 40,00,000, their net realisable value is ₹ 4,60,00,000 (₹ 5,00,00,000 – ₹ 40,00,000), so the flats will be measured at a cost of ₹ 2,60,00,000.
The flats will be shown in inventory as a current asset.

5. Shaurya Limited owns a 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 ₹ 10 crores 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 ₹ 2 crores. 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 = ₹ 75 lakhs
Rental income from Building B = ₹ 25 lakhs
Sales promotion expenses = ₹ 5 lakhs
Fees & Taxes = ₹ 1 lakhs
Ground rent = ₹ 2.5 lakhs
Repairs & Maintenance = ₹ 1.5 lakhs
Legal & Professional = ₹ 2 lakhs
Commission and brokerage = ₹ 1 lakhs
The company does not have any restrictions and contractual obligations against Property - 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 ₹ 50 - ₹ 60. And it is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.
Assume that the fair value of properties based on discounted cash flow method is measured at ₹ 10.50 crores. The treatment of fair value of properties is to be given in the financials as per the requirements of Indian accounting standards.
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.

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 Ind AS 16's requirements 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 (₹ in crores)
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 (₹ in crores)
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 March 31, 20X2, the fair value of the properties is ₹ 10.50 crores. The valuation is performed by independent valuers, who are specialists in valuing investment properties. A valuation model as recommended by International Valuation Standards Committee has been applied. The Company considers factors like management intention, terms of rental agreements, area leased out, life of the assets etc. to determine classification of assets as investment properties.

The Company has no restrictions on the realisability of its investment properties and no contractual obligations to purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

Description of valuation techniques used and key inputs to valuation on investment properties:

Valuation technique	**Significant unobservable inputs**	**Range (Weighted average)**
Discounted cash flow (DCF) method	- Estimated rental value per sq. ft. per month - Rent growth per annum - Discount rate	-₹ 50 to ₹ 60 -10% every 3 years -12% to 13%

PAST PAPERS, MOCK TEST PAPERS & REVISION TEST PAPER

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

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

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

depreciation subsequent to revaluation?
[RTP MAY 2019 | RTP MAY 2020]
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; or
(b) The accumulated depreciation is eliminated against the gross carrying amount of the asset. The amount of the adjustment of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with the paragraphs 39 and 40 of Ind AS 16.
If the Company opts for the treatment as per option (a), then the revised carrying amount of the machinery will be:

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

Journal entry

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

If the balance of accumulated depreciation is eliminated as per option (b), then the revised carrying amount of the machinery will be as follows:
Gross carrying amount is restated to Rs.150 to reflect the fair value and Accumulated depreciation is set at zero

Journal entry

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

Depreciation

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

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


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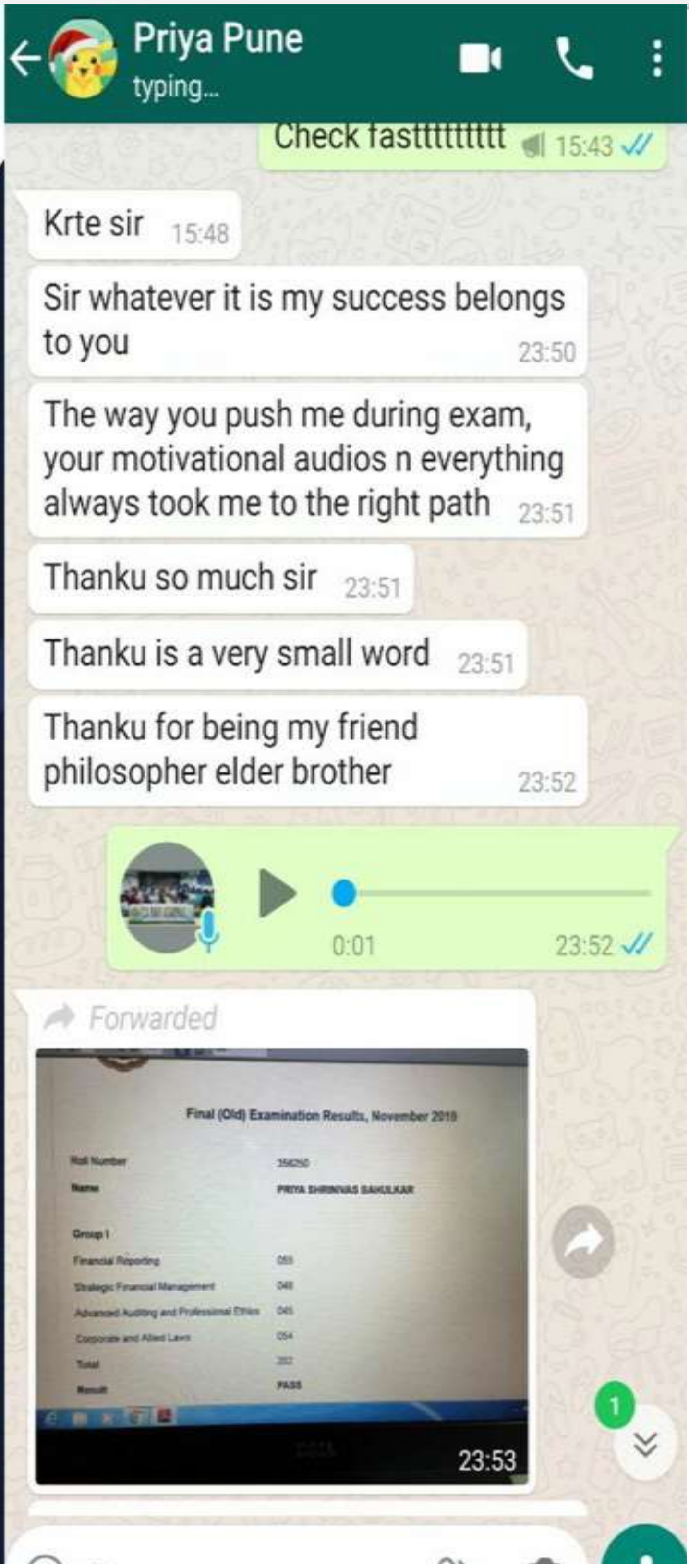
Priya Pune
typing...
Check fastttttttttt 15:43
Krte sir 15:48
Sir whatever it is my success belongs to you 23:50
The way you push me during exam, your motivational audios n everything always took me to the right path 23:51
Thanku so much sir 23:51
Thanku is a very small word 23:51
Thanku for being my friend philosopher elder brother 23:52
0:01 23:52
Forwarded
23:53

UNIT 8: INDAS 105: NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

Illustrations

1 - Measurement prior to classification as held for sale

Entity ABC owns an item of property and it was stated at the following amounts in its last financial statements:

31st March, 20X1	`
Cost	12,00,000
Depreciation	(6,00,000)
Net book value	6,00,000

The asset is depreciated at an annual rate of 10% i.e. ` 1,20,000 p.a.

Entity ABC closes its books as on 31st March each year. During July, 20X2, entity ABC decides to sell the asset and on 1st August it meets the conditions to be classified as held for sale. Analyse.

Solution

At 31st July, entity ABC should ensure that the asset is measured in accordance with Ind AS 16. It should be depreciated by further ` 40,000 (` 1,20,000 x 4/12) and should be carried at ` 5,60,000 before it is measured in accordance with Ind AS 105.

Note: From the date the asset is classified as held for sale no further depreciation will be charged.

2

S Ltd purchased a property for ` 6,00,000 on 1st April, 20X1. The useful life of the property is 15 years. On 31st March, 20X3, S Ltd classified the property as held for sale. The impairment testing provides the estimated recoverable amount of ` 4,70,000.

The fair value less cost to sell on 31st March, 20X3 was ` 4,60,000. On 31st March, 20X4 management changed the plan, as property no longer met the criteria of held for sale. The recoverable amount as at 31st March, 20X4 is ` 5,00,000. Provide the accounting treatment of events for the year ending 31st March, 20X3 and 31st March, 20X4 and value the property at the end of 20X3 and 20X4.

Solution

(a) Value of property immediately before the classification as held for sale as per Ind AS 16 as on 31st March, 20X3

	`
Purchase Price	6,00,000
Less: Accumulated Depreciation	80,000 (for two years)
Less: Impairment loss	50,000 (5,20,000-4,70,000)
Carrying Amount	**4,70,000**

On initial classification as held for sale on 31st March, 20X3, the value will be lower of:

Carrying amount after impairment	` 4,70,000
Fair Value less Cost to sell	` 4,60,000

On 31st March, 20X3 Non-current asset classified as held for sale will be recorded at ` 4,60,000 profit or loss for the year ended 31st March, 20X3.

(b) On 31st March, 20X4, held for sale property is reclassified as criteria doesn't met. The value will be lower of:

Carrying amount immediately before classification on 31st March, 20X3	` 4,70,000
Less: Depreciation based on 13 years balance life	(` 36,154)
Carrying amount had the asset is not classified as held for sale	` 4,33,846
Recoverable Amount	` 5,00,000

Property will be valued at ` 4,33,846 on 31st March, 20X4
Adjustment to the carrying amount of ` 26,154 (` 4,60,000 - 4,33,846) is charged to the profit or loss.

3

Identify whether each of the following scenarios gives rise to a discontinued operation and/or classification of assets as held for sale:

S. No	Particulars	Discontinued operation Yes/No	Assets held for sale Yes/No
1	MNO disposes of a component of the entity by selling the underlying assets. The sales transaction is incomplete at the reporting date.		
2	PQR has ceased activities that meet the definition of a discontinued operation without selling any assets.		
3	STU ceases activities and has already completed the sale of the underlying assets at the reporting date.		
4	VWX will sell or has sold assets that are within the scope of Ind AS 105, but does not discontinue any of its operations.		

Solution

Discontinued operations and assets held for sale

Particulars	Discontinued operation Yes/No	Assets held for sale Yes/No
MNO disposes of a component of the entity by selling the underlying assets. The sales transaction is incomplete at the reporting date.	Yes	Yes
PQR has ceased activities that meet the definition of a discontinued operation	Yes	No

without selling any assets.		
STU ceases activities and has already completed the sale of the underlying assets at the reporting date.	Yes	No
VWX will sell or has sold assets that are within the scope of Ind AS 105, but does not discontinue any of its operations.	No	Yes

4
Sun Ltd is a retailer of takeaway food like burger and pizzas. It decides to sell one of its outlets located in Chandani Chowk in New Delhi. The company will continue to run 200 other outlets in New Delhi.
All Ind AS 105 criteria for held for sale classification were first met at 1st October, 20X1. The outlet will be sold in June, 20X2.
Management believes that outlet is a discontinued operation and wants to present the results of outlet as 'discontinued operations'. Analysis
Solution
The Chandani Chowk outlet is a disposal group; it is not a discontinued operation as it is only one outlet. It is not a major line of business or geographical area, nor a subsidiary acquired with a view to resale.

Questions

1. On February 28, 20X1, Entity X becomes committed to a plan to sell a property. However, it plans certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months.
Can the property be classified as held for sale at the reporting date i.e. 31st March, 20X1?
Answer:
The property cannot be classified as held for sale at the balance sheet date as it is not available for sale immediately in its present condition. Although the renovations are expected to be completed within a short span 2 months, this fact is not relevant for classification. The delay in the timing of the transfer of the property imposed by the Entity X demonstrates that the property is not available for immediate sale. However, if the PPE meets the criteria for held for sale by 30th April, 20X1 (i.e., 2 months from February 28, 20X1) and the accounts are not authorised by that date, then necessary disclosures need to be given in the financial statements.

2. On 1st March, 20X1, entity R decides to sell one of its factories. An agent is appointed and the factory is actively marketed. As on 31st March, 20X1, it is expected that the factory will be sold by 28th February, 20X2. However, in May 20X1, the market price of the factory deteriorated. Entity R believed that the market will recover and thus did not reduce the price of the factory. The company's accounts are authorised for issue on 26th June, 20X1. Should the factory be shown as held for sale as on 31st March, 20X1?
Answer:
In this example, the factory ceases to meet the definition of held for sale post the balance sheet date but before the financial statements are authorised for issue, as it is not actively marketed at a reasonable price. But, since the market conditions deteriorated post the balance sheet date, the asset will be classified as held for sale as at 31st March, 20X1.

3. On 1st June, 20X1, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On 31st July, 20X1, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y. However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to

be received by 30th November, 20X1 and the sale is expected to be completed by 31st March, 20X2. Entity X follows December year end. The assets and liabilities attributable to this manufacturing unit are as under:

(Amount in `)

Particulars	Carrying value as on 31st December, 20X0	Carrying value as on 31st July, 20X1
Goodwill	500	500
Plant and Machinery	1,000	900
Building	2,000	1,850
Debtors	850	1,050
Inventory	700	400
Creditors	(300)	(250)
Loans	(2,000)	(1,850)
	2,750	2,600

The fair value of the manufacturing unit as on 31st December, 20X0 is ` 2,000 and as on 31st July, 20X1 is ` 1,850. The cost to sell is ` 100 on both these dates. The disposal group is not sold at the period end i.e., 31st December, 20X1. The fair value as on 31st December, 20X1 is lower than the carrying value of the disposal group as on that date.

Required:

1. Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?

2. The measurement of the manufacturing unit as on the date of classification as held for sale.

3. The measurement of the manufacturing unit as at the end of the year.

Answer:

Assessing whether the manufacturing unit can be classified as held for sale

The manufacturing unit can be classified as held for sale due to the following reasons:

(a) The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group must be classified as held for sale is 31st July, 20X1, i.e., the date at which management becomes committed to the plan.

(b) The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.

(c) A firm purchase agreement has been entered with the buyer.

(d) The sale is expected to be complete by 31st March, 20X2, i.e., within one year from the date of classification.

Measurement of the manufacturing unit as on the date of classification as held for sale

Following steps need to be followed:

Step 1: Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS.

This has been done and the carrying value of the disposal group as on 31st July, 20X1 is determined at ` 2,600. The difference between the carrying value as on 31st December, 20X0 and 31st July, 20X1 is accounted for as per the relevant Ind AS.

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 31st July, 20X1 is ` 1,750 (i.e.1,850-100). This is lower than the carrying value of ` 2,600. Thus an impairment loss needs to be recognised and allocated first towards goodwill and thereafter pro-rata between assets of the disposal group which are within the scope of Ind AS 105 based on their carrying value. Thus, the assets will be measured as under:

Particulars	Carrying value – 31st July, 20X1	Impairment	Carrying value as per Ind AS 105 – 31st July, 20X1
Goodwill	500	(500)	-
Plant and Machinery	900	(115)	785
Building	1,850	(235)	1,615
Debtors	1,050	-	1,050
Inventory	400	-	400
Creditors	(250)	-	(250)
Loans	(1,850)	-	(1,850)
	2,600	(850)	1,750

Measurement of the manufacturing unit as on the date of classification as at the year end
The measurement as at the year-end shall be on similar lines as done above.
The assets and liabilities in the disposal group not within the scope of this Standard are measured as per the respective Standards.
The fair value less cost to sell of the disposal group as a whole is calculated. This fair value less cost to sell as at the year-end shall be compared with the carrying value as at the date of classification as held for sale. It is provided that the fair value as on the year end is less than the carrying amount as on that date – thus the impairment loss shall be allocated in the same way between the assets of the

disposal group falling within the scope of this standard as shown above.
(a) As at 15 September, 20X1
The disposal group should be measured at ` 18,30,000 (19,00,000-70,000). The impairment write down of ` 3,30,000 (` 21,60,000 – ` 18,30,000) should be recorded within profit from continuing operations.
The impairment of ` 3,30,000 should be allocated to the carrying values of the appropriate non-current assets.

4. Following is the extract of the consolidated financial statements of A Ltd. for the year ended on:

Asset/ (liability)	Carrying amount as on 31st March, 20X1 (In ` '000)
Attributed goodwill	200
Intangible assets	950
Financial asset measured at fair value through other comprehensive income	300
Property, plant & equipment	1100
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	600
Current liabilities	(850)
Non-current liabilities – provisions	(300)
Total	2,250

On 15th September 20X1, Entity A decided to sell the business. It noted that the business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with that standard.
The disposal group is stated at the following amounts immediately prior to reclassification as held for sale.

Asset/ (liability)	Carry amount as on 15th September 20X1 (In ` '000)
Attributed goodwill	200
Intangible assets	930
Financial asset measured at fair value through other comprehensive income	360
Property, plant & equipment	1,020
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	520
Current liabilities	(870)
Non-current liabilities – provisions	(250)
Total	2,160

Entity A proposed to sell the disposal group at ` 19,00,000. It estimates that the costs to sell will be ` 70,000. This cost consists of professional fee to be paid to external lawyers and accountants.

As at 31st March 20X2, there has been no change to the plan to sell the disposal group and entity A still expects to sell it within one year of initial classification. Mr. X, an accountant of Entity A remeasured the following assets/ liabilities in accordance with respective standards as on 31st March 20X2

Available for sale:	(In ` '000)
Financial assets	410
Deferred tax assets	230
Current assets- Inventory, receivables and cash balances	400
Current liabilities	900
Non- current liabilities- provisions	250

The disposal group has not been trading well and its fair value less costs to sell has fallen to ` 16,50,000.
Required:
What would be the value of all assets/ labilities within the disposal group as on the following dates in accordance with Ind AS 105?
(a) 15 September, 20X1 and
(b) 31st March, 20X2
[RTP MAY 2018]

Answer:

(a) As at 15 September, 20X1

The disposal group should be measured at ` 18,30,000 (19,00,000-70,000). The impairment write down of ` 3,30,000 (` 21,60,000 – ` 18,30,000) should be recorded within profit from continuing operations.

The impairment of ` 3,30,000 should be allocated to the carrying values of the appropriate non-current assets.

Asset/ (liability)	Carrying value as at 15 September, 20X1	Impairment	Revised carrying value as per IND AS 105
Attributed goodwill	200	(200)	-
Intangible assets	930	(62)	868
Financial asset measured at fair value through other comprehensive income	360	-	360
Property, plant & equipment	1,020	(68)	952
Deferred tax asset	250	-	250
Current assets – inventory, receivables and cash balances	520	-	520
Current liabilities	(870)	-	(870)
Non-current liabilities – provisions	(250)	-	(250)
Total	2,160	(330)	1,830

The impairment loss is allocated first to goodwill and then pro rata to the other assets of the disposal group within Ind AS 105 measurement scope. Following assets are not in the measurement scope of the standard- financial asset measured at other comprehensive income, the deferred tax asset or the current assets. In addition, the impairment allocation can only be made against assets and is not allocated to liabilities.

(b) As on 31 March, 20X2:

All of the assets and liabilities, outside the scope of measurement under Ind AS 105, are remeasured in accordance with the relevant standards. The assets that are remeasured in this case under the relevant standards are the Financial asset measured at fair value through other comprehensive income (Ind AS 109), the deferred tax asset (Ind AS 12), the current assets and liabilities (various standards) and the non-current liabilities (Ind AS 37).

Asset/ (liability)	**Carrying amount as on 15 September, 20X1**	**Change in value to 31st March 20X2**	**Impairment**	**Revised carrying value as per Ind AS 105**
Attributed goodwill	-	-	-	-
Intangible assets	868	-	(29)	839
Financial asset measured at fair value through other comprehensive income	360	50	-	410
Property, plant & equipment	952	-	(31)	921
Deferred tax asset	250	(20)	-	230
Current assets – inventory, receivables and cash balances	520	(120)	-	400
Current liabilities	(870)	(30)	-	(900)
Non-current liabilities – provisions	(250)	-	-	(250)
Total	**1,830**	**(120)**	**(60)**	**1,650**

5. CK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June, 20X1. During the 3 months ended 30th June, 20X1 following events occurred:

On 1st April, 20X1, the Company has decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with the Company collecting any outstanding trade receivables relating to the division and settling any current liabilities On 1st April, 20X1, 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, 20X1, the Company has started to actively market the division and has received number of serious enquiries. On 1st April, 20X1 the directors estimated that they would receive Rs. 32,00,000 from the sale of the division. Since 1st April, 20X1, market condition has improved and as on 1st August, 20X1 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, 20X1 and ` 33,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June, 20X1. 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, 20X1, 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 of the division will be reported in the interim financial statements for the quarter ended 30th June, 20X1 giving relevant explanations.

Answer:

The decision to offer the division for sale on 1st April, 20X1 means that from that date the division has been classified as held for sale. The division available for immediate sale, is being actively marketed at a reasonable price and the sale is expected to be completed within one year.

The consequence of this classification is that the assets of the division will be measured at the lower of their existing carrying amounts and their fair value less cost to sell. Here the division shall be measured at their existing carrying amount ie ` 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, 20X1 so its carrying value at 30th June, 20X1 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, 20X1. 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.

6. Identify which of the following is a disposal group at 31 March 20X1:

(1) On 21 March 20X1, XYZ announced the Board's intention to sell its shares in a subsidiary company, Alpha, contingent upon the approval of Alpha's shareholders. It seems unlikely that approval will be granted in the near future and no specific potential buyer has been identified.

(2) PQR has entered into a contract to sell the entire delivery fleet of vehicles operated from its warehouse to a competitor, ABC, on 14 March 20X1. The assets will be transferred on 28 April 20X1 from which date the Group will outsource its delivery activities to another company, LMN.

(3) On 16 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 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. [RTP MAY 2019]

Answer:

Presented as held for sale

(2) PQR's fleet 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'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 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 held for sale

(1) XYZ's shares in Alpha are not available for an immediate sale as shareholders' approval is required. Also no specific potential buyer has been identified. In taking these fact into consideration for the assessment of whether the sale is highly probable, it is clearly not highly probable.

PAST PAPERS & MOCK TEST PAPERS (MTP) & REVISION TEST PAPER (RTP)

1. PB Limited purchased a plastic bottle manufacturing plant for Rs. 24 lakh on 1st April, 2015. The useful life of the plant is 8 years. On 30th September, 2017, PB Limited temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.
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 30th September, 2017 and 31st March, 2018 was Rs. 13.5 lakh and Rs. 12 lakh respectively. The accountant has made the following working:
Required:
Analyze whether the above accounting treatment is in compliance with the Ind AS. If not, advise the correct treatment showing necessary workings. [NOV 2018 8 MARKS]
Answer:
As per Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations', an entity shall classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.
For asset to be classified as held for sale, it must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable. In such a situation, an asset cannot be classified as a non-current asset held for sale, if the entity intends to sell it in a distant future. For the sale to be highly probable, the appropriate level of management must be committed to a
plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.
Further Ind AS 105 also states that an entity shall not classify as held for sale a non-current asset that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use.
An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.
In addition to Ind AS 105, Ind AS 16 states that depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.
The Accountant of PB Ltd. has treated the plant as held for sale and measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.
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:
Balance Sheet extracts as on 31st March 2018
Working Note:

Fair value less cost to sell of the Plant =	Rs. 12,00,000
Value in Use (not given) or = (since plant has temporarily not been used for manufacturing due to decline in demand)	Nil

Recoverable amount = higher of above i.e. Rs. 12,00,000
Impairment loss = Carrying amount – Recoverable amount
Impairment loss = Rs. 15,00,000 - Rs. 12,00,000 = Rs. 3,00,000

2. 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 31st March, 2019. Entity D Limited follows December year end. The assets and liabilities attributable to this manufacturing unit are as under:
The fair value of the manufacturing unit as on December 31, 2017 is Rs. 4,000 lakh and as on July 31, 2018 is Rs. 3,700 lakh. The cost to sell is Rs. 200 lakh on both these dates. The disposal group is not sold at, the period end i.e., December 31, 2018. The fair value as on 31st December, 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.
[NOV 2019 10 MARKS]
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 31st July, 2018, i.e. the date at 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 31st March, 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 31st July, 2018 is determined at Rs. 5,200 lakh. The difference between the carrying value as on 31st December, 2017 and 31st July, 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 31st July, 2018 is Rs. 3,500 lakh (i.e. Rs. 3,700 lakh - Rs. 200 lakh). This is lower than the carrying value of Rs. 5,200 lakh. 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 – 31st July, 2018	Impairment	Carrying value as per Ind AS 105 – 31st July, 2018
Goodwill	1,000	(1,000) (Refer WN)	-
Plant and Machinery	1,800	(229) (Refer WN)	1,571
Building	3,700	(471)	3,229
Debtors	2,100	-	2,100
Inventory	800	-	800
Creditors	(500)	-	(500)
Loans	(3,700)	-	(3,700)
	5,200	(1,700)	3,500

Working Note:

Allocation of impairment loss to Plant and Machinery and Building

After adjustment of impairment loss of Rs. 1,000 lakh from the full value of goodwill, the balance Rs. 700 lakh (Rs. 1,700 lakh – Rs. 1,000 lakh) is allocated to plant and machinery and Building on proportionate basis.

Plant and machinery – Rs. 700 lakh x Rs. 1,800 lakh / Rs. 5,500 lakh = Rs. 230 lakh (rounded off)

Building – Rs. 700 lakh x Rs. 3,700 lakh / Rs. 5,500 lakh = Rs. 470 lakh (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 to sell as at the year-end shall be compared with the carrying value as at the date of classification as held for sale. It is provided that the fair value as on the year end is less than the carrying amount as on that date – thus the impairment loss shall be allocated in the same way between the assets of the disposal group falling within the scope of this standard as shown above.
Measurement of the manufacturing unit as on the date of classification as at the yearend shall be on similar lines as done above.

3. 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 3 A 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 8 MARKS]
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.

4. 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

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:

$$\frac{₹\ 10,00,000}{12,00,000} = ₹\ 0.83 \text{ per ordinary share}$$

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.

$$\frac{₹\ 10,00,000 + ₹\ 1,66,295 \text{ (W.N.2)}}{12,00,000 + 5,00,000 \text{ (W.N.3)}} = ₹\ 0.69 \text{ per ordinary share}$$

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

CHAPTER-8 INDIAN ACCOUNTING STANDARD 41: AGRICULTURE

Illustrations

1

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

Solution

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

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

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

2

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

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

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

Solution

Particulars	**Amount (`)**
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

3. XYZ Ltd., on 1st December, 20X3, purchased 100 sheep from a market for ` 5,00,000. The transaction cost of 2% on the market price of the sheep was incurred which was paid by the seller. Sheep's fair value increased from ` 500,000 to ` 600,000 on 31st March, 20X4. Transaction cost of 2% would have to be incurred by the seller to get the sheep to the relevant market.

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

Solution

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

On date of Purchase

Biological Asset	Dr.	4,90,000	
Loss on initial recognition	Dr.	10,000	
To Bank			5,00,000

(Being biological asset purchased)

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

At the end of reporting period

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

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

4 Moon Ltd prepares financial statements to 31st March, each year. On 1st April 20X1 the company carried out the following transactions:
-- Purchased a land for ` 50 Lakhs.
-- Purchased 200 dairy cows (average age at 1st April, 20X1 two years) for ` 10 Lakhs.
-- Received a grant of ` 1 million towards the acquisition of the cows. This grant was non-refundable.
For the year ending 31st March, 20X2, the company has incurred following costs:
-- ` 6 Lakh to maintain the condition of the animals (food and protection).
-- ` 4 Lakh as breeding fee to a local farmer.
On 1st October, 20X1, 100 calves were born. There were no other changes in the number of animals during the year ended 31st March, 20X2. As of 31st March, 20X2, Moon Ltd had 3,000 litres of unsold milk in inventory. The milk was sold shortly after the year end at market prices.
Information regarding fair values is as follows:

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

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

Solution

Extract from the Statement of Profit & Loss

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

Extracts from Balance Sheet

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

Working Notes:

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

2. **Dairy Cows:** Under the 'fair value model' laid down in Ind AS 41 the mature cows would be recognised in the Balance Sheet at 31st March, 20X2 at the fair value of 200 x ` 5,500 = `11,00,000.
Increase in price change 200 x (5,200-5,000) = 40,000
Increase in physical change 200 x (5,500-5,200) = 60,000

The total difference between the fair value of matured herd and its initial cost (` 11,00,000 – ` 10,00,000 = a gain of ` 1,00,000) would be recognised in the profit and loss along with the maintenance costs and breeding fee of ` 6,00,000 and ` 4,00,000 respectively.
3. **Grant:** Grand relating to agricultural activity is not subject to the normal requirement of Ind AS 20. Under Ind AS 41 such grants are credited to income as soon as they are unconditionally receivable rather than being recognised over the useful economic life of the herd. Therefore, ` 10,00,000 would be credited to income of the company.
4. **Calves:** They are a biological asset and the fair value model is applied. The breeding fees are charged to income and an asset of 100 x ` 1,300 = ` 1,30,000 recognised in the Balance sheet and credited to Profit and loss.
5. **Milk:** This is agricultural produce and initially recognised on the same basis as biological assets. Thus the milk would be valued at 3,000 x ` 24 = ` 72,000. This is regarded as 'cost' for the future application of Ind AS 2 to the unsold milk.

Questions

1. 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. The enterprise's weighted average cost of capital is 6% p.a.
Only mature trees have established fair values by reference to a quoted price in an active market. The fair value (inclusive of current transport costs to get 100 logs to market) for a mature tree of the same grade as in the plantation is:
As at 31st March, 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 ` 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.
[Also asked in RTP NOV 2018 | MTP OCTOBER 2019 6 MARKS]
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 between now and the point of harvest, the fair value (and therefore the amount reported as an asset on the statement of financial position) of the plantation is estimated as follows:
As at 31st March, 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 year end dates is 126.30 (5,461.50 – 5,335.20), which will be reported as a gain in the statement or profit or loss (regardless of the fact that it has not yet been realised).

2. XY Ltd. is a farming entity where cows are milked on a daily basis. Milk is kept in cold storage immediately after milking and sold to retail distributors on a weekly basis. On 1 April 20X1, XY Ltd. ad a herd of 500 cows which were all three years old.
During the year, some of the cows became sick and on 30 September 20X1, 20 cows died. On 1 October 20X1, XY Ltd. purchased 20 replacement cows at the market for ` 21,000 each. These 20 cows were all one year old when they were purchased.

On 31 March 20X2, XY Ltd. had 1,000 litres of milk in cold storage which had not been sold to retail distributors. The market price of milk at 31 March 20X2 was ` 20 per litre. When selling the milk to distributors, XY Ltd. incurs selling costs of ` 1 per litre. These amounts did not change during March 20X2 and are not expected to change during April 20X2.

Information relating to fair value and costs to sell is given below:

Date	Fair value of a dairy cow (aged)				Costs to sell a cow
	1 year	1.5 years	3 years	4 years	
1st April 20X1	20,000	22,000	27,000	25,000	1,000
1st October 20X1	21,000	23,000	28,000	26,000	1,000
31st March 20X2	21,500	23,500	29,000	26,500	1,100

You can assume that fair value of a 3.5 years old cow on 1st October 20X1 is ` 27,000.

Pass necessary journal entries of above transactions with respect to cows in the financial statements of XY Ltd. for the year ended 31st March, 20X2? Also show the amount lying in inventory if any.

Answer:

Journal Entries on 1st October, 20X1

(All figures in ₹)

Loss (on death of 20 cows) (Refer W.N.) To Biological asset (Loss booked on death of 20 cows)	Dr.	5,20,000	5,20,000
Biological Asset (purchase of 20 new cows) (Refer W.N.) To Bank (Initial recognition of 20 new purchased cows at fair value less costs to sell)	Dr.	4,00,000	4,00,000

Journal Entries on 31st March, 20X2

Loss on remeasurement of old cows To Biological asset [(1,30,00,000 – 5,20,000) – 1,21,92,000] (Subsequent measurement of cows at fair value less costs to sell)	Dr.	2,88,000	2,88,000
Biological Asset (4,48,000 – 4,00,000) To Gain on remeasurement of new cows (Subsequent measurement of cows at fair value less costs to sell)	Dr.	48,000	48,000

Inventory (Milk) as at 31st March,20X2 = ` 19,000 (1,000 x (20 – 1))

Working Note:
Calculation of Biological asset at various dates

Date	Number	Age	Fair Value (`)	Cost to Sell (`)	Net (`)	Biological asset (`)
1st April 20X1	500	3 years	27,000	1,000	26,000	1,30,00,000
1st October 20X1	(20)	3.5 years	27,000	1,000	26,000	(5,20,000)
1st October 20X1	20	1 year	21,000	1,000	20,000	4,00,000
						1,28,80,000
31st March 20X2	480	4 years	26,500	1,100	25,400	1,21,92,000
	20	1.5 years	23,500	1,100	22,400	4,48,000
						1,26,40,000

3. Company X purchased 100 beef cattle at an auction for ` 1,00,000 on 30 September 20X1. Subsequent transportation costs were ` 1,000 that is similar to the cost X would have to incur to sell the cattle at the auction. Additionally, there would be a 2% selling fee on the market price of the cattle to be incurred by the seller.
On 31 March 20X2, the market value of the cattle in the most relevant market increases to ` 1,10,000. Transportation costs of ` 1,000 would have to be incurred by the seller to get the cattle to the relevant market. An auctioneer's fee of 2% on the market price of the cattle would be payable by the seller.
On 1 June 20X2, X sold 18 cattle for ` 20,000 and incurred transportation charges of ` 150. In addition, there was a 2% auctioneer's fee on the market price of the cattle paid by the seller.
On 15 September 20X2, the fair value of the remaining cattle was ` 82,820. 42 cattle were slaughtered on that day, with a total slaughter cost of ` 4,200. The total market price of the carcasses on that day was ` 48,300, and the expected transportation cost to sell the carcasses is ` 420. No other costs are expected.
On 30 September 20X2, the market price of the remaining 40 cattle was ` 44,800. The expected transportation cost is ` 400. Also, there would be a 2% auctioneer's fee on the market price of the cattle payable by the seller.
Pass Journal entries so as to provide the initial and subsequent measurement for all above transactions. Interim reporting periods are of 30 September and 31 March and the company determines the fair values on these dates for reporting.
Answer:
Value of cattle at initial recognition (30 September 20X1) (All figures are in `)

Value of cattle at initial recognition (30 September 20X1) **(All figures are in ₹)**

Biological asset (cattle)	Dr.	97,000*	
Loss on initial recognition	Dr.	4,000	
To Bank (Purchase and cost of transportation)			1,01,000
(Initial recognition of cattle at fair value less costs to sell)			

*Fair value of cattle = 1,00,000 – 1,000 – 2,000 (2% of 1,00,000) = 97,000

Subsequent measurement at 31 March 20X2 **(All figures are in ₹)**

Biological Assets (Cattle)	Dr.	9,800	
To Gain on Sale (Profit & Loss)			9,800
(Subsequent measurement of Cattle at fair value less costs to sell (1,06,800** – 97,000))			

** Fair value of cattle = 1,10,0000 – 1,000 – 2,200 (2% of 1,10,000) = 1,06,800

Sale of cattle on 1 June 20X2 **(All figures are in ₹)**

Biological Assets (Cattle)	Dr.	226	
To Gain on Sale (Profit & Loss)			226
(Subsequent re-measurement of 18 Cattle at fair value less costs to sell just prior to the point at which they are sold [19,450 - {(1,06,800/100) x 18}]			
Cost to Sales	Dr.	19,450	
To Biological Assets (Cattle)			19,450
(Recording a cost of sales figure separately with a corresponding reduction in the value of the biological assets)			
Bank	Dr.	19,450	
Selling expenses (150 + 400)	Dr.	550	
To Revenue			20,000
(Recognition of revenue from sale of cattle)			

Transfer of Cattle to Inventory on 15 September 20X2 **(All figures are in ₹)**

Inventory (48,300 - 420)	Dr.	47,880	
Loss on remeasurement	Dr.	1,176	
To Biological Asset (Cattle)			44,856#
To Bank (Slaughtering cost)			4,200
(Transfer of cattle to inventory)			

#Note: 44,856 is calculated as the proportion of cattle sold using the fair value (1,06,800+ 226 – 19,450) x 42/82)

Subsequent measurement of cattle at 30 September 20X2 **(All figures are in ₹)**

Loss on remeasurement	Dr.	18,440	
To Biological Asset (Cattle)			18,440
(Subsequent measurement of Cattle at fair value less costs to sell [43,504## – {(1,06,800 + 226 – 19,450)– 44,856}]			

##Fair value of cattle = 44,800 – 400 – 896 (2% of 44,800) = 43,504


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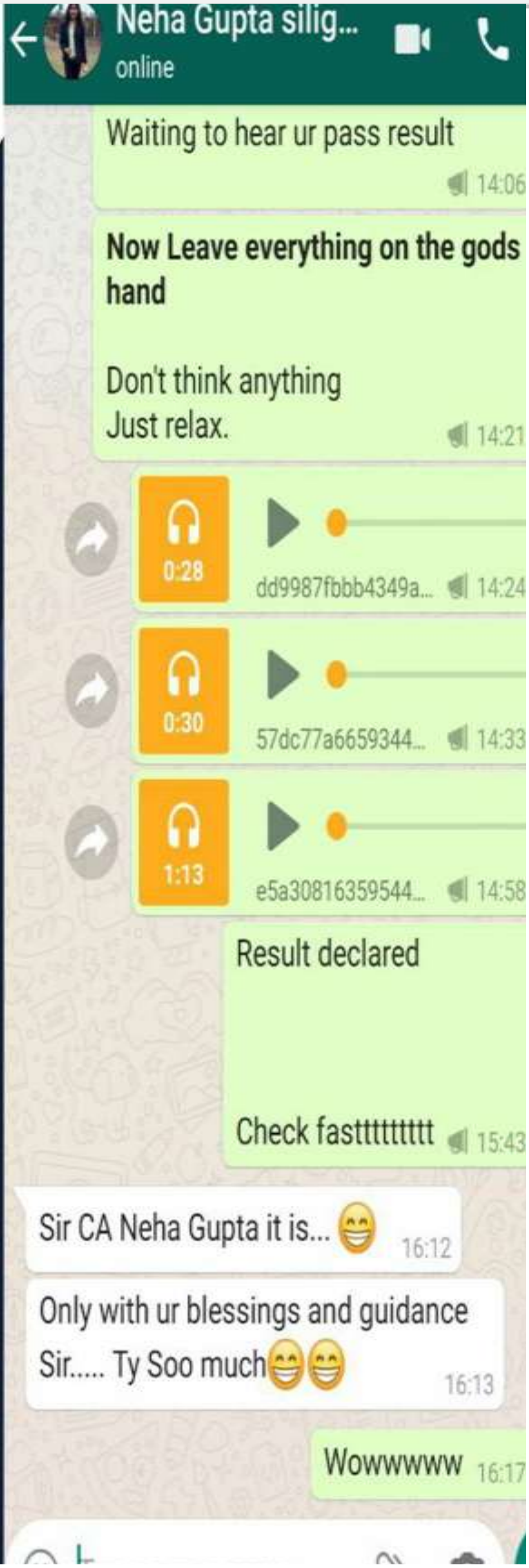
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Waiting to hear ur pass result
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Now Leave everything on the gods hand
Don't think anything
Just relax.
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Result declared
Check fastttttttt
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Sir CA Neha Gupta it is...
16:12
Only with ur blessings and guidance
Sir..... Ty Soo much
16:13
Wowwwww
16:17

CHAPTER -9 IND AS ON LIABILITIES OF THE FINANCIAL STATEMENTS

UNIT 1: INDIAN ACCOUNTING STANDARD 19: EMPLOYEE BENEFITS

Illustrations

1: Vested Accumulating Benefits
Mr. Rajan is working for Infotech Ltd. Consider the following particulars:
Annual salary of Mr. Rajan = ₹ 30,00,000
Total working days in 20X0-X1 = 300 days
Leaves allowed in 20X0-X1 as per company policy = 10 days
Leaves utilized by Mr. Rajan in 20X0-X1 = 8 days
The unutilized leaves are settled by way of payment and accordingly, carry forward of such leaves to the subsequent period is not allowed.
Compute the total employee benefit expense for Infotech Ltd. in respect of 20X0-X1.
Solution
Mr Rajan is entitled to a salary of ₹ 30,00,000 for 300 total working days.
Thus, per day salary works out to ₹ 30,00,000 ÷ 300 days = Rs. 10,000 per day
In the year 20X0-20X1, Mr. Rajan availed 8 out of 10 leaves allowed by the company.
Accordingly, leaves unutilized = 10 – 8 = 2 days
In line with the company policy, Infotech Ltd. will pay Mr. Rajan for the unutilized leave.
Thus, total expense for 20X0-20X1 = ₹ 30,00,000 + (2 days unutilized leaves x ₹ 10,000 per day) = ₹ 30,20,000

2: Non-Vested Accumulating Benefits
Mr. Niranjan is working for Infotech Ltd. Consider the following particulars:

	Year 20X0-20X1	Year 20X1-20X2
Annual salary	₹ 30,00,000	₹ 30,00,000
No. of working days during the year	300 days	300 days
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 ₹ 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.
Solution

Particulars	**Year 20X0-20X1**	**Year 20X1-20X2**
Annual Salary	₹ 30,00,000	₹ 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.	₹ 30,00,000	₹ 30,00,000

Based on the evaluation above, Mr. Niranjan has worked for 6 days more (293 days – 287 days) in 20X0-X1 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 recognized in 20X0-20X1 should be more as compared to 20X1-20X2.
Thus, if Infotech Ltd. recognizes the same expenditure of ₹ 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)	₹ 30,00,000	₹ 30,00,000
No. of working days (B)	300 days	300 days
Salary cost per day (A ÷ B)	₹ 10,000 per day	₹ 10,000 per day
No. of days worked (from above)	293 days	287 days
Expense to be recognised: **In 20X0-20X1:** ₹ 30,00,000 + [₹ 10,000 per day x 3 days (leaves unutilized expected to be utilized subsequently)]	₹ 30,30,000	
In 20X1-20X2: ₹ 30,00,000 – [₹ 10,000 per day – 3 days (excess leave utilized in 20X1-20X2)]	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			30,00,00

3: Non-Vested Accumulating Benefits
Assume same information as in Illustration 2.
Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 2 days of 20X0-20X1 subsequently.
However, in 20X1-20X2, Mr. Niranjan availed in actual all 3 days of brought forward leave.
Compute the expense to be recognised in 20X0-20X1 and 20X1-20X2. Also pass journal entries for both the years.
Solution
The expenditure to be recognized will be as under:

Particulars	**Year 20X0-20X1**	**Year 20X1-20X2**
Annual salary (A)	₹ 30,00,000	₹ 30,00,000
No. of working days (B)	300 days	300 days
Salary cost per day (A ÷ B)	₹ 10,000 per day	₹ 10,000 per day
No. of days worked (from above)	293 days	287 days
Expense to be recognised: **In 20X0-20X1:** ₹ 30,00,000 + [₹ 10,000 per day x 2 days (leaves unutilized expected to be utilized subsequently)]	₹ 30,20,000	
In 20X1-20X2: ₹ 30,00,000 – [₹ 10,000 per day x 3 days (excess leave utilized in 20X1-20X2)] + ₹ 10,000 (additional expense due to change in accounting estimate)		₹ 29,80,000

The additional ₹ 10,000 booked as an expense in 20X1-20X2 represents a change in accounting estimate (i.e. as against the entity's estimation that 2 days of unutilized leave would be utilized subsequently, actually 3 days were utilized subsequently), for which a prospective effect needs to be given, in line with Para 36 of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Journal Entry for 20X0-20X1

Employee Benefits Expense Account	Dr.	30,20,000	
To Bank Account			30,00,000
To Provision for Leave Encashment			20,000

Journal Entry for 20X1-20X2

Employee Benefits Expense Account	Dr.	29,80,000	
Provision for Leave Encashment Account	Dr.	20,000	
To Bank Account			30,00,000

4:

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

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

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

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

Solution

Type of leave (A)	Leave Entitlement (B)	Leaves c/f permissible (C)	Average leaves Unutilized (D)	No. of Employees (E)	Liability (F = D x E)
Casual Leave	30 days	10 days	5 days	30	150 days salary
Sick Leave	10 days	2 days	1 days	10	10 days salary

The entity will recognise liability in the books equal to 150 (30 x 5) days of paid casual leaves and 10 (10 x 1) days of paid sick leaves.

5

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

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

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

Solution

Vested short-term compensated absences:

Employee Benefit Expense = 100 Employees x 2 Days x ₹ 2,500 = ₹ 5,00,000

Non-vested short-term compensated absences:

Employee Benefit Expense = 100 Employees x 20% x 1 Days x ₹ 2,500 = ₹ 50,000

6

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

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

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

Solution

Paid Vacation:

Step 1: Calculation of Unused Vacation in man-days as on 31st March, 20X2:

A. No. of Employees in service for the whole year (94%):

Particulars	**Man-days**
Unused vacation as on 31st March, 20X1	3 days per employee
Entitlement to vacation for 20X1-20X2	10 days per employee
Average vacation availed in 20X1-20X2	(9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	**4 days per employee**
Total Unused vacation as on 31st March, 20X2 - (A) (350 employees x 94% x 4 days per employee)	**1,316 man-days**

B. Newcomers (6%):

Particulars	Man-days
Entitlement to vacation for 20X1-20X2	10 days per employee
Average vacation availed in 20X1-20X2	(9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	**1 day per employee**
Total Unused vacation as on 31st March, 20X2 - (B) (350 employees x 6% x 1 day per employee)	**21 man-days**
Total unused vacation as on 31st March, 20X2 (A + B)	1,337 man-days

Step 2: Calculation of average salary per day:

Particulars	Amount (₹)
Average salary per day as on 31st March, 20X1	15,000
Salary increase in 20X1-20X2	10%
Average salary per day as on 31st March, 20X2	**16,500**

Step 3: Calculation of provision for unused paid vacation: Particulars	**Amount (₹)**
Calculation of provision for unused paid vacation 20X1-20X2: (1,337 man-days x ₹ 16,500)	2,20,60,500
Provision for unused paid vacation 20X0-20X1	65,00,000

Step 4: Accounting treatment

Provision for 20X1-20X2

Employee Benefits Expenses A/c	Dr.	2,20,60,500	
To Provision for Leave Encashment			2,20,60,500

Settlement of Liability of 20X0-20X1

Provision for Leave Encashment A/c	Dr.	65,00,000	
To Cash / Bank			65,00,000

7

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

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

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

Solution

The company shall recognize a liability and an expense of an amount of ₹ 9 crores for the financial year 20X1-20X2 (i.e. 4.5% of ₹ 200 crores).

8

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

Annual bonus - during past 10 years.

Acer paid bonus to all employees who were in service during the entire financial year. Bonus was paid in June following the financial year-end. Amount of bonus for 20X1-20X2 paid in June 20X2 represented ₹ 1,25,000 per employee. Acer Ltd. used to increase amount of bonus based on official inflation rate which is 8.5% for 20X2-20X3, although there was no legal obligation to increase the bonus by such inflation rate. How would Acer Ltd. recognize liabilities and expenses for these employee benefits as on 31st March, 20X3? Pass the journal entry to show the accounting treatment.

Solution

Particulars	**Amount (₹)**
Bonus paid for 20X1-20X2	1,25,000 per employee
Bonus for 20X2-20X3 - increased by inflation of 8.5%:	1,35,625 per employee
[1,25,000 x (100% + 8.5%)]	
No. of employees in staff during the whole year [350 x (100-6%)]	329 employees
Provision for Bonus for 20X2-20X3	**4,46,20,625**

Accounting Treatment:

Provision for Bonus for 20X2-20X3

Employee Benefits Expenses A/c	Dr.	4,46,20,625	
To Provision for Bonus 20X2-20X3			4,46,20,625

Note:
It is given that the company is under no legal obligation to increase the bonus by the official inflation rate. However, the company has been increasing the bonus by the inflation rate over the past years. This has given rise to a constructive obligation for Acer Ltd. Informal practices, such as these, give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. Accordingly, provision is made for the amount considering the inflation rate.

9
A company pays each employee a lump-sum one-time benefit upon retirement. This benefit is computed based on the employee's years in service in the company and the final salary prior to retirement. To cover its liabilities from this remuneration, the company contributes 3% of annual gross salaries to the fund. Would this obligation represent a defined contribution plan or a defined benefit plan and why?
Solution
Defined benefit plan.
Reason: Although the Company pays contributions to the fund to cover its liabilities, amount of remuneration is determined in advance and Company will have to carry the risk in case the fund's assets are not sufficient to cover remuneration in full.

10
In accordance with applicable legislation, company contributes 12% and employees 12% of annual gross salaries to the provident and pension fund. Upon retirement, the employees will get the accumulated balance that is calculated based on employee's years of service and his average salary for past 15 years before retirement. The pension will be paid out of the state fund assets and the company has no further obligation except to make contributions. Would this obligation represent a defined contribution plan or a defined benefit plan?
Solution
Defined contribution plan.
Reason: Although employee's pension is determined in advance by the formula (and thus employees neither carry actuarial nor investment risks), Company's liability is limited to contributions to the fund. In this case, as pension will be paid out of the state fund, it is a state fund which carries all the risks.

11
Acer Ltd. provides lump-sum remuneration upon retirement to its employees. Remuneration is paid out of the fund to which Acer Ltd. contributes 12% of annual gross salaries. Contributions are made twice a year ie in November of the related financial year and in June after the financial year-end. Total annual gross salaries for 20X0-X1 amounted to ₹ 50 crores. Contribution made by Acer Ltd. in November 20X0 was ₹ 2.8 crores. Remuneration depends on the number of employee's service and amount of cash in the fund at retirement date (Acer Ltd. has no further obligations except for contributions).
How should this transaction appear in the financial statements of Acer Ltd. as of 31 March 20X1?
Solution

1. Calculation of accrual for contributions in 20X0-20X1:

Annual gross salaries in 20X0-20X1: ₹ 50.00 crores
Amount of total contributions for 20X0-20X1 (12%): ₹ 6.00 crores
Contributions already made in November 20X0: ₹ 2.80 crores
Accrual (₹ 6 crores - ₹ 2.8 crores) ₹ 3.20 crores

2. Accounting Treatment:

Employee Benefits Expenses Account	Dr.	6.00 crores	
To Bank Account			2.80 crores
To Contribution Payable			3.20 crores

The contribution of ₹ 6 crores will be debited to the statement profit and loss. The contribution payable of ₹ 3.20 crores will appear as a liability as at 31st March, 20X1.

12 Dinkar Ltd., a large IT company, accounts for gratuity on payment basis, and supports such accounting policy by making the following disclosure in the Financial Statements:
"Due to high labour turnover, a large degree of uncertainty is involved in estimating the liability of gratuity. Accordingly, the management opines that as the estimates of the uncertainty would confuse the readers by complicating the financial statements, such liability would be recorded on payment basis."
The management opines that by making the above disclosures, the company is complying with the requirements of all the Ind AS, as a disclosure to the effect of the above is given. The management is also willing to specifically highlight the above aspect by making it conspicuous in the financial statements.
Is the contention of management correct as per the provisions of Ind AS?

Solution

Gratuity represents a payment being made to an employee upon retirement / resignation from the organization. The amount is determined in accordance with the provisions of the Gratuity Act, 1972, which applies to Dinkar Ltd. Since the amount is determined pursuant to a formula laid down under the statue, the gratuity payable represents a Defined Benefit Plan that is to be paid to the employees, with the actuarial risk and investment risk both belonging to the employer. Thus, Dinkar Ltd. must comply with Ind AS 19 and provide for the gratuity on an annual basis.

In estimating the liability for gratuity, there would be several assumptions involved such as mortality rate, staff attrition rate, salary at the time of retirement / resignation, discount rate etc., all of which have to be considered by Dinkar Ltd. The complexity involved in this exercise does not provide Dinkar Ltd. with an excuse to avoid accrual accounting.

Dinkar Ltd. has stated that it would be willing to make a disclosure to the effect of the departure from Ind AS 10 requirements. In terms of Para 19 of Ind AS 1, departure is permitted in **extremely rare** circumstances wherein the management concludes that compliance with an Ind AS requirement would be so **misleading** that it would **conflict** with the objective of the Financial Statements set out in the Framework. In the given case, compliance with Ind AS would not be a conflict, as the compliance with Ind AS 19 would ensure that the accrual assumption laid down in the Framework is complied with. Further, a disclosure cannot be a remedy for non-compliance. Therefore, the company have to state that the Ind AS have not been complied with by the company in the preparation and presentation of its Financial Statements. Hence, the company will have to suitably modify the financial statements considering the materiality and pervasiveness of the non-compliance.

13
How will the following information be presented in the Balance Sheet of Udyog Ltd.?

Answer:

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

14
How will the following information be presented in the Balance Sheet of Udyog Ltd.?

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

Solution

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

15
AJ Ltd is engaged in the business of trading of chemicals having a net worth of ₹ 150 crores. The company's profitability is good and hence the company has introduced various benefits for its employees to keep them motivated and to ensure that they stay with the organization. The company is an associate of RJ Ltd which is listed on Bombay Stock Exchange in India.
The company initially did not have any HR function but over the last 2 years, the management set up that function and now HR department takes care of all the benefits related to the employees and how they can be structured in a manner beneficial to both the employees and the objectives of the company.
One of the employee benefits involves a lump sum payment to employee on termination of service and that is equal to 1 per cent of final salary for each year of service. Consider the salary in year 1 is ₹ 10,000 and is assumed to increase at 7 per cent (compound) each year.
Taking a discount rate at 10 per cent per year, you are required to show

(a) benefits attributed (year on year) and
(b) the obligation in respect of this benefit (year on year)
For and employee who is expected to leave at the end of year 5
Following assumptions may be taken to solve this:
- **There are no changes in actuarial assumptions.**
- **No additional adjustments are needed to reflect the probability that the employee may leave the entity at an earlier or later date.**

Solution
a. Computation of benefit attributed to prior years and current year:

Amount in ₹

Year	1	2	3	4	5
Benefit attributed to:					
- Prior years	-	131	262	393	524
- Current year (Refer W.N.1)	131	131	131	131	131
Total (i.e. current and prior years)	**131**	**262**	**393**	**524**	**655**

b. Computation of the obligation for an employee who is expected to leave at the end of year 5 (taking discount rate of 10% p.a.)

Amount in ₹

Year	1	2	3	4	5
Opening obligation (A)	-	89	196	324	475
Interest at 10% (B = A X 10%)	-	9	20	32	47
Current service cost (C) (Refer WN 2)	89	98	108	119	131
Closing obligation D = (A+B+C)	**89**	**196**	**324**	**475**	**653**

Figures have been rounded off in the above table.

Working Notes:

1. A lump sum benefit is payable on termination of service and equal to 1 per cent of final salary for each year of service. The salary in year 1 is ₹ 10,000 and is assumed to increase at 7 per cent (compound) each year.

The year on year salary would be as follows: Amount in ₹

Year	1	2	3	4	5
Salary	10,000	10,700 (10,000 x 107%)	11,449 (10,700 x 107%)	12,250 (11,449 x 107%)	13,108 (12,250 x 107%)

Accordingly, for the purpose of above-mentioned employee benefit, 1% of final salary to be considered for each year of service would be ₹ 131.

2. Computation of current service cost: Amount in ₹

Year	1	2	3	4	5
1% salary at the end of year 5	-	-	-	-	131
PV factor at the end of each year to be considered at 10% p.a. **(E)**	0.683	0.751	0.826	0.909	1.000
PV at the end of each year	89 (131 x E)	98 (131 x E)	108 (131 x E)	119 (131 x E)	131 (131 x E)

Accordingly, for the purpose of above-mentioned employee benefit, 1% of final salary to be considered for each year of service would be ₹ 131.

16

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

Solution

1. A benefit of ₹ 150 is attributed to each year.

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

17

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

Solution

1. No benefit is attributed to the service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional).

2. A benefit of ₹ 150 is attributed to each subsequent year. There is no requirement to reflect any probability of completion as the benefits vest immediately.

18

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

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

Solution

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

No benefit is attributed to subsequent years.

19
Sanat Pvt. Ltd. has a plan for the employees where employees are entitled to a benefit of 5% of final salary for each year of service before the age of 55. Compute the benefit attributed up to 55 years and after 55?
Solution
Benefit of 5% of estimated final salary is attributed to each year up to the age of 55. This is the date when further service by the employee will lead to no material amount of further benefits under the plan. No benefit is attributed to service after that age.

20
A post-employment medical plan reimburses 40 percent of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50 per cent of those costs if the employee leaves after twenty or more years of service. How will the benefit be attributed to the years of service?
Solution

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

21
A post-employment medical plan reimburses 10 percent of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50 per cent of those costs if the employee leaves after twenty or more years of service.
How will the benefit be attributed to the years of service?
Solution
1. Service in later years will lead to a materially higher level of benefit than in earlier year. So, for employees expected to leave after 20 or more years, the entity should attribute benefit on a straight-line basis under Para 71. Service beyond 20 years will lead to no material amount of further benefits. So, the benefit attributed to each of the first 20 years will be 2.5% of the Present Value of the Expected Medical Costs (50% ÷ 20 years).
2. For employees expected to leave between 10 and 20 years, the benefit attributed to each of the first 10 years is 1% (10% ÷ 10 years) of the Present Value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.
3. For employees expected to leave within ten years, no benefit is attributed.
4. The Current Service Cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefits.

22
AKJ Ltd is a listed company engaged in the business of manufacturing of electronic equipment. The company has various branch offices spread out across India and has 1,000 employees.
As per the statutory requirements, gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years -
(a) on his superannuation, or
(b) on his retirement or resignation, or
(c) on his death or disablement due to accident or disease.
The completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement.
The amount payable is determined by a formula linked to number of years of service and last drawn salary.
The amount payable to an employee shall not exceed ₹ 10,00,000.
Compute the amount of employee benefit, if any, attributed to each year of service.
Solution
The amount of gratuity would be attributed to each year of service and calculated as follows:
Number of employees not likely to fulfil the eligibility criteria will be ignored.
Other employees will be grouped according to period of service they are expected to render taking into account:
• mortality rate,
• disablement and
• resignation after 5 years.

Gratuity payable will be calculated in accordance with the formula prescribed in the governing statute based on the period of service and the salary at the time of termination of employment, assuming promotion, salary increases etc.
For those employees for whom the amount payable as per the formula does not exceed ₹ 10,00,000, over the expected period of service, the amount payable will be divided by the expected period of service and the resulting amount will be attributed to each year of the expected period of service, including the period before the stipulated period of 5 years.
In case of the remaining employees, the amount as per the formula exceeds ₹ 10,00,000 over the expected period of service of 10 years (say), and the amount of the threshold of ₹ 10,00,000 is reached at the end of 8 years (assumed) i.e. ₹ 1,25,000 (₹ 10,00,000 ÷ 8 years) is attributed to each of the first 8 years. In this case, no benefit is attributed to subsequent two years. This is because service beyond 8 years will lead to no material amount of further benefits.

23 Pratap Ltd. belongs to the ship-building industry. The company reviewed an Actuarial Valuation for the first time for its pension scheme which revealed a surplus of ₹ 60 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 20 lakhs instead of ₹ 50 lakhs. The average remaining life of the employees is estimated to be 6 years. Advise the Company in line with Ind AS 19.
Solution
1. **Recognition:** As per Ind AS 19, any Actuarial Gains and Losses should be recognized as a re-measurement of the Net Defined Benefit Liability / (Asset) in "Other Comprehensive Income".
2. **Measurement and Presentation:** In the given case, the amount of surplus from Pension Scheme of ₹ 60 lakhs is an Actuarial Gain and should be recognized as a "re-measurement" in "Other Comprehensive Income", and not to be adjusted from the amount of annual contribution in future years.

3. **Disclosure:** The change relating to Actuarial Valuation for the Pension Scheme requires disclosure under Ind AS 8. Disclosures required by Ind AS 19 should also be made in the financial statements.

24

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

The company has a large employee base. The company provided a defined benefit plan to its employees.
Following is the information relating to the balances of the fund's assets and liabilities

as at 1st April, 20X1 and 31st March, 20X2. *₹ in lacs*

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

For the financial year ended 31st March, 20X2, service cost was ₹ 55 lacs. The company made a contribution of an amount of ₹ 111 lacs to the plan. No benefits were paid during the year.
Consider a discount rate of 8%.
You are required to -
(a) Compute the balance(s) of the company to be included its balance sheet as on 31st March, 20X2 and amounts to be recognized in the statement of profit and loss and other comprehensive income for the year ended 31st March, 20X2.
(b) Give the journal entries in respect of amount(s) to be recognized. [MTP ▯ OCTOBER 2019 ▯ 8 MARKS]

Solution
(a) Extract of the Balance Sheet of RKA Private Ltd as at 31st March, 20X2

₹ in lacs
Closing net defined liability (1,580 – 1,275) lacs 305

Extract of the Statement of Profit or Loss of RKA Private Ltd for the year ended 31st March, 20X2

Particulars	**₹ in lacs**
Service cost	55
Net interest **(Refer W.N.1)**	21
Profit or loss	**76**
Other comprehensive income:	
Remeasurements **(Refer W.N.2)**	80
Total	**156**

(b) Journal entries in the books of RKA Private Ltd

Particulars		₹ in lacs	₹ in lacs
Profit & Loss	Dr.	76	
Other comprehensive income	Dr.	80	
To Cash (Contribution)			111
To Net defined benefit liability ***(Refer WN 3)***			45

Working Notes:

1. Computation of Net interest taken to the Statement of Profit or Loss

= Discount rate x Opening net defined benefit liability

= 8% x (1,400 – 1,140) lacs

= 8% x 260 lacs = 21 lacs (Rounded off to nearest lacs)

2. Computation of Remeasurements

Defined Benefit Obligation Account

Particulars	₹ in lacs	Particulars	₹ in lacs
To balance c/d (given) (closing balance)	1,580	By balance b/d (given) (opening balance)	1,400
		By Current Service Cost (given)	55
		By Interest on Opening Liability (1,400 x 8%)	112
		By Actuarial loss **(bal. figure)**	13
	1,580		1,580

OR

Statement to calculate Actuarial gain or loss on defined benefit liability:

Particulars	**₹ in lacs**
Opening balance of liability	1,400
Current service cost	55
Interest on opening liability (1,400 x 8%)	112
Actuarial loss (Bal. fig)	13
Closing balance of liability	**1,580**

Plan Assets Account

Particulars	₹ in lacs	Particulars	₹ in lacs
To balance b/d (given) (opening balance)	1,140	By balance c/d (given) (closing balance)	1,275
To Bank Account (contribution for the year)	111		
To Surplus / Actual Return (bal. figure)	24		
	1,275		**1,275**

OR

Statement to calculate Actual return on plan assets:

Particulars	**₹ in lacs**
Opening balance of asset	1,140
Cash contribution	111
Actual return (Bal. fig)	24
Closing balance of asset	**1,275**

Net interest on opening balance of plan asset = ₹ 91 lacs (i.e. ₹ 1,140 lacs x 8%) (Rounded off to nearest lacs)
Hence there is a decrease in plan assets due to remeasurement for which computation is as follows:
Actual Return – Net interest on opening plan asset
= ₹ 24 lacs – ₹ 91 lacs = ₹ 67 lacs.

Net remeasurement would be computed as follows:

Actual loss on liability + Loss on return
= ₹ 13 lacs + ₹ 67 lacs = ₹ 80 lacs.

3. Computation of increase/ decrease in net defined benefit liability:

Particulars	**₹ in lacs**
Opening net liability (₹ 1,400 lacs – ₹ 1,140 lacs)	260
Closing net liability ₹ 1,580 lacs – ₹ 1,275 lacs)	305
Increase in liability	**45**

Questions

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

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

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

Answer:

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

The entity expects that it will pay an additional twelve days of sick pay as a result of the unused entitlement that has accumulated at 31st March, 20X1 (one and a half days each, for eight employees).

Therefore, the entity would recognize a liability equal to twelve days of sick pay.

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

Answer:

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

The present value of the defined benefit obligation is the present value of monthly pension payments of 0.3% of final salary, multiplied by the number of years of service up to the end

of the reporting period. The current service cost and the present value of the defined benefit obligation are discounted because pension payments begin at the age of 65.

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

Answer:

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

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

Answer:

As per Ind AS 19, the benefit will be attributed till the period the employee service will lead to no material amount of benefits. And service in later years will lead to a materially higher level of benefit than in earlier

years. Therefore, for employees expected to leave after twenty or more years, the entity would attribute benefit on a straight-line basis. Service beyond twenty years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first twenty years is 2.5% (i.e. 50% divided by 20) of the present value of the expected medical costs.
For employees expected to leave between ten and twenty years, the benefit attributed to each of the first ten years is 2% (20 % divided by 10) of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.
For employees expected to leave within ten years, no benefit is attributed.

5. Cisca Pvt. Ltd. has a headcount of around 1,000 employees in the organisation in 20X0-20X1. As per the company's policy, the employees are given 35 days of privilege leaves (PL), 15 days of sick leaves (SL) and 10 days of casual leaves. Out of the total PL and sick leaves, 10 PL leaves and 5 sick leaves can be carried forward to next year. On the basis of past trends, it has been noted that 200 employees will take 5 days of PL and 2 days of SL and 800 employees will avail 10 days of PL and 5 days of SL.
Also the company has been incurring profits since 20XX. It has decided in 20X0-20X1 to distribute profits to its employees @ 4% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Cisca Pvt. Ltd. is expected to be around 3.5%. The profits earned during 20X0-20X1 is ₹ 2,000 crores
Cisca Pvt. Ltd. has a post-employment benefit plan also available which is in the nature of

defined contribution plan where contribution to the fund amounts to ₹ 100 crores which will fall due within 12 months from the end of accounting period.
The company has paid ₹ 20 crores to its employees in 20X0-20X1.
What would be the treatment of the short-term compensating absences, profit-sharing plan and the defined contribution plan in the books of Cisca Pvt. Ltd?
Answer:
(i) Cisca Pvt. Ltd. will recognise a liability in its books to the extent of 5 days of PL for 200 employees and 10 days of PL for remaining 800 employees and 2 days of SL for 200 employees and 5 days of SL for remaining 800 employees in its books as an unused entitlement that has accumulated in 20X0-20X1 as short-term compensated absences.
(ii) Cisca Pvt. Ltd. will recognise ₹ 70 crores (2,000 x 3.5%) as a liability and expense in its books of account.
(iii) When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service.
Under Ind AS 19, the amount of ₹ 80 crores will be recognised as a liability (accrued expense), after deducting any contribution already paid (100-20) and an expense in the statement of profit and loss. 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).
It can also be seen that the contributions are payable within 12 months from the end of the year in which the employees render the related service, they will not be discounted. However, where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they shall be discounted using the discount rate.

6. OPQ Ltd is a listed company having its corporate office at Nagpur. The company has a branch office at Chennai. The company has been operating in Indian market for the last 10 years.
The company operates a pension plan that provides a pension of 2.5% of the final salary for each year of service. The benefits become vested after seven years of service.
On 1st April, 20X8, the company increased the pension to 3% of the final salary for each year of service starting from 1st April, 20X1. On the date of the improvement, the present value of the additional benefits for service from 1st April, 20X1 to 1 April 20X8 was as follows:

- **Employees with more than seven years' service on 1 January 20X8 – ₹ 2,75,000**
- **Employees with less than 7 years of service – ₹ 2,21,000 (average 4 years to go).**

What would be the accounting treatment in this case?
Answer:

OPQ Ltd increased the pension to 3% of the final salary for each year of service starting from 1st April, 20X1 to 1st April, 20X8.
The company would recognize the total amount of ₹ 4,96,000 (i.e. ₹ 2,75,000 + ₹ 2,21,000) immediately, as for the purpose of recognition it does not make any difference as to whether the benefits are already vested or not.

7. SA Pvt Ltd is engaged in the business of retail having 100 retail outlets across Northern and Southern India. The company's head office is located at Chennai.
SA Pvt Ltd is a subsidiary of SAG Ltd. SAG Ltd is listed on the National Stock Exchange in India.
Following information is available for SA Pvt Ltd:
Plan Assets
At 1st April, 20X1, the fair value of plan assets was ₹ 10,000.
Contribution to the plan assets done on 31st March, 20X2 – ₹ 3,000
Amount paid on 31st March, 20X2 – ₹ 300
At 31st March, 20X2, the fair value of plan assets was ₹ 14,700
Actual return on plan assets – ₹ 2,000
Defined Benefit Obligation
At 1st April, 20X1, present value of the defined benefit obligation was ₹ 12,000.
At 31st March, 20X2, present value of the defined benefit obligation was ₹ 15,500.
Actuarial losses on the obligation for the year ended 31st March, 20X2 were ₹ 100.
Current Service Cost – ₹ 2,500
Benefit paid – ₹ 300
Discount rate used to calculate defined benefit liability - 10%.
As per Ind AS 19, please suggest if there is any amount based on the above-mentioned information that would be taken to other comprehensive income (with workings). Also compute net interest on the net defined benefit liability (asset).
Answer:
As per Ind AS 19, net remeasurement of ₹ 900 would be recognized in other comprehensive income.
Computation of Net remeasurement
= Remeasurement – Actuarial loss
= ₹ 1000 (Refer WN - 1) – ₹ 100 (Given in the question)= ₹ 900.

Computation of net interest expense

Particulars	Amount in ₹
Defined benefit liability as at 1 April 20X1 **(A)(Given in the question)**	12,000
Fair value of plan asset as at 1 April 20X1 **(B) (Given in the question)**	(10,000)
Net defined benefit liability **(A - B)**	2,000
Net interest expense (as it is net liability) (Refer note given below)	200

Note:
Net interest expense would be computed on net defined benefit liability using discount rate of 10% given in the question-
= Net defined benefit liability x Discount rate
= 2,000 x 10%
= ₹ 200.
Working Note:
Computation of amount of remeasurement

Particulars	Amount in ₹
Actual return on plan asset for the year ended 31 March 20X2 **(C) (Given in the question)**	2,000
Less: Interest income on ₹ 10,000 held for 12 months at 10% **(D)**	(1,000)
Remeasurement **(E = C - D)**	1,000

8. A Ltd. prepares its financial statements to 31st March each year. It operates a defined benefit retirement benefits plan on behalf of current and former employees. A Ltd. receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1st April, 20X1, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,00,00,000. On the same date, the fair value of the assets of the defined benefit plan was ₹ 5,20,00,000. On 1st April, 20X1, the annual market yield on government bonds was 5%. During the year ended 31st March, 20X2, A Ltd. made contributions of ₹ 70,00,000 into the plan and the plan paid out benefits of ₹ 42,00,000 to retired members. Both these payments were made on 31st March, 20X2.
The actuaries advised that the current service cost for the year ended 31st March, 20X2 was ₹ 62,00,000. On 28th February, 20X2, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by ₹ 15,00,000 from that date.

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

employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.

On 31st March, 20X2, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,80,00,000. On the same date, the fair value of the assets of the defined benefit plan were ₹ 5,60,00,000. Examine and present how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 20X2 as per Ind AS.

Answer:

All figures are ₹ in '000.

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

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

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

The redundancy programme represents the partial settlement of the curtailment of a defined benefit obligation. The gain on settlement of 500 (8,000 – 7,500) will be reported in the statement of profit or loss. Other movements in the net pension liability will be reported as remeasurement gains or losses in other comprehensive income.

For the year ended 31st March, 20X2, the remeasurement loss will be 3,400 (Refer W. N.).

Working Note:

Remeasurement of gain or loss

	₹ in '000
Liability at the start of the year (60,000 – 52,000)	8,000
Current service cost	6,200
Past service cost	1,500
Net finance cost	400
Gain on settlement	(500)
Contributions to plan	(7,000)
Remeasurement loss (balancing figure)	3,400
Liability at the end of the year (68,000 – 56,000)	12,000

9. On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at ₹ 20,40,000 and the present value of the defined obligation was ₹ 21,25,000. On 31st March,20X2 the plan received contributions from XYZ Ltd amounting to ₹ 4,25,000 and paid out benefits of ₹ 2,55,000. The current service cost for the financial year ending 31 March 20X2 is ₹ 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was ₹ 23,80,000, and the present value of the defined benefit obligation was ₹ 27,20,000. Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehensive income and balance sheet?\ [RTP ⍰ MAY 2020/MTP-OCT 2020]

Answer:

Reconciliation of Plan assets and Defined benefit obligation

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	Plan Assets ₹	Defined benefit obligation ₹
Fair value/present value as at 1st April 20X1	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250
Current service cost		5,10,000
Contributions received	4,25,000	-
Benefits paid	(2,55,000)	(2,55,000)
Return on gain (assets) (balancing figure)	68,000	-
Actuarial Loss (balancing figure)	-	2,33,750
Closing balance as at March 31,20X2	23,80,000	27,20,000

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

	₹
Current service cost	5,10,000
Net interest on net defined liability (₹ 1,06,250 – ₹ 1,02,000)	4,250

Defined benefit re-measurements recognised 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 recognised :

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

PAST PAPERS, MOCK TEST PAPERS & REVISION TEST PAPERS

1. In 2017-18, Diana Ltd. 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 Rs. 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 Rs. 500 lakh which will fall due within 12 months from the end of accounting period. The company has paid Rs. 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?

[MAY 2019 ? 5 MARKS]

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 for remaining 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 Rs. 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 Rs. 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, Rs. 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.

2. 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 6 MARKS]
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

3. 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 Roshan is expected to grow @ 10% per annum. The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring.
What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.
(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)
[MTP OCTOBER 2018 8 MARKS]
Answer:
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 apportioned amount of DBO [i.e. Rs. 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	b	c = b x 8%	d	e = b + c + d
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

4. 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 5 MARKS]

Answer:

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

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

Employees with more than 5 years' of service at 1st April, 2015 Rs. 60 million

Employees with less than 5 years' of service at 1st April, 2015 Rs. 20 million

The employees in the second category have completed average 2 and half years of service. Hence, they need to complete another two and half year of service until vesting.

Comment on the treatment of Rs. 80 million of the defined benefit obligation in the financial statements both as per AS 15 and Ind AS 19.

[RTP MAY 2019]

Answer:

Under AS 15, a past service cost of Rs. 60 million needs to be recognized immediately, as those benefits are already vested. The remaining Rs. 20 million cost is recognized on a straight line basis over the vesting period, i.e., period to two and half years commencing from 1st April, 2015. Under Ind AS 19, the entire past service cost of Rs. 80 million needs to be recognized and charged in profit or loss immediately. ABC Ltd. cannot defer any part of this cost.

6. **(All numbers in Rs. '000 unless 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 Rs. 60,000. On the same date, the fair value of the assets of the defined benefit plan was Rs. 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 Rs. 7,000 into the plan and the plan paid out benefits of Rs. 4200 to 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 Rs. 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 Rs. 1500 from 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 before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by Rs. 8000. Before 31st March, 20X2, ABL Ltd. made payments of Rs. 7500 to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan. On 31st March, 20X2, the actuaries advised that the present value of the defined benefit obligation was Rs. 68,000. On the same date, the fair value of the assets of the defined benefit plan were Rs. 56,000.
[RTP – NOV 2019]
Answer:
(All numbers in Rs.'000 unless otherwise stated)
On 31st March 20X2, ABL Ltd. will report a net pension liability in the statement of financial position. The amount of the liability will be Rs. 12,000 (68,000 – 56,000).

For the year ended 31st March 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 Rs. 6,200. The same treatment applies to the past service cost of Rs. 1,500.
For the year ended 31st March 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 Rs. 8,000 (60,000 – 52,000). The amount of the finance cost will be Rs. 400 (8,000 x 5%).
The redundancy programme represents the partial settlement of the curtailment of a defined benefit obligation. The gain on settlement of Rs. 500 (8,000 – 7,500) will be reported in the statement of profit or loss. Other movements in the net pension liability will be reported as remeasurement gains or losses in other comprehensive income.
For the year ended 31st March 20X2, the remeasurement loss will be Rs. 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

UNIT 2: INDIAN ACCOUNTING STANDARD 37: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

1
ABC Limited is an automobile component manufacturer. The automobile manufacturer has specified a delivery schedule, non-adherence to which will entail a penalty. As on 31st March, 20X1, the reporting date, the manufacturer has a delivery scheduled for June 20X2. However, the manufacturer is aware that he will not be able to meet the delivery schedule in June 20X2.
Determine whether the entity has a present obligation as at 31st March, 20X1, requiring recognition of provision.
Solution
In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery in June 20X2 and there is no delay as at 31st March, 20X1. Hence, there is no present obligation to pay the penalty in the current year. Therefore, there is no present obligation to recognise the provision.

2 X Shipping Ltd. is required by law to overhaul its shipping fleet once in every 3 years. The company's finance team was of the view that recognising the costs only when paid would prevent matching of revenue earned all the time with certain costs of large amounts which are incurred occasional. Thereby, it has formulated an accounting policy of providing in its books of account for the future cost of maintenance (overhauls, annual inspection etc.) by calculating a rate per hours sailed on sea and accumulating a provision over time. The provision is adjusted when the expenditure is actually incurred. Is the accounting policy of X Shipping Ltd. correct?
Solution
A provision is made for a present obligation arising out of a past event. Even a legal requirement to overhaul does not make the cost of overhaul a liability, because no obligation exists to overhaul the ships independently of the company's future actions - the company could avoid the future expenditure by its future actions for example by selling the ships. So there is no present obligation.
As per the standard, financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's balance sheet are those that exist at the end of the reporting period.
Therefore, the accounting policy of X Shipping Ltd. is not correct. The company should adopt the component approach in Ind AS 16, Property, Plant and Equipment, for accounting for the refurbishment cost.

3
X Chemical Ltd. is operating in the vicinity of a river since 20 years. A community living near X Chemical Ltd. claims that its operations has caused contamination of drinking water. X Chemical Ltd. has received notice from the governmental environmental agency that official investigations will be made into claims of pollution caused by the entity. If it is found that X Chemical Ltd. has caused contamination, then penalties and fine would be levied on it. X Chemical Ltd. believes that it has implemented all environmental safety measures to an extent that it is unlikely to cause pollution. Management is not sure whether it has all the information about the entire 20 years. Therefore, neither management nor external experts are able to assess X Chemical Ltd.'s responsibility until the investigation has completed.

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

Solution

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

4

X Ltd. has entered into an agreement with its selling agent Y, in accordance with which X Ltd. has to pay a base percentage of commission on export sales and an additional commission is to be paid if the export incentives are received. As per the accounting policy of X Ltd., it recognises export incentives when actually realised, on account of the uncertainty in realising such incentives. Export incentives have not been received for the year 20X1-20X2, however X Ltd. is hopeful of receiving the export incentives in the year 20X2-20X3. In the financial statements for 20X1-20X2, should X Ltd. provide for both base commission and additional commission?

Solution

So far as the base percentage of sales commission is concerned, it is a present obligation arising out of past events. The obligating event takes place when the sales are made and also since commission is based on percentage of sale, reliable estimation can also be made. Therefore, the base percentage of sales commission should be provided However, in respect of additional commission, it is to be paid when the export incentives are recognised and export incentives are recognised only when it is received. Therefore, the obligating event will arise only when export incentives are received. Hence, no provision for additional commission is to be made in financial year 20X1-20X2. The expectation of X Ltd. to receive the export incentives in next year would not make any difference as on 31 March 20X2.

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

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

Before the financial year end, X Sugars Ltd. received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount. Meanwhile Y Chocolates Ltd. has made demand of ` 30,00,000 since the goods were not delivered on time. What provision or disclosure would X Ltd. need to make at year end?

Solution

As per the standard, where an inflow of economic benefits is probable, an entity should disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect, measured using the principles set out in Ind AS 37. So X Sugars Ltd. would need to disclose the contingent asset of ` 2,12,50,000 (` 2,50,00,000 x 85%) at the end of the financial year 20X1-20X2. It would also need to make a provision of ` 30,00,000 towards the claim of Y Chocolates Ltd.

6 An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of ` 1 million would result. If major defects were detected in all products sold, repair costs of ` 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75% of the goods sold will have no defects, 20% of the goods sold will have minor defects and 5% of the goods sold will have major defects. In accordance with the standard, an entity assesses the probability of an outflow for the warranty obligations as a whole.

Solution

The expected value of the cost of repairs is:
(75% of nil) + (20% of 1m) + (5% of 4m) = ` 4,00,000

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

Solution

The obligation should be measured at the present value of outflows i.e., ` 30,00,000. Further a risk adjustment of 5% i.e., ` 1,50,000 (` 30,00,000 x 5%) would be made.
So, the liability will be recognised at = ` 30,00,000 + `1,50,000 = ` 31,50,000.

8

ABC Ltd. has an obligation to restore the seabed for the damage it has caused in the past. It has to pay ` 10,00,000 cash on 31st March 20X3 relating to this liability. ABC Ltd.'s management considers that 5% is an appropriate discount rate. The time value of money is considered to be material.
Calculate the amount to be provided for at 31st March 20X1 for the costs of restoring the seabed.

Solution

Discounting factor of 5% for 2nd year as on 31st March 20X1 = (1/1.05)2 = 0.907
The present value of the provision as on 31st March 20X1 is
= ` 10,00,000 x 0.907 = ` 9,07,000
The amount of increase in the provision resulting from unwinding of discounting to reflect the passage of time should be included as an element of borrowing cost in determining the profit or loss for the year.
The provision should be initially recognised at ` 9,07,000 which is the present value of ` 10,00,000 discounted at 5% for two years. At the end of year 1 i.e. 31st March 20X2, the provision increases to ` 9,52,350, and the difference of ` 45,350 is recognised as borrowing cost. Similarly, for the year ending 31st March 20X3, the provision will increase to 10,00,000 and the increase being recognised as borrowing cost. Consequently, at the end of year 2 the amount of provision will be equal to the amount due, i.e., ` 10,00,000.
Note: There may be some difference in amount due to approximation (limiting discounting factor to 3 place decimal), which can be overcome either by full scale calculation or adjustment at the end.

9

X Chemicals Ltd. engaged in the chemical industry causes environmental damage by dumping waste in the river near its factory. It does not clean up because there is no environmental legislation requiring cleaning up and X Chemicals Ltd. is causing damage for last 40 years. As at 31 March, 20X2, the State Legislature has passed a path breaking legislation requiring all polluting factories to clean-up the river water already

contaminated. The formal Gazette notification of the law is pending. How should X Chemicals Ltd. deal with this situation?

Solution

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

10

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

Solution

Since the understanding results in an enforceable agreement, the reimbursement of ` 9,00,000 (` 30,00,000 x 30%) shall be recognised as a reimbursement right and provision will be recognised for ` 30,00,000. The reimbursement right shall be treated as a separate asset and shall not be offset with the provision. In the statement of profit and loss, the expense may be presented as ` 21,00,000 after offsetting the reimbursement right.

11

X Telecom Ltd. has income tax litigation pending before appellate authorities. Legal advisor's opinion is that X Telecom Ltd. will lose the case and estimated that liability of ` 1,00,00,000 may arise in two years. The liability is recognised on a discounted basis. The discount rate at which the liability has been discounted is 10% and it is assumed that discount rate does not change over the period of 2 years.
How should X Telecom Ltd. calculate the amount of borrowing cost?

Solution

The discount factor of 10% for 2 years is 0.826. X Telecom Ltd. will initially recognise provision for ` 82,60,000 (` 1,00,00,000 x 0.826).
The discount factor of 10% at the end of year 1 is 0.909. At the end of year 1, provision amount would be ` 90,90,000 (` 1,00,00,000 x 0.909).
As per the standard, the difference between the two present values i.e., ` 8,30,000 (90,90,000-82,60,000) is recognised as a borrowing cost in year 1.
At the end of the Year 2, the liability would be ` 1,00,00,000.
The difference between the two present values i.e., ` 9,10,000 (` 1,00,00,000 - ` 90,90,000) is recognised as borrowing cost in year 2.

12

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

Solution

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

13

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

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

Solution

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

14

X Cements Ltd. has three manufacturing units situated in three different states of India. The board of directors of X Cements Ltd., in their meeting held on January 10, 20X1, decided to close down its operations in one particular state on account of environmental reasons. A detailed formal plan for shutting down the above unit was also formalised and agreed by the board of directors in that meeting, which specifies the approximate number of employees who will be compensated and expenditure expected to be incurred. Date of implementation of plan has also been mentioned. Meetings were also held with customers, suppliers, and workers to communicate the features of the formal plan to close down the operations in the said state, and representatives of all interested parties were present in those meetings. Do the actions of the board of directors create a constructive obligation that needs a provision for restructuring?

Solution

As per Ind AS 37, the conditions prescribed are:

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

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

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

15 : Warranties

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the end of the reporting period, a provision of ` 60,000 has been recognised. The provision has not been discounted as the effect of discounting is not material. Draft the Note.

Solution

A provision of ` 60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years after the reporting period.

Questions

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

During the financial year 20X1-20X2 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of ` 1,00,00,000 against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 20X1-20X2, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had more than 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 20X1-20X2.

Answer:

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

In the present case, the company is not confident that whether it would win the appeal. By

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

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

Answer:

Paragraph 14 of Ind AS 37 states that a provision shall be recognised when:

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

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

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

Further, with regard to past event paragraph 17 of Ind AS 37 states that a past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:
(a) where the settlement of the obligation can be enforced by law; or
(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation."
On the basis of the above, provision should be recognised as soon as the obligating event takes place because the entity is under legal obligation to restore the sea bed, provided the other recognition criteria stated in paragraph 14 reproduced above are met. Moreover, the amount of the provision would depend on the extent of the obligation arising from the obligating event. In the instant case, an obligating event is the laying of cables under the sea. To the extent the cables have been laid down under the sea, a legal obligation has arisen and to that extent provision for restoration of sea bed should be recognised.

3. Entity A is a dealer in washing machines. Entity A offers to its customers a scheme whereby it states that after a period of 3 years, the entity offers to buy back the washing machine at a fixed price which is expected to be less than the fair value of the machine at the end of three years. The credit emanating therefrom will be required to be used by the customer for buying a new washing machine, i.e., new washing machine will be sold at a discounted price. Past experience indicates that customers generally opt for this scheme. At the time of sale of the first washing machine should entity A recognise any provision in this regard?

Answer:
Paragraph 14 of Ind AS 37 states "A provision shall be recognised when:
(a) an entity has a present obligation (legal or constructive) as a result of a past event;
(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."
In the instant case, assuming that the entity recognises the entire revenue on the sale of first washing machine, a provision for expected cost of meeting the obligation of selling the second machine at discounted price should be recognised because sale of first washing machine is the past event.
Moreover, past experience indicates that customers generally opt for this scheme, therefore, probability of outflow of resources is more likely than not. Since it is a normal practice which the entity follows, reliable estimate of the amount of meeting the obligation can also be made.

4. U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 20X2 as per the notified Ind AS. The financial statements are due to be approved for issue on 15th May 20X2. Following are a few transactions that have taken place in some of its subsidiaries during the year:
G Ltd. is a wholly owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January 20X2, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April 20X2. They made a public announcement of their decision on 15th February 20X2.
G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 20X2. U Ltd. would collect any amounts still owed by G Ltd.'s customers after 31st May 20X2. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.:
- On the date of public announcement, it is estimated by G Ltd. that it would have to pay ` 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be ` 60 lakhs. The actual termination payments totalling to ` 520 lakhs were made in full on 15th May 20X2. As per latest estimates made on 15th May 20X2, the total relocation cost is ` 63 lakhs.
- G Ltd. had taken a property on operating lease, which was expiring on 31st March 20X6. The present value of the future lease rentals (using an appropriate discount rate) is ` 430 lakhs. On 15th May 20X2, G Ltd. made a payment to the lessor of ` 410 lakhs in return for early termination of the lease.
The loss after tax of G Ltd. for the year ended 31st March 20X2 was ` 400 lakhs. G Ltd. made further operating losses totalling ` 60 lakhs till 30th April 20X2.
What are the provisions that the Company is required to make as per Ind AS 37?
Answer:
A discontinued operation is one that is discontinued in the period or classified as held for sale at the year end. The operations of G Ltd were discontinued on 30th April 20X2 and therefore, would be treated as discontinued operation for the year ending 31st March 20X3. It does not meet the criteria for held for sale since the company is terminating its business and does not hold these for sale.
As per para 72 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', restructuring includes sale or termination of a line of business. A constructive obligation to restructure arises when:
(a) an entity has a detailed formal plan for the restructuring
(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.
The Board of directors of U Ltd have decided to terminate the operations of G Ltd. from 30th April 20X2. They have made a formal announcement on 15th February 20X2, thus creating a valid expectation that the termination will be implemented. This creates a constructive obligation on the company and requires provisions for restructuring.
A restructuring provision includes only the direct expenditures arising from the restructuring that are necessarily entailed by the restructuring and are not associated with the ongoing activities of the entity.
The termination payments fulfil the above condition. As per Ind AS 10 'Events after Reporting Date', events that provide additional evidence of conditions existing at the reporting date should be reflected in the financial statements. Therefore, the company should make a provision for ` 520 lakhs in this respect.
The relocation costs relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Hence, these would be recognised on the same basis as if they arose independently of a restructuring.
The operating lease would be regarded as an onerous contract. A provision would be made at the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. Hence, a provision shall be made for ` 410 lakhs.
Further operating losses relate to future events and do not form a part of the closure provision.
Therefore, the total provision required = ` 520 lakhs + ` 410 lakhs = ` 930 lakhs

5. A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the

stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and
financial statements have been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information?

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 only after filing of application, its accrual will be considered in the year 20X2-20X3 only.

Accordingly, the duty drawback credit is a contingent asset as at the end of the reporting period 20X1-20X2, which will be realised when the Department credits the same.

As per para 35 of Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

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

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?

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.

7. Marico has an obligation to restore environmental damage in the area surrounding its factory. Expert advice indicates that the restoration will be carried out in two distinct phases; the first phase requiring expenditure of ` 2 million to remove the contaminated soil from the area and the second phase, commencing three years later from the end of

first phase, to replant the area with suitable trees and vegetation. The estimated cost of replanting is ` 3.5 million. Marico uses a cost of capital (before taxation) of 10% and the expenditure, when incurred, will attract tax relief at the company's marginal tax rate of 30%. Marico has not recognised any provision for such costs in the past and today's date is 31 March 20X2. The first phase of the clean up will commence in a few months time and will be completed on 31 March 20X3 when the first payment of ` 2 million will be

made. Phase 2 costs will be paid three years later from the end of first phase. Calculate the amount to be provided at 31 March 20X2 for the restoration costs.

Answer:

Year	Cash Flow	10% Discount factor	Present Value
20X2-20X3	20,00,000	0.909	18,18,000
20X5-20X6	35,00,000	0.683	23,90,500
Provision required at 31 March 20X2			**42,08,500**

The provision is calculated using the pre-tax costs and a pre-tax cost of capital. The fact that the eventual payment will attract tax relief will be reflected in the recognition of a deferred tax asset for the deductible temporary difference (assuming that the recognition criteria for deferred tax assets are met.)

PAST PAPERS & REVISION TEST PAPER & MOCK TEST PAPERS

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

[NOV 2018 4 MARKS]

Answer:

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

❖ neither party has performed any of its obligations; or

❖ both parties have partially performed their obligations to an equal extent.

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

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

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

As per the facts given in the question, Sun Ltd. will not require the machine ordered. However, since it is a binding agreement, the entity cannot exit / cancel the agreement.

Further, Sun Ltd. has to scrap the machine after delivery at nil scrap value.

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

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

2. U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 2018 as per the notified Ind AS. The financial statements are due to be authorised for issue on 15th May 2018. It is seeking yo ur assistance for some transactions that have taken place in some of its subsidiaries during the year.
G Ltd. is a wholly owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January 2018, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April 2018. They made a public announcement of their decision on 15th February 2018.
G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 2018. U Ltd. would collect any amounts still owed by G Ltd's customers after 31st May 2018. They have offered the employees of G Ltd. termination payments or alternative employment opportunities. Following are some of the details relating to G Ltd.:

- **On the date of public announcement, it is estimated by G Ltd. that it would have to pay 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be Rs. 60 lakhs. The actual termination payments totalling to Rs. 520 lakhs were made in full on 15th May 2018. As per latest estimates made on 15th May 2018, the total relocation cost is Rs. 63 lakhs.**

- **G Ltd. had taken a property on operating lease, which was expiring on 31st March 2022. The present value of the future lease rentals (using an appropriate discount rate) is Rs. 430 lakhs. On 15th May 2018, G Ltd. made a payment to the lessor of Rs.410 lakhs in return for early termination of the lease.**

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

How should U Ltd. present the decision to discontinue the business of G Ltd. in its consolidated statement of comprehensive income as per Ind AS?
What are the provisions that the Company is required to make as per Ind AS 37?
[RTP NOV 2018]
Answer:
A discontinued operation is one that is discontinued in the period or classified as held for sale at the year end. The operations of G Ltd were discontinued on 30th April 2018 and therefore, would be treated as discontinued operation for the year ending 31st March 2019. It does not meet the criteria for held for sale since the company is terminating its business and does not hold these for sale.
Accordingly, the results of G Ltd will be included on a line-by-line basis in the consolidated

statement of comprehensive income as part of the profit from continuing operations of U Ltd for the year ending 31st March 2018.
As per para 72 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', restructuring includes sale or termination of a line of business. A constructive obligation to restructure arises when:
(a) an entity has a detailed formal plan for the restructuring
(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.
The Board of directors of U Ltd have decided to terminate the operations of G Ltd. from 30th April 2018. They have made a formal announcement on 15th February 2018, thus creating a valid expectation that the termination will be implemented. This creates a constructive obligation on the company and requires provisions for restructuring.
A restructuring provision includes only the direct expenditures arising from the restructuring that are necessarily entailed by the restructuring and are not associated with the ongoing activities of the entity.
The termination payments fulfil the above condition. As per Ind AS 10 'Events after Reporting Date', events that provide additional evidence of conditions existing at the reporting date should be reflected in the financial statements. Therefore, the company should make a provision for Rs. 520 lakhs in this respect.
The relocation costs relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Hence, these would be recognised on the same basis as if they arose independently of a restructuring.
The operating lease would be regarded as an onerous contract. A provision would be made at the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. Hence, a provision shall be made for Rs. 410 lakhs.
Further operating losses relate to future events and do not form a part of the closure provision. Therefore, the total provision required = Rs. 520 lakhs + Rs. 410 lakhs = Rs. 930 lakhs

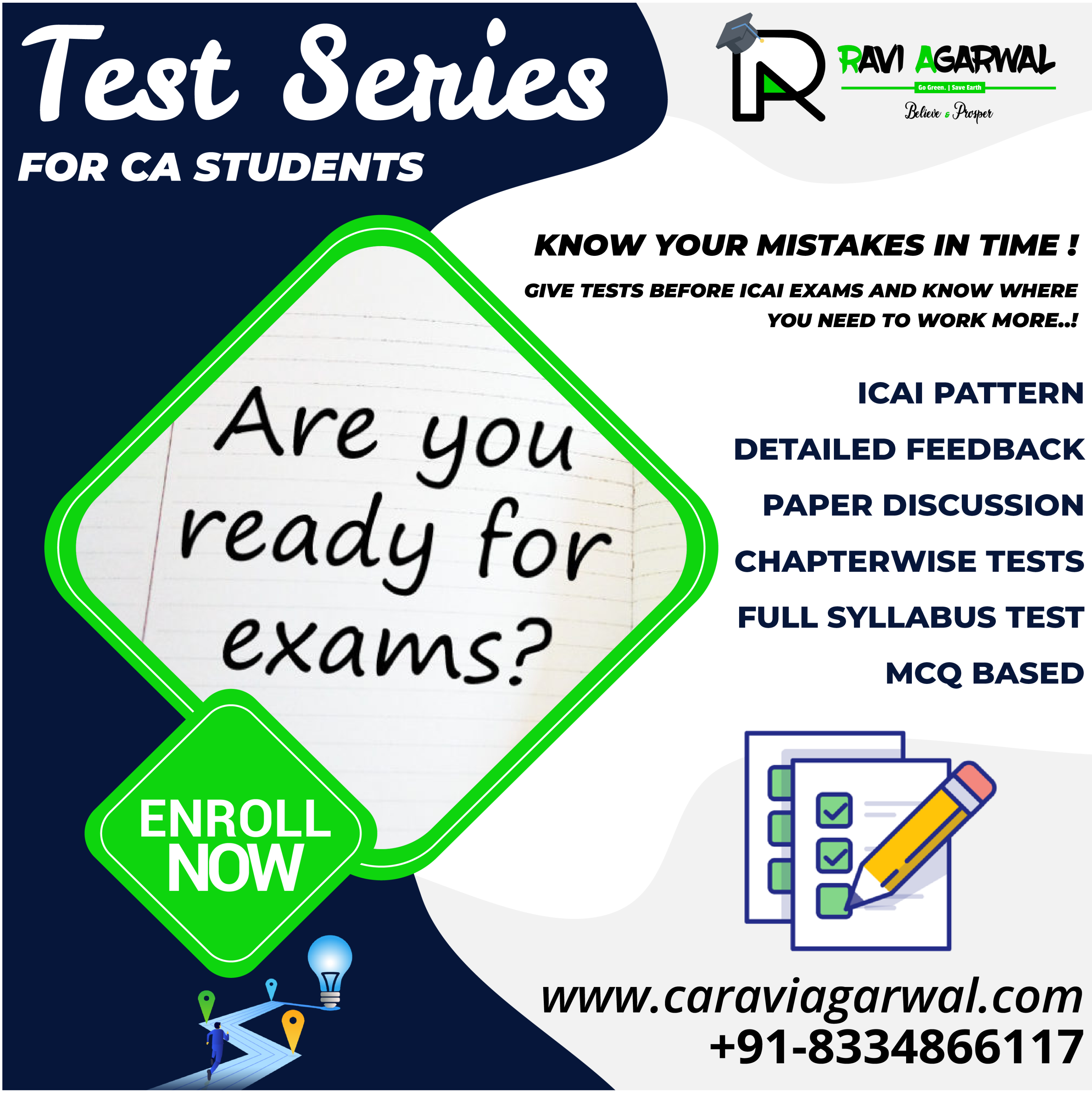
3.
(a) A manufacturer gives warranties at the time of sale to purchasers of its product.
Under the terms of the contract for sale, the manufacturer undertakes to remedy, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. As this is the first year that the warranty has been available, there is no data from the firm to indicate whether there will be claim under the warranties. However, industry research suggests that it is likely that such claims will be forthcoming. Should the manufacturer recognize a provision in accordance with the requirements of Ind AS 37. Why or why not?
(b) Assume that the firm has not been operating its warranty for five years, and reliable data exists to suggest the following:
- **If minor defects occur in all products sold, repair costs of Rs. 20,00,000 would result.**
- **If major defects are detected in all products, costs of Rs. 50,00,000 would result.**
- **The manufacturer's past experience and future expectations indicate that each year 80% of the goods sold will have no defects. 15% of the goods sold will have minor defects, and 5% of the goods sold will have major defects.**

Calculate the expected value of the cost of repairs in accordance with the requirements of Ind AS 37, if any. Ignore both income tax and the effect of discounting.
[RTP ⍰ NOV 2019]

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 24 of Ind AS 37, it is more likely than less likely that a future sacrifice of economic benefits will be required to settle the class of obligations as a whole.
If a reliable estimate can be made the provision can be measured reliably. Past data can provide reliable measures, even if the data is not firm specific but rather industry based. Ind AS 37 notes that only in extremely rare cases, a reliable measure of a provision cannot be obtained. Difficulty in estimating the amount of a provision under conditions of significant uncertainty does not justify non-recognition of the provision.

Here, the manufacturer should recognize a provision based on the best estimate of the consideration required to settle the present obligation as at the reporting date.
(b) The expected value of cost of repairs in accordance with Ind AS 37 is:
(80% x nil) + (15% x Rs. 20,00,000) + (5% x Rs. 50,00,000)
= 3,00,000 + 2,50,000 = 5,50,000

4. Entity XYZ entered into a contract to supply 1000 television sets for Rs. 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to Rs. 2.5 million. The penalty for non- performance of the contract is expected to be Rs. 0.25 million. Is the contract onerous and how much provision in this regard is required?
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 Rs. 0.5 million (Rs. 2.5 million – Rs. 2 million) and cost of exiting from the contract by paying penalty is Rs. 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 Rs. 0.25 million (lower of Rs. 0.25 million and Rs. 0.5 million).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CHAPTER -10 IND AS ON ITEMS IMPACTING THE FINANCIAL STATEMENTS

UNIT 1: INDIAN ACCOUNTING STANDARD 12 : INCOME TAXES

Illustrations

1

The directors of H wish to recognise a material deferred tax asset in relation to ` 250 Cr of unused trading losses which have accumulated as at 31st March 20X1. H has budgeted profits for ` 80 Cr for the year ended 31st March 20X2. The directors have forecast that profits will grow by 20% each year thereafter. However, the improvement in trading results may occur after the next couple of years to come at the position of breakeven. The market is currently depressed and sales orders are at a lower level for the first quarter of 20X2 than they were for the same period in any of the previous five years. H operates under a tax jurisdiction which allows for trading losses to be only carried forward for a maximum of two years. Analyse whether a deferred tax asset can be recognized in the financial statements of H for the year ended 31st March 20X1?

Solution

In relation to unused trading losses, the carrying amount is zero since the losses have not yet been recognised in the financial statements of H. A potential deferred tax asset does arise but the determination of the tax base is more problematic.

The tax base of an asset is the amount which will be deductible against taxable economic benefits from recovering the carrying amount of the asset. Where recovery of an asset will have no tax consequences, the tax base is equal to the carrying amount. H operates under a tax jurisdiction which only allows losses to be carried forward for two years. The maximum the tax base could be is therefore equal to the amount of unused losses for years 20X0 and 20X1 since these only are available to be deducted from future profits. The tax base though needs to be restricted to the extent that there is a probability of sufficient future profits to offset the trading losses. The directors of H should base their forecast of the future profitability on reasonable and supportable assumptions. There appears to be evidence that this is not the case.

H has accumulated trading losses and there is little evidence that there will be an improvement in trading results within the next couple of years. The market is depressed and sales orders for the first quarter of 20X2 are below levels in any of the previous five years.

The forecast profitability for 20X2 and subsequent growth rate therefore appear to be unrealistically optimistic.

Given that losses can only be carried forward for a maximum of two years, it is unlikely that any deferred tax asset should be recognised.

Hence, the contention of directors to recognized deferred tax assets in relation to `250 crores is not correct.

2

On 1st April 20X1, S Ltd. leased a machine over a 5 year period. The present value of lease liability is ` 120 Cr (discount rate of 8%) and is recognized as lease liability and corresponding Right of Use (RoU) Asset on the same date. The RoU Asset is depreciated under straight line method over the 5 years. The annual lease

rentals are ` 30 Cr payable starting 31st March 20X2. The tax law permits tax deduction on the basis of payment of rent.

Assuming tax rate of 30%, you are required to explain the deferred tax consequences for the above transaction for the year ended 31st March 20X2.

Solution

A temporary difference effectively arises between the value of the machine for accounting purposes and the amount of lease liability, since the rent payment is eligible for tax deduction.

Tax base of the machine is nil as the amount is not eligible for deduction for tax purposes.

Tax base of the lease liability is nil as it is measured at carrying amount less any future tax deductible amount

Recognition of deferred tax on 31st March 20X2:

Carrying amount in balance sheet	
RoU Asset (120 Cr – 24 Cr (Depreciation))	` 96.00 Dr
Lease Liability (120 Cr + 9.60 Cr (120 Cr x 8%) - 30 Cr)	` 99.60 Cr
Net Amount	` 3.60 Cr
Tax Base	` 0.00 Cr
Temporary Difference (deductible)	` 3.60 Cr
Deferred Tax asset to be recognized (` 3.60 Cr x 30%)	` 1.08 Cr

3

On 1 April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of ` 25 Cr. It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in B Ltd. at 1 April 20X1 can be used for this purpose. On 1 April 20X1, the market value of a B Ltd. share was ` 2.00

On 1 April 20X1, the individual financial statements of B Ltd. showed the net assets at ` 23 Cr.

The directors of A Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of B Ltd. at 1 April 20X1. The following matters emerged:

– Property having a carrying value of ` 15 Cr at 1 April 20X1 had an estimated market value of ` 18 Cr at that date.

– Plant and equipment having a carrying value of ` 1 Cr at 1 April 20X1 had an estimated market value of ` 13 Cr at that date.

– Inventory in the books of B Ltd. is shown at a cost of ` 2.50 Cr. The fair value of the inventory on

the acquisition date is ` 3 Cr.

The fair value adjustments have not been reflected in the individual financial statements of B Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Calculate the deferred tax impact on above and calculate the goodwill arising on acquisition of B Ltd.

Solution

Purchase Consideration:	₹ 25 Cr
Non-Controlling Interest [{(12 Cr x (20% / 80%)} x ₹ 2 per share]	₹ 6 Cr
Computation of Net Assets of B Ltd.	
As per books	₹ 23.00 Cr
Add: Fair value differences not recognized in books of B Ltd.:	
Property (18 Cr – 15 Cr)	₹ 3.00 Cr
Plant and Equipment (13 Cr – 11 Cr)	₹ 2.00 Cr
Inventory (3 Cr – 2.5 Cr)	₹ 0.50 Cr
	₹ 28.5 Cr
Less: Deferred tax liability on fair value difference @ 20%	
[(3 Cr + 2 Cr + 0.50 Cr) x 20%]	(₹ 1.10 Cr)
Total Net Assets at Fair Value	₹ 27.40 Cr
Computation of Goodwill:	
Purchase Consideration	₹ 25.00 Cr
Add: Non-Controlling Interest	₹ 6.00 Cr
	₹ 31.00 Cr
Less: Net Assets at Fair Value	(₹ 27.40 Cr)
Goodwill on acquisition date	₹ 3.60 Cr

4

On 1st April 20X1, P Ltd. had granted 1 Cr share options worth ` 4 Cr subject to a two-year vesting period. The income tax law permits a tax deduction at the exercise date of the intrinsic value of the options. The intrinsic value of the options at 31st March 20X2 was ` 1.60 Cr and at 31st March 20X3 was ` 4.60 Cr. The increase in the fair value of the options on 31st March 20X3 was not foreseeable at 31st March 20X2. The options were exercised at 31st March 20X3.

Give the accounting for the above transaction for deferred tax for period ending 31st March, 20X2 and 31st March, 20X3. Assume that there are sufficient taxable profits available in future against any deferred tax assets. Tax rate of 30% is applicable to P Ltd.

Solution:

On 31st March 20X2:

The tax benefit is calculated as under:

Carrying amount of Share based payment ` 0.00 Cr

Tax Base of Share based payment (` 1.60 Cr x ½) ` 0.80 Cr
Temporary Difference (Carrying amount – tax base) ` 0.80 Cr
Deferred Tax Asset recognized (Temporary Difference x Tax rate)
(0.80 Cr x 30%) ` 0.24 Cr
Journal Entry for above:

Deferred Tax Asset	Dr.	` 0.24 Cr	
To Tax Expense			` 0.24 Cr

(Being DTA recognized on equity option)
On 31st March 20X3:
The options have been exercised and a current tax benefit will be available to the entity on the basis of intrinsic value of ` 4.60 Cr. Initially recognized deferred tax asset will no longer be required.
The accounting entry will be done as under:

Tax Expense	Dr	` 0.24 Cr	
To Deferred Tax Asset			` 0.24 Cr

(Being DTA reversed on the exercise of the option)

5 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.
Solution
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	₹ in thousand
Profit & loss A/c	Dr.	26	
To Current Tax			26

Deferred tax:
Machine's carrying amount according to Ind AS is ` 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%

6 An entity has a deductible temporary difference of ` 50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profits up to ` 60,000. The cost of implementing this tax planning strategy is ` 12,000. The tax rate is 30%. Compute the deferred tax asset that should be recognised.

Solution

The entity should recognise a deferred tax asset of ` 14,400 @ 30% of ` 48,000 (` 60,000 – ` 12,000).
The balance deferred tax asset of ` 600 @ 30% on ` 2,000 (` 50,000 – ` 48,000) shall remain unrecognised.

7 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 ` 0,000 and the tax rate was 25%. On 28th February, 20X2, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on 21st May, 20X2. Discuss the treatment of deferred tax in case the reporting date of A Limited's financial statement is 31st December, 20X1 and these are approved for issued on 31st May, 20X2. [MTP ▯ MARCH 2018 ▯ 6 MARKS]

Solution

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.

8 A Ltd prepares financial statements to 31 March each year. The rate of income tax applicable to A Ltd is 20%. The following information relates to transactions, assets and liabilities of A Ltd during the year ended 31 March 20X2:
(i) A Ltd has a 40% shareholding in L Ltd. A Ltd purchased this shareholding for ` 45 Cr. The shareholding gives A Ltd significant influence over L Ltd but not control and therefore A Ltd. accounts for its interest in L Ltd using the equity method. The equity method carrying value of A Ltd's investment in L Ltd was ` 70 Cr on 31 March 20X1 and ` 75 Cr on 31 March 20X2. In the tax jurisdiction in which A Ltd operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend or the relevant investment is disposed of.
(ii) A Ltd. measures its head office building using the revaluation model. The building is revalued every year on 31 March. On 31 March 20X1, carrying value of the building (after revaluation) was ` 40 Cr and its tax base was ` 22 Cr. During the year ended 31 March 20X2, A Ltd charged depreciation in its statement of profit or loss of ` 2 Cr and claimed a tax deduction for tax depreciation of ` 1.25 Cr. On 31 March 20X2, the building was revalued to ` 45 Cr. In the tax jurisdiction in which A Ltd operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.
Basis the above information, you are required to compute:
(a) The deferred tax liability of A Ltd at 31 March 20X2
(b) The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31 March 20X2
Solution:
(A) Deferred Tax Liability as at 31st March 20X2
Investment in L Ltd:
Carrying Amount = ` 75 Cr
Tax base = ` 45 Cr (Purchase cost)
Temporary Difference = ` 30 Cr
Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ` 6 Cr is recognized:

Head office building
Carrying Amount = ` 45 Cr (Revalued amount on 31st of March 20X2)
Tax base = ` 20.75 Cr (22 Cr – 1.25 Cr)
Temporary Difference = ` 24.25 Cr
Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ` 4.85 Cr is created.
Total Deferred Tax Liability ` 6 Cr + ` 4.85 Cr = ` 10.85 Cr
(B) Charge to Statement of Profit or Loss for the year ended 31st March 20X2:
Investment in L Ltd.

Particulars	Carrying amount	Tax Base	Temporary Difference
Opening Balance (1st April 20X1)	` 70 Cr	` 45 Cr	` 25 Cr
Closing Balance (31st March 20X2)	` 75 Cr	` 45 Cr	` 30 Cr
Net Change			` 5 Cr
Increase in Deferred Tax Liability (20% tax rate)			` 1 Cr

Considering the increase in the value of investment arising through Statement of Profit or Loss, the accounting for the increase in deferred tax liability is made as under:

Tax expense (Profit or Loss Statement)	Dr	` 1 Cr	
To Deferred Tax Liability			` 1 Cr

(Being increase in deferred tax liability recognized)

Head Office Building:
The deferred tax liability at 31 March 20X1 is ` 3.6 Cr (20% x {` 40 Cr – ` 22 Cr}).
At 31 March 20X2, prior to revaluation, the carrying amount of the property is ` 38 Cr and its tax base is ` 20.75 Cr (` 22 Cr – ` 1.25 Cr). The deferred tax liability at this point is ` 3.45 Cr (20% x {` 38 Cr – ` 20.75 Cr}).
The reduction in this liability is ` 0.15 Cr (` 3.6 Cr – ` 3.45 Cr). This would be credited to income tax expense in arriving at profit or loss.
Post revaluation, the carrying value of the building becomes ` 45 Cr and the tax base stays the same.
Therefore, the new deferred tax liability is ` 4.85 Cr (20% x (` 45 Cr – ` 20.75 Cr)). The increase in the deferred tax liability of ` 1.4 Cr (` 4.85 Cr – ` 3.45 Cr) is charged to other comprehensive income

9 K Ltd prepares consolidated financial statements to 31st March each year. During the year ended 31st March 20X2, K Ltd entered into the following transactions:
(a) On 1st April 20X1, K Ltd purchased an equity investment for ` 2,00,000. The investment was designated as fair value through other comprehensive income. On 31st March 20X2, the fair value of the investment was ` 2,40,000. In the tax jurisdiction in which K Ltd operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. K Ltd has no intention of selling the investment in the foreseeable future.
(b) On 1st August 20X1, K Ltd sold products to A Ltd, a wholly owned subsidiary operating in the same tax jurisdiction as K Ltd, for ` 80,000. The goods had cost to K Ltd for ` 64,000. By 31st March 20X2, A Ltd had sold 40% of these goods, selling the remaining during next year.
(c) On 31st October 20X1, K Ltd received ` 2,00,000 from a customer. This payment was in respect of services to be provided by K Ltd from 1st November 20X1 to 31st July 20X2. K Ltd recognised revenue of ` 1,20,000 in respect of this transaction in the year ended 31st March 20X2 and will recognise the remainder in the year ended 31st March 20X3. Under the tax jurisdiction in which K Ltd operates, ` 2,00,000 received on 31st October 20X1 was included in the taxable profits of K Ltd for the year ended 31st March 20X2.
Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in its statement of profit or loss and other comprehensive income for the year ended 31st March 20X2. Assume tax rate to be 25%.

Solution:
(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. Because 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 (` 200,000 x 25%) as at 31st March 20X2. The carrying value of the revenue received in advance at 31st March 20X2 is ` 80,000 (` 200,000 – ` 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.

Questions

1. An asset which cost ` 150 has a carrying amount of ` 100. Cumulative depreciation for tax purposes is ` 90 and the tax rate is 25%. Calculate the tax base and the corresponding deferred tax or liability, if any.

Answer:

The tax base of the asset is ` 60 (cost of ` 150 less cumulative tax depreciation of ` 90). To recover the carrying amount of ` 100, the entity must earn taxable income of ` 100, but will only be able to deduct tax depreciation of ` 60. Consequently, the entity will pay income taxes of ` 10 (` 40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of ` 100 and the tax base of ` 60 is a taxable temporary difference of ` 40. Therefore, the entity recognises a deferred tax liability of ` 10 (` 40 at 25%) representing the income taxes that it will pay when it recovers the carrying amount of the asset.

2. On 1st April 20X1, ABC Ltd acquired 100% shares of XYZ Ltd for ` 4,373 crore. By 31st March, 20X5, XYZ Ltd had made profits of ` 5 crore, which remain undistributed. Based on the tax legislation in India, the tax base investment in XYZ Ltd is its original cost. Assume the dividend distribution tax rate applicable is 15%. Show deferred tax treatment.

Answer:

A taxable temporary difference of ` 5 therefore exists between the carrying value of the investment in XYZ at the reporting date of ` 4,378 (` 4,373 + ` 5) and its tax base of ` 4,373. Since a parent, by definition, controls a subsidiary, it will be able to control the reversal of this temporary difference,

for example - through control of the dividend policy of the subsidiary. Therefore, deferred tax on such temporary difference is generally not provided unless it is probable that the temporary will reverse in the foreseeable future

3. ABC Ltd. acquired 50% of the shares in PQR Ltd. on 1st January, 20X1 for ` 1000 crore. By 31st March, 20X5 PQR Ltd. had made profits of ` 50 crore (ABC Ltd.'s share), which remained undistributed. Based on the tax legislation in India, the tax base of the investment in PQR Ltd. is its original cost. Assume the dividend distribution tax rate applicable is 15%. Show deferred tax treatment.

Answer:

A taxable temporary difference of ` 50 therefore exists between the carrying value of the investment in PQR at the reporting date of ` 1,050 (` 1,000 + ` 50) and its tax base of ` 1,000. As ABC Ltd. does not completely control PQR Ltd. it is not in a position to control the dividend policy of PQR Ltd. As a result, it cannot control the reversal of this temporary difference and deferred tax is provided on temporary differences arising on investments in joint venture (50 x 15%).

4. A company had purchased an asset at ` 1,00,000. Estimated useful life of the asset is 5 years and depreciation rate is 20% SLM. Depreciation rate for tax purposes is 25% SLM. The operating profit is ` 1,00,000 for all the 5 years. Tax rate is 30% for the next 5 years. Calculate the Book Value as per financial and tax purposes and then DTL.

Answer:

Calculation of the Book Value as per financial and tax purposes.

Financial Accounting: ₹ 000's

Year	1	2	3	4	5
Gross Block	100	100	100	100	100
Accumulated Depreciation	20	40	60	80	100
Carrying Amount	80	60	40	20	0

Tax Accounting: ₹ 000's

Year	1	2	3	4	5
Gross Block	100	100	100	100	100
Accumulated Depreciation	25	50	75	100	100
Carrying Amount	75	50	25	0	0

Calculation of DTL: ₹ 000's

Year	1	2	3	4	5
Carrying Amount	80	60	40	20	0
Tax Base	75	50	25	0	0
Difference	5	10	15	20	0
Deferred Tax Liability (Difference x 30%)	1.5	3	4.5	6	0

5. A Ltd. acquired B Ltd. The following assets and liabilities are acquired in a business combination: ` 000's

	Fair Value	Carrying amount	Temporary Difference
Plant and Equipment	250	260	(10)
Inventory	120	125	(5)
Debtors	200	210	(10)
	570	595	(25)
9% Debentures	(100)	(100)	
	470	495	
Consideration paid	500	500	
Goodwill	30	5	(25)

Calculate Deferred Tax Asset.

Answer:

In this case there is a Deferred Tax Asset as the Tax base of assets acquired is higher by 25,000. DTA would be ` 7,500 (25,000 x 30%)

Journal entry:

Plant and equipment	Dr	250	
Inventory	Dr	120	
Debtors	Dr	200	
Goodwill	Dr	22.5 (30- 7.5)	
DTA	Dr	7.5	
To 9% Debentures			100
To Bank			500

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

(a) Taxable temporary differences relating to accelerated depreciation of ` 9,000. These are expected to reverse equally over next 3 years.

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

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on 31st March, 20X1.

Answer:

The year-wise anticipated reversal of temporary differences is as under:

Particulars	Year ending on 31st March, 20X2	Year ending on 31st March, 20X3	Year ending on 31st March, 20X4	Year ending on 31st March, 20X5
Reversal of taxable temporary difference relating to accelerated depreciation over next 3 years (₹ 9,000/3)	3,000	3,000	3,000	Nil
Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (₹ 4,000/4)	1,000	1,000	1,000	1,000

B Limited will recognise a deferred tax liability of ` 2,700 on taxable temporary difference relating to accelerated depreciation of ` 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 31st

March, 20X4 amounting to ` 900 (` 3,000 @ 30%). No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on 31st March, 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 31st March, 20X5 deferred tax asset on the remainder of ` 1,000 (` 4,000 – ` 3,000) of deductible temporary difference could be recognised at the 30% tax rate.

7. X Ltd. prepares consolidated financial statements to 31st March each year. During the year ended 31st March 2018, the following events affected the tax position of the group:
(i) Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of ` 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow Y Ltd. to transfer the tax loss to other group companies. However, it allows Y Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of X Ltd. do not consider that Y Ltd. will make taxable profits in the foreseeable future.
(ii) Just before 31st March, 2018, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore, X Ltd. recognised a provision for closure costs of ` 20,00,000 in its statement of financial position as at 31st March, 2018. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31st March 2019, X Ltd. expects to make taxable profits which are well in excess of ` 20,00,000. On 31st March, 2018, X Ltd. had taxable temporary differences from other sources which were greater than ` 20,00,000.
(iii) During the year ended 31st March, 2017, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 'Intangible Assets'. The total amount capitalised was ` 16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January, 2018. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 2018.
(iv) On 1st April, 2017, X Ltd. borrowed ` 1,00,00,000. The cost to X Ltd. of arranging the borrowing was ` 2,00,000 and this cost qualified for a tax deduction on 1st April, 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March, 2020 will be ` 1,30,43,800.

This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of ` 30,43,800 will be claimable when the loan is repaid on 31st March, 2020

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31st March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%.
Answer:

(i) The tax loss creates a potential deferred tax asset for the 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.
(ii) The provision creates a potential deferred tax asset for the group since its carrying value is ` 20,00,000 and its tax base is nil.
This deferred tax asset can be recognised because X Ltd. is expected to generate taxable profits in excess of ` 20,00,000 in the year to 31st March, 2019.
The amount of the deferred tax asset will be ` 4,00,000 (` 20,00,000 x 20%).
This asset will be presented as a deduction from the deferred tax liabilities caused by the (larger) taxable temporary differences.
(iii) The development costs have a carrying value of ` 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 ` 3,04,000 (` 15,20,000 x 20%). All deferred tax liabilities are shown as non-current.
(iv) The carrying value of the loan at 31st March, 2018 is ` 1,07,80,000 (` 1,00,00,000 – ` 2,00,000 + (` 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 (` 1,07,80,000 – ` 1,00,00,000) and a potential deferred tax asset of ` 1,56,000 (` 7,80,000 x 20%).
Due to the availability of taxable profits next year (see part (ii) above), this asset can be recognised as a deduction from deferred tax liabilities.

8. PQR Ltd., a manufacturing company, prepares consolidated financial statements to 31st March each year. During the year ended 31st March, 2018, the following events affected the tax position of the group:
• QPR Ltd., a wholly owned subsidiary of PQR Ltd., incurred a loss adjusted for tax purposes of ` 30,00,000. QPR Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow QPR Ltd. to transfer the tax loss to other group companies. However, it allows QPR Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of PQR Ltd. do not consider that QPR Ltd. will make taxable profits in the foreseeable future.

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

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

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of PQR Ltd. group at 31st March, 2018 as per Ind AS. The rate of corporate income tax is 30%. [RTP MAY 2019]

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%).

9. An entity is finalising its financial statements for the year ended 31st March, 20X2. Before 31st March, 20X2, the government announced that the tax rate was to be amended from 40 per cent to 45 per cent of taxable profit from 30th June, 20X2.
The legislation to amend the tax rate has not yet been approved by the legislature. However, the government has a significant majority and it is usual, in the tax jurisdiction concerned, to regard an announcement of a change in the tax rate as having the substantive effect of actual enactment (i.e. it is substantively enacted).
After performing the income tax calculations at the rate of 40 per cent, the entity has the following deferred tax asset and deferred tax liability balances:

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

Of the deferred tax asset balance, ` 28,000 related to a temporary difference. This deferred tax asset had previously been recognised in OCI and accumulated in equity as a revaluation surplus.
The entity reviewed the carrying amount of the asset in accordance with para 56 of Ind AS 12 and determined that it was probable that sufficient taxable profit to allow utilisation of the deferred tax asset would be available in the future.
Show the revised amount of Deferred tax asset & Deferred tax liability and present the necessary journal entries. [RTP NOV 2019]

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	₹ 1,50,000 x 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 OCl 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	31,500	28,000	(3,500)
Previously recognised as Income	58,500	52,000	(6,500)
	90,000	80,000	(10,000)
Deferred tax liability			
Previously recognized as expense	67,500	60,000	7,500
Net adjustment			(2,500)

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

QUESTIONS FROM MOCK TEST PAPERS & REVISION TEST PAPER

1. QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS. QA Ltd. had acquired 40% shares in GK Ltd. for an aggregate amount of Rs. 45 crores. The shareholding gives QA Ltd. significant influence over GK Ltd. but not control and therefore the said interest in GK Ltd. is accounted using the equity method. Under the equity method, the carrying value of investment in GK Ltd. was Rs. 70 crores on 31st March, 2017 and Rs. 75 crores as on 31st March, 2018. As per the applicable tax laws, profits recognised under the equity method are taxed if and when they are distributed as dividend or the relevant investment is disposed of. QA Ltd. wants you to compute the deferred tax liability as on 31st March, 2018 and the charge to the Statement of Profit for the same. Consider the tax rate at 20%.
[MTP AUGUST 2018 4 MARKS]
Answer:

DTL created on accumulation of undistributed profits as on 31.3.2018

	Carrying value	Value as per tax records	Tax base	Taxable temporary differences	Total Deferred tax liability @ 20%	Charged to P&L during the year
a	b	c	d	E= b-d	F = e x 20%	g
31st March, 2017	70 crore	45 crore	45 crore	25 crore	5 crore	5 crore
31st March, 2018	75 crore	45 crore	45 crore	30 crore	6 crore	1 crore (6 crore – 5 crore)

2. QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS and wants guidance on the tax treatment for the following:
(i) QA Ltd. does not have taxable income as per the applicable tax laws, but pays 'Minimum Alternate Tax' (MAT) based on its books profits. The tax paid under MAT can be carried forward for the next 10 years and as per the Company's projections submitted to its bankers, it is in a position to get credit for the same by the end of eighth year. The Company is recognising the MAT credit as a current asset under IGAAP. The amount of MAT credit as on 31st March, 2016 is Rs. 8.5 crores and as on 31st March, 2017 is Rs. 9.75 crores;
(ii) The Company measures its head office property using the revaluation model. The property is revalued every year as on 31st March. On 31st March, 2016, the carrying value of the property (after revaluation) was Rs. 40 crores whereas its tax base was Rs. 22 crores. During the year ended 31st March, 2017, the Company charged depreciation in its Statement of Profit and Loss of Rs. 2 crores and claimed a tax deduction for tax depreciation of Rs. 1.25 crores. On 31st March, 2017, the property was revalued to Rs.45 crores. As per the tax laws, the revaluation of Property, Plant & Equipment does not affect taxable income at the time of revaluation.

The Company has no other temporary differences other than those indicated above.
The Company wants you to compute the deferred tax liability as on 31st March, 2017 and the charge/credit to the Statement of Profit and Loss and/or Other Comprehensive Income for the same. Consider the tax rate at 20%. [MTP MARCH 2019 10 MARKS]

Answer:

Computation of Deferred Tax Liability

(i) MAT credit as on 31st December of Rs. 9.75 crore will be presented in the Balance Sheet as Deferred tax asset. DTA in the current year will be Rs. 1.25 crore (Rs. 9.75 crore – Rs. 8.50crore)

(ii)

(a) In case defer tax is created only on account of depreciation

	Carrying value without revaluation	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year
A	b	c	d	E= b-d	F = e x 20%	g
31st March, 2016	22 crore	22 crore	22 crore	nil	nil	nil
Less: Depreciation for the year 2016-17	(2 crore)	(1.25 crore)				
Carrying value as on 31st March, 2017	20 crore	20.75 crore	20.75 crore	(0.75 crore)	DTA (0.15 crore)	DTA (0.15 crore)

(b) Computation of tax effect taking into account the revalued figures and adjusting impact of tax effect on account of difference in depreciation

S. No.		Carrying value after revaluation	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year	Charged to OCI during the year
	a	b	c	d	E= b-d	F = e x 20%	g	h
I	31st March, 2016	40 crore	22 crore	22 crore	18 crore	DTL 3.6 crore	-	DTL 3.6 crore
IV	Revalued again on 31.3.2017 (It is assumed that revaluation has been done after taking into consideration the impact of depreciation for the current year)	45 crore	20.75 crore (22-1.25)	20.75 crore	24.25 crore	DTL 4.85 crore	DTA (0.15 crore) (Refer table (a) above)	DTL 5 crore (Refer Note below) [5 DTL (B/F) – 0.15 DTA = 4.85 DTL]

V	Additional DTL/DTA required during the year (IV-I)					DTL 1.25 crore	DTA (0.15 crore) (Refer table (a))	DTL (1.40 crore) (Refer Note below)

Note:
As per para 65 of Ind AS 12, when an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income in the periods in which they occur. Here, it is important to understand that only the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income. However, tax effects on account of depreciation of asset and the adjustment of the tax base are recognized in profit and loss.
Accordingly, first of all the tax effect has been calculated assuming that there is no revaluation (Refer Table (a) above) [Since the information for the carrying value before revaluation has not been mentioned, it is assumed to be equal to the carrying amount as per the tax records]. Later the DTA arrived due to difference in depreciation is adjusted with the DTL created due to revaluation. DTA of Rs. 0.15 crore on account of depreciation will be charged to Profit and Loss and DTL of Rs. 1.40 crore will be charged to OCI. Net effect in the year 31.3.2017 will be DTL 1.25 crore (DTL 1.4 crore – DTA 0.15 crore) [Refer Table (b) above.

3. 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 Rs. 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 not refundable) 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 2019]
Answer:
Paragraph 5 of Ind AS 115 scopes out revenue arising from lease agreements. Principles enunciated under Ind AS 17, Leases would be applicable for revenue arising from leasing agreements. Recognition of income in respect of lease would depend on its classification as per Ind AS 17, 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 straightline 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 to the 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 finance lease then lessor Jeevan India Ltd. shall recognise assets 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

UNIT 2 : INDIAN ACCOUNTING STANDARD 21 : THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

1

Future Ltd. sells a revitalising energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$. What is the functional currency of Future Ltd.?

Solution

The functional currency of Future Ltd. is L$ looking at the primary indicators. The facts presented indicate that the currency that mainly influence the cost of producing the energy drink is the L$. As stated in the fact pattern, pricing of the product in USD is done for convenience and consistency purposes; there is no indication that the sales price is influenced by the USD.

2

Small India Private Limited (Small), a subsidiary of Big Inc., takes orders from Indian customers for Big Inc's merchandise and then bills and collects for the sale of the merchandise in Rupees. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. Big Inc is based out of US and has its functional currency as USD. What is Small's functional currency?

Solution

Small, although based in India with its cash flows generated in India, is essentially a "pass through company" established by its parent. Small is totally reliant on Big Inc. for financing and goods to be sold, despite the fact that goods are sold within India and in INR. Therefore, Small is not a self-contained entity in India, rather an entity that is dependent on its parent.

Due to this dependence of Small on its parent company, it can be said that the primary economic environment for Small is that of US and thus, its functional currency should also be USD.

Hence all the transactions of Small which are denominated in any currency other than USD should be recorded in USD at the spot rate and any changes in the exchange rate would result in an exchange gain or loss to be taken to the statement of profit or loss.

3 A is an Oman based company having a foreign operation, B, in India. The foreign operation was primarily set up to execute a construction project in India. The functional currency of A is OMR.

78% of entity B 's finances have been raised in USD by way of contribution from A. B's bank accounts are maintained in USD as well as INR. Cash flows generated by B are transferred to A on a monthly basis in USD in respect of repayment of finance received from A.

Revenues of B are in USD. Its competitors are globally based. Tendering for the construction project happened in USD.

B incurs 70% of the cost in INR and remaining 30% costs in USD.

Since B is located in India can it can presume its functional currency to be INR?

Solution

No, B cannot presume INR to be its functional currency on the basis of its location. It needs to consider various factors listed in Ind AS for determination of functional currency.
Primary indicators:
1. the currency that mainly influences

(a) sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
(b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.
2. Other factors that may provide supporting evidence to determine an entity's functional currency are (**Secondary indicators**):

(a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and
(b) the currency in which receipts from operating activities are usually retained.
3. **If an entity is a foreign operation**, additional factors set out in Ind AS 21 should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:
(a) Whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy;
(b) Whether the transactions with the reporting entity are a high or a low proportion of the foreign operation's activities;
(c) Whether cash flows from the activities of the foreign operations directly affect the cash flows of the reporting entity and are readily available for remittance to it.
(d) Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.
On the basis of additional factors mentioned in point 3 above, B cannot be said to have functional currency same as that of A Ltd.
Hence primary and secondary indicators should be used for the determination of functional currency of B giving priority to primary indicators. The analysis is given below:
- Its significant revenues and competitive forces are in USD.
- Its significant portion of cost is incurred in INR. Only 30% costs are in USD.
- 78% of its finances have been raised in USD.
- It retains its operating cash flows partially in USD and partially in INR.

Keeping these factors in view, USD should be considered as the functional currency of B.

4 S Ltd is a company based out of India which got listed on Bombay Stock Exchange in the financial year ended 31st March, 20X1. Since then the company's operations have increased considerably. The company was engaged in the business of trading of motor cycles. The company only deals in imported Motor cycles. These motor cycles are imported from US.
After importing the motor cycles, these are sold across India through its various distribution channels. The company had only private customers earlier but the company also started corporate tie-up and increased its customer base to corporates also. The purchase of the motor cycles are in USD because the vendor(s) from

whom these motor cycles are purchased those are all located in US.
All other operating expenses of the company are incurred in India only because of its location and they generally happen to be in INR
Currently, its customers are both corporate and private in the ratio of 70:30 approximately. The USD denominated prices of motor cycles in India are different from those in other countries.
The company is also expecting that in the coming years, its customers base will increase significantly in India and the current proportion may also change.
Currently, the invoices are raised to the corporate customers in USD for the purpose of hedging. However, private customers don't accept the same arrangement and hence invoices are raised to them in INR.
What would be the functional currency of this company?
Solution
The functional currency of S Ltd is INR.
Following factors need to be considered for determination of functional currency:
Primary indicators
1. the currency that mainly influences

(a) sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
(b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.
2. Other factors that may provide supporting evidence to determine an entity's functional currency are (Secondary indicators):

(a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and
(b) the currency in which receipts from operating activities are usually retained.
Primary and secondary indicators should be used for the determination of functional currency of S Ltd. giving priority to primary indicators.

The analysis is given below:
Ind AS 21 gives greater emphasis to the currency of the economy that determines the pricing of transactions, as opposed to the currency in which transactions are denominated.
Sales prices for motor cycles are mainly influenced by the competitive forces and regulations in India. The market for motor cycles depends on the economic situation in India and the company is in competition with importers of other motor cycle brands.
Even though 70% of the revenue of the company is denominated in USD, Indian economic conditions are the main factors affecting the prices. This is evidenced by the fact that USD denominated sales prices in India are different from USD denominated sales prices for the same motor cycles in other countries.
Management is able to determine the functional currency because the revenue is clearly influenced by the Indian economic environment and expenses are mixed.
On the basis of above analysis, INR should be considered as the functional currency of the company.

5 Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S and a transaction for the same was made for USD 300 during the year. At the year end, a balance of the same amount is outstanding as receivable from S. It has been observed that such balance

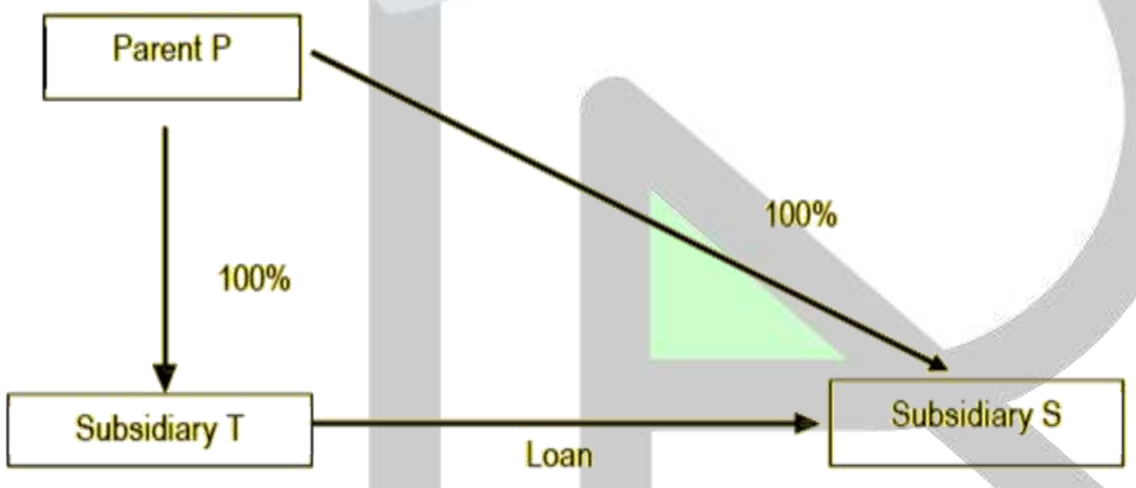
amount has been continuing as receivable from S year on year and even though the payments in respect of these balances are expected to be received in the foreseeable future but if we look at the year-end then we see this balance as outstanding every year. In addition to the trading balances between P and S, P has lent an amount of USD 500 to S that is not expected to be repaid in the foreseeable future. Should the exchange difference, if any, be recognised in the profit and loss?

Solution

The exchange gain or loss will arise in the books of accounts of P in respect of its trading balance with S and the same should be recognised in profit or loss. This being a balance for in the nature of trade receivable for P, it would not be considered as its net
investment in a foreign operation (i.e. S). The amount lent by P should be regarded as its net investment in S (i.e. foreign operation). Thus, the exchange gain or loss incurred by P on the USD 500 loan should be recognised in profit or loss in P's separate financial statements and in other comprehensive income in its consolidated financial statements.

6 Modifying the above illustration, suppose that for tax reasons, the 'permanent' funding (i.e. loan amount) extended to S is made via another entity in the group, T, rather than from P directly. That is, on the directions of P, T gives the loan to S. T is also a subsidiary of P. Where should the exchange difference, if any, be recognised?

Solution



Any exchange difference in respect of the loan is recognised in other comprehensive income in the consolidated financial statements because from the group's point of view the funding relates to an investment in a foreign operation. This is the case irrespective of the currency in which the loan is denominated. So, if the loan is denominated in T's functional currency, and this is different from that of S, then exchange differences still should be recognised in other comprehensive income in the consolidated financial statements.

7 The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due, and the exchange rate is USD 1 = Euro 2.2. How should the exchange difference, if any, be accounted for in the consolidated financial statements?

Solution

At year-end, S should restate its accounts payable to EURO 220, recognising a loss of Euro 20 in its profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P the balance receivable from S will be USD 100.

For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate.

At the time of consolidation, USD 100 which will get eliminated against the receivable in the books of P but the exchange loss of EURO 20 recorded in the subsidiary's statement of profit or loss has no equivalent gain in the parent's financial statements. Therefore, exchange loss of EURO 20 will remain in the consolidated statement of profit or loss.

The reason for this is that the intra-group balance represents a commitment to translate Euro into USD and this is similar to holding a foreign currency asset in the books of the parent company. i.e. the subsidiary would be required to buy USD to settle the obligation to the parent, so the Group has an exposure to foreign currency risk.

8 M Ltd is engaged in the business of manufacturing of bottles for pharmaceutical companies and non-pharmaceutical companies. It has a wholly owned subsidiary, G Ltd, which is engaged in the business of pharmaceuticals. G Ltd purchases the pharmaceutical bottles from its parent company. The demand of G Ltd is very high and the operations of M Ltd are very large and hence to cater to its shortfall, G Ltd also purchases the bottles from other companies. Purchases are made at the competitive prices.

M Ltd sold pharmaceuticals bottles to G Ltd for Euro 12 lacs on 1st February, 20X1. The cost of these bottles was ` 830 lacs in the books of M Ltd at the time of sale. At the year-end i.e. 31st March, 20X1, all these bottles were lying as closing stock with G Ltd.

Euro is the functional currency of G Ltd. while Indian Rupee is the functional currency of M Ltd.

Following additional information is available:

Exchange rate on 1st February, 20X1 1 Euro = ` 83

Exchange rate on 31st March, 20X1 1 Euro = ` 85

Provide the accounting treatment for the above in books of M Ltd. and G Ltd. Also show its impact on consolidated financial statements. Support your answer by Journal entries, wherever necessary, in the books of M Ltd.

Solution

Accounting treatment in the books of M Ltd (Functional Currency INR)

M Ltd will recognize sales of ` 996 lacs (12 lacs Euro x 83)

Profit on sale of inventory = 996 lacs – 830 lacs = ` 166 lacs.

On balance sheet date receivable from G Ltd. will be translated at closing rate i.e. 1 Euro = ` 85. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ` 24 lacs. (i.e. (85 - 83) x 12 Lacs)

Journal Entries

	₹ (in Lacs)	₹ (in Lacs)
G Ltd. A/c Dr. To Sales (Being revenue recorded on initial recognition)	996	996
G Ltd. A/c Dr. To Foreign exchange difference (unrealised) (Being foreign exchange difference recorded at year end)	24	24

Accounting treatment in the books of G Ltd (Functional currency EURO)
G Ltd will recognize inventory on 1st February, 20X1 of Euro 12 lacs which will also be its closing stock at year end.
Accounting treatment in the consolidated financial statements

Receivable and payable in respect of above mentioned sale / purchase between M Ltd and G Ltd will get eliminated.
The closing stock of G Ltd will be recorded at lower of cost or NRV.

	Euro (in lacs)	Rate	₹ (in lacs)
Cost	12	83	**996**
NRV (Assumed Same)	12	85	1020

Therefore, no write off is required.
The amount of closing stock includes two components–
- Cost of inventory for ` 830 lacs; and
- Profit element of ` 166 lacs; and

At the time of consolidation, the two elements amounting to ` 166 lacs will be eliminated from the closing stock.

Journal Entry

	₹ (in Lacs)	₹ (in Lacs)
Consolidated P&L A/c Dr.	166	
To Inventory		166
(Being profit element of intragroup transaction eliminated)		

Questions

1. Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for ` 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is ` 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of ` 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of `180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is ` 20 lakhs
Calculate P's gain on disposal in its consolidated financial statements.
Answer:
P's gain on disposal in its consolidated financial statements would be calculated in the following manner: **(` in Lakhs)**

Sale proceeds	1,500
Net assets of S	(1,000)
NCI derecognised	100
Foreign currency translation reserve	180
Gain on disposal	780

2. Entity A, whose functional currency is `, has a foreign operation, Entity B, with a Euro functional currency. Entity B issues to A perpetual debt (i.e. it has no maturity) denominated in euros with an annual interest rate of 6 per cent. The perpetual debt has no issuer call option or holder put option. Thus, contractually it is just an infinite stream of interest payments in Euros.
In A's consolidated financial statements, can the perpetual debt be considered, in accordance with Ind AS 21.15, a monetary item "for which settlement is neither planned nor likely to occur in the foreseeable future" (i.e. part of A's net investment in B), with the exchange gains and losses on the perpetual debt therefore being recorded in equity?
Answer:
Yes, as per Ind AS 21 net investment in a foreign operation is the amount of the reporting entity's interest in the net assets of that operation.
As per para 15 of Ind AS 21, an entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.
Analysis on the basis of above mentioned guidance
Through the origination of the perpetual debt, A has made a permanent investment in B. The interest payments are treated as interest receivable by A and interest payable by B, not as repayment of the principal debt. Hence, the fact that the interest payments are perpetual does not mean that settlement is planned or likely to occur. The perpetual debt can be considered part of A's net investment in B.
In accordance with para 15 of Ind AS 21, the foreign exchange gains and losses should be recorded in equity at the consolidated level because settlement of that perpetual debt is neither planned nor likely to occur.

3. Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).
The following balances appear in the books of of Infotech Global Ltd. at the year-end prior to translation:

	USD	L$
Property, plant and equipment	50,000	
Receivables	9,35,000	
Total assets	**9,85,000**	
Issued capital	50,000	30,055
Opening retained earnings	28,000	15,274
Profit & Loss A/c (Profit for the year)	20,000	
Accounts payable	8,40,000	
Accrued liabilities	47,000	
Total equity and liabilities	**9,85,000**	

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Translate the above balances of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.)
Prepare a working of the cumulative balance of the foreign currency translation reserve.
Additional information:
Relevant exchange rates are:
Rate at beginning of the year L$ 1 = USD 1.22
Average rate for the year L$ 1 = USD 1.175
Rate at end of the year L$ 1 = USD 1.13
Answer:
Translation of the balances for the purpose of consolidation

	USD	Rate	L$
Property, plant and equipment	50,000	1.13	44,248
Receivables	9,35,000	1.13	8,27,434
Total assets	**9,85,000**		**8,71,682**
Issued capital	50,000	—	30,055
Opening retained earnings	28,000	—	15,274
Profit for the year	20,000	1.175	17,021
Accounts payable	8,40,000	1.13	7,43,363
Accrued liabilities	47,000	1.13	41,593
Total equity and liabilities USD	**9,85,000**		**8,47,306**
Foreign Currency Translation Reserve (Refer WN-1)			**24,376**
Total equity and liabilities L$			**8,71,682**

Working Note
1 Cumulative balance of the FCTR

Particulars	Actual translated amount in L$	Amount (Refer WN-2)	Difference
	A	B	B-A
Issued capital	30,055	44,248	14,193
Opening retained earnings	15,274	24,779	9,505
Profit for the year	17,021	17,699	678
	62,350	**86,726**	**24,376**

2 Translated amount if the same conversion rate is applied to following items as applied on other items

			Translated amount
Issued capital	50,000	1.13	44,248
Opening retained earnings	28,000	1.13	24,779
Profit for the year	20,000	1.13	17,699
	98,000		86,726

4. On 30th January, 20X1, A Ltd. purchased a machinery for $ 5,000 from USA supplier on credit basis. A Ltd.'s functional currency is Rupees. The exchange rate on the date of transaction is 1 $ = ` 60. The fair value of the machinery determined on 31st March, 20X1 is $ 5,500. The exchange rate on 31st March, 20X1 is 1$ = ` 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$ = ` 67. The fair value of the machinery remain unchanged for the year ended on 31st March 20X2. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. Tax rate is 30% [RTP MAY 2018]

Answer:

(It is assumed that the revaluation method is followed in respect of Plant & Machinery)

Purchase of Machinery on credit basis on 30th January 20X1:

		₹	₹
Machinery A/c (5,000 x $ 60)	Dr.	3,00,000	
To Trade Receivables			3,00,000
(Initial transaction will be recorded at exchange rate on the date of transaction)			

Exchange difference arising on translating monetary item on 31st March 20X1:

		₹	₹
Profit & Loss A/c [(5,000 x $ 65) – (5,000 x $ 60)]	Dr.	25,000	
To Trade Receivables			20,000
Machinery A/c	Dr.	30,000	
To Revaluation Surplus (OCI)			30,000
[Being Machinery revalued to USD 5,500; (₹ 60 x (USD 5,500 - USD 5,000)]			
Machinery A/c	Dr.	27,500	
To Revaluation Surplus (OCI)			27,500
(Being Machinery measured at the exchange rate on 31-03-20X1 [USD 5,500 x (₹ 65 - ₹ 60)]			
Revaluation Surplus (OCI)	Dr.	17,250	
To Deferred Tax Liability			17,250
(DTL created @ of 30% of the total OCI amount)			

Exchange difference arising on translating monetary item and settlement of creditors on 31st March 20X2:

		₹	₹
Trade Receivables A/c (5,000 x $65)	Dr.	3,25,000	
Profit & loss A/c [(5,000 x ($ 67 -$ 65)]	Dr.	10,000	
To Bank A/c			3,35,000
Machinery A/c [(5,500 x ($ 67 - $ 65))	Dr.	11,000	
To Profit & loss A/c			11,000

5. On 1st January, 2018, P Ltd. purchased a machine for $ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was $1= ` 68. P Ltd. is not required to pay for this purchase until 30th June, 2018. Rupees strengthened against the $ in the three months following purchase and by 31st March, 2018 the exchange rate was $1 = ` 65. CFO of P Ltd. feels that these exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees. which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same.
Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2018 as per Ind AS. [RTP NOV 2018]
Answer:
As per Ind AS 21 'The Effects of Changes in Foreign Exchange Rates' the asset and liability would initially be recognised at the rate of exchange in force at the transaction date ie 1st January, 2018. Therefore, the amount initially recognised would be ` 1,36,00,000 ($ 2,00 000 x ` 68). The liability is a monetary item so it is retranslated using the rate of exchange in force at 31st March, 2018. This makes the closing liability of ` 1,30,00,000 ($ 2,00,000 x ` 65). The loss on re-translation of ` 6,00,000 (` 1,36,00,000 – ` 1,30,00,000) is recognised in the Statement of profit or loss. The machine is a non-monetary asset carried at historical cost. Therefore, it continues to be translated using the rate of ` 68 to $ 1.
Depreciation of ` 8,50,000 (` 1,36,00,000 x ¼ x 3/12) would be charged to profit or loss for the year ended 31st March, 2018. The closing balance in property, plant and equipment would be ` 1,27,50,000 (` 1,36,00,000 – ` 8,50,000). This would be shown as a non-current asset in the statement of financial position.

6. 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 2019]

Answer:

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

A Ltd. will recognise a non-monetary contract liability amounting ` 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 remaining 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.

PAST PAPERS, MOCK TEST PAPERS (MTP) & REVISION TEST PAPERS (RTP)

1. XYZ Global 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 is the statement of financial position of XYZ Global Ltd prior to translation:

	USD	Euro
Property, plant and equipment	**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 information:

Relevant exchange rates are:

Rate at the beginning of the year - Euro 1 = USD 1.25

Average rate for the year - Euro 1 = USD 1.20

Rate at the end of the year - Euro 1 = USD 1.15

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.
[MAY 2019 – 5 MARKS]
Answer:
Translation of the financial statements

	USD	Rate/Euro	Euro
	a	b	a/b
Property, plant and equipment	60,000	1.15	52,174
Receivables	9,00,000	1.15	7,82,609
Total assets	9,60,000		8,34,783
Issued capital	40,000		25,000
Opening retained earnings	25,000		15,000
Profit for the year	22,000	1.20	18,333
Accounts payable	8,15,000	1.15	7,08,696
Accrued liabilities	58,000	1.15	50,435
Total equity and liabilities	9,60,000		8,17,464
Foreign Currency Translation Reserve (FCTR) (Refer the below working)			17,319
Total equity and liabilities			8,34,783

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
	a	b	b-a
Issued capital	25,000	34,783*	9,783
Opening retained earnings	15,000	21,739**	6,739
Profit for the year	18,333	19,130***	797
	58,333	... 75,652	17,319

$* \frac{40,000}{1.15} = 34,783$ $** \frac{25,000}{1.15} = 21,739$ $*** \frac{22,000}{1.15} = 19,130$

2. What is the functional currency of an entity?
What are the primary and secondary factors that influence determination of functional currency? [NOV 2019 - 4 MARKS]
Answer:
Functional currency is the currency of the primary economic environment in which the entity operates. In this regard, the primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates.
The functional currency is normally the currency of the country in which the entity is located. It might, however, be a different currency. The following are the factors that influence determination of an appropriate functional currency

1. Primary indicators:
(a) the currency:
i. that mainly influences sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and
ii. of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
iii. the currency that mainly influences labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.
2. Secondary indicators: Other factors that may provide supporting evidence to determine an entity's functional currency are-
(a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and
(b) the currency in which receipts from operating activities are usually retained.

3. 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 14 MARKS]

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 Rs. 65 per US Dollar whereas in the open market, US Dollar can be sold at Rs. 66 per US Dollar.

No accounting entries are passed on the date of entering into purchase contract. On that date, the forward contract has a fair value of zero (refer section "option and nonoption based derivatives" below). Subsequently, say at 30th September 2017, the accounting entries are as follows: (Rs. In Crores)

1. Loss on derivative contract 5
To Derivative liability 5
(Being loss on currency forward)

2. Inventory 325
To Trade payables (financial liability) 325
(Being inventory recorded at forward exchange rate determined on date of contract)

3. Derivative liability 5
To Trade payables (financial liability) 5
(Being reclassification of derivative liability to trade payables upon settlement)

The effect is that the financial liability at the date of delivery is 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.

4. 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 30th June 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 OCTOBER 2018 6 MARKS]
Answer:

	Statement of Profit and loss		Equity Liabilities	
	Profit and loss	Other-comprehensive income	Equity	Liabilities
2014-15				
Translation Gain		2.00		
Less: Deferred Tax Expenses		(0.60)		
		1.40		
Translation Reserve			1.40	
Deferred tax liabilities				0.60
2015-16				
Translation Gain		2.00		
Less: Deferred Tax Expenses		(0.60)		
		1.40		
Translation Reserve			2.80	
Deferred tax liabilities				1.20
2016-17				
Translation loss		(1.00)		
Less: Deferred Tax Expenses		0.30		
		(0.70)		
Translation Reserve			2.10	
Deferred tax liabilities				0.90
2017-18				
Translation loss		(1.00)		
Less: Deferred Tax Expenses		0.30		
		(0.70)		
Translation Reserve			1.40	
Deferred tax liabilities				0.60
Reclassification adjustment credited to P&L	1.40			
Current Tax				(0.60)
Adjustment of deferred tax liabilities	0.60			

5. 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 Rupees and its financial year end is 31st March, 20X2.
(i) 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 30th September, 20X1.
The exchange rates as at 30th September, 20X1 was Rs. 82 / EURO and at 31st March, 20X2 was Rs. 84 / EURO.
What is the value at which the goodwill has to be recognised in the financial statements of Global Limited as on 31st March, 20X2?
(ii) Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 20X2. The exchange rate on the date of purchase by Global Limited was Rs. 83 / EURO and on 31st March, 20X2 was Rs. 84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements.
[RTP ? NOV 2019]
Answer:
(i) 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 17.5 million
To NCI (23 x 30%) 6.9 million
Thus, goodwill on reporting date would be 1.4 million EURO x Rs. 84 = Rs. 117.6 million
(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] Rs. 83 / Euro
Unrealized profit to be eliminated [a x b] Rs. 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.

9. On 1 st April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 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:

- **1st April, 20X1 - FCY 1 = Rs. 2.50.**
- **31st March, 20X2 – FCY 1 = Rs. 2.75.**
- **Average rate for the year ended 31st Match, 20X2 – FCY 1 = Rs. 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 2020]

Answer:

Initial carrying amount of loan in books

Loan amount received = 60,00,000 FCY
Less: Incremental issue costs = 2,00,000 FCY
58,00,000 FCY

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 Rs. 2.50/FCY
= Rs. 1,45,00,000 Therefore, the loan would initially be recorded at Rs. 1,45,00,000.

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

Period	Opening Financial Liability (FCY) A	Interest @ 12% (FCY) B	Cash Flow (FCY) C	Closing Financial Liability (FCY) A+B-C
20X1-20X2	58,00,000	6,96,000	6,00,000	58,96,000

The finance cost in FCY is 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 Rs. 16,84,320 (6,96,000 FCY x Rs. 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 is 58,96,000 FCY x INR 2.75 / FCY = Rs. 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
Rs. [1,62,14,000 - (1,45,00,000 + 16,84,320 – 16,50,000)] = Rs. 16,79,680.
This exchange difference is taken to profit and loss.


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thanku so much sir 18:12
finally i became CA 18:12
i remember how u always pushed me hard 18:12
and helped me when i was so scared how to revise and complete syllabus 18:13
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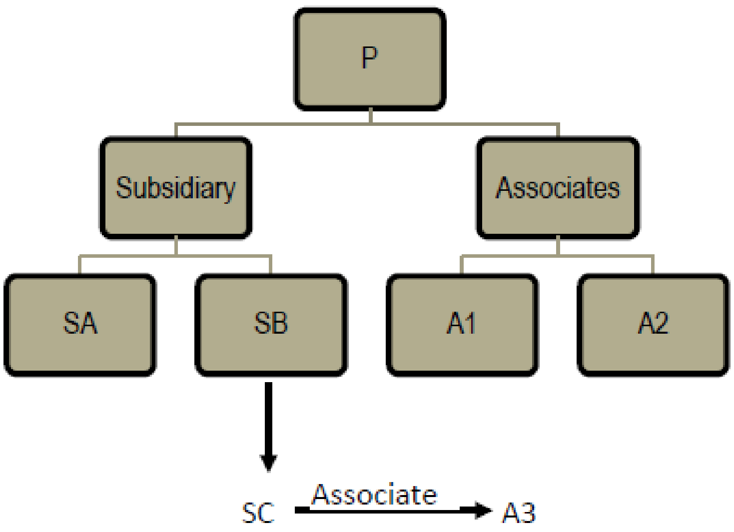
CHAPTER 11. IND AS ON DISCLOSURES IN THE FINANCIAL STATEMENTS

UNIT 1: IND AS 24: RELATED PARTY DISCLOSURES

1 : Associates and subsidiaries
Entity P Limited has a controlling interest in subsidiaries SA Limited and SB Limited and SC Limited. SC Limited is a subsidiary of SB Limited. P Limited also has significant influence over associates A1 Limited and A2 Limited. Subsidiary SC Limited has significant influence over associate A3 Limited
Examine related party relationships of various entities.
Solution



• In Separate Financial Statements of P Limited, SA Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.

• In the Individual Financial Statements of SA Limited, P Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.

• In the Individual Financial Statements of SB Limited, P Limited, SA Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.

• In the Individual Financial Statements of SC Limited, P Limited, SA Limited, SB Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.

• In the Individual Financial Statements of associates A1 Limited, A2 Limited and A3 Limited; P Limited, SA Limited, SB Limited and SC Limited are related parties.

• A1 Limited, A2 Limited and A3 Limited are not related to each other.

• For Parent's consolidated financial statements, A1 Limited, A2 Limited and A3 Limited are related to the Group

2 : Key management personnel

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.

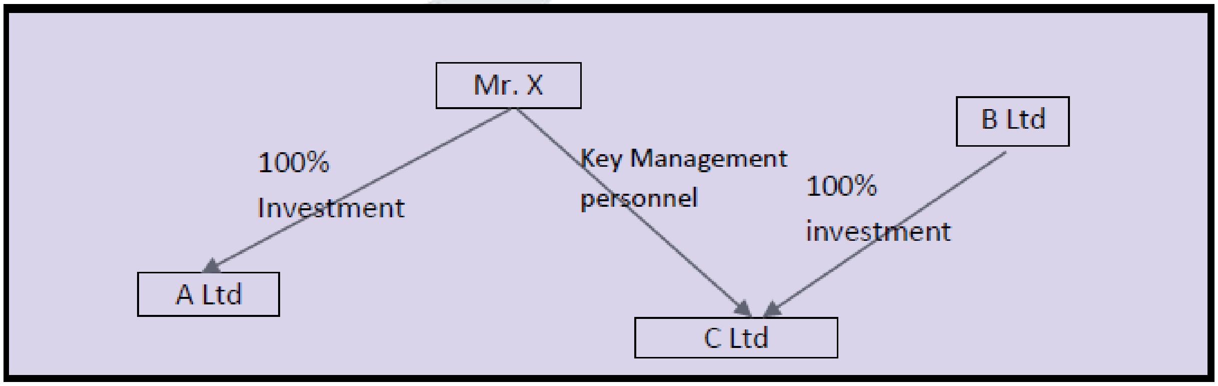
(b) Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a KMP of B Limited and not C Limited.

(c) Will the outcome in (a) & (b) would be different if Mr. X has joint control over A Limited.

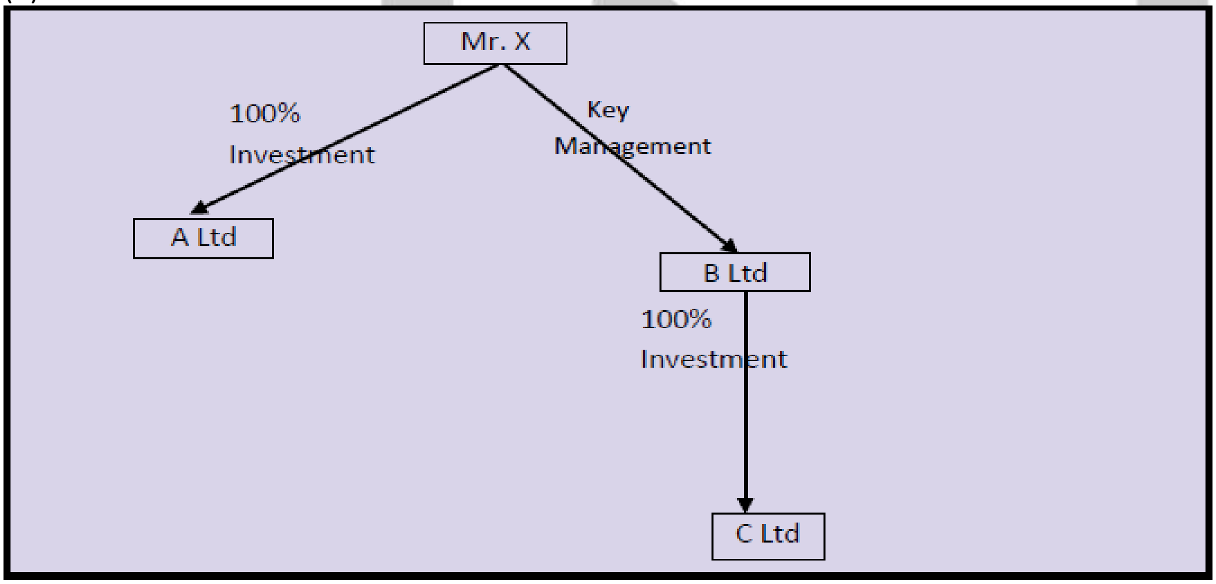
(d) Will the outcome in (a) & (b) would be different if Mr. X has significant influence over A Limited.

Solution

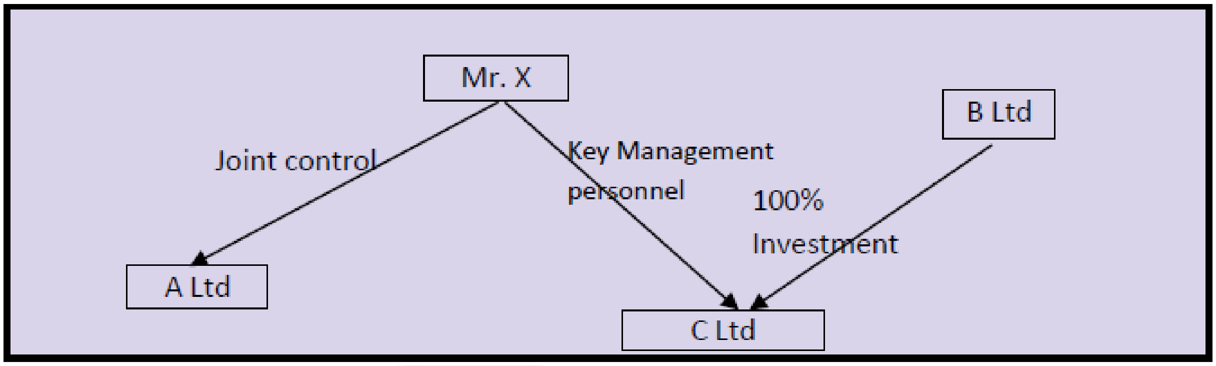
(a) A Limited is related to C Limited because Mr. X controls A Limited and is a member of KMP of C Limited.



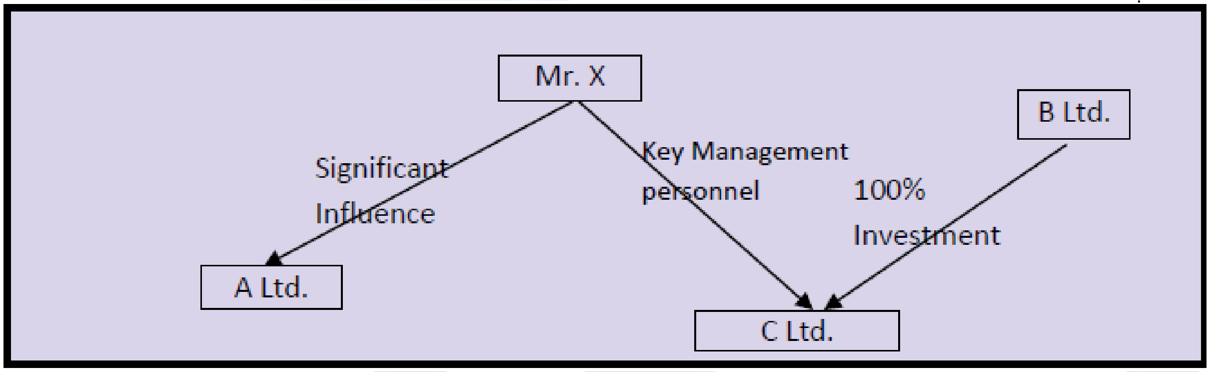
(b) Still A Limited will be related to C Limited.



(c) No, Still A Limited will be related to C Limited.



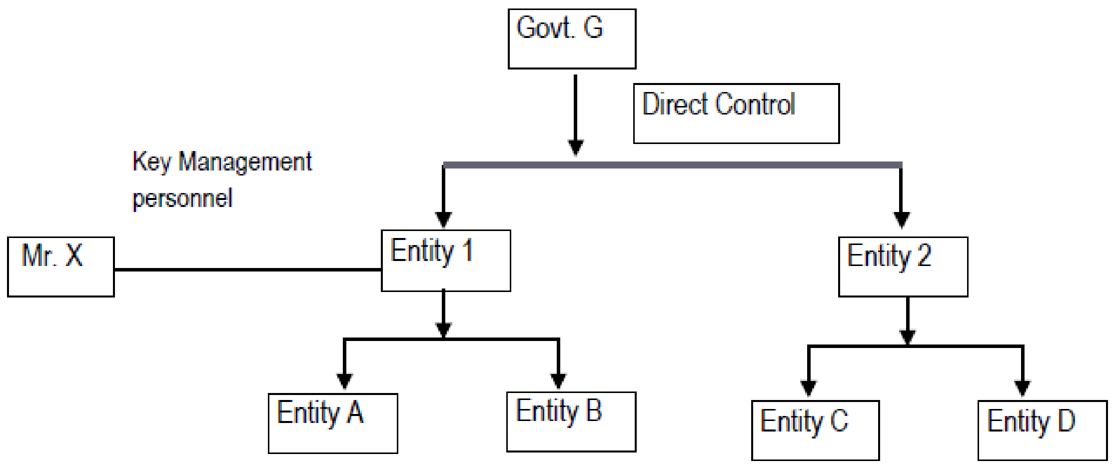
(d) Yes, A Ltd. is not controlled by Mr. X. Therefore, despite Mr. X being KMP of C Ltd., A Ltd., having significant influence of Mr. X, will not be considered as related party of C Limited.



3 : Person as investor
Mr. X has an investment in A Limited and B Limited.
Required
(i) Examine when can related party relationship be established
(a) from the perspective of A Limited's financial statements:
(b) from the perspective of B Limited's financial statements:
(ii) Will A Limited and B Limited be related parties if Mr. X has only significant influence over both A Limited and B Limited
Solution

(i) (a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Mr. X has control, joint control or significant influence over Entity B.
(b) If Mr. X controls or jointly controls A Limited, A Limited is related to Entity B when Mr. X has control, joint control or significant influence over Entity B.
(ii) No, A Ltd. & B Ltd., will not be considered as related party since no direct or indirect control is exercised on each other in any of the manner.

4 : Partial exemption for government related entities
Government G directly controls Entity 1 and Entity 2. It indirectly controls Entity A and Entity B through Entity 1, and Entity C and Entity D through Entity 2. Person X is a member of the key management personnel in Entity 1.
Examine the entity to whom the exemption for disclosure to be given and for transaction with whom.
Solution
For Entity A's financial statements, the exemption of Ind AS 24 applies to:
(a) transactions with Government G; and
(b) transactions with Entities 1 and 2 and Entities B, C and D. However, that exemption does not apply to transactions with Person X.



5 Power Limited is a producer of electricity. Transmission Limited regularly purchases electricity from Power Limited. Power Limited whose financial year ends on March 31, 20X2, acquired 100% shareholding of Transmission Limited on July 15, 20X1. However, the entire shareholding is disposed of on March 21, 20X2. Power Limited and Transmission Limited had transactions when Transmission Limited was a subsidiary of Power Limited and also in the period when it was not a subsidiary of Power Limited.
For which period, related party disclosure should Power Limited make in its financial statements for the year ended March 31, 20X2 with respect to transactions with Transmission Limited.
Solution
Power Limited should in its financial statements for the year ended March 31, 20X2 make related party disclosures for the period from July 15, 20X1 to March 21, 20X2 when Transmission Limited was its subsidiary.

Questions
1. Mr. X is a domestic partner of Ms. Y. Mr. X has an investment in A Limited and Ms. Y has an investment in B Limited.
Required
(a) Examine when can a related party relationship is established, from the perspective of A Limited's financial statements:
(b) Examine when can related party relationship is established, from the perspective of B Limited's financial statements:

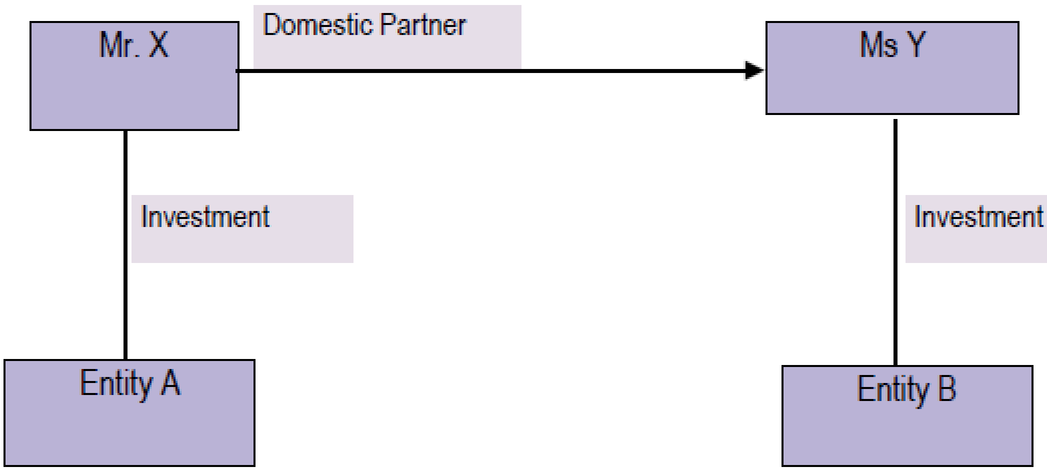
(c) Will A Limited and B Limited be related parties if Mr. X has only significant influence over A Limited and Ms. Y also has significant influence over B Limited:

Answer:

(a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Ms. Y has control, joint control or significant influence over B Limited.

(b) If Mr. X controls or jointly controls A Limited, A Limited is related to B Limited when Ms. Y has control, joint control or significant influence over B Limited.

(c) No, Significant influence does not lead to direct/indirect control between the A Ltd. & B Ltd.



2. A Limited has both (i) joint control over B Limited and (ii) joint control or significant influence over C Limited

Required

(a) Examine related party relationship from the perspective of C Limited's financial statements.

(b) Examine related party relationship from the perspective of B Limited's financial statements.

Answer

(a) C Limited is related to B Limited

(b) B Limited is related to C Limited.

3. ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs. P whose husband is a director in XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1st June, 20X1. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 20X1 to 31st May 20X1 totalled ` 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 period from 1st June 20X1 to 31st March 20X2 totalled ` 60,00,000. On 31st March 20X2, 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 31st March 20X2 as per Ind AS. You are required to mention the disclosure requirements as well. [ALSO ASKED IN RTP NOV 2018]

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 20X2 within its revenue and show ` 18,00,000 within trade receivables at 31st March 20X2.
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 20X1, ABC Ltd. would also be regarded as a related party of XYZ Ltd. because from that date ABC Ltd. is an entity controlled by another related party.
Because ABC Ltd. is a related party with whom XYZ Ltd. has transactions, then XYZ Ltd. should disclose:
– The nature of the related party relationship.
– The revenue of ` 60,00,000 from ABC Ltd. since 1st June 20X1.
– The outstanding balance of ` 18,00,000 at 31st March 20X2.
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.

4. 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 ` 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 ` 1,50,000 per meeting. The Accountant of X Ltd. believes that they being not the employees of the organisation, their fee should not be disclosed as per related party transaction in accordance with Ind AS 24.
Examine whether the sitting fee paid to independent director and non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?
[ALSO ASKED IN RTP MAY 2018]
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. Independent directors are not employee of the company and this para requires rewording. 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 (` 10,00,000 + ` 7,50,000) ` 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.

5. Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 20X2 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:
One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period 20X1-20X2. Mr. Y owns 100% of the shares in PQR Ltd. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases.
Provide answers to the query raised by the Managing Director Mr. Y as per Ind AS. [RTP NOV 2018]
Answer:
Ongoing through the queries raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:
Related parties are generally characterised by the presence of control or influence between the two parties. Ind AS 24 'Related Party Disclosures' identifies related parties as, inter alia, key management personnel and companies controlled by key management personnel. On this basis, PQR Ltd. is a related party of ABC Ltd. The transaction is required to be disclosed in the financial statements of ABC Ltd. since Mr. Y is Key Management personnel of ABC Ltd. Also at the same time, it owns 100% shares of PQR Ltd. ie. he controls PQR Ltd. This implies that PQR Ltd. is a related party of ABC Ltd. Where transactions occur with related parties, Ind AS 24 requires that details of the transactions are disclosed in Notes to the financial statements. This is required even if the transactions are carried out on an arm's length basis. Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to ABC Ltd. does not affect the need for disclosure.

6. 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 2019]
Answer:
(a) As per para 18 of Ind AS 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 a reporting 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 control of, 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 paragraph 25 applies to:
(i) transactions with Government Uttar Pradesh State Government; and

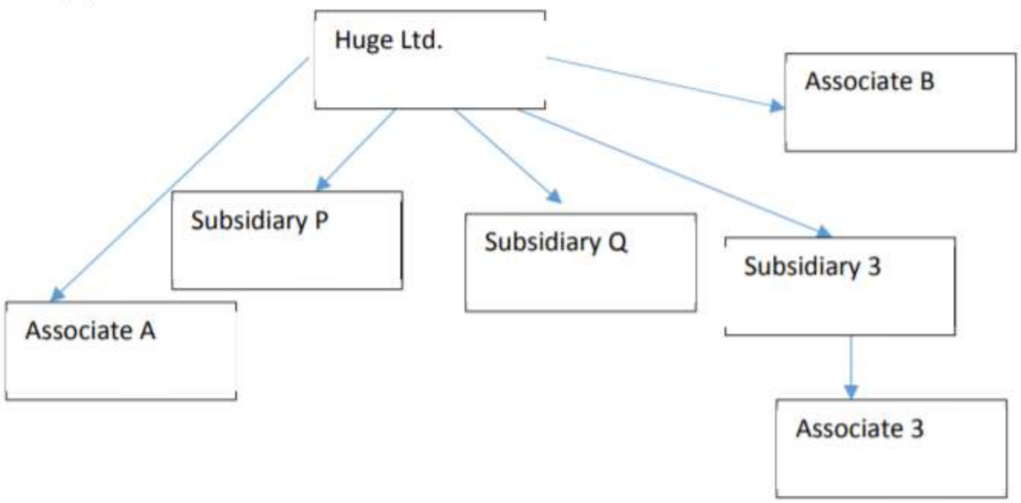
(ii) transactions with Entities PQR and ABC and Entities Q, A and B.
Similar exemptions are available to Entities PQR, ABC, Q, A and B, with the transactions with UP State Government and other entities controlled directly or indirectly by UP State Government. However, that exemption does not apply to 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 in paragraph 25:
(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.

7. S Ltd., a wholly owned subsidiary of P Ltd is the sole distributor of electricity to consumers in a specified geographical area. A manufacturing facility of P Ltd is located in the said geographical area and, accordingly, P Ltd is also a consumer of electricity supplied by S Ltd. The electricity tariffs for the geographical area are determined by an independent rate-setting authority and are applicable to all consumers of S Ltd, including P Ltd. Whether the above transaction is required to be disclosed as a related party transaction as per Ind AS 24, Related Party Disclosures in the financial statements of S Ltd.?
Answer:
As per paragraph 9(b)(i) of Ind AS 24, each parent, subsidiary and fellow subsidiary in a 'group' is related to the other members of the group. Thus, in the case under discussion, P Ltd is a related party of S Ltd from the perspective of financial statements of S Ltd.
Paragraph 11 of Ind AS 24 states as follows:
"In the context of this Standard, the following are not related parties:
(a) two entities simply because they have a director or other member of management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.
(b) two joint venturers simply because they share joint control of a joint venture.
(c) (i) providers of finance,(ii) trade unions, (iii) public utilities, and (iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).
(d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence." Being engaged in distribution of electricity, S Ltd is a public utility. Had the only relationship between S Ltd and P Ltd been that of a supplier and a consumer of electricity, P Ltd would not have been regarded as a related party of S Ltd. However, as per the facts of the given case, this is not the only relationship between S Ltd and P Ltd. Apart from being a supplier of electricity to P Ltd., S Ltd is also a subsidiary of P Ltd; this is a relationship that is covered within the related party relationships to which the disclosure requirements of the standard apply. In view of the above, the supply of electricity by S Ltd to P Ltd is a related party transaction that attracts the disclosure requirements contained in paragraph 18 and other relevant requirements of the standard.

This is notwithstanding the fact that P Ltd is charged the electricity tariffs determined by an independent rate-setting authority (i.e., the terms of supply to P Ltd are at par with those applicable to other consumers) Ind AS 24 does not exempt an entity from disclosing related party transactions merely because they have been carried out on an arm's length basis.

QUESTIONS FROM MOCK TEST PAPERS & REVISION TEST PAPER

1. 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 10 MARKS]
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.

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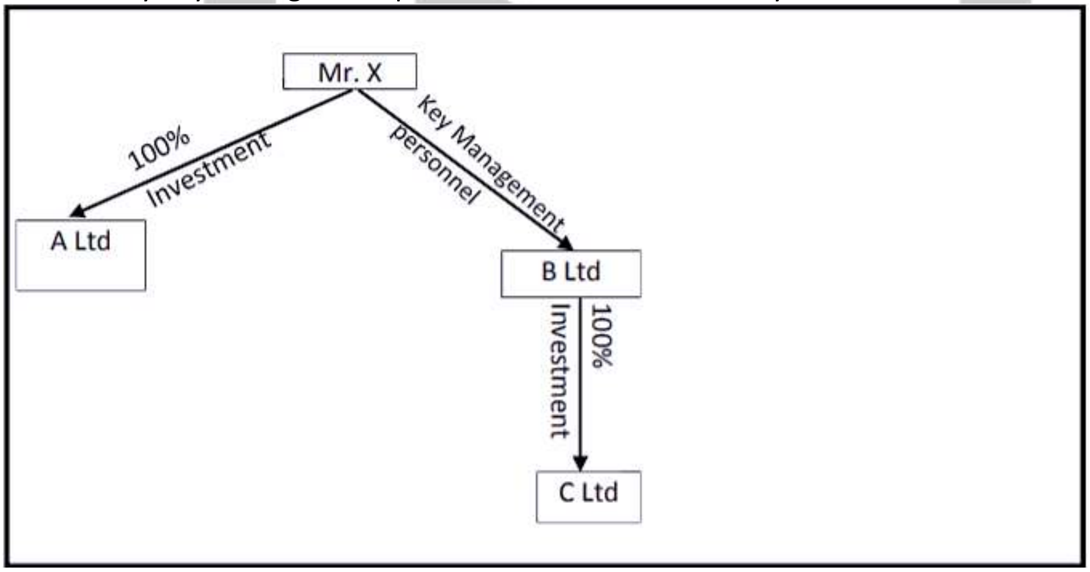
(iv) For Subsidiary Q's separate financial statements- Parent, Subsidiaries P and R and Associates A, B and C are related parties.
(v) For Subsidiary R's financial statements- Parent, Subsidiaries P and Q and Associates A, B and C are related parties.
(vi) For the financial statements of Associates A, B and C- Parent and Subsidiaries

2. 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 AUGUST 2018 4 MARKS]
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".



3. An Indian company has a parent company out side India. Parent company negotiates software licenses with end vendor and based on number of licences, parent company get its reimbursement from Indian company. Say, license cost of Rs. 12 Lac is charged for calendar year of 2018. Parent company generates is invoice in February'18. Indian company accounts full invoice in February'18 and then for Indian financial year, accounts Reimbursement expense of Rs. 3. 00 Lac during FY 1718 (for licencing cost relating to period January'18 to March'18) and

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Prepaid expenses of Rs. 9 Lac for licensing cost reimbursement relating to April'18 to December'18. Prepaid expense is subsequently reversed and expense of Rs. 9 Lac is accounted for in FY 18-19.
What amount should be disclosed at Related party transaction?
[MTP MARCH 2019 4 MARKS]
Answer:
Paragraph 9 of Ind AS 24 Related Party Disclosures defines Related Party Transactions as under:
"A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged."
Paragraph 6 of Ind AS 24 states as under:
"6 A related party relationship could have an effect on the profit or loss and financial position of an entity…"
In the given case, there is a transfer of resources to the extent of Rs.12 lac from the company to the parent towards software license. Of this transfer of resources, the company has consumed the benefits relating to Rs.3 lac of software license cost which is recognise in profit or loss. The benefits relating to Rs.9 lac of software license cost will be consumed in the next reporting period and therefore is recognised in balance sheet as prepaid expenses.
Paragraph 18 of Ind AS 24 states as under:
"18 If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments necessary for users to understand the potential effect of the relationship of the financial statements. At a minimum, disclosures shall include:
a. The amount of the transactions;
b. The amount of outstanding balances, including commitments, and; (i) Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and (ii) Details of any guarantees given or received;
c. Provisions for doubtful debts related to the amount of outstanding balances; and
d. The expense recognised during the period in respect of bad and doubtful debts due from related parties."
Therefore, the company has to disclose:
1. The amount of transaction with the parent of Rs.12 lac towards software license;
2. Outstanding balance of Rs.9 lac presented as prepaid expense along with the terms and conditions and state that the same will be settled in the next reporting period by receipt of software licensing services.

3. The amount of Rs.3 lac recognised as software license expense in profit or loss for the benefits consumed during the period to make it understandable to users.
Paragraph 113 of Ind AS 1 Presentation of Financial Statements states as under:
"113 An entity shall present notes in a systematic manner. An entity shall cross-reference each line items in the balance sheet and in the statement of profit and loss, and in the statement of changes in equity and of cash flows to any related information in the notes."
Therefore, the company shall cross-reference the software license expense recognised in profit or loss and prepaid expenses recognised in balance sheet to the notes disclosing related party transactions.

UNIT 2 : INDIAN ACCOUNTING STANDARD 33 : EARNINGS PER SHARE

1 ABC Ltd. issues 9% preference shares of fair value of ` 10 each on 1.4.20X1. Total value of the issue is ` 10,00,000. The shares are issued for a period of 5 years and would be redeemed at the end of 5th year. The shares are to be redeemed at ` 11 each.
At the end of the year 3, i.e. on 31.3.20X4, company finds that it has earned good returns than expected over last three years and can make the redemption of preference shares early. To compensate the shareholders for two years of dividend which they need to forego, company decided to redeem the shares at ` 12 each instead of original agreement of ` 11. Comment on the impact of early conversion of preference shares at a premium on earnings for the year 20X3-20X4 attributable to ordinary equity holders of ABC Ltd. for basic EPS. Ignore the EIR impact in the solution and answer on the basis of Ind AS 33 only.
Solution
In the given situation, ` 1 per share is the excess payment made by the company amounting to ` 1,00,000 in all. The amount of ` 1,00,000 will be deducted from the earnings of the year 20X3-20X4 while calculating the basic EPS of year 20X3-20X4.

2 An entity has following preference shares in issue at the end of 20X4:
• 5% redeemable, non-cumulative preference shares: These shares are classified as liabilities. During the year, a dividend was paid on the 5% preference shares – ` 100,000.
• Increasing-rate, cumulative, non-redeemable preference shares issued at a discount in 20X0, with a cumulative dividend rate from 20X5 of 10%: The shares were issued at a discount to compensate the holders, because dividend payments will not commence until 20X5. The accrual for the discount in the current year, calculated using the effective interest method amounted to, say, ` 18,000. These shares are classified as equity – ` 200,000.
• 8% non-redeemable, non-cumulative preference shares: At the beginning of the year, the entity had ` 100,000 8% preference shares outstanding but, at 30 June 20X4, it repurchased ` 50,000 of these at a discount of ` 1,000 – ` 50,000.
• 7% cumulative, convertible preference shares (converted in the year): These shares were classified as equity, until their conversion into ordinary shares at the beginning of the year. No dividend was accrued in respect of the year, although the previous year's dividend was paid immediately prior to conversion. To induce conversion, the terms of conversion of the 7% convertible preference shares were also amended, and the revised terms entitled the preference shareholders to an additional 100 ordinary shares on conversion with a fair value of ` 300 – Nil.
The profit after tax for the year 20X4 is ` 150,000.
Determine the adjustments for the purpose of calculating EPS.
Solution
Adjustments for the purpose of calculating EPS are made as follows:

Particulars	Amount (₹)	Amount (₹)
Profit after tax		150,000
Amortisation of discount on issue of increasing-rate preference shares (Refer Note 1)	(18,000)	
Discount on repurchase of 8% preference shares (Refer Note 2)	1,000	(17,000)
Profit attributable to ordinary equity holders for basic EPS (Refer Note 3-5)		1,33,000

Notes:

1. The original discount on issue of the increasing-rate preference shares is treated as amortised to retained earnings and treated as preference dividends for EPS purposes and adjusted against profit attributable to the ordinary equity holders. There is no adjustment in respect of dividend, because these do not commence until 20X5. Instead, the finance cost is represented by the amortisation of the discount in the dividend-free period. In future years, the accrual for the dividend of ` 20,000 will be deducted from profits.

2. The discount on repurchase of the 8% preference shares has been credited to equity so should be added to profit.

3. The dividend on the 5% preference shares has been charged to the income statement, because the preference shares are treated as liabilities, so no adjustment is required for it from the profit.

4. No accrual for the dividend on the 8% preference shares is required, because they are non-cumulative. If a dividend had been declared for the year, it would have been deducted from profit for the purpose of calculating basic EPS, because the shares are treated as equity and the dividend would have been charged to equity in the financial statements.

5. The 7% preference shares were converted at the beginning of the year, so there is no adjustment in respect of the 7% preference shares, because no dividend accrued in respect of the year. The payment of the previous year's cumulative dividend is ignored for EPS purposes, because it will have been adjusted for in the prior year. Similarly, the excess of the fair value of additional ordinary shares issued on conversion of the convertible preference shares over the fair value of the ordinary shares to which the shareholders would have been entitled under the original conversion terms would already have been deducted from profit attributable to the ordinary shareholders, and no further adjustment is required.

It may be noted that as per Sections 53 and 55 of the Companies Act, 2013, a company cannot issue shares at discount or any irredeemable preference shares. However, the above illustration has been given only to explain the concept given in Ind AS.

3

Following is the data for company XYZ in respect of number of equity shares during the financial year 20X1-20X2. Find out the number of shares for the purpose of calculation of basic EPS as per Ind AS 33.

No.	Date	Particulars	No of shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	100,000
2	15-Jun-20X1	Issue of equity shares	75,000
3	8-Nov-20X1	Conversion of convertible 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

Solution

The closing balance of the outstanding shares is 2,05,000 by a normal addition and subtraction. But as per weighted average concept, one need to find out for how many days each type of shares was actually held during the year.

The shares which were there on 1st April 20X1, were held for the whole year. Therefore, weighted average number of such shares will be given by the formula:

No of shares x no of days the shares were held during the year / 365

= 1,00,000 x 365 / 365 = 1,00,000

But the shares which were issued on 15th June 20X1, were held for only 290 days. Therefore, the weighted average number of shares will be 75,000 x 290 / 365 = 59,589.

Following the above formula, the weighted average number of shares for calculation of EPS for the year 20X1-20X2 will be as follows:

Sr. No.	Date	Particulars	No of shares	No of days shares were outstanding	Weighted average no of shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	1,00,000	365	1,00,000
2	15-Jun-20X1	Issue of equity shares	75,000	290	59,589
3	8-Nov-20X1	Conversion of convertible preference shares in Equity	50,000	144	19,726
4	22-Feb-20X2	Buy back of shares	(20,000)	(38)*	(2,082)
5	31-Mar-20X2	Closing balance of outstanding equity shares	2,05,000		1,77,233

* 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.

4 On 31 March, 20X2, the issued share capital of a company consisted of ` 100,000,000 in ordinary shares of ` 25 each and ` 500,000 in 10% cumulative non-redeemable preference shares (classified as equity) of Re 1 each. On 1 October, 20X2, the company issued 1,000,000 ordinary shares fully paid by way of capitalisation of reserves in the proportion 1:4 for the year ended 31 March, 20X3.
Profit for 20X1-20X2 and 20X2-20X3 is ` 450,000 and ` 550,000 respectively.
Calculate the basic EPS for 20X1-20X2 and 20X2-20X3.
Solution

	20X2-20X3 ₹'000	20X1-20X2 ₹'000
Calculation of earnings		
Profit for the year	550	450
Less: Preference shares dividend	(50)	(50)
Earnings (A)	500	400

	No. of shares in '000	No. of shares in '000
Number of ordinary shares		
Shares in issue for full year	4,000	4,000
Capitalisation issue at 1 October 20X2	1,000	1,000
Number of shares (B)	5,000	5,000
Earnings per ordinary share (A/B)	10 Paise	8 Paise*

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*The comparative EPS for 20X1-20X2 can alternatively be calculated by adjusting the previously disclosed EPS in 20X1-20X2 (in this example, 10 Paise) by the following factor:
Number of shares before the bonus issue/ Number of shares after the bonus issue
*Adjusted EPS for 20X1-20X2 10 Paise x (4,000/ 5,000) = 8 Paise

5
X Ltd.
1 January 1,000,000 shares in issue
28 February Issued 200,000 shares at fair value
31 August Bonus issue 1 share for 3 shares held
30 November Issued 250,000 shares at fair value
Calculate the number of shares which would be used in the basic EPS calculation. Consider reporting date as December end.
Solution

Period	**Calculations**	**Weighted average number of shares**
1 January - 28 February	1,000,000 × 2 / 12 × 4 / 3	222,222
1 March - 31 August	1,200,000 × 6 / 12 × 4 / 3	800,000
1 September - 30 November	1,600,000 × 3 / 12	400,000
1 December - 31 December	1,850,000 × 1 / 12	154,167
		1,576,389

6 At 31 December 20X1, the issued share capital of a company consisted of 1.8 million ordinary shares of ` 10 each, fully paid. The profits for the year ended 31 December 20X1 and 20X2 amounted to ` 630,000 and ` 875,000 respectively. On 31 March 20X2, the company made a rights issue on a 1 for 4 basis at ` 30. The market price of the shares immediately before the rights issue was ` 60. Calculate EPS.
Solution
Calculation of theoretical ex rights price:

	Number of shares		₹
Initial holding	4	Market Value (4 x 60)	240
Rights taken up	1	Cost (1 x 30)	30
New holding	**5**	**Theoretical price**	**270**

Theoretical ex rights price = 270/5 = ` 54
Calculation of bonus element
The bonus element of the rights issue is given by the fraction:
Market price before rights issue/Theoretical ex-rights price =60 / 54 = 10/9
This corresponds to a bonus issue of 1 for 9. The bonus ratio will usually be greater than 1 (that is, the market price of the shares immediately prior to the exercise of rights is greater than the theoretical ex-rights price). If the ratio is less than 1, it might indicate that the market price has fallen significantly during the rights period,

which was not anticipated when the rights issue was announced. In this situation, the rights issue should be treated as an issue of shares for cash at full market price.

It can be demonstrated, using the figures in the illustration, that a rights issue of 1 for 4 at ` 30 is equivalent to a bonus issue of 1 for 9 combined with an issue of shares at full market price of ` 54 per share. Consider an individual shareholder holding 180 shares:

	Number of shares (in '000s)	Value	₹ (in million)
Original holding	1,800	Value at ₹60 per share	108.00
Rights shares (1:4)	450	Value at ₹30 per share	13.50
Holding after rights issue	2,250	Value at ₹54 per share	121.50

The additional 450 thousand rights shares at `30 can be shown to be equivalent to a bonus issue of 1 for 9 on the original holding, followed by an issue of 1:8 at full market price of `54 following the bonus issue, as follows:

	Number of shares (in '000s)	Value	₹ (in million)
Original holding	1,800	Value at ₹60 per share	108.00
Bonus issue of 1 for 9	200	Value Nil	nil
	2000	**Value at ₹ 54 per share**	**108.00**
Issue of 1 for 8 at full price (450-200)	250	Value at ₹ 54 per share	13.50
Total holding	**2250**	**Value at ₹54 per share**	**121.50**

The shareholder is therefore indifferent as to whether the entity makes a rights issue of 1 for 4 at ` 30 per share, or a combination of a bonus issue of 1 for 9 followed by a rights issue of 1 for 8 at full market price of ` 54 per share.

Having calculated the bonus ratio, the ratio should be applied to adjust the number of shares in issue before the rights issue, both for the current year and for the previous year. Therefore, the weighted average number of shares in issue for the current and the previous period, adjusted for the bonus element, would be:

Weighted average number of shares:

	20X2	20X1
No of actual shares in issue before rights	1,800,000	1,800,000
Correction for bonus issue (1:9)	200,000	200,000
Deemed no of shares in issue before right issue	2,000,000	2,000,000

(1.8 million x 10/9 for the whole year)

The no of shares after the rights issue would be

= 1.8 million x 5/4 = 2,250,000

Therefore, the weighted average number of shares would be

2.0 million for the whole year		2,000,000
1.8 million x 10/9 x 3/12 (before rights issue)	500,000	-
2.25 million x 9/12 (after rights issue)	1,687,500	-
Weighted average number	**2,187,500**	**2,000,000**

	20X2	**20X1**
Calculation of earnings		**(as previously stated)**
Profits for the year	₹ 875,000	₹ 630,000
Weighted average number	2,187,500	1,800,000
Basic EPS	**40p**	**35p**
Basic EPS for 20X1 (as restated)		₹ 630,000 / 2,000,000
		= 31.50p

In practice, the restated EPS for 20X1 can also be calculated by adjusting the EPS figure of the previous year by the reciprocal of the bonus element factor:

* 35p x 9/10 = 31.50 p

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Entity A has in issue 25,000 4% debentures with a nominal value of Re 1. The debentures are convertible to ordinary shares at a rate of 1:1 at any time until 20X9. The entity's management receives a bonus based on 1% of profit before tax.

Entity A's results for 20X2 showed a profit before tax of ` 80,000 and a profit after tax of ` 64,000 (for simplicity, a tax rate of 20% is assumed in this question).

Calculate Earnings for the purpose of diluted EPS.

Solution

For the purpose of calculating diluted EPS, the earnings should be adjusted for the reduction in the interest charge that would occur if the debentures were converted, and for the increase in the management bonus payment that would arise from the increased profit. **Amount (`)**	
Profit after tax	64,000

Add: Reduction in interest cost (25,000 × 4%) (Refer Note)	1,000
Less: Tax expense (1,000 × 20%)	(200)
Less: Increase in management bonus (1,000 × 1%)	(10)
Add: Tax benefit (10 × 20%)	2
Earnings for the purpose of diluted EPS	**64,792**

8 ABC Ltd. has 1,000,000 ` 1 ordinary shares and 1,000 ` 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 ` 4.50 per share and earnings for the period are ` 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.
Solution
Basic EPS is ` 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) = ` 7,900.
Incremental shares calculation
Assume all bonds are converted to shares, even though this converts ` 100 worth of bonds into 20 shares worth only ` 90 and is therefore not economically rational.
This gives 1000 x 20 = 20,000 additional shares.
Earnings per incremental share = ` 7,900 / 20,000 = ` 0.395
Diluted EPS = (` 500,000 + ` 7,900) / (1,000,000 + 20,000) = ` 0.498 per share

9 At 30 June 20X1, the issued share capital of an entity consisted of 1,500,000 ordinary shares of ` 1 each. On 1 October 20X1, the entity issued ` 1,250,000 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 20X6 to 20X9, into the number of ordinary shares set out below:
30 June 20X6: 135 ordinary shares;
30 June 20X7: 130 ordinary shares;
30 June 20X8: 125 ordinary shares; and
30 June 20X9: 120 ordinary shares.
If the loan stocks are not converted by 20X9, they would be redeemed at par.
This illustration assumes that the written equity conversion option is accounted for as a derivative liability and marked to market through profit or loss. The change in the options' fair value reported in 20X2 and 20X3 amounted to losses of ` 2,500 and ` 2,650 respectively. 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 30 June 20X2 and 20X3 amounted to ` 825,000 and ` 895,000 respectively and relate wholly to continuing operations. The rate of tax for both periods is 33%.

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Calculate Basic and Diluted EPS.
Solution

	20X3	20X2
Trading results	₹	₹
A. Profit before interest, fair value movements and tax	895,000	825,000
B. Interest on 8% convertible loan stock (20X2: 9/12 × ₹100,000)	(100,000)	(75,000)
C. Change in fair value of embedded option	(2,650)	(2,500)
Profit before tax	792,350	747,500
Taxation @ 33% on (A-B)	(262,350)	(247,500)
Profit after tax	**530,000**	**500,000**
Calculation of basic EPS		
Number of equity shares outstanding	1,500,000	1,500,000
Earnings	₹ 530,000	₹ 500,000
Basic EPS	35 paise	33 paise

Calculation of diluted EPS
Test whether convertibles are dilutive:
The saving in after-tax earnings, resulting from the conversion of ` 100 nominal of loan stock, amounts to ` 100 × 8% × 67% + ` 2,650/12,500 = ` 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 35 paise. Hence the convertibles are dilutive.

	20X3	**20X2**
Adjusted earnings	₹	₹
Profit for basic EPS	530,000	500,000
Add: Interest and other charges on earnings saved	102,650	77,500
as a result of the conversion	(100,000 + 2,650)	(75000+ 2500)
Less: Tax relief thereon	(33,000)	(24,750)
Adjusted earnings for equity	**599,650**	**552,750**

Adjusted number of shares
From the conversion terms, it is clear that the maximum number of shares issuable on conversion of ` 1,250,000 loan stock after the end of the financial year would be at the rate of 135 shares per ` 100 nominal (that is, 1,687,500 shares).

	20X3	20X2
Number of equity shares for basic EPS	1,500,000	1,500,000
Maximum conversion at date of issue 1,687,500 × 9/12		1,265,625
Maximum conversion after balance sheet date	1,687,500	–
Adjusted shares	**3,187,500**	**2,765,625**
Adjusted earnings for equity	₹ 599,650	₹ 552,750
Diluted EPS (approx.)	**19 paise**	**20 paise**

10 At 31 December 20X7 and 20X8, the issued share capital of an entity consisted of 4,000,000 ordinary shares of ` 25 each. The entity has granted options that give holders the right to subscribe for ordinary shares between 20Y6 and 20Y9 at ` 70 per share. Options outstanding at 31 December 20X7 and 20X8 were 630,000. There were no grants, exercises or lapses of options during the year. The profit after tax, attributable to ordinary equity holders for the years ended 31 December 20X7 and 20X8, amounted to ` 500,000 and ` 600,000 respectively (wholly relating to continuing operations).
Average market price of share:
Year ended 31 December 20X7 = ` 120
Year ended 31 December 20X8 = ` 160
Calculate basic and diluted EPS.
Solution

	20X8	20X7
Calculation of basic EPS		
Profit after tax	₹ 600,000	₹ 500,000
Number of share	4,000,000	4,000,000
Basic EPS (approx.)	15 paise	13 paise.
Calculation of diluted EPS		
Adjusted number of shares		
Number of shares under option:		
Issued at full market price:		
(630,000 × 70) ÷ 120		367,500
(630,000 × 70) ÷ 160	275,625	
Issued at nil consideration — dilutive	354,375	262,500
Total number of shares under option	630,000	630,000
Number of equity shares for basic EPS	4,000,000	4,000,000
Number of dilutive shares under option	354,375	262,500
Adjusted number of shares (A)	4,354,375	4,262,500
Profit after tax (B)	₹ 600,000	₹ 500,000
Diluted EPS (B/A)	14 paise	12 paise

Note: If options had been granted or exercised during the period, the number of 'nil consideration' shares in respect of these options would be included in the diluted EPS calculation on a weighted average basis for the period prior to exercise

11- Effects of share options on diluted earnings per share

Profit attributable to ordinary equity holders of the parent entity for year 20X1	` 1,200,000
Weighted average number of ordinary shares outstanding during year 20X1	500,000 shares
Average market price of one ordinary share during year 20X1	` 20.00
Weighted average number of shares under option during year 20X1	100,000 shares
Exercise price for shares under option during year 20X1	` 15.00

Calculate basic and diluted EPS.

Solution

Calculation of earnings per share

	Earnings	*Shares*	*Per share*
Profit attributable to ordinary equity holders of the parent entity for year 20X1	₹ 1,200,000		
Weighted average shares outstanding during year 20X1		500,000	
Basic earnings per share			**₹ 2.40**
Weighted average number of shares under option		100,000	
Weighted average number of shares that would have been issued at average market price: (100,000 × ₹ 15.00) ÷ ₹ 20.00	Refer Note	(75,000)	
Diluted earnings per share	**₹ 1,200,000**	**525,000**	**₹ 2.29**

Note: Earnings have not increased because the total number of shares has increased only by the number of shares (25,000) deemed to have been issued for no consideration.

12- Contingently issuable shares Ordinary shares outstanding during 20X1	**1,000,000 (there were no options, warrants or convertible instruments outstanding during the period)**

An agreement related to a recent business combination provides for the issue of additional ordinary shares based on the following conditions:

	5,000 additional ordinary shares for each new retail site opened during 20X1
	1,000 additional ordinary shares for each ₹ 1,000 of consolidated profit in excess of ₹ 2,000,000 for the year ended 31 December 20X1
Retail sites opened during the year:	*one on 1 May 20X1*
	one on 1 September 20X1
Consolidated year-to-date profit attributable to ordinary equity holders of the parent entity:	*₹ 1,100,000 as of 31 March 20X1*
	₹ 2,300,000 as of 30 June 20X1
	₹ 1,900,000 as of 30 September 20X1 (including a ₹ 450,000 loss from a discontinued operation)
	₹ 2,900,000 as of 31 December 20X1
Calculate basic and diluted EPS.	

Solution

Basic earnings per share					
	First quarter	*Second quarter*	*Third quarter*	*Fourth quarter*	*Full year*
Numerator (₹)	1,100,000	1,200,000	(400,000)	1,000,000	2,900,000
Denominator:					
Ordinary shares outstanding	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Retail site contingency	–	3,333[6]	6,667[7]	10,000	5,000[8]
Earnings contingency[9]	–	–	–	–	–
Total shares	1,000,000	1,003,333	1,006,667	1,010,000	1,005,000
Basic earnings per share (₹)	1.10	1.20	(0.40)	0.99	2.89

6 5,000 shares × 2/3

7 5,000 shares + (5,000 shares × 1/3)

8 (5,000 shares × 8/12) + (5,000 shares × 4/12)

9 The earnings contingency has no effect on basic earnings per share because it is not certain that the condition is satisfied until the end of the contingency period. The effect is negligible for the fourth-quarter and full-year calculations because it is not certain that the condition is met until the last day of the period.

					Diluted earnings per share
	First quarter	Second quarter	Third quarter	Fourth quarter	Full year
Numerator (₹)	1,100,000	1,200,000	(400,000)	1,000,000	2,900,000
Denominator:					
Ordinary shares outstanding	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Retail site contingency	–	5,000	10,000	10,000	10,000
Earnings contingency	–[10]	300,000[11]	–[12]	900,000[13]	900,000
Total shares	1,000,000	1,305,000	1,010,000	1,910,000	1,910,000
Diluted earnings per share (₹)	1.10	0.92	(0.40)[14]	0.52	1.52

10 Company A does not have year-to-date profit exceeding ` 2,000,000 at 31 March 20X1. The Standard does not permit projecting future earnings levels and including the related contingent shares.
11 [(` 2,300,000 – ` 2,000,000) ÷ 1,000] × 1,000 shares = 300,000 shares.
12 Year-to-date profit is less than ` 2,000,000.
13 [(` 2,900,000 – ` 2,000,000) ÷ 1,000] × 1,000 shares = 900,000 shares.
14 Because the loss during the third quarter is attributable to a loss from a discontinued operation, the antidilution rules do not apply. The control number (ie profit or loss from, continuing operations attributable to the equity holders of the parent entity) is positive. Accordingly, the effect of potential ordinary shares is included in the calculation of diluted earnings per share.

13 Assume the following facts for Company XY:
- Income from continuing operations : INR 30,00,000
- Loss from discontinued operations: (INR 36,00,000)
- Net loss: (INR 6,00,000)
- Weighted average Number of shares outstanding 10,00,000
- Incremental common shares outstanding relating to stock options 2,00,000
(a) You are required to calculate the basic and diluted EPS for Company XY from the above information.
(b) Assume, if in above case, Loss from continued operations is ` 10,00,000 and income from discontinued operations is ` 36,00,000 calculate the diluted EPS.
Solution:
a) Step 1:
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
= ` 30,00,000 / 10,00,000 = ` 3.00
Basic Loss per share (Discontinued operations) = Loss from discontinued operations / Weighted average Number of shares outstanding

553

= ` (36,00,000) / 10,00,000 = (` 3.60)
Overall Basic Loss per share = (` 6,00,000) / 10,00,000 = ` (0.60) (i)
Step 2: 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
= ` 30,00,000 / 12,00,000 = ` 2.50
Loss per share (Discontinued operations) = Loss from discontinued operations / Adjusted weighted average number of shares outstanding
= ` (36,00,000) / 12,00,000 = (` 3.00)
Overall Diluted Loss per share = ` 6,00,000 / 12,00,000 = ` (0.50) (ii)
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 ` 3.00 to ` 2.50). Therefore, even though there is an anti-dilution [Loss per share reduced from ` 0.60 (i) to ` 0.50 (ii) above], diluted loss per share of ` 0.50 is reported.
(b) 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
= ` (10,00,000) + ` 36,00,000
= ` 26,00,000
Weighted average number of shares outstanding = 10,00,000
Diluted EPS = ` 2.60
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.

14

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 ` 2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.

When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one ordinary share is ` 3. Income tax is ignored.
Calculate basic and diluted EPS when

Profit attributable to ordinary equity holders of the parent entity Year 1	**` 1,000,000**
Ordinary shares outstanding	**1,200,000**
Convertible bonds outstanding	**2,000**

Solution
Allocation of proceeds of the bond issue:

Liability component (Refer Note 1)	₹ 1,848,122
Equity component	₹ 151,878
	₹ 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:

$$\frac{₹1,000,000}{1,200,000} = ₹\ 0.83 \text{ per ordinary share}$$

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.

$$\frac{₹1,000,000 + ₹166,331}{1,200,000 + 500,000} = ₹\ 0.69 \text{ per ordinary share}$$

Notes:

1. This represents the present value of the principal and interest discounted at 9% – ` 2,000,000 payable at the end of three years; ` 120,000 payable annually in arrears for three years.
2. Profit is adjusted for the accretion of ` 166,331 (` 1,848,122 x 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. 500,000 ordinary shares = 250 ordinary shares x 2,000 convertible bonds.

15

An entity has two classes of shares in issue:

- **5,000 non-convertible preference shares**
- **10,000 ordinary shares**

The preference shares are entitled to a fixed dividend of ` 5 per share before any dividends are paid on the ordinary shares. Ordinary dividends are then paid in which the preference shareholders do not participate. Each preference share then participates in any additional ordinary dividend above ` 2 at a rate of 50% of any additional dividend payable on an ordinary share.

The entity's profit for the year is ` 100,000, and dividends of ` 2 per share are declared on the ordinary shares.

Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

Solution

The calculation of basic EPS is as follows:

	₹	₹
Profit		100,000
Less: Dividends payable for the period:		
Preference (5,000 × ₹ 5)	25,000	
Ordinary (10,000 × ₹ 2)	20,000	(45,000)
Undistributed earnings		55,000

Allocation of undistributed earnings:
Allocation per ordinary share = A
Allocation per preference share = B where B = 50% of A
(A × 10,000) + (50% × A × 5,000) = ` 55,000
A = 55,000 / (10,000 + 2,500) = ` 4.4
B = 50% of A
B = ` 2.2

Dividend per share are:	**Preference shares ` per share**	**Ordinary shares ` per share**
Distributed earnings	5.00	2.00
Undistributed earnings	2.20	4.40
Totals	**7.20**	**6.40**

Proof: (5,000 × ` 7.2) + (10,000 × ` 6.4) = `100,000

17
(This illustration does not illustrate the classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS 32).

Profit attributable to equity holders of the parent entity	**` 100,000**
Ordinary shares outstanding	**10,000**
Non-convertible preference shares	**6,000**
Non-cumulative annual dividend on preference shares (before any dividend is paid on ordinary shares)	**` 5.50 per share**

After ordinary shares have been paid a dividend of ` 2.10 per share, the preference shares participate in any additional dividends on a 20:80 ratio with ordinary shares.

Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

Solution

Dividends on preference shares paid (6000 x ` 5.50 per share)	` 33,000
Dividends on ordinary shares paid (10,000 x ` 2.10 per share)	` 21,000

Basic earnings per share is calculated as follows:	`	`
Profit attributable to equity holders of the parent entity		100,000
Less: Dividend paid:		
Preference	33,000	
Ordinary	21,000	(54,000)
Undistributed earnings		46,000

Allocation of undistributed earnings:

Allocation per ordinary share = A

Allocation per preference share = B; B = 1/4 A

(A x 10,000) + (1/4 x A x 6,000) = ` 46,000

A = ` 46,000 ÷ (10,000 + 1,500)

A = ` 4.00

B = 1/4 A

B = Re. 1.00

Dividend per share:

	Preference shares	Ordinary shares
Distributed earnings	₹ 5.50	₹ 2.10
Undistributed earnings	₹ 1.00	₹ 4.00
Totals	**₹ 6.50**	**₹ 6.10**

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An entity issues 100,000 ordinary shares of Re 1 each for a consideration of ` 2.50 per share. Cash of ` 1.75 per share was received by the balance sheet date. The partly paid shares are entitled to participate in dividends for the period in proportion to the amount paid.

Calculate number of shares for calculation of Basic EPS.

Solution

The number of ordinary share equivalents that would be included in the basic EPS calculation on a weighted basis is as follows:

(100,000 × ` 1.75) / ` 2.50 = 70,000 shares.

Questions

1. ABC Ltd 1 January 20X1 Shares in issue 1,000,000
31 March 20X1 (a) Rights issue 1 for 5 at 90 paise
(b) Fair value of shares ` 1 (cum-rights price)

Calculate the number of shares for use in the EPS calculation for the calendar year.

Answer:

Rights issue bonus fraction

	Shares	₹ per share	₹
Cum-rights	5	1	5.0
Rights	1	0.9	0.9
Ex-rights	**6**		**5.9**

Theoretical ex-rights price (5.9 / 6) = 0.9833

Bonus fraction = Cum-rights price / Theoretical ex-rights price

= 1/0.9833

	Number of shares
1 January - 31 March (1,000,000 × 3/12 × 1/.9833)	254,237
1 April - 31 December (1,200,000 × 9/12)	900,000
	1,154,246

2. 1 January Shares in issue 1,000,000
5% Convertible bonds ` 100,000
(terms of conversion 120 ordinary shares for ` 100)
31 March Holders of ` 25,000 bonds converted to ordinary shares.
Profit for the year ended 31 December ` 200,000
Tax rate 30%.
Calculate basic and diluted EPS. Ignore the need to split the convertible bonds into liability and equity elements.
Answer:

	Number of shares	Profit ₹
Profit		200,000
Outstanding shares	1,000,000	
New shares on conversion (weighted average)		
9/12 × ₹ 25,000 / 100 × 120	22,500	-
Figures for basic EPS	1,022,500	200,000
Basic EPS is (₹ 200,000 / 1,022,500) = 0.196 per share		
Dilution adjustments		
Unconverted shares ₹ 75,000 / 100 × 120	90,000	
Interest: ₹ 75,000 × 5% × 0.7		2,625
Converted shares pre conversion adjustment		
3/12 × ₹ 25,000 / 100 × 120	7,500	
Interest: [3/12 × ₹ 25,000 × 5% × 0.7]		219
	1,120,000	**202,844**

Diluted EPS is (₹ 202,844 / 1,120,000) = 0.181

3.	**1 January**	**Shares in issue**	**1,000,000**
	Profit for the year ended 31 December		**` 100,000**
	Average fair value during period		**` 8**

The company has in issue 200,000 options to purchase equal ordinary shares

Exercise price	**` 6**

Calculate the diluted EPS for the period.

Answer:

Diluted EPS

	Number of Shares	Profit (₹)	EPS
Basic	1,000,000	100,000	0.10
Dilution (Refer W.N.)	50,000	–	–
	1,050,000	100,000	0.095

Working Notes:

Proceeds of issue	(200,000 × ₹ 6)	=	1,200,000
Number that would have been issued at Fair value (1,200,000 / ₹ 8)=			150,000
Number actually issued			200,000
Number for "free" (200,000 – 150,000)			50,000

4. Calculate Basic EPS for period ending 20X0, 20X1 and 20X2, when

	20X0	20X1	20X2
Profit attributable to ordinary equity holders of the parent entity	₹ 1,100	₹ 1,500	₹ 1,800

Shares outstanding before rights issue	**500 shares**
Rights issue	**One new share for each five outstanding shares**
Exercise price	**` 5.00**
Date of rights issue	**1 January 20X1**
Last date to exercise rights	**1 March 20X1**
Market price of one ordinary share immediately before exercise on 1 March 20X1:	**` 11.00**
Reporting date	**31 December**

Answer:

Calculation of theoretical ex-rights value per share

$$\frac{\text{Fair value of all outstanding shares before the exercise of rights + total amount received from exercise of rights}}{\text{Number of shares outstanding before exercise + number of shares issued in the exercise}}$$

$$\frac{(₹11.00 \times 500 \text{ shares}) + (₹5.00 \times 100 \text{ shares})}{500 \text{ shares} + 100 \text{ shares}}$$

Theoretical ex-rights value per share = ₹10.00

Calculation of adjustment factor

$$\frac{\text{Fair value per share before exercise of rights}}{\text{Theoretical ex-rights value per share}} \quad \frac{₹ 11.00}{₹ 10.00} = 1.10$$

Calculation of basic earnings per share

	20X0	20X1	20X2
20X0 Basic EPS as originally reported: ₹1,100 / 500 shares	₹ 2.20		
20X0 Basic EPS restated for rights: ₹1,100 / (500 shares x 1.1)	₹ 2.00		
20X1 Basic EPS including effects of rights issue:		₹ 2.54	
{₹1,500 / [(500 x 1.1 x 2/12) + (600x10/12)]}			
20X2 Basic EPS: ₹ 1,800 / 600 shares			₹ 3.00

5. Calculate Subsidiary's and Group's Basic EPS and Diluted EPS, when

Parent:	
Profit attributable to ordinary equity holders of the parent entity	₹ 12,000 (excluding any earnings of, or dividends paid by, the subsidiary)
Ordinary shares outstanding	10,000
Instruments of subsidiary owned by the parent	800 ordinary shares
	30 warrants exercisable to purchase ordinary shares of subsidiary
	300 convertible preference shares
Subsidiary:	
Profit	₹ 5,400
Ordinary shares outstanding	1,000
Warrants	150, exercisable to purchase ordinary shares of the subsidiary
Exercise price	₹ 10
Average market price of one ordinary share	₹ 20
Convertible preference shares	400, each convertible into one ordinary share
Dividends on preference shares	₹ 1 per share
No inter-company eliminations or adjustments were necessary except for dividends.	
Ignore income taxes. Also, ignore classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS 32.	

Answer:

Subsidiary's earnings per share

Basic EPS ₹ 5.00 calculated: $\frac{₹\ 5,400\ (a) - ₹400\ (b)}{1,000\ (c)}$

Diluted EPS ₹ 3.66 calculated: $\frac{₹\ 5,400\ (d)}{(1,000 + 75\ (e) + 400(f))}$

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 (₹ 5,000) increased by ₹ 400 preference dividends for the purpose of calculating diluted earnings per share.

(e) Incremental shares from warrants, calculated: [(₹ 20 – ₹ 10) ÷ ₹ 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 ₹ 1.63 calculated: $\frac{₹\ 12,000(a) + ₹\ 4,300(b)}{10,000(c)}$

Diluted EPS ₹ 1.61 calculated: $\frac{₹\ 12,000 + ₹\ 2,928(d) + ₹\ 55(e) + ₹\ 1,098(f)}{10,000}$

(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 × ` 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 × ` 3.66 per share).
(e) Parent's proportionate interest in subsidiary's earnings attributable to warrants, calculated: (30 ÷ 150) × (75 incremental shares × ` 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 × ` 3.66 per share).

QUESTIONS FROM MOCK TEST PAPERS (MTP) & REVISION TEST PAPER (RTP)

1. 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.
[MTP ⍰ OCTOBER 2019 ⍰ 5 Marks]
Answer:
(i) As per para 14 (b) of Ind AS 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. The 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 profit or loss for calculating EPS.

(ii) As per para 36 of Ind AS 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".

2. P Ltd. is a subsidiary company of ABC Ltd. It preparing both Separate financial statement (SFS) and consolidated financial statements (CFS) for the year ending on 31st March, 20XI. It has net profit after tax of Rs. 20,00,000 as per SFS & Rs. 16,00,000 as per CFS. Share capital of P Ltd. is 2,00,000 shares of Rs. 10 each. ABC Ltd. has acquired 80% shares of P Ltd. Accountant of P Ltd. had calculated following Basic EPS for its SFS:

Calculation of Basic EPS in its SFS	
Net Profit after tax	₹ 16,00,000
Number of equity shares attributable to Parent company ABC Ltd. (2,00,000 x 80%)	1,60,000 shares
Basic EPS	₹ 10 per share

Examine the correctness of the above presentation of Basic EPS.
[RTP MAY 2018]
Answer:
As per paragraph 4 of Ind AS 33 "Earnings per Share", when an entity presents both consolidated financial statements and separate financial statements prepared in accordance with Ind AS 110, Consolidated Financial Statements, and Ind AS 27, Separate Financial Statements, respectively, the disclosures required by this Standard shall be presented both in the consolidated financial statements and separate financial statements. In consolidated financial statements such disclosures shall be based on consolidated information and in separate financial statements such disclosures shall be based on information given in separate financial statements. An entity shall not present in consolidated financial statements, earnings per share based on the information given in separate financial statements and shall not present in separate financial statements, earnings per share based on the information given in consolidated financial statements.
Also paragraph 9 of the standard states that an entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders. Further, paragraph A1 of Appendix A of Ind AS 33 states that for the purpose of calculating earnings per share based on the consolidated financial statements, profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting for noncontrolling interests.
Therefore. the requirements of paragraph 9 of Ind AS 33 have been provided in the context of calculating EPS in the consolidated financial statements of an entity.
The accountants of P Ltd. had followed this for calculation of Basic EPS in its SFS. As per ITFG

Bulletin 11, for SFS analogy may be drawn from paragraph 9 of Ind AS 33 that in case of separate financial statements, the parent entity mentioned in paragraph 9 will imply the legal entity of which separate financial statements are being prepared and accordingly, when an entity presents EPS in its separate financial statements, then the same shall be calculated based on the profit or loss attributable to its equity shareholders.
Hence, the presentation of Basic EPS by the Accountant of P Ltd. on the basis of consolidated financial statements in its separate financial statements is not correct. The correct presentation of Basic EPS would be as follows:

Calculation of Basic EPS of P Ltd. in SFS	
Net Profit after tax	₹ 20,00,000
No. of share issued	2,00,000 shares
Basic EPS	₹ 10 per share

3. An entity issues 2,000 convertible bonds at the beginning of Year 1. The bonds have a three-year term, and are issued at par with a face value of Rs. 1,000 per bond, giving total proceeds of Rs. 2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.
When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one ordinary share is Rs. 3. Income tax is ignored.
Calculate basic and diluted EPS when Profit attributable to ordinary equity holders of the parent entity Year 1 Rs. 1,000,000
Ordinary shares outstanding 1,200,000
Convertible bonds outstanding 2,000
[RTP ? MAY 2019]
Answer:

Allocation of proceeds of the bond issue:

Liability component (Refer Note 1)	₹ 1,848,122
Equity component	₹ 151,878
	₹ 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:

$$\frac{₹\ 1{,}000{,}000}{1{,}200{,}000} = ₹\ 0.83 \text{ per ordinary share}$$

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.

$$\frac{₹1{,}000{,}000 + ₹166{,}331}{1{,}200{,}000 + 500{,}000} = ₹\ 0.69 \text{ per ordinary share}$$

Notes:

1. This represents the present value of the principal and interest discounted at 9% – Rs. 2,000,000 payable at the end of three years; Rs. 120,000 payable annually in arrears for three years.
2. Profit is adjusted for the accretion of Rs. 166,331 (Rs. 1,848,122 × 9%) of the liability because of the passage of time. However, it is assumed that interest @ 6% for the year has already been adjusted.
3. 500,000 ordinary shares = 250 ordinary shares x 2,000 convertible bonds

4. 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 Limited	Non-controlling interest	Total (₹ in '000)
Profit for the year	39,000	3,000	42,000
Other Comprehensive Income	5,000	Nil	5,000
Total Comprehensive Income	44,000	3,000	47,000

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 the 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%.
[RTP – MAY 2020]
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

Calculation of finance cost and closing balance of 6% convertible debentures

Year	Opening balance ₹ in '000	Finance cost @ 8% ₹ in '000	Interest paid @ 6% ₹ in '000	Closing balance ₹ in '000
	a	b = a x 8%	c	d = a + b - c
31.3.20X2	1,68,948	13,515.84	10,800	1,71,663.84
31.3.20X3	1,71,663.84	13,733.11	10,800	1,74,596.95

Finance cost of convertible debentures for the year ended 31.3. 20X3 is Rs. 13,733.11 thousand and closing balance as on 31.3. 20X3 is Rs. 1,74,596.95 thousand.

Calculation of Basic EPS ₹ in '000

Profit for the year	39,000
Less: Dividend on preference shares (80,000 thousand x ₹ 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 ₹ 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)	13,733.11	
Less: Tax @ 25%	(3,433.28)	10,299.83
		45,299.83

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. 45,299.83 thousand / 3,37,500 thousand shares
= Rs. 0.134

UNIT 3: IND AS 108: OPERATING SEGMENTS

Illustrations

1 ABC Ltd. manufactures and sells healthcare products, and food and grocery products. Three products namely A, B & C are manufactured. Product A is classified as healthcare product and product B & C are classified as food and grocery products. Products B & C are similar products. Discrete financial information is available for each manufacturing locations and for the selling activity of each product. There are two line managers responsible for manufacturing activities of products A, B & C. Manager X manages product A and Manager B manages products B & C. The operating results of health care products (product A) and food and grocery products (products B & C) are regularly reviewed by the CODM. Identify reportable segments of ABC Ltd.

Solution

In this situation both the healthcare, and food and grocery product line meet the criteria for operating segments set out above. Therefore, it is likely that ABC Ltd.'s operating segments would be classified as being (i) healthcare and (ii) food and grocery segments.

Not every part of an entity is necessarily an operating segment or part of an operating segment. For example, a corporate headquarters or some functional departments may not earn revenues or may earn revenues that are only incidental to the activities of the entity and would not be operating segments. For the purposes of Ind AS 108, an entity's post-employment benefit plans are not operating segments.

2 The CEO along with other Board members do a review of financial information about various business segments and take decisions on the basis of discrete information available for these segments and are correctly identified as Chief Operating Decision Maker (CODM). Review of only revenue information is done for decision making about those segments by the CODM. As per CODM, many segments require minimal costs due to centralization of costs. Whether review of only the revenue related information is sufficient for these segments to be considered as operating segments for the purposes of Ind AS 108 'Operating Segments'?

Solution

Many entities would be considering the decision making for segments on the basis of revenue growth – especially the ones aggressively trying to build a market share. Common examples would be businesses into technology sector or those creating or launching new products from time to time. For them, the decision making for different regional segments would need revenue growth and related information for further investment decision.

The logic given by the CODM is that since many segments require minimal costs (due to centralization of costs), therefore, revenue-only data is a fair representation of the operating results.

In the above case, review of the information that is based only on revenue data may be appropriate to consider that the segment meets the definition of an operating segment.

3 X Ltd. is engaged in the manufacture and sale of two distinct type of products A & B. X Ltd. supplies the product in the domestic market in India as well as in Singapore. There are two regional managers responsible for manufacturing activities of product A & B worldwide and also two other managers responsible for different geographical areas. For internal reporting purposes, X Ltd. provides information product-wise and as per the geographical location of the company. The CODM regularly reviews the operating results of both sets of components. How should X Ltd. identify its operating segments?

Solution

In this situation, both the geographical sales areas and product areas may meet the criteria for operating segment. However, in such situation, it is more difficult to determine clearly which set of components should be identified as the entity's operating segments. In such situation the entity should determine which set of components constitutes the operating segments by reference to the core principle. The core principle is that the entity should disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. The entity should also assess whether the identified operating segments could realistically represent the level at which the CODM is assessing performance and allocating resources.

Therefore, X Ltd. should consider all the above factors and apply judgement to determine which component should be disclosed as operating segment.

4 . CODM of XY Ltd. receives and reviews multiple sets of information when assessing the businesses' overall performance to take a decision on resources allocation. It receives the information as under:

- Level 1 Report: Summary report for all 4 regions

- Level 2 Report: Summary report for 20 Sub-regions within those regions

- Level 3 Report: Detailed report for 50 Branches within the sub-regions

What factors and level should be considered for determining an operating segment?

Solution

We need to consider multiple factors (including but not limited to below):

- The process that CODM may use to assess the performance (Key Financial Matrix, KPIs, Ratio etc.);
- Identify the segment managers and their responsibility areas;
- The process of budgeting for resource allocations.

5 XY Ltd. has operations in France, Italy, Germany, UK and India. It wishes to apply aggregation criteria on geographical basis.

How will the aggregation criteria apply for reporting segments in the given scenario?

Solution

XY Ltd. needs to assess and prove that each country possesses the same economic characteristics. Factors including exchange control regulations, currency risks and economic conditions are required to be considered. Considering above factors, it may be possible to aggregate the results of France, Italy and Germany (falling within EU region) and results of UK and India may be separately reported (no aggregation is permitted).

6 X Ltd. is engaged in the business of manufacturing and selling papers. Varieties of paper like adhesive paper, anti-rust paper, antique paper, art paper etc., are manufactured and sold by X Ltd. Should X Ltd. classify these papers into different segments?

Solution

Two or more operating segments may be aggregated into a single operating segment if the segments have similar economic characteristics, and the segments are similar with respect to various factors like nature of the product and production process, type of customers, method of distribution and regulatory requirement.

In case of X Ltd., so far as varieties of paper concerned, if all factors such as nature of the product and production process, type of customers, method of distribution and regulatory requirement are common, there is no need to create different segments for each type of paper.

7

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?

Solution

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.

8. *X Ltd. has identified the following business components.*

Segment	Revenue (₹)		Profit (₹)	Assets (₹)
	External	Internal		
Pharma	97,00,000	Nil	20,00,000	55,00,000
FMCG	Nil	4,00,000	2,50,000	25,00,000
Ayurveda	3,00,000	Nil	2,00,000	4,00,000
Others	8,00,000	41,00,000	5,50,000	6,00,000
Total for the entity	1,08,00,000	45,00,000	30,00,000	90,00,000

Which of the segments would be reportable as per the criteria prescribed in Ind AS108?

Solution
Quantitative thresholds are calculated below:

Segments	Pharma	FMCG	Ayurveda	Others
% segment sales to total sales	63.40	2.61	1.96	32.03
% segment profit to total profits	66.67	8.33	6.67	18.33
% segment assets to total assets	61.11	27.78	4.44	6.67

Segment Pharma would separately reportable since they meet all three size criteria, though any one criteria is required. FMCG segment does not satisfy the revenue and profit test but does satisfy the asset test. So it would be separately reportable. Ayurveda segment does not meet any threshold. It may not be classified as reportable segment.
An entity may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria.
If the total external revenue reported by operating segments constitutes less than 75% of the entity's revenue, additional operating segments should be identified as reportable segments (even if they do not meet the criteria) until at least 75% of the entity's revenue is included in reportable segments.

Note

• External revenue of reportable segments must be ≥ 75% of total external revenue of the entity.

• Operating segments that do not meet any of the quantitative thresholds may be considered reportable, and separately disclosed, if information about the segment is useful to users.

9 An entity has branches in different parts of the country – catering to different customers and selling local made products (a product of one region is not sold in any other region). No region or product contributes more than 5% to total revenue of the entity.
Discuss how many segments are reportable?
Solution

Under the quantitative threshold, external revenue of reportable segments must be ≥ 75% of total external revenue of the entity. Considering above case, minimum 15 operating segments need to be reportable (75% [threshold] / 5% {revenue}).

10
GH Ltd. has four distinct operating segments. The management of GH is concerned as it is unsure on how common costs be reasonably allocated to different operating segments. They intend to allocate management charges, interest costs of internal funding, cost of management of properties and pension costs.
Whether such costs need to conform to the accounting policies as used to prepare the financial statements?
Solution

Ind AS 108 does not prescribe any specific basis but suggests that a reasonable basis to be used in allocation of common costs. Here, it may not be reasonable to allocate management charges to most profitable segment. However, it may be reasonable to charge interest costs of internal funding on the basis of actual usage over time, even if majority of funds are used for running a loss-making segment.

A reasonable manner of allocation of above costs could be:

Management Charges: These may be allocated based on Net Assets invested or Revenue earned by the segments. It needs to be understood if there is an operating segment which is yet to earn revenue, it would fail to have any costs being allocated.

Interest costs: As mentioned above, these may be allocated on the basis of actual usage and time.

Cost of management of properties: Based on value of property used at each segment.

Pension costs: Based on salary expenses of each segment**.**

Questions

1. X Ltd. has identified 4 operating segments for which revenue data is given below:

	External Revenue (₹)	Internal Revenue (₹)	Total (₹)
Segment A	30,00,000	Nil	30,00,000
Segment B	6,50,000	Nil	6,50,000
Segment C	8,50,000	1,00,000	9,50,000
Segment D	5,00,000	49,00,000	54,00,000
Total Revenue	**50,00,000**	**50,00,000**	**1,00,00,000**

Additional information:
Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years.
Which of the segments would be reportable under the criteria identified in Ind AS 108?
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% [(` 35,00,000 / 50,00,000) 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.
In this situation, Segments A, C and D will be reportable segments and Segment B will be shown as other segment.
Alternatively, segment B can be considered as a reportable segment as well as it meets the definition of operating segment. If Segment B is considered as reportable segment:
External revenue reported: ` 30,00,000 + ` 6,50,000 + ` 5,00,000 = ` 41,50,000
% of Total External Revenue = ` 41,50,000 / ` 50,00,000 = 83%
Accordingly, Segments A, B and D will be reportable segments and Segment C will be shown as other segment.

2. X Ltd. is operating in coating industry. Its business segments comprise Coating and Others (consisting of chemicals, polymers and related activities). Certain information for financial year 20X1-20X2 is given below: (` in lakhs)

Segments	External Revenue (including GST)	GST	Other operating income	Result	Asset	Liabilities
Coating	2,00,000	5,000	40,000	10,000	50,000	30,000
Others	70,000	3,000	15,000	4,000	30,000	10,000

Additional information:

1. Unallocated income net of expenses is ` 30,00,00,000

2. Interest and bank charges is ` 20,00,00,000

3. Income tax expenses is ` 20,00,00,000 (current tax ` 19,50,00,000 and deferred tax ` 50,00,000)

4. Unallocated Investments are ` 1,00,00,00,000 and other assets are ` 1,00,00,00,000.

5. Unallocated liabilities, Reserves & surplus and share capital are ` 2,00,00,00,000, ` 3,00,00,00,000 & ` 1,00,00,00,000 respectively.

6. Depreciation amounts for coating & others are ` 10,00,00,000 and ` 3,00,00,000 respectively.

7. Capital expenditure for coating and others are ` 50,00,00,000 and ` 20,00,00,000 respectively.

8. Revenue from outside India is ` 6,20,00,00,000 and segment asset outside India ` 1,00,00,00,000.

Based on the above information, how X Ltd. would disclose information about reportable segment revenue, profit or loss, assets and liabilities for financial year 20X1-20X2?

Answer:

Segment information

(A) Information about operating segment

(1) the company's operating segments comprise:

Coatings: consisting of decorative, automotive, industrial paints and related activities.

Others: consisting of chemicals, polymers and related activities.

(2) Segment revenues, results and other information.

(₹ in Lakhs)

	Revenue	Coating	Others	Total
1.	**External Revenue (gross)**	**2,00,000**	**70,000**	**2,70,000**
	GST	(5,000)	(3,000)	(8,000)
	Total Revenue (net)	1,95,000	67,000	2,62,000
2.	**Results**			
	Segment results	10,000	4,000	14,000
	Unallocated income (net of unallocated expenses)			3,000
	Profit from operation before interest, taxation and exceptional items			**17,000**
	Interest and bank charges			(2,000)
	Profit before exceptional items			**15,000**
	Exceptional items			Nil
	Profit before taxation			**15,000**

	Income Taxes			
	-Current taxes			(1,950)
	-Deferred taxes			(50)
	Profit after taxation			**13,000**
3.	**Other Information**			
(a)	**Assets**			
	Segment Assets	50,000	30,000	80,000
	Investments			10,000
	Unallocated assets			10,000
	Total Assets			**1,00,000**
(b)	**Liabilities/Shareholder's funds**			
	Segment liabilities	30,000	10,000	40,000
	Unallocated liabilities			20,000
	Share capital			10,000
	Reserves and surplus			30,000
	Total liabilities/shareholder's funds			**1,00,000**
(c)	**Others**			
	Capital Expenditure	(5,000)	(2,000)	
	Depreciation	(1,000)	(300)	
Geographical Information				**(₹ in lakhs)**
		India (₹)	**Outside India (₹)**	**Total (₹)**
	Revenue	2,00,000	62,000	2,62,000
	Segment assets	90,000	10,000	1,00,000
	Capital expenditure	7,000		7,000

Notes:

(i) The operating segments have been identified in line with the Ind AS 108, taking into account the nature of product, organisation structure, economic environment and internal reporting system.

(ii) Segment revenue, results, assets and liabilities include the respective amounts identifiable to each of the segments. Unallocable assets include unallocable fixed assets and other current assets. Unallocable liabilities include unallocable current liabilities and net deferred tax liability.

(iii) Corresponding figures for previous year have not been provided. However, in practical scenario the corresponding figures would need to be given.

3. 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?

Answer:

The entity should use First-In, First-Out (FIFO) method for its Ind AS 108 disclosures, even though it uses the weighted average cost formula for measuring inventories for inclusion in its financial statements. Where chief operating decision maker uses only one measure of segment asset, same measure should be used to report segment information. Accordingly, in the given case, the method used in preparing the financial information for the chief operating decision maker should be used for reporting under Ind AS 108.

However, reconciliation between the segment results and results as per financial statements needs to be given by the entity in its segment report.

4. 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?

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 reported loss 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	1,500	18%	Yes
C	(2,300)	28%	Yes
D	(4,500)	54%	Yes
E	6,000	72%	Yes
Total	**1,480**		

Hence B, C, D, E are reportable segments.

PAST EXAMINATION PAPERS, MOCK TEST PAPERS & REVISION TEST PAPERS

1. 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	1,00,000	2,500	20,000	5,000	25,000	15,000
Refining	35,000	1,500	7,500	2,000	15,000	5,000

Additional Information: (Rs. in lakh)

- **Unallocated revenue net of expenses is Rs. 1,500.**
- **Interest and bank charges is Rs. 1,000**
- **Income-tax expense is Rs. 1,000 (current tax Rs. 975 and deferred tax Rs. 25)**
- **Investments Rs. 5,000 and unallocated assets Rs. 5,000**
- **Unallocated liabilities, Reserves & Surplus and Share capital are Rs. 10,000; Rs. 15,000 and Rs. 5,000 respectively.**
- **Depreciation amounts for crushing and refining are Rs. 500 and Rs. 150 respectively.**
- **Capital expenditure for crushing and refining are Rs. 2,500 and Rs. 1,000 respectively.**
- **Revenue from outside India is Rs. 15,000 and segment assets outside India Rs. 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?

(MAY – 2018 ⍰ 10 MARKS)
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

2. A Ltd. is a cash rich company. It has its business running across the country which as per AS 17 constitutes geographical segments. The company has also got substantial investments. The company has provided its segmental report for its primary segment and secondary geographical segments and the extract of its Note on Investment from its draft financial statements for the year ending 31st March 2018:

Primary segment report

	Segment 1	Segment 2	Segment 3	Total
Segment Revenue	2,655	2,121	1,264	6,040
Segment Results	504	1,111	114	1,729
Unallocable Costs				
Interest Income				403
Finance Costs				(120)
Others				(50)
Net Profit Before Tax				1,962

Segmental report for its secondary geographical segments

All figures are Rs. in crores

Geography	Segment Assets	Segment Revenue
Delhi	1,962	2522
Mumbai	1,691	1241
Chennai	2,030	1255
Others (refer Additional information 1)	1,082	1022
Total	6,765	6040

Note on Investment

Investment in:	Rs. in crores
Mutual Funds - Liquid Funds	500
Mutual Funds - ETFs	20
X Ltd. a wholly owned subsidiary	100
A Foundation – 100%	20
Time Deposit	20
Total	660

Additional information:
1. Segment Assets in 'Others' category comprises of Rs. 744 crores held for a new project yet to commence operations in Kolkata.
2. Tax expenses are not considered in above segment reporting as the management is of the opinion that taxes are not a part of operating cost.
3. Mutual funds are valued at MTM basis as of year-end. These were initially invested for Rs. 300 crore for liquid funds and Rs. 25 crore for ETFs respectively.
4. The Foundation has a clause in its deed that in the event of liquidation, the net assets of the trust shall be transferred to another trust with similar objects.
Analyse the extracts given above and Identify the errors and misstatements in the segment reports / Note on Investment and also prepare the rectified Note to Accounts on Investment in accordance with the Accounting Standards.
(MTP APRIL 2018 15 MARKS)
Answer:

1. **Geographical segment reporting:** The category 'others' in the secondary geographical segment report represents 16% of the total geographical segment assets. Para 48 of AS 17 inter alia requires to disclose the total carrying amount of segment assets by geographic allocation of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segments'.
Hence to comply with AS 17 disclosures, the management has to further breakdown the 'others' category and identify reportable geographies. Kolkata segment assets is 10.997% of total geographical assets i.e. [(744 / 6,765) x 100]. Therefore, Kolkata segment will be considered as the reportable geographical segment.
The revised secondary segmental reporting will be as follows:

All figures are Rs. in crores

Geography	Segment Assets	Segment Revenue
Delhi	1,962	2,522
Mumbai	1,691	1,241
Chennai	2,030	1,255
Kolkata	744	0
Others	338	1,022
TOTAL	6,765	6,040

Besides above, the same para also mandates to disclose 'the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all segments'. Hence, the management has to show the addition to segment assets in a separate table; and if there are no additions during the year, the same has to be stated as 'Nil' for the year.

2. **Primary Business Segment Report:** The management's interpretation of presenting 'Net profit before taxes' is incorrect. The standard requires allocating expenses to each segment to the possible extent, and unallocated costs to be shown separately. In this case, tax expense will be added as an unallocable cost.

3. **Notes to Accounts on Investment**

	Refer Note No.	Rs. in crore
Non-current Investment (at cost)		
X Ltd., a wholly owned subsidiary		100
A Foundation	1	20
Total Non-current Investment (A)		120
Current Investment	2	325
Total Current Investment (B)		325
Total (A+B)		445

In accordance with Para 35 (d) of AS 13, a note should be given that there exists a significant restriction on the realisability of investments or the remittance of income and proceeds of disposal. Accordingly, the note is prepared as follows:

Note 1: The Company has a 100% stake holding in A Foundation. There exists a significant restriction on the realisability of investments due to the clause in the constitution deed of the Foundation that in the event of liquidation, the net assets of the trust shall be transferred to another trust with similar objects.

Note 2: Para 31 of AS 13 states – 'Investment classified as current investment should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis'. Assuming that the MTM values provided represent the fair value, accordingly investments in mutual funds are treated as follows:

Investment in Mutual Funds	Rs. in crore
Mutual Funds - Liquid Funds (MTM)	300
Mutual Funds - ETFs	25
Total	325

Note 3: Time deposit will be a part of cash and cash equivalents

3. An entity uses the weighted average cost formula to assign costs to inventories and cost of goods sold for financial reporting purposes, but the reports provided to the chief operating decision maker use the First-In, First-Out (FIFO) method for evaluating the performance of segment operations. Which cost formula should be used for Ind AS 108 disclosure purposes?
(RTP MAY 2019)
Answer:
The entity should use First-In, First-Out (FIFO) method for its Ind AS 108 disclosures, even though it uses the weighted average cost formula for measuring inventories for inclusion in its financial statements. Where chief operating decision maker uses only one measure of segment asset, same measure should be used to report segment information. Accordingly, in the given case, the method used in preparing the financial information for the chief operating decision maker should be used for reporting under Ind AS 108.
However, reconciliation between the segment results and results as per financial statements needs to be given by the entity in its segment report.

4. 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 2020)
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 reported loss 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 Rs. 8,280 crores.
(ii) All segments in loss, i.e., C and D – Total loss Rs. 6,800 crores.
Greater of the above – Rs. 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	1,500	18%	Yes
C	(2,300)	28%	Yes
D	(4,500)	54%	Yes
E	6,000	72%	Yes
Total	1,480		

Hence B, C, D, E are reportable segments.

CHAPTER-12 ACCOUNTING AND REPORTING OF FINANCIAL INSTRUMENTS

Illustrations

1: Trade receivables

A Ltd. makes sale of goods to customers on credit of 45 days. The customers are entitled to earn a cash discount @ 2% per annum if payment is made before 45 days and an interest @ 10% per annum is charged for any payments made after 45 days.

Evaluate whether such trade receivable are financial assets or not.

Solution

A financial asset is an asset where there is a contractual right to receive cash or another financial asset from another entity.

In the above case, A Ltd. has the contractual right to receive cash /bank from its trade receivable recorded in its books of accounts, after the expiry of credit period of 45 days or earlier after passing discounts of 2 % per annum.

Hence trade receivables would meet the definition of financial assets.

2: Deposits

Z Ltd. (the 'Company') makes sale of goods to customers on credit. Goods are carried in large containers for delivery to the dealers' destinations. All dealers are required to deposit a fixed amount of ` 10,000 as security for the containers, which is returned only when the contract with Company terminates. The deposits carry 8% per annum which is payable only when the contract terminates.

If the containers are returned by the dealers in broken condition or any damage caused, then appropriate adjustments shall be made from the deposits at the time of settlement.

How would such deposits be treated in books of the dealers?

Solution

A financial asset is an asset where there is a contractual right to receive cash or another financial asset from another entity.

In the above case, such security deposits are receivable in cash / bank at the end of contract period between the dealer and the Company.

Hence they meet the definition of financial assets.

3: Perpetual debt instruments

A Ltd. issues a bond at principal amount of CU 1000 per bond. The terms of bond require annual payments in perpetuity at a stated interest rate of 8 per cent applied to the principal amount of CU 1,000. Assuming 8 per cent to be the market rate of interest for the instrument when it was issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition.

Evaluate the financial instrument in the hands of both the holder and the issuer.

Solution

A financial asset is an asset where there is a contractual right to receive cash or another financial asset from another entity.

• For the Holder – There is right to receive cash in future. Hence, it will be classified as a financial asset

• For the Issuer – There is contractual obligation to pay cash in future. Hence, it will be classified as a financial liability.

4: Creditors for sale of goods

A Ltd. (the 'Company') makes purchase of steel for its consumption in normal course of business. The purchase terms provide for payment of goods at 30 days credit and interest payable @ 12% per annum for any delays beyond the credit period.

Analyse whether the transaction leads to any financial instruments and if yes, then what is the nature of that financial instrument?

Solution

A financial liability is any liability where there is a contractual obligation to deliver cash or other financial asset to another entity.

In the above case, A Ltd. has entered into a contractual arrangement for purchase of goods at a fixed consideration payable to the creditor. A contractual arrangement that provides for payment in fixed amount of cash to another entity meets the definition of financial liability.

5: Contract for exchange on unfavorable conditions

A Ltd. (the 'Company') makes a borrowing for INR 10 lacs from RBC Bank, with bullet repayment of INR 10 lacs and an annual interest rate of 12% per annum. Now, Company defaults at the end of 5th year and consequently, a rescheduling of the payment schedule is made beginning 6th year onwards. The Company is required to pay INR 1,300,000 at the end of 6th year for one time settlement, in lieu of defaults in payments made earlier.

(a) Does the above instrument meet definition of financial liability? Please explain.

(b) Analyse the differential amount to be exchanged for one-time settlement.

Solution

(a) A Ltd. has entered into an arrangement wherein against the borrowing, A Ltd. has contractual obligation to make stream of payments (including interest and principal). This meets definition of financial liability.

(b) Let's compute the amount required to be settled and any differential arising upon one time settlement at the end of 6th year –

♦ Loan principal amount = ` 10,00,000

♦ Amount payable at the end of 6th year = ` 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 = ` 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 payable in comparison to amount that would have been paid without one time settlement). Hence the rescheduled arrangement meets definition of 'financial liability'.

6: Preference shares with non-cumulative dividend

Silver Ltd. issued irredeemable preference shares with face value of ` 10 each and premium of ` 90. These shares carry dividend @ 8% per annum, however dividend is paid only when Silver Ltd declares dividend on equity shares. Analyse the nature of this instrument.

Solution

In the above case, two main characteristics of the preference shares are:

(i) Preference shares carry dividend, which is payable only when Company declares dividend on equity shares

(ii) Preference share are irredeemable.

Analysing the definition of equity, an instrument meets definition of equity if:

(a) It contains no contractual obligation to pay cash; and

(b) Where an instrument shall be settled in own equity instruments, it's a non-derivative contract that will be settled only by issue of fixed number of shares or a derivative contract that will be settled by issue of fixed number of shares for a fixed amount of cash.

In the above instrument, there is no contractual obligation on the Company to pay cash since –

(i) Face value is not redeemable (except in case of liquidation); and

(ii) Dividend is payable only if Company declares dividend on equity shares. Since dividend on equity shares is discretionary and the Company can choose not to pay, Company has an unconditional right to avoid payment of cash on preference shares also.

Hence preference shares meet definition of equity instrument.

7: Non-derivative contract to be settled in own equity instruments

A Ltd. invests in compulsorily convertible preference shares (CCPS) issued by its subsidiary – B Ltd. at ` 1,000 each (` 10 face value + ` 990 premium). Under the terms of the instrument, each CCPS is compulsorily convertible into one equity share of B Ltd at the end of 5 years. Such CCPS

carry dividend @ 12% per annum, payable only when declared at the discretion of B Ltd. Evaluate this under definition of financial instrument.

Solution

B Ltd. has issued CCPS which provide for –

(a) Conversion into fixed number of equity shares, ie, one equity share for every CCPS

(b) Non-cumulative dividends.

Applying the definition of 'equity' under Ind AS 32 –

(a) There is no contractual obligation to deliver cash or other financial asset. Dividends are payable only when declared and hence, at the discretion of the Issuer – B Ltd., thereby resulting in no contractual obligation over B Ltd.

(b) Conversion is into a fixed number of equity shares.
Hence it meets definition of equity instrument and shall be classified as such in books of B Ltd.

8: Settlement in variable number of shares

Target Ltd. took a borrowing from Z Ltd. for ` 10,00,000. Z Ltd. enters into an arrangement with Target Ltd. for settlement of the loan against issue of a certain number of equity shares of Target Ltd. whose value equals ` 10,00,000. For this purpose, fair value per share (to determine total number of equity shares to be issued) shall be determined based on the market price of the shares of Target Ltd. at a future date, upon settlement of the contract. Evaluate this under definition of financial instrument.

Solution

In the above scenario, Target Ltd. is under an obligation to issue variable number of equity shares equal to a total consideration of ` 10,00,000. Hence equity shares are used as currency for purpose of settlement of an amount payable by Target Ltd.

Since this is variable number of shares to be issued in a non-derivative contract for fixed amount of cash, it tantamounts to use of equity shares as 'currency' and hence this contract meets the definition of financial liability in books of Target Ltd.

UNIT 2: CLASSIFICATION AND MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Illustrations

1 An entity holds investments to collect their contractual cash flows. The funding needs of the entity are predictable and the maturity of its financial assets is matched to the entity's estimated funding needs.
The entity performs credit risk management activities with the objective of minimising credit losses. In the past, sales have typically occurred when the financial assets' credit risk has increased such that the assets no longer meet the credit criteria specified in the entity's documented investment policy. In addition, infrequent sales have occurred as a result of unanticipated funding needs.
Reports to key management personnel focus on the credit quality of the financial assets and the contractual return. The entity also monitors fair values of the financial assets, among other information.
Evaluate the business model.

Solution

- Although the entity considers, among other information, the financial assets' fair values from a liquidity perspective (ie the cash amount that would be realised if the entity needs to sell assets), the entity's objective is to hold the financial assets in order to collect the contractual cash flows.
- Sales would not contradict that objective if they were in response to an increase in the assets' credit risk, for example if the assets no longer meet the credit criteria specified in the entity's documented investment policy. Infrequent sales resulting from unanticipated funding needs (eg in a stress case scenario) also would not contradict that objective, even if such sales are significant in value.

Hence the business model of the company is to collect contractual cash flows and not realisation from sale of financial assets.

2 An entity's business model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets that are credit impaired.
If payment on the loans is not made on a timely basis, the entity attempts to realise the contractual cash flows through various means—for example, by contacting the debtor by mail, telephone or other methods.
The entity's objective is to collect the contractual cash flows and the entity does not manage any of the loans in this portfolio with an objective of realising cash flows by selling them.
In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate. Evaluate the business model.

Solution

The objective of the entity's business model is to hold the financial assets in order to collect the contractual cash flows. The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (eg some of the financial assets are credit impaired at initial recognition).
Moreover, the fact that the entity enters into derivatives to modify the cash flows of the portfolio does not in itself change the entity's business model.

3 Entity B sells goods to customers on credit. Entity B typically offers customers up to 60 days following the delivery of goods to make payment in full. Entity B collects cash in accordance with the contractual cash flows of trade receivables and has no intention to dispose of the receivables.
Evaluate the business model.
Solution
Entity's B objective is to collect contractual cash flows from trade receivables and therefore, trade receivables meet the business model test for the purpose of classifying the financial assets at amortised cost.

4 An entity anticipates capital expenditure in a few years. The entity invests its excess cash in short and long-term financial assets so that it can fund the expenditure when the need arises. Many of the financial assets have contractual lives that exceed the entity's anticipated investment period.
The entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell financial assets to re-invest the cash in financial assets with a higher return. The managers responsible for the portfolio are remunerated based on the overall return generated by the portfolio.
Evaluate the business model.
Solution
The objective of the business model is achieved by both collecting contractual cash flows and selling financial assets. The entity will make decisions on an ongoing basis about whether collecting contractual cash flows or selling financial assets will maximise the return on the portfolio until the need arises for the invested cash.
In contrast, consider an entity that anticipates a cash outflow in five years to fund capital expenditure and invests excess cash in short-term financial assets. When the investments mature, the entity reinvests the cash in new short-term financial assets. The entity maintains this strategy until the funds are needed, at which time the entity uses the proceeds from the maturing financial assets to fund the capital expenditure. Only sales that are insignificant in value occur before maturity (unless there is an increase in credit risk). The objective of this contrasting business model is to hold financial assets to collect contractual cash flows.

5
An entity has a business model with the objective of originating loans to customers and subsequently selling those loans to a securitisation vehicle. The securitisation vehicle issues instruments to investors. The originating entity controls the securitisation vehicle and thus consolidates it.
The securitisation vehicle collects the contractual cash flows from the loans and passes them on to its investors. In the consolidated balance sheet, loans continue to be recognised because they are not derecognised by the securitisation vehicle.
Evaluate the business model.
Solution
The entity originating loans to customers has the objective of realising contractual cash flows on the loan portfolio only through sale to securitisation vehicle. However, the consolidated group originates loans with the objective of holding them to collect the contractual cash flows.
- Hence, the consolidated financial statements provide for a business model with the objective of collecting contractual cash flows by holding to maturity.
- And in separate financial statements of the entity originating loans to customers, business model is to collect cash flows through sale only.

6

A financial institution holds financial assets to meet liquidity needs in a 'stress case' scenario (eg, a run on the bank's deposits). The entity does not anticipate selling these assets except in such scenarios. The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect the contractual cash flows. The entity evaluates the performance of the assets on the basis of interest revenue earned and credit losses realised.

However, the entity also monitors the fair value of the financial assets from a liquidity perspective to ensure that the cash amount that would be realised if the entity needed to sell the assets in a stress case scenario would be sufficient to meet the entity's liquidity needs. Periodically, the entity makes sales that are insignificant in value to demonstrate liquidity.

Evaluate the business model.

Solution

The objective of the entity's business model is to hold the financial assets to collect contractual cash flows. The analysis would not change – - If during a previous stress case scenario the entity had sales that were significant in value in order to meet its liquidity needs; or - Recurring sales activity that is insignificant in value is not inconsistent with holding financial assets to collect contractual cash flows; or - If the entity is required by its regulator to routinely sell financial assets to demonstrate that the assets are liquid, and the value of the assets sold is significant, the entity's business model is not to hold financial assets to collect contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to the analysis. In contrast, if an entity holds financial assets to meet its everyday liquidity needs and meeting that objective involves frequent sales that are significant in value, the objective of the entity's business model is not to hold the financial assets to collect contractual cash flows.

7

Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.

Evaluate the Contractual cash flows characteristics test

Solution

The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.

However, if the interest payments were indexed to another variable such as the debtor's performance (eg the debtor's net income) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor's performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement.

8

Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer. Analyse the nature of cash flows.

Solution

The holder would analyse the convertible bond in its entirety. The contractual cash flows are not payments of principal and interest on the principal amount outstanding because they reflect a return that is inconsistent with a basic lending arrangement; ie the return is linked to the value of the equity of the issuer.

9

Instrument H is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due.

Instrument H pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards. Deferred interest does not accrue additional interest. Analyse the nature of cash flows.

Solution

The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional

interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding.

If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.

10

Instrument D is loan with recourse and is secured by collateral. Does the collateral affect the nature of contractual cash flows?

Solution

The fact that a loan is collateralised (since with recourse) does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding. The collateral is only a security to recover dues.

11

Instrument G is a loan that pays an inverse floating interest rate (ie the interest rate has an inverse relationship to market interest rates). Analyse the nature of cash flows.

Solution

Here, interest on the instrument has an inverse relationship to the market rate of interest. Hence, it is unlike a basic lending arrangement which normally comprises of interest payable on any funds lent, as a consideration for the time value of money, credit risk and profit margin normally existing in such arrangements. This arrangement with an inverse floating interest rate provides the lender with a return which may be higher or lower to the market rate of interest and hence, is not necessarily a consideration for the time value of money on the principal amount outstanding.

Thus, these do not represent contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

12 : Hold-to-collect' business model test
An entity purchased a debt instrument for 1,00,000.
The instrument pays interest of 6,000 annually and has 10 years to maturity when purchased. The entity intends to hold the asset to collect the contractual cash flows.
Evaluate the business model test.
Solution
Entity's objective is to hold the asset to collect the contractual cash flows and not to sell the assets before the maturity period.
Thus, the debt instrument would meet the 'hold-to-collect' business model test.

13 : Hold-to-collect' business model test
An entity purchased a debt instrument for 1,00,000.
The instrument pays interest of 6,000 annually and has 10 years to maturity when purchased. The entity intends to hold the asset to collect the contractual cash flows.

Six years have passed and the entity is suffering a liquidity crisis and needs to sell the asset to raise funds.
Evaluate the business model test.
Solution
Since the sale of financial assets was not expected on initial classification and therefore, does not affect the classification (i.e. there is no retrospective reclassification).
Thus, the debt instrument would still meet the 'hold-to-collect' business model test.

14 : SPPI or contractual cash flow test
SPPI test for loan with zero interest and no fixed repayment terms
Parent H Ltd. provides a loan to its Subsidiary S Ltd. The loan is classified as a current liability in Subsidiary S's financial statements and has the following terms:
– Interest free loan.
– No fixed repayment terms
– Repayable on demand of Parent H Ltd.
Does the loan meet the 'SPPI' or contractual cash flows characteristic test?
Solution
Yes. The terms for the repayment of the principal amount of the loan on demand satisfies the criterion of SPPI.

15 : SPPI Test for loan with zero interest repayable in ten years
Parent H Ltd. provides a loan of INR 100 million to Subsidiary B. The loan has the following terms:
– No interest
– Repayable in ten years.
Does the loan meet the 'SPPI' or contractual cash flows characteristic test?
Solution
Yes. The terms for the repayment of the principal amount of the loan on demand satisfies the criterion of SPPI.

16 : SPPI Test for loan with interest rate
Entity A Ltd. lends Entity B Ltd. INR 5 million for ten years, subject to the following terms:
– Interest is based on the prevailing variable market interest rate.
– Variable interest rate is capped at 10%.
– Repayable in ten years.
Does the loan meet the 'SPPI' or contractual cash flows characteristic test?
Solution

Contractual cash flows of both a fixed rate instrument and a floating rate instrument are payments of principal and interest as long as the interest reflects consideration for the time value of money and credit risk. Therefore, a loan that contains a combination of a fixed and variable interest rate meets the contractual cash flow characteristics test.

17: Trade receivables – Amortised cost
H Ltd. makes sale of goods to customers on credit of 60 days. The customers are entitled to earn a cash discount @ 5% per annum if payment is made before 60 days and an interest @ 12% per annum is charged for any payments made after 60 days. Company does not have a policy of selling its debtors and holds them to collect contractual cash flows.
Evaluate the financial instrument.
Solution
In the above case, since H Ltd. has a contractual right to receive cash flows from its customers and therefore such trade receivable are financial assets for H Ltd.
Further, H Ltd. business model test to collect will satisfy as the objective is to hold its trade receivable to collect contractual cash flows till the end of maturity period. And such trade receivable recorded in books represents contractual cash flows that are solely payments of principal and interest if paid beyond credit period.

Hence such trade receivables are classified at amortised cost.

18: Security Deposits – Amortized Costs
A Ltd. (the 'Company') has obtained the premises from B Ltd. on lease to carry on its business. The lease contract period is 5 years. As per the lease agreement, A Ltd. has paid security deposits to B Ltd. amounting to ` 10 Lac which is refundable after the expiry of lease agreement.
How would such deposits be treated in books of the A Ltd. ?
Solution
In the above case, since A Ltd. has a contractual right to receive cash flows from its Lessor, B Ltd. and therefore such security deposits receivable are financial assets for A Ltd.
Further, A Ltd. business model test to collect will be satisfied as the objective is to hold its security deposits receivable to collect contractual cash flows till the end of maturity period. And such trade receivable recorded in books represents contractual cash flows that are solely payments of principal and interest.
Hence such security deposits receivables are classified at amortised cost.

19 : Hold-to-collect' or 'hold-to-collect & sell' business model test
Entity A has surplus funds – INR 50 million
A has not yet found suitable investment opportunity so it buys medium dated (5 year maturity) high quality government bonds in order to generate interest income.
If a suitable investment opportunity arises before the maturity date, the entity will sell the bonds and use the proceeds for the acquisition of a business operation. It is likely that a suitable business opportunity will be found before maturity date.
Whether the investment opportunity will meet the 'hold-to-collect' or 'hold-to-collect & sell business model test?
Solution
Government bonds would not meet the 'hold-to-collect' business model test because it is considered likely that the bonds will be sold well before their contractual maturity.
However, it is likely that such investment would meet the 'hold-to-collect and sell' business model test.

20
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?
Solution
The loans from ABC Bank carry interest @ 10% and 12% for 5 year term and 3 year term respectively. Additionally, there is a processing fee payable @ 1% on the principal amount on date of transaction. It is assumed that ABC Bank charges all customers in a similar manner and hence this is representative of the market rate of interest 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%*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.

21: Deposits carrying off-market rate of interest:
Containers Ltd provides containers for use by customers for multiple purposes. The containers are returnable at the end of the service contract period (3 years) between Containers Ltd and its customers. In addition to the monthly charge, there is a security deposit that each customer makes with Containers Ltd for ` 10,000 per container and such deposit is refundable when the service contract terminates. Deposits do not carry any interest. Analyse the fair value upon initial recognition in books of customers leasing containers. Market rate of interest for 3 year loan is 7% per annum.

Solution
In the above case, lessee (ie, customers leasing the containers) make interest free deposits, which are refundable at the end of 3 years. Now, this money if it was to lent to a third party would fetch interest @ 7% per annum.
Hence, discounting all future cash flows (ie, ` 10,000)
Fair value on initial recognition = 10,000 / (1+0.07)3 = 8,163.
Differential on day 1 = 10,000 – 8,163 = 1,837
The differential on day 1 shall be treated as follows:
- **Scenario 1 –** If fair valuation is determined using level 1 inputs or other observable inputs, difference on day 1 recognised in profit or loss

- **Scenario 2 –** If fair valuation is determined using other inputs, difference on day 1 shall be recognised in profit or loss unless it meets definition of an asset or liability.

However, in case of security deposits level 1 fair value is not available. Therefore, in the above case, the fair valuation is made based on unobservable inputs and hence applying scenario 2, difference can be recognised as an asset if it meets the definition. Now, since the lessee gets to use the containers in return for making an interest free deposit plus monthly charges, the lost interest representing day 1 difference between value of deposit and its fair value is like ‘’prepaid lease rent’ and can be recognised as such. Prepaid rent (ROU Asset) shall be charged off to profit or loss in a straight lined manner as ‘lease rent’.

22: Accounting for transaction costs on initial and subsequent measurement of a financial asset measured at fair value with changes through other comprehensive income:
An entity acquires a financial asset for CU100 plus a purchase commission of CU2. Initially, the entity recognises the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. How would transaction costs be accounted in books of the entity?
Solution
- On that date, the entity measures the asset at CU100 (without regard to the possible commission on sale) and recognises a loss of CU2 in other comprehensive income.

- If the financial asset is measured at fair value through other comprehensive income in accordance with Ind AS 109.4.1.2A, the transaction costs are amortised to profit or loss using the effective interest method.

23: Determining fair value upon initial measurement
The shareholders of Company C provide C with financing in the form of loan notes to enable it to acquire investments in subsidiaries. The loan notes will be redeemed solely out of dividends received from these subsidiaries and become redeemable only when C has sufficient funds to do so. In this context, 'sufficient funds' refers only to dividend receipts from subsidiaries. Analyse the initial measurement of loan notes.
Solution
In this case –
Loan notes are repayable only then C earns returns in form of dividends from subsidiaries. Hence, C cannot be forced to obtain additional external financing or to liquidate its investments to redeem the shareholder loans. Consequently, the loan notes are not considered payable on demand.

Accordingly –

- Loan notes shall be initially measured at their fair value (plus transaction costs), being the present value of the expected future cash flows, discounted using a market-related rate. The amount and timing of the expected future cash flows should be determined on the basis of the expected dividend flow from the subsidiaries. Also, the valuation would need to take into account possible early repayments of principal and corresponding reductions in interest expense.
- Since the loan notes are interest-free or bear lower-than-market interest, there will be a difference between the nominal value of the loan notes - i.e. the amount granted - and their fair value on initial recognition. Because the financing is provided by shareholders, acting in the capacity of shareholders, the resulting credit should be reflected in equity as a shareholder contribution in C's balance sheet. Conversely, in books of shareholders, the difference between amount invested and its fair value shall be recorded as 'investment in C Ltd' being representative of the underlying relationship between shareholders and C Ltd.

24 : Use of cost v/s fair value determination for equity instruments

Silver Ltd. has made an investment in optionally convertible preference shares (OCPS) of a Company – Bronze Ltd. at ` 100 per share (face value ` 100 per share). Silver Ltd. has an option to convert these OCPS into equity shares in the ratio of 1:1 and if such option not exercised till end of 9 years, then the shares shall be redeemable at the end of 10 years at a premium of 20%.

Analyse the measurement of this investment in books of Silver Ltd.

Solution

The classification assessment for a financial asset is done based on two characteristics:

i. Whether the contractual cash flows comprise cash flows that are solely payments of principal and interest on the principal outstanding

ii. Entity's business model (BM) for managing financial assets – Whether the Company's BM is to collect cash flows; or a BM that involves realisation of both contractual cash flows & sale of financial assets;

In all other cases, the financial assets are measured at fair value through profit or loss.

In the above case, the Holder can realise return either through conversion or redemption at the end of 10 years, hence it does not indicate contractual cash flows that are solely payments of principal and interest. Therefore, such investment shall be carried at fair value through profit or loss. Accordingly, the investment shall be measured at fair value periodically with gain/ loss recorded in profit or loss.

25 : Accounting for assets at amortised cost

A Ltd has made a security deposit whose details are described below. Make necessary journal entries for accounting of the deposit in the first year and last year. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of Security Deposit (Starting Date)	1-Apr-20X1
Date of Security Deposit (Finishing Date)	31-Mar-20X6
Description	Lease
Total Lease Period	5 years
Discount rate	12.00%
Security deposit (A)	10,00,000
Present value factor at the 5th year	0.567427

Solution

The above security deposit is an interest free deposit redeemable at the end of lease term for ` 10,00,000. Hence, this involves collection of contractual cash flows and shall be accounted at amortised cost.

Upon initial measurement –

Particulars	Details
Security deposit (A)	10,00,000

Total Lease Period (Years)	5
Discount rate	12.00%
Present value factor of 5th year end	0.56743
Present value of deposit at beginning (B)	5,67,427
Prepaid lease payment at beginning (A-B)	4,32,573

Journal Entries

Year – 1 beginning

Particulars		Amount	Amount
Security deposit A/c	Dr.	5,67,427	
Prepaid lease expenses	Dr.	4,32,573	
To Bank A/c			10,00,000

Subsequently, every annual reporting year, interest income shall be accrued @ 12% per annum and prepaid expenses shall be amortised on straight line basis over the lease term.

Year 1 end

Particulars		Amount	Amount
Security deposit A/c (5,67,427 x 12%)	Dr.	68,091	
To Interest income A/c			68,091
Depreciation (4,32,573 / 5 years)	Dr.	86,515	
To Prepaid lease expenses			86,515

At the end of 5th year, the security deposit shall accrue ₹ 10,00,000 and prepaid lease expenses shall be fully amortised (i.e. depreciated as per Ind AS 116, this prepaid lease rent would be shown as ROU asset). Journal entry for realisation of security deposit –

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,07,143	
To Interest income A/c			1,07,143
Depreciation (4,32,573 / 5 years)	Dr.	86,515	
To Prepaid lease expenses (ROU Asset)			86,515
Bank A/c	Dr.	10,00,000	
To Security deposit A/c			10,00,000

26 : Accounting for assets at FVTPL

A Ltd. invested in equity shares of C Ltd. on 15th March for ` 10,000. Transaction costs were ` 500 in addition to the basic cost of ` 10,000. On 31 March, the fair value of the equity shares was ` 11,200 and market rate of interest is 10% per annum for a 10 year loan. Pass necessary journal entries. Analyse the measurement principle and pass necessary journal entries.

Solution

The above investment is in equity shares of C Ltd and hence, does not involve any contractual cash flows that are solely payments of principal and interest. Hence, these equity shares shall be measured at fair value through profit or loss. Also, an irrecoverable option exists to designate such investment as fair value through other comprehensive income.

Journal Entries

Particulars		Amount	Amount
Upon initial recognition –			
Investment in equity shares of C Ltd.	Dr.	10,000	
Transaction cost	Dr.	500	
To Bank A/c			10,500
(Being investment recognized at fair value plus transaction costs upon initial recognition)			
Profit and Loss A/c	Dr.	500	
To Transaction cost			500
(Being transaction cost incurred on assets measured at FVTPL transferred to P&L A/c)			
Subsequently –			
Investment in equity shares of C Ltd.	Dr.	1,200	
To Fair value gain on financial instruments			1,200
(Being fair value gain recognized at year end in P&L)			
Fair value gain on financial instruments	Dr.	1,200	
To Profit and Loss A/c			1,200
(Being fair value gain transferred to P&L A/c)			

27: Accounting for assets at FVOCI

Metallics Ltd. has made an investment in equity instrument of a company – Castor Ltd. for 19% equity stake. Significant influence not exercised. The investment was made for ` 5,00,000 for 10,000 equity shares on 01 April 20X1. On 30 June 20X1 the fair value per equity share is ` 45. The Company has taken an irrevocable option to measure such investment at fair value through other comprehensive income.

Solution

The Company has made an irrecoverable option to carry its investment at fair value through other comprehensive income. Accordingly, the investment shall be initially recognised at fair value and all subsequent fair value gains/ losses shall be recognised in other comprehensive income (OCI).

Journal Entries

Particulars	Amount	Amount
Upon initial recognition –		
Investment in equity shares of C Ltd. Dr.	5,00,000	
To Bank a/c		5,00,000
(Being investment recognized at fair value plus transaction costs upon initial recognition)		
Subsequently –		
Fair value loss on financial instruments Dr.	50,000	
To Investment in equity shares of C Ltd.		50,000
(Being fair value loss recognised)		
Fair value reserve in OCI Dr.	50,000	
To Fair value loss on financial instruments		50,000
(Being fair value loss recognized in other comprehensive income)		

28: Accounting for assets at FVOCI

XYZ Ltd. is a company incorporated in India. It provides INR 10,00,000 interest free loan to its wholly owned Indian subsidiary (ABC). There are no transaction costs.

How should the loan be accounted for, in the Ind AS financial statements of XYZ, ABC and consolidated financial statements of the group?

Consider the following scenarios:

a) The loan is repayable on demand.

b) The loan is repayable after 3 years. The current market rate of interest for similar loan is 10% p.a. for both holding and subsidiary.

c) The loan is repayable when ABC has funds to repay the loan.

Solution

Ind AS 109 requires that a financial assets and liabilities are recognized on initial recognition at its fair value, as adjusted for the transaction cost. In accordance with Ind AS 113 Fair Value Measurement, the fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Using the guidance, the loan will be accounted for as below in various scenarios:

Scenario (a)
Since the loan is repayable on demand, it has fair value equal to cash consideration given. The parent and subsidiary recognize financial asset and liability, respectively, at the amount of loan given. Going forward, no interest is accrued on the loan.
Upon repayment, both the parent and the subsidiary reverse the entries made at origination.
Scenario (b)
Both parent and subsidiary recognize financial asset and liability, respectively, at fair value on initial recognition. 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.

Accounting in the books of XYZ Ltd (Parent)

S. No.	Particulars		Amount	Amount
	On the date of loan			
1	Loan to ABC Ltd (Subsidiary)	Dr.	7,51,315	
	Deemed Investment (Capital Contribution) in ABC Ltd	Dr.	2,48,685	
	To Bank			10,00,000
	(Being the loan is given to ABC Ltd and recognised at fair value)			
	Accrual of Interest income			
2	Loan to ABC Ltd	Dr.	75,131	
	To Interest income			75,131
	(Being interest income accrued) – Year 1			
3	Loan to ABC Ltd	Dr.	82,645	
	To Interest income			82,645
	(Being interest income accrued) – Year 2			
4	Loan to ABC Ltd	Dr.	90,909	
	To Interest income			90,909
	(Being interest income accrued) – Year 3			
	On repayment of loan			
5	Bank	Dr.	10,00,000	
	To Loan to ABC Ltd (Subsidiary)			10,00,000

Accounting in the books of ABC Ltd (Subsidiary)

S. No.	Particulars		Amount	Amount
	On the date of loan			
1	Bank	Dr.	10,00,000	
	To Loan from XYZ Ltd (Payable)			751,315
	To Equity (Deemed Capital Contribution from ABC Ltd)			2,48,685
	(Being the loan is given to ABC Ltd and recognised at Fair value)			
	Accrual of Interest			
2	Interest expense	Dr.	75,131	
	To Loan from XYZ Ltd (Payable)			75,131
	(Being interest expense recognised) – Year I			
3	Interest expense	Dr.	82,645	
	To Loan from XYZ Ltd (Payable)			82,645
	(Being interest expense recognised) – Year II			
4	Interest expense	Dr.	90,909	
	To Loan from XYZ Ltd (Payable)			90,909
	(Being interest expense recognised) – Year III			
	On repayment of loan			
5	Loan from XYZ Ltd (Payable)	Dr.	10,00,000	
	To Bank			10,00,000

Working Notes:-

1	**Computation of Present value of loan**
Rate	10%
Amount of Loan	10,00,000
Year	3
Present Value	7,51,315
	Computation of interest for Year I
2	
Present Value	7,51,315
Rate	10%
Period of interest - for 1 year	1
Closing value at the end of year 1	8,26,446
Interest for 1st year	75,131
	Computation of interest for Year 2

3	
Value of loan as at the beginning of Year 2	8,26,446
Rate	10%
Period of interest - for 2nd year	1
Closing value at the end of year 2	9,09,091
Interest for 2nd year	82,645
	Computation of interest for Year 3
4	
Value of loan as at the beginning of Year 3	9,09,091
Rate	10%
Period of interest - for 3rd year	1
Closing value at the end of year 3	10,00,000
Interest for 3rd year	90,909

Scenario (c)

Generally, a loan, which is repayable when funds are available, can't be stated to be repayable on demand. Rather, the entities need to estimate repayment date and determine its measurement accordingly. If the loan is expected to be repaid in three years, its measurement will be the same as in scenario (b).

In the Consolidated Financial Statements (CFS), the loan and interest income/expense will get knocked-off as intra-group transaction in all three scenarios. Hence the above accounting will not have any impact in the CFS. However, if the loan is in foreign currency, exchange difference will continue to impact the statement of profit and loss in accordance with the requirements of Ind AS 21.

29 : Trade creditors at market terms

A Company purchases its raw materials from a vendor at a fixed price of ` 1,000 per tonne of steel. The payment terms provide for 45 days of credit period, after which an interest of 18% per annum shall be charged. How would the creditors be classified in books of the Company?

Solution

In the above case, creditors for purchase of steel shall be carried at amortised cost, ie, fair value of amount payable upon initial recognition plus interest (if payment is delayed). Here, fair value upon initial recognition shall be the price per tonne, since the transaction is at market terms between two knowledgeable parties in an arms-length transaction and hence, the transaction price is representative of fair value.

30

An entity is about to purchase a portfolio of fixed rate assets that will be financed by fixed rate debentures. Both financial assets and financial liabilities are subject to the same interest rate risk that gives rise to opposite changes in fair value that tend to offset each other. Provide your comments.

Solution

The fixed rate assets provide for contractual cash flows and based on business model of the entity, such fixed rate assets may be classified as 'amortised cost' (if entity collects contractual cash flows) or fair value through other comprehensive income (FVOCI) (if entity manages through collecting contractual cash and sale of financial assets). In the absence of fair value option, the entity can classify the fixed rate assets as FVOCI with gains and losses on changes in fair value recognised in other comprehensive income and fixed rate debentures at amortised cost. However, reporting both assets and liabilities at fair value through profit and loss, ie, FVTPL corrects the measurement inconsistency and produces more relevant information. Hence, it may be appropriate to classify the entire group of fixed rate assets and fixed rate debentures at fair value through profit or loss (FVTPL).

31: Issue of borrowings with fixed rate of interest

A Ltd has made a borrowing from RBC Bank for ` 10,000 at a fixed interest of 10% per annum. Loan processing fees were additionally paid for ` 500 and loan is payable after 5 years in bullet repayment of principal. Details are as follows:

Particulars	**Details**
Loan amount	**` 10,000**
Date of loan (Starting Date)	**1-Apr-20X1**
Date of repayment of principal amount (Finishing Date)	**31-March-20X6**
Interest rate	**10.00%**
Interest charge	**Interest to be charged and paid yearly**
Upfront fees	**` 500**

Solution

The loan taken by A Ltd shall be measured at amortised cost as follows:

- Initial measurement – At transaction price less processing fees
= 10,000 – 500 = 9,500
- Subsequently – interest to be accrued using effective rate of interest as follows:

Year end	**Opening balance**	**Interest @ 11.42%**	**Repayment of interest & principal**	**Closing balance**
1	9,500	1,085	1,000	9,585
2	9,585	1,095	1,000	9,679
3	9,679	1,105	1,000	9,785
4	9,785	1,117	1,000	9,902
5	9,902	1,098*	11,000	-

Computation of IRR

IRR would be the rate using which the present value of cash flow should come out to be ` 9,500 i.e. (` 10,000 less ` 500).

For this, we should first compute present value of cashflows using any two rates as follows:

Year end	Opening balance	Repayment/Cashflows	Closing balance	PVF @ 10%	Present Value at 10% rate	PVF @ 13%	Present Value at 13% rate
1	9,500	1,000	8,500	0.909	909	0.885	885
2	8,500	1,000	7,500	0.826	826	0.783	783
3	7,500	1,000	6,500	0.751	751	0.693	693
4	6,500	1,000	5,500	0.683	683	0.613	613
5	5,500	11,000	(5,500)	0.621	6,830	0.543	5,970*
				8,945	10 ,000		

*Difference is due to approximation

Taking 10% as discount rate, present value (PV) comes out to be ` 10,000.

If rate is increased by 3% over a base rate of 10%, PV decreases by ` 1,055 (i.e. ` 10,000 less ` 8945).

To decrease PV by ` 1,055, rate should be increased = 3%

To decrease PV by Re.1, rate should be increased = 3%

1,055 +

To decrease PV by ` 500, rate should be increased = 3 % X 500 =1,055

= 1.42%

This would mean that the discount rate to get present value of cashflows equivalent to ` 9,500 should be 11.42% (i.e. 10% + 1.42%).

32: Issue of borrowings with fixed rate of interest

A Ltd has made a borrowing from RBC Bank for ` 10,000 at a fixed interest of 12% per annum. Loan processing fees were additionally paid for ` 500 and loan is payable 4 half-yearly installments of ` 2,500 each. Details are as follows

Particulars	*Details*
Loan amount	*₹ 10,000*
Date of loan (Starting Date)	*1-Apr-20X1*
Date of loan (Finishing Date)	*31-March-20X3*
Description of repayment	*Repayment of loan starts from 30-Sept-20X1 (To be paid half yearly)*
Installment amount	*₹ 2,500*
Interest rate	*12.00%*
Interest charge	*Interest to be charged quarterly*
Upfront fees	*₹ 500*

How would loan be accounted in books of A Ltd?

Consider IRR is 16.60% p.a.

Solution

The loan taken by A Ltd shall be measured at amortised cost as follows:

- Initial measurement – At transaction price less processing fees = 10,000 – 500 = 9,500
- Subsequently – interest to be accrued using effective rate of interest as follows:

Date	Amount of Loan	Re-payment	Upfront fees paid	Amount of Interest	Days	IRR Calcula-tion	Revised Interest computed	Loan Balance
1-Apr-20X1	10,000	-	500	-	-	9,500	-	-
30-Jun-20X1	-	-	-	300	90	(300)	389	9,589
30-Sep-20X1	-	2500	-	300	92	(2,800)	401	7,190
31-Dec-20X1	-	-	-	225	92	(225)	301	7,266
31-Mar 20X2	-	2500	-	225	90	(2,725)	297	4,838
30-Jun-20X2	-	-	-	150	91	(150)	200	4,888
30-Sep-20X2	-	2500	-	150	92	(2,650)	204	2,442
31-Dec-20X2	-	-	-	75	92	(75)	102	2,473
31-Mar-20X3	-	2500	-	75	91	(2,575)	102	-
					IRR	16.60%		

33 : Issue of variable number of shares against issue of CCPS

A Ltd. issued compulsorily convertible preference shares (CCPS) at ` 100 each (` 10 face value + ` 90 premium per share) for ` 10,00,000. These are convertible into equity shares at the end of 10 years, where the number of equity shares to be issued shall be determined based on fair value per equity share to be determined at the time of conversion Evaluate if this is financial liability or equity? What if the conversion ratio was fixed at the time of issue of such preference shares?

Solution

i. As per Ind AS 109, non-derivative contracts which will be settled against issue of variable number of own equity shares meet the definition of financial liability.

In this case, A Ltd. has issued CCPS which are convertible into variable number of shares. Hence, it is akin to use of own equity shares as currency for settlement of the liability of CCPS issued. Accordingly, it meets the definition of financial liability.

Measurement –

Initial measurement – This shall be measured at fair value on date of transaction. Since A Ltd shall give shares worth ` 10 lacs at the end of 10 years which is equal to the amount borrowed on day 1, the liability is recognised at fair value, determined by discounting future settlement of the borrowed amount. For difference arising on day 1 between amount borrowed and that recognised as liability using level 3 inputs, it is deferred and recognised on a systematic basis over the period of liability.

Subsequent measurement – Such liability shall be carried at fair value through profit or loss.
ii. Per Ind AS 109, a non-derivative contract that involves issue of fixed number of equity shares shall be classified as equity.

In this case, if the conversion of CCPS was into a fixed number of equity shares at the end of 10 years, then it meets the definition of equity and hence, shall be classified as 'equity instrument'.
An equity instrument is carried at cost and no further adjustments made to its carrying value after initial recognition.

34: Accounting treatment of processing fees belonging to undisbursed loan Amount
X Ltd. had taken 6 year term loan in April 20X0 from bank and paid processing fees at the time of sanction of loan.
The term loan is disbursed in different tranches from April 20X0 to April 20X6. On the date of transition to Ind AS, i.e. 1.4.20X5, it has calculated the net present value of term loan disbursed upto 31.03.20X5 by using effective interest rate and proportionate processing fees has been adjusted in disbursed amount while calculating net present value. What will be the accounting treatment of processing fees belonging to undisbursed term loan amount?
Solution
Processing fee is an integral part of the effective interest rate of a financial instrument and shall be included while calculating the effective interest rate.
(a) Accounting treatment in case future drawdown is probable
It may be noted that to the extent there is evidence that it is probable that the undisbursed term loan will be drawn down in the future, the processing fee is accounted for as a transaction cost under Ind AS 109, i.e., the fee is deferred and deducted from the carrying value of the financial liabilities when the draw down occurs and considered in the effective interest rate calculations.
(b) Accounting treatment in case future drawdown is not probable
If it is not probable that the undisbursed term loan will be drawn down in the future, then the fees is recognised as an expense on a straight-line basis over the term of the loan.

35: Accounting treatment of prepayment premium and processing fees for obtaining new loan to prepay old loan
PQR Limited had obtained term loan from Bank A in 20X1-20X2 and paid loan processing fees and commitment charges.
In May 20X5, PQR Ltd. has availed fresh loan from Bank B as take-over of facility i.e. the new loan is sanctioned to pay off the old loan taken from Bank A. The company paid prepayment premium to Bank A to clear the old term loan and paid processing fees to Bank B for the new term loan.
Whether the prepayment premium and the processing fees both will be treated as transaction cost (as per Ind AS 109, Financial Instruments) of obtaining the new loan, in the financial statements of PQR Ltd?

Solution
(a) Accounting treatment of prepayment premium
Ind AS 109, provides that if an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment in the statement of profit and loss.

Since the original loan was prepaid, the prepayment would result in extinguishment of the original loan. The difference between the CV of the financial liability extinguished and the consideration paid shall be recognised in profit or loss as per Ind AS 109. Accordingly, the prepayment premium shall be recognised as part of the gain or loss on extinguishment of the old loan.

(b) Accounting treatment of Unamortised processing fee of old loan

Unamortised processing fee related to the old loan will also be required to be charged to the statement of profit and loss.

(c) Accounting treatment of Processing fee for new loan

Transaction costs are "Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument."

It is assumed that the loan processing fees solely relates to the origination of the new loan (i.e. does not represent loan modification/renegotiation fees). Hence, the processing fees paid to avail fresh loan from Bank B will be considered as transaction cost in the nature of origination fees of the new loan and will be included while calculating effective interest rate as per Ind AS 109.

36: Accounting treatment of share held as stock in trade

A share broking company is dealing in sale/purchase of shares for its own account and therefore is having inventory of shares purchased by it for trading.

How will these instruments be accounted for in the financial statements?

Solution

Ind AS 2, Inventories, states that this Standard applies to all inventories, except financial instruments (Ind AS 32, Financial Instruments: Presentation and Ind AS 109, Financial Instruments).

Accordingly, the principles of recognising and measuring financial instruments are governed by Ind AS 109, its presentation is governed by Ind AS 32 and disclosures are in accordance with Ind AS 107, Financial Instruments: Disclosures, even if these instruments are held as stock-in trade by a company.

Further Ind AS 101, First-time Adoption of Indian Accounting Standards does not provide any transitional relief from the application of the above standards.

Accordingly, in the given case, the relevant requirements of Ind AS 109, Ind AS 32 and Ind AS 107 shall be applied retrospectively

37

Bonds for ` 1,00,000 reclassified as FVTPL. Fair value on reclassification is ` 90,000. Pass the required journal entry.

Solution

Particulars		Amount	Amount
Bonds at FVTPL	Dr.	90,000	
Loss on reclassification	Dr.	10,000	
To Bonds at amortised cost			1,00,000

38

Bonds for ` 1,00,000 reclassified as FVOCI. Fair value on reclassification is ` 90,000. Pass the required journal entry.

Solution

Particulars	Amount	Amount
Bonds at FVOCI Dr.	90,000	
OCI (Loss on reclassification) Dr.	10,000	
To Bonds at amortised cost		1,00,000

39

Bonds for ` 100,000 reclassified as Amortised cost. Fair value on reclassification is ` 90,000. Pass the required journal entry.

Solution

Particulars	Amount	Amount
Bonds at Amortised cost Dr.	90,000	
Loss on reclassification Dr.	10,000	
To Bonds at FVTPL		1,00,000

40

Bonds for ` 100,000 reclassified as FVOCI. Fair value on reclassification is ` 90,000. Pass the required journal entry.

Solution

Particulars	Amount	Amount
Bonds at FVOCI Dr.	90,000	
Loss on reclassification Dr.	10,000	
To Bonds at FVTPL		1,00,000

41

Bonds for ` 100,000 reclassified as Amortised cost. Fair value on reclassification is ` 90,000 and ` 10,000 loss was recognised in OCI till date of reclassification. Pass required journal entry.

Solution

Particulars	Amount	Amount
Bonds at FVOCI Dr.	10,000	
To OCI - Loss on reclassification		10,000
[Being loss recognized in OCI now reversed prior to reclassification]		
Bonds (Amortised cost) Dr.	1,00,000	
To Bonds at FVOCI		1,00,000
[Being bonds reclassified from FVOCI to Amortised cost]		

42

Bonds for ` 100,000 reclassified as FVTPL. Fair value on reclassification is ` 90,000. Pass the required journal entry.

Solution

Particulars		Amount	Amount
P&L - Loss on reclassification	Dr.	10,000	
To Bonds at FVTOCI			10,000
Bonds at FVTPL	Dr.	90,000	
To Bonds at FVOCI			90,000

43 :12 month expected credit loss – Probability of default approach

Entity A originates a single 10 year amortising loan for CU1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Entity A estimates that the loan at initial recognition has a probability of default (PoD) of 0.5 per cent over the next 12 months. Entity A also determines that changes in the 12-month PoD are a reasonable approximation of the changes in the lifetime PoD for determining whether there has been a significant increase in credit risk since initial recognition. Loss given default (LGD) is estimated as 25% of the balance outstanding. Calculate loss allowance.

Solution

At reporting date, no change in 12-month POD and entity assesses that there is no significant increase in credit risk since initial recognition – therefore lifetime ECL is not required to be recognised.

Particulars	Details
Loan	` 1,000,000 (A)
LGD	25% (B)
PoD – 12 months	0.5% (C)
Loss allowance (for 12-months ECL)	` 1,250 (A*B*C)

44: 12 month expected credit loss – Loss rate approach

Bank A originates 2,000 bullet loans with a total gross carrying amount of CU 500,000. Bank A segments its portfolio into borrower groups (Groups X and Y) on the basis of shared credit risk characteristics at initial recognition. Group X comprises 1,000 loans with a gross carrying amount per client of CU 200, for a total gross carrying amount of CU 200,000. Group Y comprises 1,000 loans with a gross carrying amount per client of CU 300, for a total gross carrying amount of CU 300,000. There are no transaction costs and the loan contracts include no options (for example, prepayment or call options), premiums or discounts, points paid, or other fees. Calculate loss rate when

Group	Historic per annum average defaults	Present value of observed loss assumed
X	4	CU 600
Y	2	CU 450

Solution

- Bank A measures expected credit losses on the basis of a loss rate approach for Groups X and Y. In order to develop its loss rates, Bank A considers samples of its own historical default and loss experience for those types of loans.
- In addition, Bank A considers forward-looking information, and updates its historical information for current economic conditions as well as reasonable and supportable forecasts of future economic conditions. Historically, for a population of 1,000 loans in each group, Group X's loss rates are 0.3 per cent, based on four defaults, and historical loss rates for Group Y are 0.15 per cent, based on two defaults.

	Number of clients in sample	**Estimated per client gross carrying amount at default**	**Total estimated gross carrying amount at default**	**Historic per annum average defaults**	**Estimated total gross carrying amount at default**	**Present value of observed loss assumed**	**Loss rate**
Group	A	B	C = A × B	D	E = B × D	F	G = F ÷ C
X	1,000	CU 200	CU 2,00,000	4	CU 800	CU 600	0.3%
Y	1,000	CU 300	CU 3,00,000	2	CU 600	CU 450	0.15%

45: Life time expected credit losses (provision matrix for short term receivables)

Company M, a manufacturer, has a portfolio of trade receivables of CU 30 million in 20X1 and operates only in one geographical region. The customer base consists of a large number of small clients and the trade receivables are categorised by common risk characteristics that are representative of the customers' abilities to pay all amounts due in accordance with the contractual terms. The trade receivables do not have a significant financing component in accordance with Ind AS 115. In accordance with paragraph 5.5.15 of Ind AS 109 the loss allowance for such trade receivables is always measured at an amount equal to lifetime expected credit losses. Please use the following information of debtors outstanding:

	Gross carrying amount
Current	**CU 15,000,000**
1–30 days past due	**CU 7,500,000**
31–60 days past due	**CU 4,000,000**
61–90 days past due	**CU 2,500,000**
More than 90 days past due	**CU 1,000,000**
	CU 30,000,000

	Current	1–30 days past due	31–60 days past due	61–90 days past due	More than 90 days past due
Default rate	0.3%	1.6%	3.6%	6.6%	10.6%
Determine the expected credit losses for the portfolio					

Solution

To determine the expected credit losses for the portfolio, Company M uses a provision matrix. The provision matrix is based on its historical observed default rates over the expected life of the trade receivables and is adjusted for forward-looking estimates. At every reporting date the historical observed default rates are updated and changes in the forward-looking estimates are analysed. In this case it is forecast that economic conditions will deteriorate over the next year.
On that basis, Company M estimates the following provision matrix:

	Current	1–30 days past due	31–60 days past due	61–90 days past due	More than 90 days past due
Default rate	0.3%	1.6%	3.6%	6.6%	10.6%

The trade receivables from the large number of small customers amount to CU 30 million and are measured using the provision matrix.

	Gross carrying amount	**Lifetime expected credit loss allowance (Gross carrying amount x lifetime expected credit loss rate)**
Current	CU 15,000,000	CU 45,000
1–30 days past due	CU 7,500,000	CU 120,000
31–60 days past due	CU 4,000,000	CU 144,000
61–90 days past due	CU 2,500,000	CU 165,000
More than 90 days past due	CU 1,000,000	CU 106,000
	CU 30,000,000	**CU 580,000**

UNIT 3: FINANCIAL INSTRUMENTS: EQUITY AND FINANCIAL LIABILITIES

Illustrations

1: Redeemable preference shares with mandatory dividend

A Ltd. (issuer) issues preference shares to B Ltd (holder). Those preference shares are redeemable at the end of 10 years from the date of issue and entitle the holder to a cumulative dividend of 15% p.a. The rate of dividend is commensurate with the credit risk profile of the issuer. Examine the nature of the financial instrument.

Solution

This instrument provides for mandatory fixed dividend payments and redemption by the issuer for a fixed amount at a fixed future date. Since there is a contractual obligation to deliver cash (for both dividends and repayment of principal) to the preference shareholder that cannot be avoided, the instrument is a financial liability in its entirety.

2 : Redeemable debentures with discretionary dividend

X Co. Ltd. (issuer) issues debentures to Y Co. Ltd. (holder). Those debentures are redeemable at the end of 10 years from the date of issue. Interest of 15% p.a. is payable at the discretion of the issuer. The rate of interest is commensurate with the credit risk profile of the issuer. Examine the nature of the financial instrument.

Solution

This instrument has two components – (1) mandatory redemption by the issuer for a fixed amount at a fixed future date, and (2) interest payable at the discretion of the issuer.

The first component is a contractual obligation to deliver cash (for repayment of principal with or without premium, as per terms) to the debenture holder that cannot be avoided. This component of the instrument is a financial liability.

The second component of interest payable is discretion of the issuer and hence will be classified as equity. This is also discussed in detailed in the compound financial instrument section (Also refer Illustration 27 in the subsequent section).

3: Perpetual loan with mandatory interest

P Co. Ltd. (issuer) takes a loan from Q Co. Ltd. (holder). The loan is perpetual and entitles the holder to fixed interest of 8% p.a. Examine the nature of the financial instrument.

Solution

This instrument has two components – (1) mandatory interest by the issuer for a fixed amount at a fixed future date, and (2) perpetual nature of the principal amount.

The first component is a contractual obligation to deliver cash (for payment of interest) to the lender that cannot be avoided. This component of the instrument is a financial liability.

4: Restriction on the ability of an entity to satisfy a contractual obligation
Does the lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, will lead to contractual obligation?
Solution
Lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument.

5: Optionally convertible redeemable preference shares
D Ltd. issues preference shares to G Ltd. The holder has an option to convert these preference shares to equity instruments of the issuer anytime up to a period of 10 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 10 years. Examine the nature of the financial instrument.
Solution
This instrument has two components – (1) contractual obligation that is conditional on holder exercising its right to redeem, and (2) conversion option with the holder.
The first component is a financial liability because the entity does not have the unconditional right to avoid delivering cash.
In the section "Compound financial instruments", we will also analyse the other component – the conversion option with the holder and we will explain the nature of the instrument in its entirety.

6: Settlement alternative is non-financial obligation
LMN Ltd. issues preference shares to PQR Ltd. These preference shares are redeemable at the end of 5 years from the date of issue.
The instrument also provides a settlement alternative to the issuer whereby it can transfer a particular commercial building to the holder, whose value is estimated to be significantly higher than the cash settlement amount. Examine the nature of the financial instrument.
Solution
Such preference shares are financial liability because the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation.
7: Cap on amount payable on liquidation
ABC Ltd. has two classes of puttable shares – Class A shares and Class B shares. On liquidation, Class B shareholders are entitled to a pro rata share of the entity's residual assets up to a maximum of ` 10,000,000. There is no limit to the rights of the Class A shareholders to share in the residual assets on liquidation. Examine the nature of the financial instrument.
Solution
The cap of ` 10,000,000 means that Class B shares do not have entitlement to a pro rata share of the residual assets of the entity on liquidation. They cannot therefore be classified as equity

8: Investment manager's share in a mutual fund
Mutual Fund X has an Investment Manager Y. At the inception of the fund, Y had invested a nominal or token amount in units of X. Such units rank last for repayment in the event of liquidation. Accordingly, they constitute the most subordinate class of instruments. Examine the nature of the financial instrument.
Solution
The units held by Y holders are classified as equity as they are most subordinate class of instruments and will be entitled to residual interest.
However, the units held by other unit holders are classified as financial liability as they are not the most subordinate class of instruments – they are entitled to pro rate share of net assets on liquidation, and their claim has a priority over claims of Y.
It may be noted that the most subordinate class of instruments may consist of two or more legally separate types of instruments

9: Differential voting rights
T Motors Ltd. has issued puttable ordinary shares and puttable 'A' ordinary shares whereby holders of ordinary shares are entitled to one vote per share whereas holders of 'A' ordinary shares are not entitled to any voting rights. The holders of two classes of shares are equally entitled to receive share in net assets upon liquidation. Examine whether the financial instrument will be classified as equity.
Solution
Neither of the two classes of puttable shares can be classified as equity, as they do not have identical features due to the difference in voting rights. It is not possible for T Motors Ltd. to achieve equity classification of the ordinary shares by designating them as being more subordinate than the 'A' ordinary shares, as this does not reflect the fact that the two classes of share are equally entitled to share in entity's residual assets on liquidation.

10: Conversion into a variable number of equity instruments
S Ltd. has issued a class of puttable ordinary shares to T Ltd. Besides the put option (which is consistent with other classes of ordinary shares), T Ltd. is also entitled to convert the class of ordinary shares held by it into equity instruments of S Ltd. whose number will vary as per the market value of S Ltd. Examine whether the financial instrument will be classified as equity.
Solution
The shares cannot qualify for equity classification in their entirety as in addition to the put option there is also a contractual obligation to settle the instrument in variable number of entity's own equity instruments.

11: Management fee contract between issuer and puttable instrument holder
P Ltd. has issued puttable ordinary shares to Q Ltd. Q Ltd. has also entered into an asset management contract with P Ltd. whereby Q Ltd. is entitled to 50% of the profit of P Ltd. Normal commercial terms for similar contracts will entitle the service provider to only 4%-6% of the net profits. Examine whether the financial instrument will be classified as equity.
Solution
The puttable ordinary shares cannot qualify for equity classification as (a) in addition to the put option, there is another contract between the issuer (P Ltd.) and holder of puttable instrument (Q Ltd.) whose cash flows are based substantially on profit or loss of issuer, (b) whose contractual terms are not similar to a contract between a non-instrument holder and issuer and (c) it has the effect of substantially restricting return on puttable ordinary shares.

12: Written put option on own equity instruments
On 1 January 20X1, Entity X writes a put option for 1,00,000 of its own equity shares for which it receives a premium of ` 5,00,000.
Under the terms of the option, Entity X may be obliged to take delivery of 1,00,000 of its own shares in one year's time and to pay the option exercise price of ` 22,000,000. The option can only be settled through physical delivery of the shares (gross physical settlement). Examine the nature of the financial instrument and how it will be accounted.
Solution
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 ` 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.
The accounting for financial instrument in the above illustration is as below (Ind AS 32.23):
• The financial liability is recognised initially at the present value of the redemption amount, and is reclassified from equity – In the illustration above, this would imply that a financial liability for an amount of present value of ` 22,000,000, say ` 20,000,000 will be recognised through a debit to equity. The initial premium received (` 500,000) 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 ` 20,000,000 in the aforementioned illustration will be measured at amortised cost and finance cost of ` 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. This means, in case of illustration above, an amount of ` 22,000,000 will be reclassified from financial liability to equity.

13: Written put option over non-controlling interests
Parent P holds a 70% controlling interest in Subsidiary S. The remaining 30% is held by Entity Z. On 1 January 20X1, P writes an option to Z which grants Z the right to sell its shares to Parent P on 31 December 20X2 for ` 1,000. Parent P receives a payment of ` 100 for the option. The applicable discount rate for the put liability is determined to be 12%. State by which amount the financial instrument will be recognised and under which category.
Solution
On 1 January 20X1, the present value of the (estimated) exercise price is ` 797 (` 1,000 discounted over 2 years at 12%).
Accordingly, P will recognise a financial liability of ` 797 and ` 203 ie the difference between cash paid i.e. ` 1000 and the financial liability of ` 797 will be recognised to equity.

14: Conversion into a number of equity instruments equivalent to a fixed value
CBA Ltd. issues convertible debentures to RQP Ltd. for a subscription amount of ` 100 crores. Those debentures are convertible after 5 years into equity shares of CBA Ltd. using a pre-determined formula. The formula is:

$$\frac{100 \text{ crores } X \ (1+10\%)\text{^}5}{\text{Fair value on date of conversion}}$$

Examine the nature of the financial instrument.
Solution

Such a contract is a financial liability of the entity even though the entity can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. The underlying thought behind this conclusion is that the entity is using its own equity instruments 'as currency'.

15: Conversion into a fixed number of equity instruments

DF Ltd. issues convertible debentures to JL Ltd. for a subscription amount of ` 100 crores. Those debentures are convertible after 5 years into 15 crore equity shares of ` 10 each. Examine the nature of the financial instrument.

Solution

This contract is an equity instrument because changes in the fair value of equity shares arising from market related factors do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered.

16: Written option for a fixed or variable number of equity instruments

ST Ltd. purchases an option from AT Ltd. entitling the holder to subscribe to fixed number of equity shares of issuer at a fixed exercise price of ` 50 per share at any time during a period of 3 months. Holder paid an initial premium of ` 2 per option. Examine whether the financial instrument will be classified as equity.

Solution

For the issuer AT Ltd., this option is an equity instrument as it will be settled by the exchange of a fixed amount of cash for a fixed number of its own equity instruments.

If, on the other hand, if the exercise price of the option was variable, say benchmarked to an index or a variable, other than the market price of equity shares of AT Ltd., the written option will be classified as a "financial liability" in the books of the issuer, AT Ltd.

17: Written option with multiple exercise prices

WC Ltd. writes an option in favour of GT Ltd. wherein the holder can purchase issuer's equity instruments at prices that fluctuate in response to the share price of issuer.

As per the terms, if the share price of issuer is less than ` 50 per share, option can be exercised at ` 40 per share. If the share price is equal to or more than ` 50 per share, option can be exercised at ` 60 per share. Explain the nature of the financial instrument.

Solution

As the contract will be settled by delivery of fixed number of instruments for a variable amount of cash, it is a financial liability.

18: Share swap arrangements

Acquirer Ltd. enters into an arrangement with shareholders of Target Ltd. wherein Acquirer Ltd. will purchase shares of Target Ltd. in a share swap arrangement against a variable amount of cash i.e. market value of Target Ltd.'s equity shares. The share swap ratio is agreed as 1:5 i.e. 1 equity share of Acquirer Ltd. for every 5 equity shares held in Target Ltd. Examine whether the financial instrument will be classified as equity.

Solution

Such arrangements will not meet the condition for classification as "equity instrument" since the contract will be settled by delivery of fixed number of Acquirer Ltd.'s own equity instruments against a variable amount of cash i.e. market value of Target Ltd.'s equity shares. Such a contract will likely result in a derivative liability or asset for both the parties.

19: Conversion ratio changes with time

On 1 January 20X1, NKT Ltd. subscribes to convertible preference shares of VT Ltd. The conversion ratio varies as below:

Conversion upto 31 March 20X1: 1 equity share of VT Ltd. for each preference share held Conversion upto 30 June 20X1: 1.5 equity share of VT Ltd. for each preference share held Conversion upto 31 December 20X1: 2 equity share of VT Ltd. for each preference share held. Examine whether the financial instrument will be classified as equity.

Solution

The convertible preference shares can be classified as "equity instrument" in the books of the issuer, VT Ltd. The conversion ratio doesn't change corresponding to any underlying variable, it only varies in response to passage of time which is a certain event and hence fixed.

20: Conversion ratio changes to protect rights of convertible instrument holders

On 1 January 20X1, HT Ltd. subscribes to convertible preference shares of RT Ltd. The preference shares are convertible in the ratio of 1:1.

The terms of the instrument entitle HT Ltd. to proportionately more equity shares of RT Ltd. in case of a stock split or bonus issue. Examine whether the financial instrument will be classified as equity.

Solution

The convertible preference shares can be classified as "equity instrument" in the books of the issuer, RT Ltd. The variability in the conversion ratio is only to protect the rights of the holder of convertible instrument vis-à-vis other equity shareholders.

The conversion was always intended to be in a fixed ratio and hence the holder is exposed to the change in equity value. The variability is brought in to maintain holder's exposure in line with other holders.

21: Conversion ratio changes if issuer subsequently issues shares to others at a lower price

On 1 January 20X1, PG Ltd. subscribes to convertible preference shares of BG Ltd. at ` 100 per preference share. The preference shares are convertible in the ratio of 10:1 i.e. 10 equity shares for each preference share held. On a fully diluted basis, PG Ltd. is entitled to 30% stake in BG Ltd.

If subsequent to the issuance of these convertible preference shares, BG Ltd. issues any equity instruments at a price lower than ` 10 per share, conversion ratio will be changed to compensate PG Ltd. for dilution in its stake below the expected dilution at a price of ` 10 per share. Examine the nature of the financial instrument.

Solution

The convertible preference shares will be classified as "financial liability" in the books of the issuer, BG Ltd. The variability in the conversion ratio underwrites the return on preference shares and not just protects the rights of convertible instrument holders vis-à-vis equity shareholders.

22: Conversion ratio is variable in a narrow range
On 1 January 20X1, NG Ltd. subscribes to convertible preference shares of AG Ltd. at ` 100 per preference share. On a fully diluted basis, NG Ltd. is entitled to 30% stake in AG Ltd.
The preference shares are convertible at fair value, subject to, NG Ltd.'s stake not going below 15% and not going above 40%. Examine the nature of the financial instrument.
Solution
The convertible preference shares will be classified as "financial liability" in the books of the issuer, AG Ltd. The variability in the conversion ratio underwrites the return on preference shares to an extent and also restricts that return. The preference shareholder is not entitled to residual net assets of the issuer.
In certain situations, an instrument is convertible only at the option of issuer. While such instruments provide the issuer with an unconditional right to avoid payment of cash, it is important to understand the economic substance of the option. It is also very important to determine whether the option is exercised by the issuer or by shareholders acting in their capacity as instrument holders.
For example, if the convertible instrument is held by the equity shareholders of the issuer and the conversion requires unanimous consent of all the shareholders, it would be inappropriate to consider that the issuer has an unconditional right to avoid payment of cash. In this situation, it would be more relevant to consider the rights of the instrument holders in their capacity as equity shareholders of the issuer.

23: Instrument convertible only at the option of issuer
XYZ Ltd. issues optionally convertible debentures with the following terms:
The debentures carry interest at the rate of 7% p.a.
Issuer has option to either:
Convert the instrument into a fixed number of its own shares at any time, or redeem the instrument in cash at any time. The redemption price is the fair value of the fixed number of shares into which the instrument would have converted if it had been converted. The holder has no conversion or redemption options.
Debentures have a tenor of 12 years and, if not converted or redeemed earlier, will be repaid in cash at maturity, including accrued interest, if any.
Examine the nature of the financial instrument.
Solution
The issuer has the ability to convert the debentures into a fixed number of its own shares at any time. The issuer, therefore, has the ability to avoid making a cash payment or settling the debentures in a variable number of its own shares. Therefore, such a financial instrument is likely to be classified as equity.
However, it must be noted that mere existence of a right to avoid payment of cash is not conclusive. The instrument is to be accounted for as per its substance and hence it needs to be seen whether the conversion option is substantive.
In this particular situation, the issuer will need to determine whether it is favourable to exercise the conversion option or redemption option. In case of latter, the instrument will be classified as a financial liability (a hybrid instrument, whose measurement is dealt with in a subsequent section).
Practical situations do arise wherein the issuer has an option or obligation to issue own equity instruments only in particular circumstances i.e. the instrument is contingently convertible.

24: Conversion ratio changes under independent scenarios
On 1 January 20X1, STAL Ltd. subscribes to convertible preference shares of ATAL Ltd.
The preference shares are convertible as below:
Convertible 1:1 if another strategic investor invests in the issuer within one year
Convertible 1.5:1: if an IPO is successfully completed within 2 years

Convertible 2:1: if a binding agreement for sale of majority stake by equity shareholders is entered into within 3 years
Convertible 3:1: if none of these events occur in 3 years' time.
Examine whether the financial instrument will be classified as equity.
Solution
In this case the four events can be viewed as discrete because the achievement of each one of these can occur independently of the other (as they relate to different periods). The arrangement can therefore be considered to be economically equivalent to four separate contracts. The price per share and the amount of shares to be issued is fixed in each of these discrete periods, with each event relating to a different year and therefore a separate risk. The "fixed for fixed" test is therefore met.
The instrument is therefore classified as "equity instrument".

25: Conversion ratio changes under inter-dependent scenarios
On 1 January 20X1, RHT Ltd. subscribes to convertible preference shares of RDT Ltd.
The preference shares are convertible as below:
Convertible 1:1 if another strategic investor invests at an enterprise valuation (EV) of USD 100 million.
Convertible 1.5:1: if another strategic investor invests at EV of USD 150 million
Convertible 2:1: if another strategic investor invests at EV of USD 200 million
Convertible 3:1: if no strategic investment is made within a period of 3 years
Examine the nature of the financial instrument.
Solution
The four events are interdependent because the second event cannot be met without also meeting the first event, and the third event cannot be met unless the first two are met.
Therefore, this contract should be treated as a single instrument when applying the "fixed for fixed" test. The test is then failed because the number of shares to be exchanged for cash are variable.

26: Foreign currency convertible bond
Entity A issues a bond with face value of USD 100 and carrying a fixed coupon rate of 6% p.a. Each bond is convertible into 1,000 equity shares of the issuer. Examine the nature of the financial instrument.
Solution
While the number of equity shares is fixed, the amount of cash is not. The variability in cash arises on account of fluctuation in exchange rate of INR-USD. Such a foreign currency convertible bond (FCCB) will qualify the definition of "financial liability".

However, Ind AS 32.11 provides, "the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency."
Accordingly, FCCB will be treated as an "equity instrument".

27: Redeemable debentures with discretionary dividend (continued from Illustration 2)
X Co. Ltd. (issuer) issues debentures to Y Co. Ltd. (holder). Those debentures are redeemable at the end of 10 years from the date of issue. Interest of 15% p.a. is payable at the discretion of the issuer. The rate of

interest is commensurate with the credit risk profile of the issuer. Examine the nature of the financial instrument.

Solution

This instrument has two components – (1) mandatory redemption by the issuer for a fixed amount at a fixed future date, and (2) interest payable at the discretion of the issuer.

The first component is a contractual obligation to deliver cash (for repayment of principal with or without premium, as per terms) to the debenture holder that cannot be avoided. This component of the instrument is a financial liability.

The other component, discretionary interest is an equity feature because issuer can avoid payment of cash or another financial asset in this respect.

, this instrument is concluded to be a compound financial instrument.

28: Perpetual loan with mandatory interest (continued from Illustration 3)

P Co. Ltd. (issuer) takes a loan from Q Co. Ltd. (holder). The loan is perpetual and entitles the holder to fixed interest of 8% p.a. Examine the nature of the financial instrument.

Solution

This instrument has two components – (1) mandatory interest by the issuer for a fixed amount at a fixed future date, and (2) perpetual nature of the principal amount.

The first component is a contractual obligation to deliver cash (for payment of interest) to the lender that cannot be avoided. This component of the instrument is a financial liability.

The other component, perpetual principal, is an equity feature because issuer is not required to pay cash or another financial asset in this respect.

Therefore, this instrument is concluded to be a compound financial instrument.

29: Optionally convertible redeemable preference shares (continued from Illustration 5)

D Ltd. issues preference shares to G Ltd. The holder has an option to convert these preference shares to equity instruments of the issuer anytime up to a period of 10 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 10 years. Examine the nature of the financial instrument.

Solution

This instrument has two components – (1) contractual obligation that is conditional on holder exercising its right to redeem, and (2) conversion option with the holder.

The first component is a financial liability because the entity does not have the unconditional right to avoid delivering cash.

The other component, conversion option with the holder, is an equity feature if the "fixed for fixed" test is satisfied. If the conversion option does not fulfil that test, say, because the conversion ratio varies in response to an underlying variable, it is a derivative liability.

Such an instrument is called a "hybrid instrument".

30: Perpetual loan with mandatory interest (continued from Illustration 3) P Co. Ltd. (issuer) takes a loan from Q Co. Ltd. (holder) for ` 12 lakhs. The loan is perpetual and entitles the holder to fixed interest of 8% p.a. The rate of interest commensurate with credit risk profile of the issuer is 12% p.a. Calculate the value of the liability and equity components.

Solution

The values of the liability and equity components are calculated as follows:
Present value of interest payable in perpetuity (` 96,000 discounted at 12%) = ` 800,000
Therefore, equity component = fair value of compound instrument, say, ` 1,200,000 less financial liability component i.e. ` 800,000 = ` 400,000.
In subsequent years, the profit and loss account is charged with interest of 12% on the debt instrument.

31: Optionally convertible redeemable preference shares (continued from Illustration 29) On 1 July 20X1, D Ltd. issues preference shares to G Ltd. for a consideration of ` 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 fixed coupon of 6% p.a. and is payable every year. The prevailing market rate for similar preference shares, without the conversion feature, is 9% p.a.
Calculate the value of the liability and equity components.
Solution

The values of the liability and equity components are calculated as follows:
Present value of principal payable at the end of 3 years (` 10 lakhs discounted at 9% for 3 years) = ` 772,183
Present value of interest payable in arrears for 3 years (` 60,000 discounted at 9% for each of 3 years) = ` 151,878
Total financial liability = ` 924,061
Therefore, equity component = fair value of compound instrument, say, ` 1,000,000 less financial liability component i.e. ` 924,061 = ` 75,939.
In subsequent years, the profit and loss account is charged with interest of 9% on the debt instrument.

32: Optionally convertible preference shares with issuer's redemption option
D Ltd. issues preference shares to G Ltd. for a consideration of ` 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. and is payable at the end of every year.
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.
Solution

The values of the liability and equity components are calculated as follows:
Present value of principal payable at the end of 3 years (` 10 lakhs discounted at 13% for 3 years) = ` 6,93,050
Present value of interest payable in arrears for 3 years (` 100,000 discounted at 13% for each of 3 years) = ` 2,36,115
Paragraph AG 31 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 shares of the issuer, and without any other embedded derivatives features.
The liability component = Present value of principal + Present value of Interest
= ` 6,93,050 + ` 2,36,115 = ` 9,29,165
Equity Component = ` 10,00,000 – ` 9,29,165 = ` 70,835

33: Optionally convertible redeemable preference shares (continued from Illustration 31)
The amortisation schedule of the instrument is set out below:

Dates	Cash flows	Finance cost at effective interest rate	Liability	Equity
1July 20X1	1,000,000	-	9,24,061	75,939
30 June 20X2	(60,000)	83,165	9,47,226	75,939
30 June 20X3	(60,000)	85,250	9,72,476	75,939
30 June 20X4	(10,60,000)	87,524	-	75,939

Assume that D Ltd. has an early redemption option to prepay the instrument at ` 11 lakhs and on 30 June 20X3, it exercises that option. At 30 June 20X3, the interest rate has changed. At that time, D Ltd. could have issued a one-year (i.e. maturity 30 June 20X4) non-convertible instrument at 5%. Calculate the value of the liability and equity components.
Solution

Ind AS 32 requires that the amount paid (of ` 11 lakhs) is split by the same method as is used in the initial recording. However, at 30 June 20X3, the interest rate has changed. At that time, D Ltd. could have issued a one-year (i.e. maturity 30 June 20X4) non-convertible instrument at 5%.
The split will be made as below:

Particulars	Amount (`)
Present value of principal payable at 30 June 20X4 in one year's time (` 10 lakhs discounted at 5% for one year)	9,52,381
Present value of interest payable (` 60,000 discounted at 5% for one year)	57,142
Total liability component	10,09,523
Consideration paid	11,00,000
Residual – equity component	90,477

Accordingly, the difference between consideration allocated to liability component (` 10,09,523) less carrying amount of financial liability on date of redemption i.e. 30 June 20X3 (` 9,72,476), amounting to ` 37,047 is recognised in profit or loss.
The residual i.e. consideration allocated to equity component is debited to equity.

UNIT 4: DERIVATIVES AND EMBEDDED DERIVATIVES

Illustrations

1: Prepaid interest rate swap (fixed rate payment obligation prepaid at inception)

Entity S enters into a ` 100 crores notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C.

♦ **The interest rate of the variable part of the swap is reset on a quarterly basis to three-month Mumbai Interbank Offer Rate (MIBOR).**

♦ **The interest rate of the fixed part of the swap is 10% p.a.**

♦ **Entity S prepays its fixed obligation under the swap of ` 50 crores (` 100 crores × 10% × 5 years) at inception, discounted using market interest rates**

♦ **Entity S retains the right to receive interest payments on the ` 100 crores reset quarterly based on three-month MIBOR over the life of the swap.**

Analyse.

Solution

The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond.

Therefore, the contract fulfils the condition 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors'.

Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the LIBOR index. Accordingly, the contract is regarded as a derivative contract.

2: Prepaid pay-variable, receive-fixed interest rate swap

♦ **Entity S enters into a ` 100 crores notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C.**

♦ **The variable leg of the swap is reset on a quarterly basis to three-month MIBOR.**

♦ **The fixed interest payments under the swap are calculated as 10% of the swap's notional amount, i.e. ` 10 crores p.a.**

♦ **Entity S prepays its obligation under the variable leg of the swap at inception at current market rates. Say, that amount is ` 36 crores.**

♦ **It retains the right to receive fixed interest payments of 10% on ` 100 crores every year.**

Analyse.

Solution

In effect, this contract results in an initial net investment of ` 36 crores which yields a cash inflow of ` 10 crores every year, for five years. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C. Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions.

For this reason, the instrument fails the condition 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors'. Therefore, the contract is not accounted for as a derivative contract.

3: Prepaid forward

Entity XYZ enters into a forward contract to purchase 1 million ordinary shares of Entity T in one year

- **The current market price of T is ` 50 per share**
- **The one-year forward price of T is ` 55 per share**
- **XYZ is required to prepay the forward contract at inception with a ` 50 million payment.**

Analyse.

Solution

Purchase of 1 million shares for current market price is likely to have the same response to changes in market factors as the contract mentioned above. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

4:

Entity ABC Ltd., whose functional currency is Indian Rupees, sells products in France denominated in Euro. ABC enters into a contract with an investment bank to convert Euro to Indian Rupees at a fixed exchange rate. The contract requires ABC to remit Euro based on its sales volume in France in exchange for Indian Rupees at a fixed exchange rate of 80.00. Is that contract a derivative?

Solution

Yes. The contract has two underlying variables (the foreign exchange rate and the volume of sales); no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and a payment provision.

5:

The definition of a derivative requires that the instrument "is settled at a future date". Is this criterion met even if an option is expected not to be exercised, for example, because it is out of the money?

Solution

Yes. An option is settled upon exercise or at its maturity. Expiry at maturity is a form of settlement even though there is no additional exchange of consideration

6

Silver Ltd. has purchased 100 ounces of gold on 10 March 20X1. The transaction provides for a price payable which is equal to market value of 100 ounces of gold on 10 April 20X1 and shall be settled by issue of such number of equity shares as is required to settle the aforementioned transaction price at ` 10 per share on 10 April 20X1. Whether this is classified as liability or equity? Own use exemption does not apply.

Solution

In the above scenario, there is a contract for purchase of 100 ounces of gold whose consideration varies in response to changing value of gold. Analysing this contract as a derivative –

(a) Value of contract changes in response to change in market value of gold;

(b) There is no initial net investment

(c) It will be settled at a future date, i.e. 10 April 20X1.

Since the above criteria are met, this is a derivative contract.
Now, a derivative contract that is settled in own equity other than exchange of fixed amount of cash for fixed number of shares is classified as 'liability'. In this case, since the contract results in issue of variable number of shares based on transaction price to be determined in future, hence, this shall be classified as 'derivative financial liability'.
Per Ind AS 109.4.2.1 – A derivative financial liability shall be carried at fair value through profit or loss.

7 : Derivative contract:
Entity – B Ltd writes an option contract for sale of shares of Target Ltd. at a fixed price of ` 100 per share to C Ltd. This option is exercisable anytime for a period of 90 days ('American option'). Evaluate this under the definition of financial instrument.
Solution
In the above case – B Ltd has written an option, which if exercised by C Ltd. will result in B Ltd. selling equity shares of Target Ltd. for fixed cash of ` 100 per share. Such option will be exercised by C Ltd. only if the market price of shares of Target Ltd. increases beyond ` 100, thereby resulting in contractual obligation over B Ltd. to settle the contract under potential unfavorable terms.
In the above case, if the market price is already ` 120 which means that if option is exercised by C Ltd, then B Ltd shall buy shares from the market at ` 120 per share and sell at ` 100, thereby resulting in a loss or exchange at unfavorable terms to B Ltd. Hence, it meets the definition of financial liability in books of B Ltd.
The additional question that arises here is the nature of this financial liability and if it meets the definition of derivative. A derivative is a financial instrument that meets following conditions –
(a) Its value changes in response to change in specified variable like interest rate, equity index, commodity price, etc. If the variable is non-financial, it is not specific to party to the contract
(b) It requires no or little initial net investment
(c) It is settled at a future date.
Evaluating the above instrument, B Ltd. has written an option whose value changes based on change in market price of equity share, it requires no initial net investment and is settled at a future date (anytime in 90 days). Hence, it meets definition of derivative financial liability in books of B Ltd.

8: Derivative contract to be settled in own equity instruments
A Ltd. issues warrants to all existing shareholders entitling them to purchase additional equity shares of A Ltd. (with face value of ` 100 per share) at an issue price of ` 150 per share. Evaluate whether this constitutes an equity instrument or a financial liability?
Solution
In this case, Company A Ltd. has issued warrants entitling the shareholders to purchase equity shares of the Company at a fixed price. Hence, it constitutes a contractual arrangement for issuance of fixed number of shares against fixed amount of cash.
Now, evaluating this contract under definition of derivative –
(i) The value of warrant changes in response to change in value of underlying equity shares;
(ii) This involves no initial net investment
(iii) It shall be settled at a future date.

Hence, this warrant meets the definition of derivative.
Applying definition of equity under Ind AS 32, a derivative contract that will be settled by exchange of fixed number of equity shares for fixed amount of cash meets definition of equity instrument. The above contract is

derivative contract that will be settled by issue of fixed number of own equity instruments by A Ltd. for fixed amount of cash and hence meets definition of equity instrument.

9

A lease contract contains a provision that rentals increase each year by ` 3 million. Is there an embedded derivative in this contract?

Solution

The price adjustment feature does not meet the definition of a derivative on a stand-alone basis since its value does not change in response to changes of some underlying. There is no underlying in this case; hence there is no embedded derivative in the lease contract

10: Debt instrument with indexed repayments

Entity X issues a redeemable fixed interest rate debenture to Entity Y. Amount of interest and principal is indexed to the value of equity instruments of Entity X.

Analyse

Solution

In the given case, the host is a fixed interest rate debt instrument. The economic characteristics and risks of a debt instrument are not closely related to those of an equity instrument.

Hence, the exposure of this hybrid instrument to changes in value of equity instruments is an embedded derivative which is required to be separated.

The response above will not change even if the interest payment and principal repayments are indexed to a commodity index or similar underlying.

11: Lease contracts dependent on inflation index

A lease contract, between two Indian companies of an asset in India, includes contingent lease rentals that are dependent upon an US inflation index. Can the entity treat inflation linked features as closely related?

Solution

For inflation linked features, an embedded derivative in a lease contract is considered as closely related to the host if it is an inflation—related index related to inflation in the entity's own economic environment.

In this case, whilst the asset and the lessor and lessee are located in India, lease payment are linked to US index. Hence, embedded derivative is not closely related and needs to be separated.

12: Lease contracts dependent on inflation index

As per the contract entered between lease and lessor, lease rentals will increase by ` 3 million, if profit after tax is over ` 200 million. Can the entity treat inflation linked features as closely related?

Solution

No. Whilst contingent rentals based on sales are closely related to a host lease contract, the same is not true of contingent rentals based on profit after tax.

13: Debt instrument with prepayment option

Entity PQR borrows ` 100 crores from CFDH Bank on 1 April 20X1.

Interest is payable at 12% p.a. and there is a bullet repayment of principal at the end of the term.

Term of the loan is 6 years.

The loan includes an option to prepay the loan at 1st April each year with a prepayment penalty of 3%.

There are no transaction costs.
Without the prepayment option, the interest rate quoted by bank is 11% p.a.
Analyse
Solution
Step 1: Identify the host contract and embedded derivative, if any
In the given case,
• Host is a debt instrument comprising annual interest payment at 12% p.a. and bullet principal repayment at the end of 6 years.
• Option to prepay the debt at ` 103 crores is an embedded derivative

Step 2: Determine the amortised cost of the host debt instrument
Whether the prepayment option is likely to be exercised or not, the amortised cost of the host debt instrument should be calculated as present value (PV) of expected cash flows using a fair market interest rate for a debt without the prepayment option (11% p.a. in this case). This is calculated below as ` 104.23 crores:

Year	Cash outflow	PV @ 11% p.a.	Finance cost	Amortised cost
	₹ crores			
1	12.00	10.81	11.46	103.68
2	12.00	9.74	11.41	103.09
3	12.00	8.77	11.34	102.43
4	12.00	7.90	11.27	101.70
5	12.00	7.12	11.20	100.90
6	112.00	59.88	11.10	-
		104.22	**67.78**	

Step 3: Compare the exercise price of the prepayment option with the amortised cost of the host debt instrument

Year	Amortised cost	Exercise price of prepayment option	Difference
	₹ Crores		
1	103.68	103.00	0.7%
2	103.09	103.00	0.1%
3	102.43	103.00	-0.6%
4	101.70	103.00	-1.3%
5	100.90	103.00	-2.1%
6	-	N/A	

The management of Entity PQR may formulate an appropriate accounting policy to determine what constitutes “approximately equal”. In this case, if the management determines that a difference of more than 2% will indicate that the option's exercise price is not approximately equal to the amortised cost of the host debt instrument, it will need to separate the embedded derivative and account for it as per principles given in the subsequent sub-section.

It may be questioned as to why an option to repay a fixed rate loan early meets the definition of embedded derivative. Let us revisit an important phrase from the definition of embedded derivative:
"…some or all of the cash flows that otherwise would be required by the contract to be modified…"
In the context of a fixed rate debt, it may be interpreted that:
• the option affects cash flows only if exercised; and
• the cash flows of a fixed rate debt do not vary with interest rates.

However, in this context, a variation in cash flows should be interpreted as a possible change in the fair value of expected cash flows. Accordingly, the option's expected cash flows vary according to interest rates in a similar way as a separate option to purchase a fixed rate debt asset at a fixed price. A fixed price option to prepay a fixed rate loan will increase in value as interest rates decline (and vice versa).

14: Purchase contract settled in a foreign currency
On 1 January 20X1, ABG Pvt. Ltd., a company incorporated in India enters into a contract to buy solar panels from A&A Associates, a firm domiciled in UAE, for which delivery is due after 6 months i.e. on 30 June 20X1 The purchase price for solar panels is US$ 50 million.
The functional currency of ABG is Indian Rupees (`) and of A&A is Dirhams.
The obligation to settle the contract in US Dollars has been evaluated to be an embedded derivative which is not closely related to the host purchase contract.
Exchange rates:
1. Spot rate on 1 January 20X1: USD 1 = ` 60
2. Six-month forward rate on 1 January 20X1: USD 1 = ` 65
3. Spot rate on 30 June 20X1: USD 1 = ` 66
Analyse
Solution
This contract comprises of two components:
• Host contract to purchase solar panels denominated in ` i.e. a notional payment in ` at 6-month forward rate (` 3,250 million or ` 325 crores)
• Forward contract to pay US Dollars and receive ` i.e. a notional receipt in `. In other words, a forward contract to sell US Dollars at ` 65 per US Dollar

It may be noted that the notional ` payment in respect of host contract and the notional ` receipt in respect of embedded derivative create an offsetting position.
Subsequently, the host contract is not accounted for until delivery. The embedded derivative is recorded at fair value through profit or loss. This gives rise to a gain or loss on the derivative, and a corresponding derivative asset or liability.
On delivery ABG records the inventory at the amount of the host contract (` 325 crores). The embedded derivative is considered to expire. The derivative asset or liability (i.e. the cumulative gain or loss) is settled by becoming part of the financial liability that arises on delivery.
In this case the carrying value of the currency forward at 30 June 20X1 on maturity is ` 50 million X (66 minus 65) = ` 5 crores (liability/loss). The loss arises because ABG has agreed to sell US Dollars at ` 65 per US Dollar whereas in the open market, US Dollar can be sold at ` 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 30 June 20X1, the accounting entries are as follows (all in ` crores):

1.	Loss on derivative contract	5	
	To Derivative liability		5
	(Being loss on currency forward)		
2.	Inventory	325	
	To Trade payables (financial liability)		325
	(Being inventory recorded at forward exchange rate determined on date of contract)		
3.	Derivative liability	5	
	To Trade payables (financial liability)		5
	(Being reclassification of derivative liability to trade payables upon settlement)		

The effect is that the financial liability at the date of delivery is ` 330 crores (= ` 325 crores + ` 5 crores), equivalent to US$ 50 million at the spot rate on 30 June 20X1.
Going forward, the financial liability is a US$ denominated financial instrument. It is retranslated at the dollar spot rate in the normal way, until it is settled.

15: Contracts for purchase or sale of non-financial item
Key terms of contracts to buy/sell non-financial items
Company Z is engaged in the business of importing oil seeds for further processing as well as trading purposes. It enters into the following types of contracts as on 1 October 20X1:

Particulars	Contract 1	Contract 2	Contract 3
Nature of Contract	**Import of oil seeds from a foreign supplier**	**Purchase of oil seeds from a domestic producer / supplier**	**Contract to sell oil seeds on the commodity exchange**
Quantity and rate	**100 MT at USD 400 per MT to be delivered as on 31 March 20X2**	**50 MT at ` 30,000 per MT to be delivered as on 31 January 20X2**	**50 MT at USD 450 per MT, maturing as on 15 January 20X2**
Net settlement clause included in the contract	**Yes**	**Yes**	**Yes**

Net settlement in practice for similar contracts	**There have also been several instances of the oil seeds being sold prior to or shortly after taking delivery.** **These instances of net settlement constitute approximately 30 per cent of the value of total import contracts.**	**Yes – company Z has net settled some of the domestic purchase contracts.** **However, these instances constitute only 1 per cent of the total domestic purchase contracts in value.** **The remaining contracts are settled by taking delivery of oil seeds which are used for further processing.**	**Yes – these contracts are required to be net settled with the exchange on the maturity date.** **Company Z enters into these types of derivative contracts to hedge the risks on its domestic oil seeds purchase contracts**

Company Z is required to determine if the contracts entered into for purchase and sale of oil seeds are derivatives within the scope of lnd AS 109 or are executory contracts outside the scope of lnd AS 109.

Solution

Contract 1:

The following factors indicate that this contract does not meet the 'own use' exemption:

• The contract permits net settlement, and

• There is a past practice of a significant proportion (30 per cent in this illustration) of similar contracts being settled on a net basis either in cash or by sale of the oil seeds prior to delivery/shortly after taking delivery.

Therefore, this contract would fall within the scope of lnd AS 109 and should be recognised as a derivative instrument as on 1 October 20X1. The contract would be in the nature of a forward contract to buy 100 MT of oil seeds as on 31 March 20X2 at USD 400 per MT. Company Z would have to recognise the fair value changes (based on change in forward purchase rate) on this contract in the statement of profit and loss at each reporting date.

Contract 2

Contract 2 also permits net settlement in cash. Further, there have been some instances of similar domestic purchase contracts being settled net in cash in the past. However, these have been infrequent in nature and insignificant in proportion to the total value of similar contracts (i.e.1 percent in this illustration).
Company Z is in the practice of taking delivery of the oil seeds purchased under similar contracts and using them for further processing in its plants.
This indicates that the domestic purchase contract meets the criteria for the 'own-use' exemption and should be considered as an executory contract.

Therefore, this contract would not fall within the scope of Ind AS 109.

Contract 3

This contract is in the nature of a derivative contract transacted on a commodity exchange and is required to be net settled in cash on maturity. Therefore, this derivative contract would be covered by lnd AS 109 and required to be classified and measured at FVTPL.

16: Foreign currency embedded derivatives

Company A, an Indian company whose functional currency is `, enters into a contract to purchase machinery from an unrelated local supplier, company B. The functional currency of company B is also `. However, the contract is denominated in USD, since the machinery is sourced by company B from a US based supplier. Payment is due to company B on delivery of the machinery.

Key terms of the contract:

Contractual features	Details
Contract/order date	9 September 20X1
Delivery/payment date	31 December 20X1
Purchase price	USD 1,000,000
USD/₹ Forward rate on 9 September 20X1 for 31 December 20X1 maturity	67.8
USD/₹ Spot rate on 9 September 20X1	66.4
USD/₹ Forward rates for 31 December, on:	
30 September	67.5
31 December (spot rate)	67.0

Company A is required to analyse if the contract for purchase of machinery (a capital asset) from company B contains an embedded derivative and whether this should be separately accounted for on the basis of the guidance in Ind AS 109. Also give necessary journal entries for accounting the same.

Solution

Based on the guidance above, the USD contract for purchase of machinery entered into by company A includes an embedded foreign currency derivative due to the following reasons:

The host contract is a purchase contract (non-financial in nature) that is not classified as, or measured at FVTPL.

The embedded foreign currency feature (requirement to settle the contract by payment of USD at a future date) meets the definition of a stand-alone derivative – it is akin to a USD-` forward contract maturing on 31 December 20X1.

USD is not the functional currency of either of the substantial parties to the contract (i.e., neither company A nor company B).

Machinery is not routinely denominated in USD in commercial transactions around the world. In this context, an item or a commodity may be considered 'routinely denominated' in a particular currency only if such currency was used in a large majority of similar commercial transactions around the world. For example, transactions in crude oil are generally considered routinely denominated in USD. A transaction for acquiring machinery in this illustration would generally not qualify for this exemption.

USD is not a commonly used currency for domestic commercial transactions in the economic environment in which either company A or B operate. This exemption generally applies when the business practice in a particular economic environment is to use a more stable or liquid foreign currency (such as the USD), rather than the local currency, for a majority of internal
or cross-border transactions, or both. In the illustration above, companies A and B are companies operating in India and the purchase contract is an internal/domestic transaction. USD is not a commonly used currency for internal trade within this economic environment and therefore the contract would not qualify for this exemption.
Accordingly, company A is required to separate the embedded foreign currency derivative from the host purchase contract and recognise it separately as a derivative.
The separated embedded derivative is a forward contract entered into on 9 September 20X1, to exchange USD 10,00,000 for ` at the USD/` forward rate of 67.8 on 31 December 20X1. Since the forward exchange rate has been deemed to be the market rate on the date of the contract, the embedded forward contract has a fair value of zero on initial recognition.
Subsequently, company A is required to measure this forward contract at its fair value, with changes in fair value recognised in the statement of profit and loss. The following is the accounting treatment at quarter-end and on settlement:

Accounting treatment:

Date	Particulars	Amount (₹)	Amount (₹)
09-Sep-X1	***On initial recognition of the forward contract***		
	(No accounting entry recognised since initial fair value of the forward contract is considered to be nil)	Nil	Nil
30-Sep-X1	***Fair value change in forward contract***		
	Derivative asset (company B) Dr. [(67.8-67.5) x10,00,000]	3,00,000	
	To Profit or loss		3,00,000
31-Dec-X1	***Fair value change in forward contract***		
	Forward contract asset (company B) Dr. [{(67.8-67) x 10,00,000} - 3,00,000]	5,00,000	
	To Profit or loss		5,00,000
31-Dec-X1	***Recognition of machinery acquired and on settlement***		
	Property, plant and equipment Dr. (at forward rate)	6,78,00,000	
	To Forward contract asset (company B)		8,00,000
	To Creditor (company B) / Bank		6,70,00,000

UNIT 5: RECOGNITION AND DERECOGNITION OF FINANCIAL INSTRUMENTS

Illustrations

1: Regular way contracts: forward contracts

ST Ltd. enters into a forward contract to purchase 10 lakh shares of ABC Ltd. in a month's time for ` 50 per share. This contract is entered into with a broker, Mr. AG and not through regular trading mode in a stock exchange. The contract requires Mr. AG to deliver the shares to ST Ltd. upon payment of agreed consideration. Shares of ABC Ltd. are traded on a stock exchange. Regular way delivery is two days. Assess the forward contract.

Solution

In this case, the forward contract is not a regular way transaction and hence must be accounted for as a derivative i.e. between the date of entering into the contract to the date of delivery, all fair value changes are recognised in profit or loss.

On the other hand, if the forward contract is a regular way transaction, such fair value changes are recognised in other comprehensive income if share of ABC Ltd. are equity instruments and not held for trading.

2: Regular way contracts: option contracts

NKT Ltd. purchases a call option in a public market permitting it to purchase 100 shares of VT Ltd. at any time over the next one month at a price of ` 1,000 per share. If NKT Ltd. exercises its option, it has 7 days to settle the transaction according to regulation or convention in the options market. VT Ltd.'s shares are traded in an active public market that requires two-day settlement.

Solution

In this case, the options contract is a regular way transaction as the settlement of the option is governed by regulation or convention in the marketplace for options. Fair value changes between the trade date and settlement date are recognised in other comprehensive income if share of VT Ltd. are equity instruments and not held for trading by NKT Ltd.

The illustrations below explain the flow of journal entries in case of trade date accounting and settlement date accounting for regular way purchase and sale of financial assets.

3: Regular way purchase of financial asset

On 1 January 20X1, X Ltd. enters into a contract to purchase a financial asset for ` 10 lakhs, which is its fair value on trade date. On 4 January 20X1 (settlement date), the fair value of the asset is ` 10.5 lakhs. The amounts to be recorded for the financial asset will depend on how it is classified and whether trade date or settlement date accounting is used. Pass necessary journal entries.

Solution

Journal Entries in the Buyer's Books

Trade date accounting

Dr. / Cr.	Particulars	Amortised cost	Fair value through P&L	Fair value through OCI
1 January 20X1				
Dr.	Financial asset	10,00,000	10,00,000	10,00,000
Cr.	Financial liability (to pay)	(10,00,000)	(10,00,000)	(10,00,000)
4 January 20X1				
Dr.	Financial asset	-	50,000	50,000
Dr.	Financial liability (to pay)	10,00,000	10,00,000	10,00,000
Cr.	Profit or loss	-	(50,000)	-
Cr.	Other comprehensive income	-	-	(50,000)
Cr.	Cash	(10,00,000)	(10,00,000)	(10,00,000)

Settlement date accounting

Dr. / Cr.	Particulars	Amortised cost	Fair value through P&L	Fair value through OCI
4 January 20X1				
Dr.	Financial asset	10,00,000	10,50,000	10,50,000
Cr.	Profit or loss	-	(50,000)	-
Cr.	Other comprehensive income	-	-	(50,000)
Cr.	Cash	(10,00,000)	(10,00,000)	(10,00,000)

The above mentioned accounting principles apply only to financial assets and Ind AS 109 does not contain any such principles for financial liabilities.

4: Part of a financial asset

State whether the derecognition principles will be applied or not.

i. Interest strip of an interest-bearing financial asset i.e. the part entitles its holder to interest cash flows of a financial asset

ii. Dividend strip of an equity share i.e. the part entitles its holder to only dividends arising from an equity share

iii. Cash flows (principal and asset) upto a certain tenure or first right on a proportion of cash flows of an amortising financial asset. Say, the part entitles its holder to first 80% of the cash flows or cash flows for first 4 of the 6 years' tenure.

Solution

Derecognition requirements are applied to a part of a financial asset if that part meets **any of the following three** conditions:
a) The part comprises only **specifically identified cash flows** from a financial asset (or a group of similar financial assets).
For example, when an entity enters into an interest rate strip whereby the counterparty obtains the right to the interest cash flows, but not the principal cash flows from a debt instrument, derecognition principles are applied to the interest cash flows
b) The part comprises only a **fully proportionate (pro rata) share of the cash flows** from a financial asset (or a group of similar financial assets).

For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 per cent share of all cash flows of a debt instrument, derecognition principles are applied to 90 per cent of those cash flows.
c) The part comprises only a **fully proportionate (pro rata) share of specifically identified cash flows** from a financial asset (or a group of similar financial assets).
For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 per cent share of interest cash flows from a financial asset, derecognition principles are applied to 90 per cent of those interest cash flows.
The example of a part of a financial asset at (iii) in Illustration 4 above will not qualify conditions at (b) and (c) above since it does not represent pro rata share of all or specifically identified cash flows.
In (b) and (c) above, if there is more than one counterparty, each counterparty is not required to have a proportionate share of the cash flows provided that the transferring entity has a fully proportionate share.
In all other cases, derecognition principles are applied to the financial asset in its entirety (or to the group of similar financial assets in their entirety).

5: Part of a financial asset
State whether the derecognition principles will be applied or not.
i. Entity Y transfers the rights to the first or the last 90 per cent of cash collections from a financial asset (or a group of financial assets)
ii. Entity Z transfers the rights to 90 per cent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 per cent of the principal amount of the receivables.

Solution
In the above circumstances, Entity Y and Entity Z need to apply the derecognition requirements to the financial asset (or a group of similar financial assets) in its entirety.

6: Proportionate "pass through" arrangement
Entity A makes a five-year interest-bearing loan (the 'original asset') of ` 100 crores to Entity B. Entity A settles a Trust and transfers the loan to that Trust. The Trust issues participatory notes to an investor, Entity C, that entitle the investor to the cash flows from the asset.
As per Trust's agreement with Entity C, in exchange for a cash payment of ` 90 crores, Trust will pass to Entity C 90% of all principal and interest payments collected from Entity B (as, when and if collected). Trust accepts no obligation to make any payments to Entity C other than 90% of exactly what has been received

from Entity B. Trust provides no guarantee to Entity C about the performance of the loan and has no rights to retain 90% of the cash collected from Entity B nor any obligation to pay cash to Entity C if cash has not been received from Entity B.
Compute the amount to be dercognised.
Solution
If the three conditions are met, the proportion sold is derecognised, provided the entity has transferred substantially all the risks and rewards of ownership. Thus, Entity A would report a loan asset of ` 10 crores and derecognise ` 90 crores.

7: Repurchase agreements
A financial asset is sold under repurchase agreement. The repurchase price as per that agreement is (a) fixed price or (b) sale price plus a lender's return. Let's look at three alternate scenarios:
i. Repurchase agreement is for the same financial asset.
ii. Repurchase agreement is for substantially the same asset
iii. Repurchase agreement provides the transferee a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date.
State whether the derecognition principles will be applied or not.
Solution
In each of these scenarios, the transferred financial asset is not derecognised because the transferor retains substantially all the risks and rewards of ownership.
Let's look at another scenario:
Repurchase agreement provides the transferor only a right of first refusal to repurchase the transferred asset at fair value if the transferee subsequently sells it
In this scenario, the transferred financial asset is derecognised because the transferor has transferred substantially all the risks and rewards of ownership.

8: Put options on transferred financial assets
A financial asset is sold and the transferee has a put option. Let's look at some alternate scenarios:
i. Put option is deeply in the money
ii. Put option is deeply out of the money.
State whether the derecognition principles will be applied or not.
Solution
In the first scenario, the transferred asset does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. However, in the second scenario, the transferor has transferred substantially all the risks and rewards of ownership.

9: Call options on transferred financial assets
A financial asset is sold and the transferor has a call option. Let's look at some alternate scenarios:
i. Call option is deeply in the money
ii Call option is deeply out of the money.
What it the transferor holds a call option on an asset that is readily obtainable in the market? iii Call option is neither deeply in the money nor deeply out of the money
State whether the derecognition principles will be applied or not.
Solution

In the first scenario, the transferred asset does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. However, in the second scenario, the transferor has transferred substantially all the risks and rewards of ownership.
In the third scenario, the asset is derecognised. This is because the entity (i) has neither retained nor transferred substantially all the risks and rewards of ownership, and (ii) has not retained control.

10: Amortising interest rate swaps
An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortising interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount.
Scenarios:
i. Notional amount of the swap amortises so that it equals the principal amount of the transferred financial asset outstanding at any point in time.
ii. Amortisation of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset.
State whether the derecognition principles will be applied or not.

Solution
In the first scenario, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to recognise all of the transferred asset or continues to recognise the transferred asset to the extent of its continuing involvement.
Such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset.

11: Assignment of receivables
ST Ltd. assigns its trade receivables to AT Ltd. The carrying amount of the receivables is ` 10,00,000. The consideration received in exchange of this assignment is ` 9,00,000. Customers have been instructed to deposit the amounts directly in a bank account for the benefit of AT Ltd. AT Ltd. has no recourse to ST Ltd. in case of any shortfalls in collections.
State whether the derecognition principles will be applied or not.
Solution
In this situation, ST Ltd. has transferred the rights to contractual cash flows and has also transferred substantially all the risks and rewards of ownership (credit risk being the most significant risk in this situation).
Accordingly, ST Ltd. derecognises the financial asset and recognises ` 1,00,000, the difference between consideration received and carrying amount, as an expense in the statement of profit or loss.
12A: Debt factoring with recourse – continuing involvement asset
Entity C agrees with factoring company D to enter into a debt factoring arrangement. Under the terms of the arrangement, the factoring company D agrees to pay ` 91.5 crores, less a servicing charge of ` 1.5 crores (net proceeds of ` 90 crores), in exchange for 100% of the cash flows from short-term receivables.
The receivables have a face value of ` 100 crores and carrying amount of ` 95 crores.
The customers will be instructed to pay the amounts owed into a bank account of the factoring company.
Entity C also writes a guarantee to the factoring company under which it will reimburse any credit losses upto ` 5 crores, over and above the expected credit losses of ` 5 crores. The guarantee is estimated to have a fair value of ` 0.5 crores. Calculate the amount of continuing involvement asset.

Solution

In this situation, the "continuing involvement asset" will be recognised at ` 5 crores i.e. lower of:

i. the amount of the asset – ` 95 crores

ii. the guarantee amount – ` 5 crores

12B: Debt factoring with recourse – associated liability

Continuing illustration 12A, calculate the amount of associated liability.

Solution

The amount of associated liability is recognised at ` 5.5 crores, as below:

i. the guarantee amount (i.e. ` 5 crores) plus

ii. the fair value of the guarantee (i.e. ` 0.5 crores).

12C: Debt factoring with recourse – gain or loss on derecognition

Continuing illustration 12A and 12B, pass the necessary Journal Entry.

Solution

The journal entries passed by Entity C on the date of derecognition is as below:

Cash	Dr.	` 90 crores	
Loss on derecognition	Dr.	` 5.5 crores	
Continuing involvement asset	Dr.	` 5 crores	
To Receivables			` 95 crores
To Associated liability			` 5.5 crores

The guarantee liability of ` 0.5 crores shall be amortised in profit or loss over the underlying period.

13: Renegotiation of terms of (defaulted) borrowings subsequent to the year-end

Ind AS 109, Financial Instruments requires recognition of renegotiation gain/loss subject to fulfillment of certain conditions as mentioned in the standard. If there has been a renegotiation of terms of (defaulted) borrowings subsequent to the year end, but before the date of approval of financial statements, then should such modification gain/loss be recognised in the current year financial statements itself or in the next year when the terms of (defaulted) borrowings have been renegotiated in accordance with Ind AS 109?

Solution

As per paragraph 5.4.3 of Ind AS 109, Financial Instruments, whenever contractual cash flows of a financial instrument are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss.

In accordance with the above, modification gain or loss should be recognised in profit or loss in the period in which the renegotiation has contractually taken place. Accordingly, in the given case, if the terms of the (defaulted) borrowings have been renegotiated in the next year, then the related gain/loss should also be recognised in the next year.

COMPREHENSIVE ILLUSTRATIONS

1

A Ltd. issued redeemable preference shares to a Holding Company – Z Ltd. The terms of the instrument have been summarized below. Account for this in the books of Z Ltd.

Nature	**Non-cumulative redeemable preference shares**
Repayment:	**Redeemable after 5 years**
Date of Allotment:	**1-Apr-20X1**
Date of repayment:	**31-Mar-20X6**
Total period:	**5.00 years**
Value of preference shares issued:	**100,000,000**
Dividend rate	**0.0001%**
Market rate of interest	**12% per annum**
Present value factor	**0.56743**

Solution

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

For example, a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument.

In the above case, since A Ltd has issued preference shares to its Holding Company – Z Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by Z Ltd. in its subsidiary.

Following is the table summarising the computations on initial recognition:

Market rate of interest	12%
Present value factor	0.56743
Present value	56,742,686
Loan component	56,742,686
Investment in subsidiary	43,257,314

Subsequently, such preference shares shall be carried at amortised cost at each reporting date. The computation of amortised cost at each reporting date has been done as follows:

Year	Date	Opening Asset	Days	Interest @ 12%	Closing balance
	1-Apr-20X1				56,742,686
1	31-Mar-20X2	56,742,686	365	6,809,122	63,551,808
2	31-Mar-20X3	63,551,808	365	76,26,217	71,178,025
3	31-Mar-20X4	71,178,025	365	85,41,363	79,719,388
4	31-Mar-20X5	79,719,388	365	95,66,327	89,285,715
5	31-Mar-20X6	89,285,715	365	10,714,285	100,000,000

Journal Entries to be done at every reporting date

Particulars		Amount	Amount
Date of transaction			
Investment - Equity portion	Dr.	43,257,314	
Loan receivable	Dr.	56,742,686	
To Bank			100,000,000
Interest income - March 31, 20X2			
Loan receivable	Dr.	6,809,122	
To Interest income			6,809,122
Interest income - March 31, 20X3			

Loan receivable	Dr.	76,26,217	
To Interest income			76,26,217
Interest income - March 31, 20X4			
Loan receivable	Dr.	85,41,363	
To Interest income			85,41,363
Interest income - March 31, 20X5			
Loan receivable	Dr.	95,66,327	
To Interest income			95,66,327
Interest income - March 31, 20X6			
Loan receivable	Dr.	10,714,285	
To Interest income			10,714,285
Settlement of transaction			
Bank	Dr.	100,000,000	
To Loan receivable			100,000,000

Solution

(a) Applying the guidance for compound instruments, the present value of the bond is computed to identify the liability component and then difference between the present value of these bonds & the issue price of ` 1 crore shall be allocated to the equity component. In determining the present value, the rate of 8 per cent will be used, which is the interest rate paid on debt of a similar nature and risk that does not provide an option to convert the liability to ordinary shares.

Present value of bonds at the market rate of debt

Present value of principal to be received in eight years discounted at 8%

(10,000,000 X 0.5403)	=	5,403,000
Present value of interest stream discounted at 8% for 8 years		
(6,00,000 X 5.7466)	=	3,447,960
Total present value	=	8,850,960
Equity component	=	1,149,040
Total face value of convertible bonds	=	10,000,000

The accounting entries will be as follows:

	Dr. Amount (`)	Cr. Amount (`)
1 July 20X1		
Bank Dr.	10,000,000	
To Convertible bonds (liability)		8,850,960
To Convertible bonds (equity component)		1,149,040
(Being entry to record the convertible bonds and the recognition of the liability and equity components)		
30 June 20X2		
Interest expense Dr.	708,077	
To Bank		600,000
To Convertible bonds (liability)		108,077
(Being entry to record the interest expense, where the expense equals the present value of the opening liability multiplied by the market rate of interest).		

(b) The stream of interest expense is summarised below, where interest for a given year is calculated by multiplying the present value of the liability at the beginning of the period by the market rate of interest, this is being 8 per cent.

Date	Payment	Interest expense at 8%	Increase in bond liability	Total bond liability
01 July 20X1				8,850,960
30 June 20X2	600,000	708,077	108,077	8,959,037
30 June 20X3	600,000	716,723	116,723	9,075,760
30 June 20X4	600,000	726,061	126,061	9,201,821
30 June 20X5	600,000	736,146	136,146	9,337,967
30 June 20X6	600,000	747,037	147,037	9,485,004
30 June 20X7	600,000	758,800	158,800	9,643,804
30 June 20X8	600,000	771,504	171,504	9,815,308
30 June 20X9	600,000	784,692*	184,692	10,000,000

*difference is due to rounding off

(c) If the holders of the bonds elect to convert the bonds to ordinary shares at the end of the third year (after receiving their interest payments), the entries in the third year would be:

		Dr. Amount (`)	Cr. Amount (`)
30 June 20X4			
Interest expense	Dr.	726,061	
To Bank			600,000
To Convertible bonds (liability)			126,061
(Being entry to record interest expense for the period)			
30 June 20X4			
Convertible bonds (liability)	Dr.	9,201,821	
Convertible bonds (equity component)	Dr.	1,149,040	
To Ordinary share capital A/c			10,350,861
(Being entry to record the conversion of bonds into shares of A Limited)			

4

Entity A (an ` functional currency entity) enters into a USD 1,000,000 sale contract on 1 January 20X1 with Entity B (an ` functional currency entity) to sell equipment on 30 June 20X1.

Spot rate on 1 January 20X1: `/USD	**45**
Spot rate on 31 March 20X1: `/USD	**57**
Three-month forward rate on 31 March 20X1: `/USD	**45**
Six-month forward rate on 1 January 20X1: `/USD	**55**
Spot rate on 30 June 20X1: `/USD	**60**

Assume that this contract has an embedded derivative that is not closely related and requires separation. Please provide detailed journal entries in the books of Entity A for accounting of such embedded derivative until sale is actually made.

Solution The contract should be separated using the 6 month USD/` forward exchange rate, as at the date of the contract (`/USD = 55). The two components of the contract are therefore:

- A sale contract for ` 55 Million
- A six-month currency forward to purchase USD 1 Million at 55
- This gives rise to a gain or loss on the derivative, and a corresponding derivative asset or liability.

On delivery

1. Entity A records the sales at the amount of the host contract = ` 55 Million
2. The embedded derivative is considered to expire.
3. The derivative asset or liability (i.e. the cumulative gain or loss) is settled by becoming part of the financial asset on delivery.
4. In this case the carrying value of the currency forward at 30 June 20X1 on maturity is = ` (1,000,000 x 60 – 55 x 1,000,000) = ` 5,000,000 (profit/asset)

The table summarising the computation of gain/ loss to be recorded at every period end –

Date	Transaction	Sales	Debtors	Derivative Asset (Liability)	(Profit) Loss
		`	`	`	`
1-Jan-20X1	Embedded Derivative	Nil Value			
31-Mar-20X1	Change in Fair Value of Embedded Derivatives MTM (55-45) x 1 Million			(10,000,000)	10,000,000
30-Jun-20X1	Change in Fair Value of Embedded Derivatives (60-45) x 1 Million			15,000,000	(15,000,000)
30-Jun-20X1	Recording sales at forward rate	(55,000,000)	55,000,000		
30-Jun-20X1	Embedded derivative- settled against debtors		5,000,000	(5,000,000)	

Journal Entries to be recorded at every period end

a. **01 January 20X1 – No entry to be made**

b. **31 March 20X1 –**

Particulars	**Dr. Amount (`)**	**Cr. Amount (`)**
Profit and loss A/c Dr. To Derivative financial liability A/c (being loss on mark to market of embedded derivative booked)	10,000,000	10,000,000

c. **30 June 20X1 –**

Particulars	**Dr. Amount (`)**	**Cr. Amount (`)**
Derivative financial asset A/c Dr. Derivative financial liability A/c Dr. To Profit and loss A/c (being gain on embedded derivative based on spot rate at the date of settlement booked)	5,000,000 10,000,000	15,000,000

d. **30 June 20X1 –**

Particulars	**Dr. Amount (`)**	**Cr. Amount (`)**
Trade receivable A/c Dr. To Sales A/c (being sale booked at forward rate on the date of transaction)	55,000,000	55,000,000

e. **30 June 20X1 –**

Particulars	**Dr. Amount (`)**	**Cr. Amount (`)**
Trade receivable A/c Dr To Derivative financial asset A/c (being derivative asset re-classified as a part of trade receivables, bringing it to spot rate on the date of sale)	5,000,000	5,000,000

Solution

i. **Assessment of the arrangement using the definition of derivative included under Ind AS 109**

Upon evaluation of contract in question it is noted that the contract meets the definition of a derivative as follows:

a) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

d) the initial amount received to enter into the contract is zero. A contract which would give the holder a similar response to foreign exchange rate changes would have required an investment of USD 20,000 on inception.

e) the contract is settled in future

The derivative liability is a written put option contract.

As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

ii. **Accounting on 1st January 20X1**

As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recorded on the date of entering into the contract.

iii. Accounting on 31st March 20X1

The value of the derivative put option contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (`)	Cr. Amount (`)
Profit and loss A/c Dr. To derivative financial liability (Being mark to market loss on the put option contract recorded)	25,000	25,000

iv. Accounting on 30th June 20X1

The change in value of the derivative put option contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (`)	Cr. Amount (`)
Derivative financial liability A/c Dr. To Profit and loss A/c (Being partial reversal of mark to market loss on the put option contract recorded)	10,000	10,000

Accounting on 30th September 20X1

The change in value of the derivative option contract shall be recorded as a zero in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (`)	Cr. Amount (`)
Derivative financial liability A/c Dr. To Profit and loss A/c (Being gain on mark to market of put option contract booked to make the value the derivative liability as zero)	15,000	15,000

v. Accounting on 31st December 20X1

The settlement of the derivative put option contract by actual purchase of USD 20,000 shall be recorded in the books of SamCo Ltd. upon exercise by JT Corp. by recording the following journal entry:

Particulars	Dr. Amount (`)	Cr. Amount (`)
Bank (USD Account) @ 20,000 x 66 Dr . Profit and loss A/c Dr . To Bank @ 20,000 x 68 (being loss on settlement of put option contract booked on actual purchase of USD)	13,20,000 40,000	13,60,000

6

ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1 April 20X1 @ ` 150 each. The rate of dividend is 10% payable every year. The preference shares are convertible into 5,000 equity shares of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion options is 15% per annum. Transaction cost on the date of issuance is 2% of the value of the proceeds.

Key terms:

Date of Allotment	**01-Apr-20X1**
Date of Conversion	**01-Apr-20X6**
Number of Preference Shares	**10,000**
Face Value of Preference Shares	**150**
Total Proceeds	**15,00,000**
Rate of dividend	**10%**
Market Rate for Similar Instrument	**15%**
Transaction Cost	**30,000**
Face value of equity share after conversion	**10**
Number of equity shares to be issued	**5,000**
Effective interest rate	**15.86%**

Solution

This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

a. **Computation of Liability & Equity Component**

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-20X1		0	1	0.00
31-Mar-20X2	Dividend	150,000	0.869565	130,434.75
31-Mar-20X3	Dividend	150,000	0.756144	113,421.6
31-Mar-20X4	Dividend	150,000	0.657516	98,627.4
31-Mar-20X5	Dividend	150,000	0.571753	85,762.95
31-Mar-20X6	Dividend	150,000	0.497177	74,576.55
Total Liability Component				502,823.25
Total Proceeds				1,500,000.00
Total Equity Component (Bal fig)				997,176.75

b. **Allocation of transaction costs**

Particulars	Amount	Allocation	Net Amount
Liability Component	502,823	10,056	492,767
Equity Component	997,177	19,944	977,233
Total Proceeds	1,500,000	30,000	1,470,000

c. **Accounting for liability at amortised cost:**

- Initial accounting = Present value of cash outflows less transaction costs
- Subsequent accounting = At amortised cost, ie, initial fair value adjusted for interest and repayments of the liability.

Assume the effective interest rate is 15.86%

	Opening Financial Liability A	Interest B	Cash Flow C	Closing Financial Liability A+B-C
01-Apr-20X1	492,767	-	-	4,92,767
31-Mar-20X2	492,767	78,153	150,000	4,20,920
31-Mar-20X3	420,920	66,758	150,000	3,37,678
31-Mar-20X4	337,678	53,556	150,000	2,41,234
31-Mar-20X5	241,234	38,260	150,000	1,29,494
31-Mar-20X6	129,494	20,506	150,000	-

d. **Journal Entries to be recorded for entire term of arrangement are as follows:**

Date	Particulars	Debit	Credit
01-Apr-20X1	Bank A/c Dr.	1,470,000	
	To Preference Shares A/c		**492,767**
	To Equity Component of Preference shares A/c		**977,233**
	(Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)		
31-Mar-20X2	Preference shares A/c Dr.	150,000	
	To Bank A/c		**150,000**
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X2	Finance cost A/c Dr.	78,153	
	To Preference Shares A/c		**78,153**
	(Being interest as per EIR method recorded)		

31-Mar-20X3	**Preference shares A/c Dr.**	**150,000**	
	To Bank A/c		**150,000**
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X3	Finance cost A/c Dr.	66,758	
	To Preference Shares A/c		**66,758**
	(Being interest as per EIR method recorded)		
31-Mar-20X4	**Preference shares A/c Dr.**	**150,000**	
	To Bank A/c		**150,000**
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X4	Finance cost A/c Dr.	53,556	
	To Preference Shares A/c		**53,556**
	(Being interest as per EIR method recorded)		
31-Mar-20X5	**Preference shares A/c Dr.**	**150,000**	
	To Bank A/c		**150,000**
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X5	Finance cost A/c Dr.	38,260	
	To Preference Shares A/c		**38,260**
	(Being interest as per EIR method recorded)		
31-Mar-20X6	Preference shares A/c Dr.	150,000	
	To Bank A/c		**150,000**
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X6	Finance cost A/c Dr.	20,506	
	To Preference Shares A/c		**20,506**
	(Being interest as per EIR method recorded)		
31-Mar-20X6	Equity Component of Preference shares A/c Dr.	977,233	
	To Equity Share Capital A/c		**50,000**
	To Securities Premium A/c		**927,233**

	(Being Preference shares converted in equity shares and remaining equity component is recognised as securities premium)		

Questions

1. **As part of staff welfare measures, Y Co Ltd. has contracted to lend to its employees sums of money at 5% per annum rate of interest. The amounts lent are to be repaid in five equal instalments for principle along with the interest. The market rate of interest is 10% per annum for comparable loans. Y lent ` 1,600,000 to its employees on 1st January 20X1.**

   Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for the year ended 31 December 20X1, for the transaction and also compute the value of loan initially to be

   recognised and amortised cost for all subsequent years.

   For the purpose of calculation, following discount factors at interest rate of 10% per annum may be adopted –

   At the end of year –

Year	Present value factor
1	.909
2	.827
3	.751
4	.683
5	.620

(i) Calculation of initial recognition amount of loan to its employees:

Year end	Amortised cost (opening balance)	Interest to be recognised	Repayment (including interest)	Amortised cost (closing balance)
20X1	1,406,272	140,627	400,000	1,146,899
20X2	1,146,899	114,690	384,000	877,589
20X3	877,589	87,759	368,000	597,348
20X4	597,348	59,735	352,000	305,083
20X5	305,083	30,917*	336,000	-

(iii) Journal Entries to be recorded of Y Ltd. for the year ended 31 December 20X1

*** Where the difference between the amount given by the Company to its employees and its fair value represents another asset, then such asset shall be recognised. Accordingly, such difference is recognised as prepaid employee cost and amortised over the period of loan.**

2. Wheel Co. Limited has a policy of providing subsidized loans to its employees for the purpose of buying or building houses. Mr. X, who's executive assistant to the CEO of Wheel Co. Limited, took a loan from the Company on the following terms:

- **Principal amount: 1,000,000**
- **Interest rate: 4% for the first 400,000 and 7% for the next 600,000**
- **Start date: 1 January 20X1**
- **Tenure: 5 years**
- **Pre-payment: Full or partial pre-payment at the option of the employee**
- **The principal amount of loan shall be recovered in 5 equal annual instalments and will be first applied to 7% interest bearing principal**
- **The accrued interest shall be paid on an annual basis**
- **Mr. X must remain in service till the term of the loan ends**

The market rate of a comparable loan available to Mr. X, is 12% per annum.

Following table shows the contractually expected cash flows from the loan given to Mr. X:

(amount in `)

		Inflows			
Date	Outflows	Principal	Interest income 7%	Interest income 4%	Principal outstanding
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1		200,000	42,000	16,000	800,000
31-Dec-20X2		200,000	28,000	16,000	600,000
31-Dec-20X3		200,000	14,000	16,000	400,000
31-Dec-20X4		200,000	-	16,000	200,000
31-Dec-20X5		200,000	-	8,000	-

Mr. S, pre-pays ` 200,000 on 31 December 20X2, reducing the outstanding principal as at that date to ` 400,000.

Following table shows the actual cash flows from the loan given to Mr. X, considering the pre-payment event on 31 December 20X2: **(amount in `)**

		Inflows			
Date	Outflows	Principal	Interest income 7%	Interest income 4%	Principal outstanding
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1		200,000	42,000	16,000	800,000
31-Dec-20X2		400,000	28,000	16,000	400,000
31-Dec-20X3		200,000	-	16,000	200,000
31-Dec-20X4		200,000	-	8,000	-
31-Dec-20X5		-	-	-	-

Record journal entries in the books of Wheel Co. Limited considering the requirements of Ind AS 109.

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 Mr. X is 12%, the fair value of the contractual cash flows shall be as follows:

Benefit to Mr. X, to be considered a part of employee cost for Wheel Co. ` 1,56,121.

The deemed employee cost is to be amortised over the period of loan i.e. the minimum period that Mr. X must remain in service.

The amortization schedule of the ` 843,878 loan is shown in the following table:

Date	Loan outstanding	Total cash inflows (principal repayment + interest	Interest @ 12%
1-Jan-20X1	843,878		
31-Dec-20X1	687,143	258,000	101,265
31-Dec-20X2	525,600	244,000	82,457
31-Dec-20X3	358,672	230,000	63,072
31-Dec-20X4	185,713	216,000	43,041
31-Dec-20X5	(0)	208,000	22,287

Journal Entries to be recorded at every period end:

a. **1 January 20X1 –**

Particulars		Dr. Amount (`)	Cr. Amount (`)
Loan to employee A/c	Dr.	843,879	
Pre-paid employee cost A/c	Dr	156,121	
To Bank A/c			1,000,000
(Being loan asset recorded at initial fair value)			

b. **31 December 20X1 –**

Particulars	Dr. Amount (`)	Cr. Amount (`)

Bank A/c Dr. To Interest income (profit and loss) @12% A/c To Loan to employee A/c (Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	258,000	101,265 156,735

Employee benefit (profit and loss) A/c Dr. To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	31,224	31,224

On 31 December 20X2, due to pre-payment of a part of loan by Mr. X, the carrying value of the loan shall be re-computed by discounting the future remaining cash flows by the original effective interest rate.

There shall be two sets of accounting entries on 31 December 20X2, first the realisation of the contractual cash flow as shown in (c) below and then the accounting for the pre- payment of ` 200,000 included in (d) below:

c. **31 December 20X2 –**

Particulars	**Dr. Amount (`)**	**Cr. Amount (`)**
Bank A/c Dr. To Interest income (profit and loss) @12% A/c To Loan to employee A/c (Being second instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	244,000	82,45 7 161,54 3
Employee benefit (profit and loss) A/c Dr. To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	31,224	31,224

Computation of new carrying value of loan to employee:

	Inflows				
Date	Principal	Interest income 7%	Interest income 4%	Discount factor @12%	PV
31-Dec-20X3	200,000	-	16,000	0.8929	192,857
31-Dec-20X4	200,000	-	8,000	0.7972	165,816
Total (revised carrying value)					358,673
Less: Current carrying value					525,601
Adjustment required					166,928

The difference between the amount of pre-payment and adjustment to loan shall be considered a gain, though will be recorded as an adjustment to pre-

paid employee cost, which shall be amortised over the remaining tenure of the loan.

d. **31 December 20X2 prepayment–**

Particulars	Dr. Amount (`)	Cr. Amount (`)
Bank A/c Dr.	200,000	
To Pre-paid employee cost A/c		33,072
To Loan to employee A/c		166,928
(Being gain to Wheel Co. 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-Dec-20X2	358,673		
31-Dec-20X3	185,714	216,000	43,041
31-Dec-20X4	-	208,000	22,286

Amortisation of employee benefit cost shall be as follows:

Date	Balance	Amortised to P&L	Adjustment
1-Jan-20X1	156,121		33,072
31-Dec-20X1	124,897	31,224	
31-Dec-20X2	60,601	31,224	
31-Dec-20X3	30,300	30,300	
31-Dec-20X4	-	30,300	

a. 31 December 20X3 –

Particulars	Dr. Amount (`)	Cr. Amount (`)
Bank A/c Dr. To Interest income (profit and loss) @12% A/c To Loan to employee A/c (Being third instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	216,000	 43,041 172,959
Employee benefit (profit and loss) A/c Dr To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	30,300	 30,300

b. 31 December 20X4 –

Particulars	Dr. Amount (`)	Cr. Amount (`)
Bank A/c Dr To Interest income (profit and loss) @12% A/c To Loan to employee A/c (Being last instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	208,000	 22,286 185,714
Employee benefit (profit and loss) A/ Dr To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	30,300	 30,300

3. Wheel Co. Limited borrowed ` 500,000,000 from a bank on 1 January 20X1. The original terms of the loan were as follows:

- **Interest rate: 11%**
- **Repayment of principal in 5 equal instalments**
- **Payment of interest annually on accrual basis**
- **Upfront processing fee: ` 5,870,096**

Effective interest rate on loan: 11.50%

On 31 December 20X2, Wheel Co. Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

- **Interest rate 15%**
- **Repayment of outstanding principal in 10 equal instalments starting 31 December 20X3**
- **Payment of interest on an annual basis**

Record journal entries in the books of Wheel Co. Limited till 31 December 20X3, after giving effect of the changes in the terms of the loan on 31 December 20X2

Answer:

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On the date of initial recognition, the effective interest rate of the loan shall be computed keeping in view the contractual cash flows and upfront processing fee paid. The following table shows the amortisation of loan based on effective interest rate:

Date	Cash flows (principal)	Cash flows (interest and fee)	Amortised cost (opening + interest – cash flows)	Interest @ EIR (11.50 %)
1-Jan-20X1	(500,000,000)	5,870,096	494,129,904	
31-Dec-20X1	100,000,000	55,000,000	395,954,843	56,824,939
31-Dec-20X2	100,000,000	44,000,000	297,489,650	45,534,807
31-Dec-20X3	100,000,000	33,000,000	198,700,959	34,211,310
31-Dec-20X4	100,000,000	22,000,000	99,551,570	22,850,610
31-Dec-20X5	100,000,000	11,000,000	(0)	11,448,430

a. **1 January 20X1 –**

Particulars	Dr. Amount (`)	Cr. Amount (`)
Bank A/c Dr. To Loan from bank A/c (Being loan recorded at its fair value less transaction costs on the initial recognition date)	494,129,904	494,129,904

b. **31 December 20X1 –**

Particulars	Dr. Amount (`)	Cr. Amount (`)
Loan from bank A/c Dr. Interest expense (profit and loss) Dr. To Bank A/c (Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised	98,175,061 56,824,939	155,000,000

cost of loan)		

c. **31 December 20X2 – Before Wheel Co. Limited approached the bank –**

Particulars	Dr. Amount (`)	Cr. Amount (`)
Interest expense (profit and loss) Dr.	45,534,807	
To Loan from bank A/c To Bank A/c (Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)		1,534,807 44,000,000

Upon receiving the new terms of the loan, Wheel Co. Limited, re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

Date	Cash flows (principal)	Interest outflow @15%	Discount factor	PV of cash flows
31-Dec-20X2	(400,000,000)			
31-Dec-20X3	40,000,000	60,000,000	0.8969	89,686,099
31-Dec-20X4	40,000,000	54,000,000	0.8044	75,609,805
31-Dec-20X5	40,000,000	48,000,000	0.7214	63,483,092
31-Dec-20X6	40,000,000	42,000,000	0.6470	53,053,542
31-Dec-20X7	40,000,000	36,000,000	0.5803	44,100,068
31-Dec-20X8	40,000,000	30,000,000	0.5204	36,429,133
31-Dec-20X9	40,000,000	24,000,000	0.4667	29,871,422
31-Dec-20Y0	40,000,000	18,000,000	0.4186	24,278,903
31-Dec-20Y1	40,000,000	12,000,000	0.3754	19,522,235
31-Dec-20Y3	40,000,000	6,000,000	0.3367	15,488,493
PV of new contractual cash flows discounted at 11.50%				451,522,791
Carrying amount of loan				397,489,650

Difference	54,033,141
Percentage of carrying amount	13.59%

Note: Calculation above done on full decimal, though in the table discount factor is limited to 4 decimals.

Considering a more than 10% change in PV of cash flows compared to the carrying value of the loan, the existing loan shall be considered to have been extinguished and the new loan shall be accounted for as a separate financial liability. The accounting entries for the same are included below:

d. 31 December 20X2 – accounting for extinguishment

Particulars	Dr. Amount (`)	Cr. Amount (`)
Loan from bank (old) A/c Dr Finance cost (profit and loss) Dr To Loan from bank (new) A/c (Being new loan accounted for at its principal amount in absence of any transaction costs directly related to such loan and correspondingly a de-recognition of existing loan)	397,489,650 2,510,350	 400,000,000

e. **31 December 20X3**

Particulars	Dr. Amount (`)	Cr. Amount (`)
Loan from bank A/c Dr. Interest expense (profit and loss) Dr. To Bank A/c (Being first instalment of the new loan and payment of interest accounted for as an adjustment to the amortised cost of loan)	40,000,000 60,000,000	 100,000,000

4. **K ltd. issued 500,000, 6% convertible debentures @ ` 10 each on 01 April 20X1. The debentures are due for redemption on 31 March 20X5 at a premium of 10%, 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 debentures without conversion rights was 10%.**

You are required to separate the debt and equity components at the time of issue and show the accounting entries in Company's books at initial recognition. The following present values of Re 1 at 6% and at 10% are provided:

Interest rate	Year 1	Year 2	Year 3	Year 4
6%	0.94	0.89	0.84	0.79
10%	0.91	0.83	0.75	0.68

Answer:

Computation of debt component of convertible debentures on 01 April 20X1

Particulars	Amount
Present value of principal amount repayable after 4 years	
(A) 5,000,000 x 50% x 1.10 x 0.68 (10% discount factor)	1,870,000
(B) Present value of interest [300,000 x 3.17] (4 years cumulative 10% discount factor)	951,000
Total present value of debt component (A) + (B)	2,821,000
Issue proceeds from convertible debentures	5,000,000
Value of equity component	2,179,000

Particulars	Dr. Amount (`)	Cr. Amount (`)
Bank A/c Dr.	5,000,000	
To 6% debenture A/c (liability component)		2,821,000
To 6% debenture A/c (equity component)		2,179,000
(Being disbursement recorded at fair value)		

5. **On 1 April 20X1, an 8% convertible loan with a nominal value of ` 6,00,000 was issued at par. It is redeemable on 31 March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each ` 200 worth of loan.**

An equivalent loan without the conversion option would have carried interest at 10%. Interest of ` 48,000 has already been paid and included as a finance cost.

Present value rates are as follows:

Year End	@ 8%	@ 10%
1	0.93	0.91
2	0.86	0.83
3	0.79	0.75
4	0.73	0.68

Explain how will the Company account for the above loan notes in the financial statements for the year ended 31 March 20X2?

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 present value of interest and principal
The rate at which the same is to be discounted, is the rate of equivalent loan note without the conversion option would have carried interest at 10%, therefore this is the rate to be used for discounting
Step 3 Calculation of the debt element of the loan note as follows:
8% Interest discounted at a rate of 10% Present Value (6,00,000 x 8%)

S. No	Year	Interest amount	PVF	Amount
Year 1	20X2	48,000	0.91	43,680
Year 2	20X3	48,000	0.83	39,840
Year 3	20X4	48,000	0.75	36,063
1,19,583				
Year 4	20X5	648,000	0.68	4,40,640
Amount to be recognised as a liability		5,60,223		

Initial proceeds (6,00,000)
Amount to be recognised as equity 39,777
* In year 4, the loan note is redeemed therefore ` 6,00,000 + ` 48,000 = ` 6,48,000

Step 4 The next step is to recognise the interest component equivalent to the loan that would carry if there was no option to cover. Therefore, the interest should be recognised at 10%. As on date ` 48,000 has been recognised in the statement of profit and loss i.e. 6,00,000 x 8% but we have discounted the present value of future interest payments and redemption amount using discount factors of 10%, so the finance charge in the statement of profit and loss must also be recognised at the same rate i.e. for the purpose of consistency.
The additional charge to be recognised in the income statement is calculated as:
Debt component of the financial instrument ` 5,60,000

PAST EXAMINATION PAPERS, MOCK TEST PAPERS (MTP) & REVISION TEST PAPERS (RTP)

1. 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.

[MAY 2018 – 8 MARKS]

Answer:

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.

Subsequently, such preference shares shall be carried at amortised cost at each reporting date as follows:

Year	Date	Opening Balance	Interest @ 12%	Closing balance
	1st April, 2015	3,55,90,000	-	3,55,90,000
1	31st March, 2016	3,55,90,000	42,70,800	3,98,60,800
2	31st March, 2017	3,98,60,800	47,83,296	4,46,44,096
3	31st March, 2018	4,46,44,096	53,55,904*	5,00,00,000

* ₹ 4,46,44,096 x 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		Amount	Amount
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 transaction recorded)			
31st March, 2016	Redeemable Preference Shares	Dr.	42,70,800	
	To Interest Income			42,70,800
	(Being interest income on loan component recognized)			
31st March, 2017	Redeemable Preference Shares	Dr.	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 Preference Shares			5,00,00,000
	(Being settlement of transaction done at the end of the third year)			

2. 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 Rs. 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:
[MAY 2018 – 8 MARKS]
Answer:

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 recorded on the date of entering into the contract.

(ii) Accounting on 31st March 2017

Particulars		Dr. (₹)	Cr. (₹)
Profit and loss A/c	Dr.	50,000	
To Derivative financial liability			50,000
(Being mark to market loss on forward contract recorded)			

(iii) Accounting on 30th June 2017

Particulars		Dr. (₹)	Cr. (₹)
Derivative financial liability A/c	Dr.	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

Particulars		Dr. (₹)	Cr. (₹)
Derivative financial liability A/c	Dr.	30,000	
Derivative financial asset A/c	Dr.	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

Particulars		Dr. (₹)	Cr. (₹)
Cash (USD Account) (USD 40,000 x ₹ 62)	Dr.	24,80,000	
Profit and loss A/c	Dr.	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)			

3. NAV Limited granted a loan of Rs. 120 lakh to OLD Limited for 5 years @ 10% p.a. which is Treasury bond yield of equivalent maturity. But the incremental borrowing rate of OLD Limited is 12%. In this case, the loan is granted to OLD Limited at below market rate of interest. Ind AS 109 requires that a financial asset or financial liability is to be measured at

Year	1	2	3	4	5
PVF	0.892	0.797	0.712	0.636	0.567

fair value at the initial recognition. Should the transaction price be treated as fair value? If not, find out the fair value. What is the accounting treatment of the difference between the transaction price and the fair value on initial recognition in the book of NAV Ltd.?
Present value factors at 12%:

[NOV 2018 ? 4 MARKS]
Answer:
Since the loan is granted to OLD Ltd at 10% i.e below market rate of 12%. It will be considered as loan given at off market terms. Hence the Fair value of the transaction will be lower from its transaction price & not the transaction price.

Calculation of fair value

Year	Future cash flow (in lakh)	Discounting factor @ 12%	Present value (in lakh)
1	12	0.892	10.704
2	12	0.797	9.564
3	12	0.712	8.544
4	12	0.636	7.632
5	120+12=132	0.567	74.844
			111.288

The fair value of the transaction be Rs. 111.288 lakh.
Since fair value is based on level 1 input or valuation technique that uses only data from observable markets, difference between fair value and transaction price will be recognized in Profit and Loss as fair value loss i.e Rs. 120 lakh– Rs. 111.288 lakh= Rs. 8.712 lakh.
Note: One may also calculate the above fair value by the way of annuity on interest amount rather than separate calculation.

4. Veer Limited issues convertible bonds of Rs. 75,00,000 on 1st April, 2018. The bonds have a life of five years and a face value of Rs. 20 each, and they offer interest payable at the end of each financial year at a rate of 4.5 per cent annum. The bonds are issued at their face value and each bond can be converted into one ordinary share in Veer Ltd at any time in the next five years. Companies of a similar risk profile have recently issued debt at 6 per cent per annum with similar terms but without the option for conversion. You are required to:
(i) Provide the appropriate accounting entries for initial recognition as per the relevant Ind AS in the books of the company.

(ii) Calculate the stream of interest expenses across the five years of the life of the bonds.
(iii) Provide the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the fourth year.
[NOV 2018 ? 8 MARKS]
Answer:

Present value of bonds at the market rate of debt

Present value of principal to be received in 5 years discounted at 6%
(75,00,000 x 0.747) = 56,02,500
Present value of interest stream discounted at 6% for 5 years
(3,37,500 x4.212) = 14,21,550
Total present value = 70,24,050
Equity component = 4,75,950
Total face value of convertible bonds = 75,00,000

(i) **Journal Entries**

	Dr. Amount (₹)	Cr. Amount (₹)
1st April, 2018		
Cash Dr.	75,00,000	
To Convertible bonds (liability)		70,24,050
To Convertible bonds (equity component)		4,75,950
(Being entry to record the convertible bonds and the recognition of the liability and equity components)		
31st March, 2019		
Interest expense Dr.	4,21,443	
To Cash		3,37,500
To Convertible bonds (liability)		83,943
(Being entry to record the interest expense)		

(ii) The stream of interest expense is summarised below, where interest for a given year is calculated by multiplying the present value of the liability at the beginning of the period by the market rate of interest, this is being 6 per cent.

Date	Payment	Interest expense at 6% (e of previous year x 6%)	Increase in bond liability (c-b)	Total bond liability (e of previous year +d)
(a)	(b)	(c)	(d)	(e)
1st April, 2018				70,24,050
31st March, 2019	3,37,500	4,21,443	83,943	71,07,993
31st March, 2020	3,37,500	4,26,480	88,980	71,96,973
31st March, 2021	3,37,500	4,31,818	94,318	72,91,291
31st March, 2022	3,37,500	4,37,477	99,977	73,91,268
31st March, 2023	3,37,500	4,46,232*	1,08,732	75,00,000

* Difference is due to rounding off.

(iii) If the holders of the bond elect to convert the bonds to ordinary shares at the end of the fourth year (after receiving their interest payments), the entries in the fourth year would be:

		Dr. (₹)	Cr. (₹)
31st March, 2022			
Interest expense A/c	Dr.	4,37,477	
To Cash A/c			3,37,500
To Convertible bonds (liability) A/c			99,977
(Being entry to record interest expense for the period)			
31st March, 2022			
Convertible bonds (liability) A/c	Dr.	73,91,268	
Convertible bonds (equity component) A/c	Dr.	4,75,950	
To Ordinary share capital A/c			78,67,218
(Being entry to record the conversion of bonds into ordinary shares of Veer Limited)			

5. Growth Limited on 1st April, 2015 issued 50,000, 7% convertible debentures of face value of Rs. 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31st March, 2020 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10%. The date of transition to Ind AS is 1st April, 2017.
Suggest how Growth Limited should account for this compound financial instrument on the date of transition. Also discuss Ind AS on 'Financial Instrument' presentation in the above context. The present value of Rs. 1 receivable at the end of each year based on discount rates of 7% and 10% can be taken as:
[NOV 2018 – 8 MARKS]
Answer:
Since the liability is outstanding on the date of Ind AS transition, Growth Ltd. is required to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, first the liability component will be measured 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).
Calculation of Equity & Liability component on initial recognition

	(₹)
Present interest payments for 5 years on debentures by applying annuity factor [(50,000 x 7% x 100) x 3.79]	13,26,500
PV of principal repayment (including premium) (50,000x110x0.62)	34,10,000
Total liability component	47,36,500
Total equity component (Balancing figure)	2,63,500
Total proceeds from issue of Debentures	50,00,000

Thus, on the date of transition, the amount of Rs. 50,00,000 being the amount of debentures will split as under:
Debt Rs. 47,36,500
Equity Rs. 2,63,500

6. Perfect Ltd. issued 50,000 Compulsory Cumulative Convertible Preference Shares (CCCPS) as on 1st April, 2017 @ Rs. 180 each. 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 Rs. 10 each) of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion 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) Discounting Factor @ 15%
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 Equity Shares. Keeping in view the provisions of relevant Ind AS
[MAY 2019 – 12 MARKS]

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 Rs. 180 each = Rs. 90,00,000

Dividend @ 10% = Rs. 9,00,000

a. Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-2017		0	1	0.00
31-Mar-2018	Dividend	9,00,000	0.8696	7,82,640
31-Mar-2019	Dividend	9,00,000	0.7561	6,80,490
31-Mar-2020	Dividend	9,00,000	0.6575	5,91,750
31-Mar-2021	Dividend	9,00,000	0.5718	5,14,620
31-Mar-2022	Dividend	9,00,000	0.4971	4,47,390
Total Liability Component				30,16,890
Total Proceeds				90,00,000
Total Equity Component (Bal fig)				59,83,110

b. Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
	a	b	a-b
Liability Component	30,16,890	60,338	29,56,552
Equity Component	59,83,110	1,19,662	58,63,448
Total Proceeds	90,00,000	1,80,000	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.

	Opening Financial Liability A	Interest @ 15.86% B	Cash Flow (Dividend payment) C	Closing Financial Liability A+B-C
01-Apr-2017	29,56,552			29,56,552
31-Mar-2018	29,56,552	4,68,909	9,00,000	25,25,461
31-Mar-2019	25,25,461	4,00,538	9,00,000	20,25,999
31-Mar-2020	20,25,999	3,21,323	9,00,000	14,47,322
31-Mar-2021	14,47,322	2,29,545	9,00,000	7,76,867
31-Mar-2022	7,76,867	1,23,133*	9,00,000	-

*Difference of ₹ 78 (adjusted in the interest value of 31st March, 2022) is due to approximation of figures in the earlier years.

d. Journal Entries to be recorded for entire term of arrangement are as follows:

Date	Particulars		Debit ₹	Credit ₹
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/c			58,63,448
	(Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)			
31-Mar-2018	Preference shares A/c	Dr.	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	Finance cost 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/c Dr. To Bank A/c (Being dividend at the coupon rate of 10% paid to the shareholders)	9,00,000	9,00,000
31-Mar-2019	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	4,00,538	4,00,538
31-Mar-2020	Preference shares A/c Dr. To Bank A/c (Being dividend at the coupon rate of 10% paid to the shareholders)	9,00,000	9,00,000
31-Mar-2020	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	3,21,323	3,21,323
31-Mar-2021	Preference shares A/c Dr. To Bank A/c (Being dividend at the coupon rate of 10% paid to the shareholders)	9,00,000	9,00,000
31-Mar-2021	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	2,29,545	2,29,545
31-Mar-2022	Preference shares A/c Dr. To Bank A/c (Being dividend at the coupon rate of 10% paid to the shareholders)	9,00,000	9,00,000
31-Mar-2022	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	1,23,133	1,23,133
31-Mar-2022	Equity Component of Preference shares A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being preference shares converted in equity shares and remaining equity component is recognised as securities premium)	58,63,448	1,25,000 57,38,448

7. Vedika Ltd. issued 80,000 8% convertible debentures of Rs. 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 debentures without 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. The following present values of Rupee 1 at 8% and 12% are provided for a period of 5 years.

[MAY 2019 ? 10 MARKS]
Answer:

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	Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c Dr.	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.

8. On 1 January 20X0, Preet Ltd. issues 10 year bonds for Rs. 10,00,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for Rs. 10,00,000. No costs or fees are incurred. The effective interest rate is 10%. On 1 January 20X5 (i.e. after 5 years) Preet Ltd. 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 Rs. 15,00,000; and
? legal and other fees of Rs. 1,00,000 are incurred.

Preet Ltd. determines that the market interest rate on 1 January 20X5 for borrowings on similar terms is 11%.
Analyse whether the extinguishment accounting will apply or not as per Ind AS. If yes, determine the fair value of the modified liability and compute the gain or loss on modification.
[MTP MARCH 2018 14 MARKS]
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 January 20X0	10,00,000			10,00,000
31 December 20X0	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X1	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X2	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X3	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 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 Rs. 10,00,000.
On this date, Preet Ltd. will compute the present value of:

- cash flows under the new terms – i.e. Rs. 15,00,000 payable on 31 December 20Y1 and Rs.

50,000 payable for each of the 7 years ending 31 December 20Y1.

- any fee paid (net of any fee received) – i.e. Rs. 1,00,000

using the original effective interest rate of 10%.
The total of these amounts to Rs. 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 on this basis is Rs. 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. Rs. 10,00,000 – Rs. 9,58,097 – Rs. 1,00,000 = Loss of Rs. 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	0.513158	7,69,737	0.481658	7,22,487
1,00,000		1,00,000		
50,000 for 7 years	4.868418	2,43,421	4.712195	2,35,610
		11,13,158		9,58,097
PV of original cash flows @ original EIR		(10,00,000)		
Difference		1,13,158		
Difference %		11.32%		

9.

(i) On 1st April, 2014, S Ltd. issued 5,000, 8% convertible debentures with a face value of Rs. 100 each maturing on 31st March, 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 1st April, 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 treatment in the books of S Ltd., by passing appropriate journal entries, 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.

The following present values of Re. 1 at 8%, 9% & 12% are supplied to you:

[RTP MAY 2018 | MTP AUGUST 2018 (10 Marks) & APRIL 2019 (12 Marks)]

Answer:

(1) **At the time of initial recognition**

	Rs.
Liability component	
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

	Rs.	Rs.
Bank Dr.	5,00,000	
To 8% Debentures (Liability component)		4,27,700
To 8% Debentures (Equity component)		72,300
(Being Debentures are initially recorded a fair value)		

(2) **At the time of repurchase of convertible debentures**

The repurchase price is allocated as follows:

	Carrying Value @ 12%	Fair Value @ 9%	Difference
	Rs.	Rs.	Rs.
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	3,98,500	4,21,000	
Liability component	4,66,100	4,91,360	(25,260)
Equity component (5,25,000 -4,91,360)	72,300	33,640*	38,660
Total	**5,38,400**	**5,25,000**	**13,400**

*(5,25,000 – 4,91,360) = 33,640

680

Journal Entries

		Rs.	Rs.
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	
To Bank A/c			33,640
To Reserves and Surplus A/c			38,660
(Being the cash paid for the equity component recognised)			

(ii) On 1 January 2018, Entity X writes a put option for 1,00,000 of its own equity shares for which it receives a premium of Rs. 5,00,000.
Under the terms of the option, Entity X may be obliged to take delivery of 1,00,000 of its own shares in one year's time and to pay the option exercise price of Rs. 22,000,000.
The option can only be settled through physical delivery of the shares (gross physical settlement). Examine the nature of the financial instrument and how it will be accounted assuming that the present value of option exercise price is Rs. 2,00,000?
[MTP ? AUGUST 2018 ? 5 MARKS]
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 cost as per Ind AS 109 and finance cost of Rs. 2,000,000 will be recognised over the exercise period.

• If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity ie. an amount of Rs. 22,000,000 will be reclassified from financial liability to equity.

10. Discuss the need of hedge accounting and types of various hedges?
[MTP OCTOBER 2018 8 MARKS]

Answer

Hedge accounting may be required due to accounting mismatches in:

• **Measurement –** some financial instruments (non-derivative) are not measured at fair value with changes being recognised in the statement of profit and loss whereas all derivatives, which commonly are used as hedging instruments, are measured at fair value

• **Recognition –** unsettled or forecast transactions that may be hedged are not recognised on the balance sheet or are included in the statement of profit and loss only in a future accounting period, whereas all derivatives are recognised at inception. Recognition mismatches include the hedge of a contracted or expected but not yet recognised sale, purchase or financing transaction in a foreign currency and future committed variable interest payments.

Types of hedge accounting

1. Fair value hedge accounting model

• A fair value hedge seeks to offset the risk of changes in the fair value of an existing asset or liability or an unrecognised firm commitment that may give rise to a gain or loss being recognised in the statement of profit and loss.

• A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect the statement of profit and loss.

1. Cash flow hedge accounting model

• A cash flow hedge seeks to offset certain risks of the variability of cash flows in respect of an existing asset or liability or a highly probable forecast transaction that may be reflected in the statement of profit and loss in a future period.

• A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction or a firm commitment in respect of foreign currency and (ii) could affect the statement of profit and loss.

1. Net investment hedging

• An investor in a non-integral operation is exposed to changes in the carrying amount of the net assets of the foreign operation (the net investment) arising from the translation of those assets into the reporting currency of the investor.

11. 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, Hello Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

- **Interest rate 15%**
- **Repayment of outstanding principal in 10 equal instalments starting 31st December 2018.**
- **Payment of interest on an annual basis**

Record journal entries in the books of Hello Limited till 31st December 2018, after giving effect of the changes in the terms of the loan on 31st December 2017. [MTP ? OCTOBER 2018 ? 14 MARKS]

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	Cash flows (principal)	Cash flows (interest and fee)	Amortised cost (opening + interest – cash flows)	Interest @ EIR (11.50%)
1-Jan-2016	(500,000,000)	5,870,096	494,129,904	
31-Dec-2016	100,000,000	55,000,000	395,954,843	56,824,939
31-Dec-2017	100,000,000	44,000,000	297,489,650	45,534,807
31-Dec-2018	100,000,000	33,000,000	198,700,959	34,211,310
31-Dec-2019	100,000,000	22,000,000	99,551,570	22,850,610
31-Dec-2020	100,000,000	11,000,000	(0)	11,448,430

a. 1 January 2016

Particulars		Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c	Dr.	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

Particulars		Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan from bank A/c	Dr.	98,175,061	
Interest expense (profit and loss)	Dr.	56,824,939	
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 Hello Limited approached the bank –

Particulars		Dr. Amount (Rs.)	Cr. Amount (Rs.)
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)			

Date	Cash flows (principal)	Interest outflow @15%	Discount factor	PV of cash flows
31-Dec-2017	(400,000,000)			
31-Dec-2018	40,000,000	60,000,000	0.8969	89,686,099
31-Dec-2019	40,000,000	54,000,000	0.8044	75,609,805
31-Dec-2020	40,000,000	48,000,000	0.7214	63,483,092
31-Dec-2021	40,000,000	42,000,000	0.6470	53,053,542
31-Dec-2022	40,000,000	36,000,000	0.5803	44,100,068
31-Dec-2023	40,000,000	30,000,000	0.5204	36,429,133
31-Dec-2024	40,000,000	24,000,000	0.4667	29,871,422
31-Dec-2025	40,000,000	18,000,000	0.4186	24,278,903
31-Dec-2026	40,000,000	12,000,000	0.3754	19,522,235
31-Dec-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 facto is limited to 4 decimals.

Considering a more than 10% change in PV of cash flows compared to the carrying valu of the loan, the existing loan shall be considered to have been extinguished and the ne loan shall be accounted for as a separate financial liability. The accounting entries for th same are included below:

d. 31 December 2017 – accounting for extinguishment

Particulars		Dr. Amount (Rs.)	Cr. Amount (Rs.)
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

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
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)		

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 requi rements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

12.

(1) QA Ltd. issued 10,00,000 of 8% Long Term bond-A Series of Rs. 1 each on 1 st April, 2016. The bond tenure is 3 years. Interest is payable annually on 1st April each year. The investors expect an effective interest rate on the loan at 10%. QA Ltd. wants you to suggest the suitable accounting entries for the issue of these bonds as per applicable Ind AS. Consider the discounting factor 3 years, 10% discounting factor is 0.751315 and 3 years cumulative discounting factor is 2.48685.

(i) What is the principal value of the bond at the initial recognition at the time of issue of bond as per applicable Ind AS?

(ii) What is the present value of the interest payment to be recognised as part of the sale price of the bond as per applicable Ind AS?

(iii) What are the proceeds of the sale of the bond to be recognized at the time of initial recognition as per applicable Ind AS?

(iv) What is the accounting entry to be passed at the time of accounting for payment of interest for the first year?

(2) QA Ltd. has also issued 10,00,000 of 8% Long Term Bond-B Series of Rs. 1 each on 1 st April, 2016. The bond tenure is 3 years. Interest is payable annually on 1st April each year. However, the bond holders of this series are entitled to convert the bonds to shares of Rs. 1 each on the date of maturity, instead of receiving the principal repayment. Interest rate on the similar bond without conversion option is 10%. QA Ltd. has requested you to suggest the following for this type of instrument:

(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 8 MARKS]
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

To Discount on Bond A/s Rs. 15,026

To Cash/Bank A/c Rs. 80,000

Workings for the above

Since the Effective interest rate on the loan is 10% while the Bond has been issued at 8%, the financial liability will be recognized at fair value determined as follows:

Calculation of initial recognition amount of 8% Long term Loan Bond A Series

Particulars	*Rs.*
Present value of the principal repayable after 3 years (10,00,000 x .751315)	7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]	1,98,948
Total Present Value of Long term Loan Bond	9,50,263

Interest for the first year recognized in the books as per effective interest rate method

= Rs.9,50,263 x 10% = Rs. 95,026

However, interest paid is @ 8% i.e. Rs. 10,00,000 x 8% = Rs. 80,000

(2) **(a)** Option (B) : Cash/Bank A/c Rs. 10,00,000

To 8% LT Bond Series B A/c Rs. 9,50,263

To Share Option A/c Rs. 49,737

Workings for the above

It is a compound instrument.

Calculation of initial recognition amount of 8% Long term Loan Bond B Series liability and equity component

Particulars		Rs.
Present value of the principal repayable after 3 years (10,00,000 x .751315)		7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]		1,98,948
Total Present Value of Long term Loan Bond B	I	
Issue proceeds from convertible bond	II	9,50,263
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

To 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. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity.

13. 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. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each Rs. 200 worth of loan . An equivalent loan without the conversion option would have carried interest at 10%.

Interest of Rs. 48,000 has already been paid and included as a finance cost.

Present value rates are as follows:

Year End	@ 8%	@ 10%
1	0.93	0.91
2	0.86	0.83
3	0.79	0.75
4	0.73	0.68

How will the Company present the above loan notes in the financial statements for the year ended 31 March 2019?
[MTP ⍰ MARCH 2019 ⍰ 8 MARKS]
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 present value of interest and principal The rate at which the same is to be discounted, is the rate of equivalent loan note without the conversion option would have carried interest at 10%, therefore this is the rate to be used for discounting

Step 3 Calculation of the debt element of the loan note as follows:
8% Interest discounted at a rate of 10% Present Value (6,00,000 x 8%)

S. No	Year	Interest amount	PVF	Amount
Year 1	2019	48,000	0.91	43,680
Year 2	2020	48,000	0.83	39,840
Year 3	2021	48,000	0.75	36,063
				1,19,583
Year 4	2022	648,000	0.68	4,40,640
Amount to be recognised as a liability				5,60,223
Initial proceeds				(6,00,000)
Amount to be recognised as equity				39,777

* In year 4, the loan note is redeemed therefore Rs. 6,00,000 + Rs. 48,000 = Rs. 6,48,000.

Step 4 The next step is to recognise the interest component equivalent to the loan that would carry if there was no option to cover. Therefore, the interest should be recognised at 10%. As on date Rs. 48,000 has been recognised in the statement of profit and loss i.e. 6,00,000 x 8% but we have discounted the present value of future interest payments and redemption amount using discount factors of 10%, so the finance charge in the statement of profit and loss must also be recognised at the same rate i.e. for the purpose of consistency.

The additional charge to be recognised in the income statement is calculated as:
Debt component of the financial instrument Rs. 5,60,000

Interest charge (5,60,000 x 10%)	Rs. 56,000
Already charged to the income statement	(Rs. 48,000)
Additional charge required	Rs. 8,000

Journal Entries for recording additional finance cost for year ended 31 March 2019

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Finance cost A/c Dr.	8,000	
To Debt component A/c		8,000
(Being interest recorded for difference between amount recorded earlier and that to be recorded per Ind AS 32)		

14. ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1 April 20X1 @ Rs 150 each. The rate of dividend is 10% payable every year. The preference shares are convertible into 5,000 equity shares of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion options is 15% per annum. Transaction cost on the date of issuance is 2% of the value of the proceeds.

Key terms:

Date of Allotment	01-Apr-20X1
Date of Conversion	01-Apr-20X6
Number of Preference Shares	10,000
Face Value of Preference Shares	150
Total Proceeds	15,00,000
Rate of dividend	10%
Market Rate for Similar Instrument	15%
Transaction Cost	30,000
Face value of equity share after conversion	10
Number of equity shares to be issued	5,000
Effective interest rate	15.86%

You are required to compute the 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 equity shares keeping in view the provisions of relevant Ind AS.

[MTP OCTOBER 2019 12 MARKS]

Answer

This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

a. Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-20X1		0	1	0.00
31-Mar-20X2	Dividend	150,000	0.869565	130,434.75
31-Mar-20X3	Dividend	150,000	0.756144	113,421.6
31-Mar-20X4	Dividend	150,000	0.657516	98,627.4
31-Mar-20X5	Dividend	150,000	0.571753	85,762.95
31-Mar-20X6	Dividend	150,000	0.497177	74,576.55
Total Liability Component				502,823.25
Total Proceeds				1,500,000.00
Total Equity Component (Bal fig)				997,176.75

b. Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
Liability Component	502,823	10,056	492,767
Equity Component	997,177	19,944	977,233
Total Proceeds	1,500,000	30,000	1,470,000

c. Accounting for liability at amortised cost:

- Initial accounting = Present value of cash outflows less transaction costs
- Subsequent accounting = At amortised cost, ie, initial fair value adjusted for interest and repayments of the liability.

Assume the effective interest rate is 15.86%

	Opening Financial Liability A	Interest B	Cash Flow C	Closing Financial Liability A+B-C
01-Apr-20X1	492,767	-	-	4,92,767
31-Mar-20X2	492,767	78,153	150,000	4,20,920
31-Mar-20X3	420,920	66,758	150,000	3,37,678
31-Mar-20X4	337,678	53,556	150,000	2,41,234
31-Mar-20X5	241,234	38,260	150,000	1,29,494
31-Mar-20X6	129,494	20,506	150,000	-

d. Journal Entries to be recorded for entire term of arrangement are as follows:

Date	Particulars		Debit	Credit
01-Apr-20X1	Bank A/c	Dr.	1,470,000	
	To Preference Shares A/c			492,767
	To Equity Component of Preference shares A/c			977,233
	(Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)			
31-Mar-20X2	Preference shares A/c	Dr.	150,000	
	To Bank A/c			150,000
	(Being Dividend at the coupon rate of 10% paid to the shareholders)			
31-Mar-20X2	Finance cost A/c	Dr.	78,153	
	To Preference Shares A/c			78,153
	(Being interest as per EIR method recorded)			
31-Mar-20X3	Preference shares A/c	Dr.	150,000	
	To Bank A/c			150,000
	(Being Dividend at the coupon rate of 10% paid to the shareholders)			
31-Mar-20X3	Finance cost A/c	Dr.	66,758	
	To Preference Shares A/c			66,758
	(Being interest as per EIR method recorded)			

31-Mar-20X4	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X4	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	53,556	53,556
31-Mar-20X5	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X5	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	38,260	38,260
31-Mar-20X6	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X6	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	20,506	20,506
31-Mar-20X6	Equity Component of Preference shares A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being Preference shares converted in equity shares and remaining equity component is recognised as securities premium)	977,233	50,000 927,233

15. Croton Limited is engaged in the business of trading commodities. The 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?
[MTP OCTOBER 2019 8 MARKS]
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 appropriately 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. The option to measure investment in equity shares at fair value through other comprehensive income has to be made at initial recognition. Therefore, equity shares that were held for trading previously 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. The business model also includes sales of these instruments on a regular basis. Hence, these instruments will be classified as FVTOCI. Therefore, such NCD investments shall be classified as subsequently measured at Fair Value through Other Comprehensive Income. The 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. The company must rectify this by reclassifying as FVTOCI.

16. KK Ltd. has granted an interest free loan of Rs. 10,00,000 to its wholly owned Indian Subsidiary YK Ltd. There is no transaction cost attached to the said loan. The Company has not finalised any terms and conditions including the applicable interest rates on such loans. The Board of Directors of the Company are evaluating various options and has requested your firm to provide your views under Ind AS in following situations:
(i) The Loan given by KK Ltd. to its wholly owned subsidiary YK Ltd. is interest free and such loan is repayable on demand.
The said Loan is interest free and will be repayable after 3 years from the date of granting such loan. The current market rate of interest for similar loan is 10%. Considering the same, the fair value of the loan at initial recognition is Rs. 8,10,150. (iii) The said loan is interest free and will be repaid as and when the YK Ltd. has funds to repay the Loan amount. Based on the same, KK Ltd. has requested you to suggest the accounting treatment of the above loan in the stand-alone financial statements of KK Ltd. and YK Ltd. and also in the consolidated financial statements of the group. Consider interest for only one year for the above loan.
Further the Company is also planning to grant interest free loan from YK Ltd. to KK Ltd. in the subsequent period. What will be the accounting treatment of the same under applicable Ind AS?
[RTP MAY 2019]
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/c	Dr.	₹ 10,00,000	
To Loan from KK Ltd. A/c			₹ 10,00,000
On repayment			
Loan from KK Ltd. A/c	Dr.	₹ 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 something other than the financial instrument, an entity shall measure the fair value of the financial instrument. The difference in fair value and transaction cost will treated as investment in Subsidiary YK Ltd.

Both KK Ltd. and YK Ltd. should recognise financial asset and liability, respectively, at fair value on initial recognition, i.e., the present value of Rs. 10,00,000 payable at the end of 3 years using discounting factor of 10%. Since the question mentions fair value of the loan at initial recognition as Rs. 8,10,150, the same has been considered. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Journal entries in the books of KK Ltd. (for one year)

At origination			
Loan to YK Ltd. A/c	Dr.	₹ 8,10,150	
Investment in YK Ltd. A/c	Dr.	₹ 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/c	Dr.	₹ 81,015	
To Interest income A/c			₹ 81,015
Transferring of interest to Profit and Loss			
Interest income A/c	Dr.	₹ 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/c	Dr.	₹ 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/c	Dr.	₹ 81,015	
To Loan from KK Ltd. A/c			₹ 81,015
On repayment			
Loan from KK Ltd. A/c	Dr.	₹ 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.

17. 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.
[RTP NOV 2019]
Answer

On Initial recognition

		Debit (₹)	Credit (₹)
Financial asset-FVOCI	Dr.	1,000	
To Cash			1,000

On Impairment of debt instrument

		Debit (₹)	Credit (₹)
Impairment expense (P&L)	Dr.	30	
Other comprehensive income	Dr.	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

	Debit (₹)	Credit (₹)
Cash	950	
To Financial asset –FVOCI		950
Loss on sale (P&L)	20	
To Other comprehensive income		20

18. 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.

[RTP MAY 2020]

Answer

The preference shares provide the holder with the right to receive a predetermined amount of annual 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 April, 20X5 ₹	Interest @18% ₹	Paid at 4% ₹	31 March, 20X6 ₹
20X5-20X6	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:

	₹	₹
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

19. 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 Ind 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? ((MAY – 2019 8 MARKS)MTP-OCT 2020 8 Marks)

Answer:

Paragraph 42 of Ind AS 103 provides that in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed of directly the previously held equity interest.

Applying the above, Deepak Ltd. records the following entry in its consolidated financial statements:

		(₹ in crore)	
		Debit	Credit
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 (4,320 + 378 + 54 + 27)			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. The 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, 2020	4,860
Carrying amount of interest in Shaun Ltd. at 1st April, 2020	(4,779)
	81
Unrealised gain previously recognised in OCI	54
Gain on previously held interest in Shaun Ltd. recognised in profit or loss	135

CHAPTER -13 BUSINESS COMBINATION AND CORPORATE RESTRUCTURING

Illustrations

1: Asset acquisition

An entity acquires an equipment and a patent in exchange for ` 1,000 crore cash and land. The fair value of the land is ` 400 crore and its carrying value is ` 100 crore. Fair values of the equipment and patent are estimated to be ` 500 crore and ` 1,000 crore, respectively. The equipment and patent relate to a product that has just recently been commercialised. The market for this product is still developing.

Assume the entity incurred no transaction costs. For ease of convenience, the tax consequences on the gain have been ignored. How should the transaction be accounted for?

Solution

As per paragraph 2(b) of Ind AS 103, the standard does not apply to "the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in Ind AS 38, Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill". In the given case, the acquisition of equipment and patent does not represent acquisition of a business as equipment and patent relate to a product that has just recently been commercialised.

The cost of the asset acquisition is determined based on the fair value of the assets given, unless the fair value of the assets received is more reliably determinable. In the given case, the fair value measurement of the land appears more reliable than the fair value estimate of the equipment and patent. Thus, the entity should record the acquisition of the equipment and patent as ` 1,400 crore (the total fair value of the consideration transferred).

Thus, the fair value of the consideration given, i.e., ` 1,400 crore is allocated to the individual assets acquired based on their relative estimated fair values. The entity should record a gain of ` 300 crore for the difference between the fair value and carrying value of the land.

The equipment is recorded at its relative fair value ((` 500 / ` 1,500) × ` 1,400 = ` 467 crore).

The patent is recorded at its relative fair value ((` 1,000 / ` 1,500) × ` 1,400 = ` 933 Crore).

2

Company A is a pharmaceutical company. Since inception, the Company had been conducting in-house research and development activities through its skilled workforce and recently obtained an intellectual property right (IPR) in the form of patents over certain drugs. The Company's has a production plant that has recently obtained regulatory approvals. However, the Company has not earned any revenue so far and does not have any customer contracts for sale of goods. Company B acquires Company A.

Does Company A constitute a business in accordance with Ind AS 103?

Solution

The definition of business requires existence of inputs and processes. In this case, the skilled workforce, manufacturing plant and IPR, along with strategic and operational processes constitutes the inputs and processes in line with the requirements of Ind AS 103.

When the said inputs and processes are applied as an integrated set, the Company A will be capable of producing outputs; the fact that the Company A currently does not have revenue is not relevant to the analysis of the definition of business under Ind AS 103. Basis this and presuming that Company A would have been able to obtain access to customers that will purchase the outputs, the present case can be said to constitute a business as per Ind AS 103.

3

Modifying the above illustration, if Company A had revenue contracts and a sales force, such that Company B acquires all the inputs and processes other than the sales force, then whether the definition of the business is met in accordance with Ind AS 103?

Solution

Though the sales force has not been taken over, however, if the missing inputs (i.e., sales force) can be easily replicated or obtained by the market participant to generate output, it may be concluded that Company A has acquired business. Further, if Company B is also into similar line of business, then the existing sales force of the Company B may also be relevant to mitigate the missing input. As such, the definition of business is met in accordance with Ind AS 103.

4: Potential voting rights

Company P Ltd., a manufacturer of textile products, acquires 40,000 equity shares of Company X (a manufacturer of complementary products) out of 1,00,000 shares in issue. As part of the same agreement, the Company P purchases an option to acquire an additional 25,000 shares. The option is exercisable at any time in the next 12 months. The exercise price includes a small premium to the market price at the transaction date.

After the above transaction, the shareholdings of Company P's two other original shareholders are 35,000 and 25,000. Each of these shareholders also has currently exercisable options to acquire 2,000 additional shares. Assess whether control is acquired by Company P.

Solution

In assessing whether it has obtained control over Company X, Company P should consider not only the 40,000 shares it owns but also its option to acquire another 25,000 shares (a so-called potential voting right). In this assessment, the specific terms and conditions of the option agreement and other factors are considered as follows: • the options are currently exercisable and there are no other required conditions before such options can be exercised

• if exercised, these options would increase Company P's ownership to a controlling interest of over 50% before considering other shareholders' potential voting rights (65,000 shares out of a total of 1,25,000 shares)

• although other shareholders also have potential voting rights, if all options are exercised Company P will still own a majority (65,000 shares out of 1,29,000 shares)

• the premium included in the exercise price makes the options out-of-the-money. However, the fact that the premium is small and the options could confer majority ownership indicates that the potential voting rights have economic substance.

By considering all the above factors, Company P concludes that with the acquisition of the 40,000 shares together with the potential voting rights, it has obtained control of Company X.

5

Veera Limited and Zeera Limited are both in the business of manufacturing and selling of Lubricant. Shareholders of Veera Limited and Zeera Limited agreed to join forces to benefit from lower delivery and distribution costs. The business combination is carried out by setting up a new entity called Meera Limited that issues 100 shares to Veera Limited shareholders and 50 shares to Zeera Limited shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also respective company's shareholders get the voting rights in Meera Limited based on their respective shareholdings.

Determine the acquirer by applying the principles of Ind AS 103 'Business Combinations'

Solution

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 combined entity after the business combination - The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. Based on above mentioned para, acquirer shall be the either of the combining entities (i.e. Veera Limited or Zeera Limited) whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity.

Hence in the above scenario Veera Limited shareholder gets 67% Share [(100/150) x100] and Zeera Limited shareholder gets 33.33% share in Meera Limited. Hence Veera Limited is acquirer as per the principles of Ind AS 103.

6

ABC Ltd. incorporated a company Super Ltd. to acquire 100% shares of another entity Focus Ltd. (and therefore to obtain control of the Focus Ltd.). To fund the purchase, Super Ltd. acquired a loan from XYZ Bank at commercial interest rates. The loan funds are used by Super Ltd. to acquire entire voting shares of Focus Ltd. at fair value in an orderly transaction. Post the acquisition, Super Ltd. has the ability to elect or appoint or to remove a majority of the members of the governing body of the Focus Ltd. and also Super Ltd.'s management is in a power where it will be able to dominate the management of the Focus Ltd. Can Super Ltd. be identified as the acquirer in this business combination?

Solution

Paragraph 6 of Ind AS 103 states that for each business combination, one of the combining entities shall be identified as the acquirer.

While paragraph 7 states that the guidance in Ind AS 110 shall be used to identify the acquirer that is the entity that obtains control of another entity called the acquiree. If a business combination has occurred but applying the guidance in Ind AS 110 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 of Ind AS 103 shall be considered in making that determination.

Further, paragraph B15 provides that, 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:

(a) The relative voting rights in the combined entity after the business combination: The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.

(b) The existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest: The acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.

(c) The composition of the governing body of the combined entity: The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.

(d) The composition of the senior management of the combined entity: The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.

(e) The terms of the exchange of equity interests: The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities. The key drivers of the accounting are identifying the party on whose behalf the new entity has been formed and identifying the business acquired. In this scenario, as Super Ltd. has the ability to elect or appoint or to remove a majority of the members of the governing body of the Focus Ltd. and has the ability to dominate the management of the Focus Ltd. Accordingly, Super Ltd. will be identified as the acquirer unless there are conditions to conclude to the contrary.

7

Can an acquiring entity account for a business combination based on a signed non-binding letter of intent where the exchange of consideration and other conditions are expected to be completed with 2 months?

Solution

No. as per the requirement of the standard a non- binding Letter of Intent (LOI) does not effectively transfer control and hence this cannot be considered as the basis for determining the acquisition date.

8

On 1st April, X Ltd. agrees to acquire the share of B Ltd. in an all equity deal. As per the binding agreement X Ltd. will get the effective control on 1st April. However, the consideration will be paid only when the shareholders' approval is received. The shareholders meeting is scheduled to happen on 30th April. If the shareholders' approval is not received for issue of new shares, then the consideration will be settled in cash. What is the acquisition date?

Solution

The acquisition date in the above case is 1st April. This is because, in the above scenario, even if the shareholders don't approve the shares, consideration will be settled through payment of cash.

9 : Business Combination without a Court approved scheme

ABC Ltd. acquired all the shares of XYZ Ltd. The negotiations had commenced on 1st January, 20X1 and the agreement was finalised on 1st March, 20X1. While ABC Ltd. obtains the power to control XYZ Ltd.'s operations on 1st March, 20X1, the agreement states that the acquisition is effective from 1st January, 20X1 and that ABC Ltd. is entitled to all profits after that date. In addition, the purchase price is based on XYZ Ltd.'s net asset position as at 1st January, 20X1. What is the date of acquisition?

Solution

Paragraph 8 of Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

Further paragraphs 6 and 7 of Ind AS 110, Consolidated Financial Statements, inter alia, state that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Thus, an investor controls an investee if and only if the investor has all the following:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

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.

Therefore, in this case, notwithstanding that the price is based on the net assets as at 1st January, 20X1 and that XYZ Ltd.'s shareholders do not receive any dividends after that date, the date of acquisition for accounting purposes will be 1st March, 20X1. It is only on 1st March, 20X1 and not 1st January, 20X1, that ABC Ltd. has the power to direct the relevant activities of XYZ Ltd. so as to affect its returns from its involvement with XYZ Ltd. Accordingly, the date of acquisition is 1st March, 20X1.

10 : Acquisition date- Regulatory approval

ABC Ltd. and XYZ Ltd. are manufacturers of rubber components for a particular type of equipment. ABC Ltd. makes a bid for XYZ Ltd.'s business and the Competition Commission of India (CCI) announces that the proposed transaction is to be scrutinised to ensure that competition laws are not breached. Even though the contracts are made subject to the approval of the CCI, ABC Ltd. and XYZ Ltd. mutually agree the terms of the acquisition and the purchase price before competition authority clearance is obtained. Can the acquisition date in this situation be the date on which ABC Ltd. and XYZ Ltd. agree the terms even though the approval of CCI is awaited (Assume that the approval of CCI is substantive)?

Solution

Paragraph 8 of Ind AS 103 provides that 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.

For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date. Since CCI approval is a substantive approval for ABC Ltd. to acquire control of XYZ Ltd.'s operations, the date of acquisition cannot be earlier than the date on which approval is obtained from CCI. This is pertinent given that the approval from CCI is considered to be a substantive process and accordingly, the acquisition is considered to be completed only on receipt of such approval.

11

On 1st April, 20X1, PQR Ltd. acquired 30% of the voting ordinary shares of XYZ Ltd. for ` 8,000 crore. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28. At 31st March, 20X2, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

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

The carrying amount of the investment in the associate on 31st March, 20X2 was therefore ` 8,850 crore (8,000 + 700 + 100 + 50).

On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash ` 25,000 crore. The following additional information is relevant at that date:

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

How should such business combination be accounted for?

Solution

Paragraph 42 of Ind AS 103 provides that in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in statement of profit and loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Applying the above, PQR Ltd. records the following entry in its consolidated financial statements:

		(₹ in crore)	
		Debit	Credit
Identifiable net assets of XYZ Ltd.	Dr.	30,000	
Goodwill (W.N.1)	Dr.	4,000	
Foreign currency translation reserve	Dr.	100	

PPE revaluation reserve Dr.	50	
To Cash		25,000
To Investment in associate -XYZ Ltd.		8,850
To Retained earnings (W.N.2)		50
To Gain on previously held interest in XYZ recognised in Profit or loss (W.N.3)		250
(To recognise acquisition of XYZ Ltd.)		

Working Notes:

1. Calculation of Goodwill

	₹ in crore
Cash consideration	25,000
Add: Fair value of previously held equity interest in XYZ Ltd.	9,000
Total consideration	34,000
Less: Fair value of identifiable net assets acquired	(30,000)
Goodwill	4,000

2. The credit to retained earnings represents the reversal of the unrealized gain of ` 50 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 XYZ Ltd. is calculated as follows:`

	₹ in crore
Fair Value of 30% interest in XYZ Ltd. at 1st April, 20X2	9,000
Carrying amount of interest in XYZ Ltd. at 1st April, 20X2	(8,850)
	150
Unrealised gain previously recognised in OCI	100
Gain on previously held interest in XYZ Ltd. recognised in profit or loss	250

12: Business Combination Achieved by Contract Alone

Sita Ltd and Beta Ltd decides to combine together for forming a Dual Listed Corporation (DLC). As per their shareholder's agreement, both the parties will retain original listing and Board of DLC will be comprised of 10 members out of which 6 members will be of Sita Ltd and remaining 4 board members will be of Beta Ltd. The fair value of Sita Ltd is ` 100 crores and fair value of Beta Ltd is ` 80 crores. The fair value of net identifiable assets of Beta Limited is ` 70 crores. Assume non-controlling Interest (NCI) to be measured at fair value.

You are required to determine the goodwill to be recognised on acquisition.

Solution

Sita Ltd has more Board members and thereby have majority control in DLC. Therefore, Sita Ltd is identified as acquirer and Beta Ltd as acquiree.

Since no consideration has been transferred, the goodwill needs to be calculated as the difference of Part A and Part B:

Part A:
1) Consideration paid by Acquirer. - Nil
2) Controlling Interest in Acquiree – ` 80 crores
3) Acquirer's previously held interest - Nil
Part B:
Fair value of net identifiable asset – ` 70 crores
Goodwill is recognised as ` 10 crores (80 – 70 crores) in business combination achieved through contract alone when NCI is measured at fair value.

13

Should stamp duty paid on acquisition of land pursuant to a business combination be capitalised to the cost of the asset or should it be treated as an acquisition related cost and accordingly be expensed off?

Solution

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to effect a business combination are not part of the consideration transferred.

Paragraph 53 of Ind AS 103 states that, acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception.

Note: The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109.

The stamp duty payable for transfer of assets in connection with the business combination is an acquisition-related cost as described under paragraph 53 of Ind AS 103. Stamp duty is a cost incurred by the acquirer in order to effect the business combination and it is not part of the fair value exchange between the buyer and seller for the business. In such cases, the stamp duty is incurred to acquire the ownership rights in land in order to complete the process of transfer of assets as part of the overall business combination transaction but it does not represent consideration paid to gain control over business from the sellers.

It may be noted that the accounting treatment of stamp duty incurred for separate acquisition of an item of property, plant and equipment (i.e. not as part of business combination) differs under Ind AS 16, Property, Plant and Equipment. Unlike Ind AS 16, the acquisition accounting as per Ind AS 103 requires assets and liabilities acquired in a business combination to be measured at fair value. While incurred in connection with a business combination, stamp duty does not increase the future economic benefits from the net assets comprising the business (which would be recognised at fair value) and hence cannot be capitalised. The examples of costs given in paragraph 53 is only an inclusive list; they are only indicative and do not preclude any other cost to be considered as acquisition-related cost. In the given case, the transfer of land and the related stamp duty is required to be accounted as part of the business combination transaction as per requirements of Ind AS 103 and not as a separate transaction under Ind AS.

Accordingly, stamp duty incurred in relation to land acquired as part of a business combination transaction are required to be recognised as an expense in the period in which the acquisition is completed and given effect to in the financial statements of the acquirer.

14

ABC Ltd. acquires PQR Ltd. on 30th June, 20X1. The assets acquired from PQR Ltd. include an intangible asset that comprises wireless spectrum license. For this intangible asset, ABC Ltd. is required to make an additional one-time payment to the regulator in PQR's jurisdiction in order for the rights to be transferred for its use. Whether such additional payment to the regulator is an acquisition-related cost?

Solution

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to effect a business combination are not part of the consideration transferred.

Paragraph 53 of Ind AS 103 states that, acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109.

The payment to the regulator represents a transaction cost and will be regarded as acquisition related cost incurred to effect the business combination. Applying the requirements of para 53 of Ind AS 103, it should be expensed as it is incurred. Transfer of rights in the instant case cannot be construed to be separate from the business combination because the transfer of the rights to ABC Ltd. is an integral part of the business combination itself.

It may be noted that had the right been acquired separately (i.e. not as part of business combination), the transaction cost is required to be capitalised as part of the intangible asset as per the requirements of Ind AS 38, Intangible Assets.

15

ABC Ltd. acquired a beverage company PQR Ltd. from XYZ Ltd. At the time of the acquisition, PQR Ltd. is the defendant in a court case whereby certain customers of PQR Ltd. have alleged that its products contain pesticides in excess of the permissible levels that have caused them health damage PQR Ltd. is being sued for damages of ` 2 crore. XYZ Ltd. has indemnified ABC Ltd. for the losses, if any, due to the case for amount up to ` 1 crore. The fair value of the contingent liability for the court case is ` 70 lakh.

How should ABC Ltd. account for the contingent liability and the indemnification asset? What if the fair value of the liability is ` 1.2 crore instead of ` 70 lakh.

Solution

In the current scenario, ABC Ltd. measures the identifiable liability of entity PQR Ltd. at ` 70 lakh and also recognises a corresponding indemnification asset of ` 70 lakhs on its consolidated balance sheet. The net impact on goodwill from the recognition of the contingent liability and associated indemnification asset is nil. However, in the case where the liability's fair value is more than ` 1 crore ie. ` 1.2 crore, the indemnification asset will be limited to ` 1 crore only.

16

ABC Ltd. pays ` 50 crore to acquire PQR Ltd. from XYZ Ltd. PQR Ltd. manufactured products containing fiber glass and has been named in 10 class actions concerning the effects of these fiber glass. XYZ Ltd. agrees to indemnify ABC Ltd. for the adverse results of any court cases up to an amount of ` 10 crore. The class actions have not specified amounts of damages and past experience suggests that claims may be up to ` 1 crore each, but that they are often settled for small amounts.

ABC Ltd. makes an assessment of the court cases and decides that due to the potential variance in outcomes, the contingent liability cannot be measured reliably and accordingly no amount is recognised in respect of the court cases. How should indemnification asset be accounted for?

Solution

Since no liability is recognised in the given case, ABC Ltd. will also not recognise an indemnification asset as part of the business combination accounting.

17

Company A, FMCG company acquires an online e-commerce company E, with the intention to start its retail business. The e-commerce company has over the period have 10 million registered users. However, the e-commerce company E does not have any intention to sale the customer list. Should this customer list be recorded as an intangible in a business combination?

Solution

In this situation the customer database does not give rise to legal or contractual right. Accordingly, the assessment of its separability will be assessed. The database can be useful to other players and Company E has the ability to transfer this to them. Accordingly, the intention not to transfer will not affect the assessment whether to record this as an intangible or not. Hence customer list should be recorded as an intangible in a business combination.

18

ABC Ltd. a pharmaceutical group acquires XYZ Ltd. another pharmaceutical business. XYZ Ltd. has incurred significant research costs in connection with two new drugs that have been undergoing clinical trials. Out of the two drugs, one drug has not been granted necessary regulatory approvals. However, ABC Ltd. expects that approval will be given within two years. The other drug has recently received regulatory approval. The drugs' revenue-earning potential was one of the principal reasons why entity ABC Ltd. decided to acquire entity XYZ Ltd. Whether the research and development on either of the drugs be recognised as an intangible asset in the books of ABC Ltd.?

Solution

Ind AS 38, Intangible Assets provides explicit guidance on recognition of acquired in-process research and development. Paragraph 21 of Ind AS 38 provides guidance regarding general recognition conditions which require it to be probable that expected future economic benefits will flow to the entity before an intangible asset can be recognised and for the cost to be measured reliably.

As per paragraph 33 of Ind AS 38, both of the standard's general recognition criteria, i.e. probability of benefits and reliable measurement, are always considered to be satisfied for intangible assets acquired in a business combination. The fair value of an intangible asset reflects expectations about the probability of these benefits, despite uncertainty about the timing or the amount of the inflow. There will be sufficient information to measure the fair value of the asset reliably if it is separable or arises from contractual or other legal rights.

If there is a range of possible outcomes with different probabilities, this uncertainty is taken into account in the measurement of the asset's fair value. Paragraph 34 of Ind AS 38, provides that in accordance with this Standard and Ind AS 103, an acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination.
This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset. An acquiree's in-process research and development project meets the definition of an intangible asset when it:
(a) meets the definition of an asset; and
(b) is identifiable, i.e. is separable or arises from contractual or other legal rights.
In accordance with above,
(i) The fair value of the first drug reflects the probability and the timing of the regulatory approval being obtained. As per the standard, the recognition criterion of probable future economic benefits is considered to be satisfied in respect of the asset acquired accordingly an asset is recognised. Subsequent expenditure on an in-process research or development project acquired separately is to be dealt with in accordance with paragraph 43 of Ind AS 38.
(ii) The rights to the second drug also meet the recognition criteria in Ind AS 8 and are recognised. The approval means it is probable that future economic benefits will flow to ABC Ltd. This will be reflected in the fair value assigned to the intangible asset.Thus, recognising in-process research and development as an asset on acquisition applies different criteria to those that are required for internal projects. The research costs of internal R&D projects may under no circumstances be capitalised as an intangible asset. It may be pertinent to note that entities will be required to recognise on acquisition some research and development expenditure that they would not have been able to recognise if it had been an internal project. Although the amount attributed to the project is accounted for as an asset, Ind AS 38 requires that any subsequent expenditure incurred after the acquisition of the project is to be accounted for in accordance with paragraphs 54 to 62 of Ind AS 38.

19

Vadapav Ltd. is a successful company has number of own stores across India and also offers franchisee to other companies. Efficient Ltd. is one of the franchisee of Vadapav Ltd. and is and operates number of store in south India. Vadapav Ltd. decided to acquire Efficient Ltd due to its huge distribution network and accordingly purchased the outstanding shares on 1st April, 20X2. On the acquisition date, Vadapav Ltd. determines that the license agreement reflects current market terms.

Solution

Vadapav will record the franchisee right as an intangible asset (reacquired right) while doing purchase price allocation and since it is at market terms no gain or loss will be recorded on settlement.

20

ABC Ltd. acquires PQR Ltd. for a consideration of ` 1 crore. Four years ago, ABC Ltd. had granted a ten-year license allowing PQR Ltd. to operate in Europe. The cost of the license was ` 2,50,000. The contract allows either party to terminate the franchise at a cost of the unexpired initial fee plus 20%. At the date of acquisition, the settlement amount is ` 1,80,000 [(` 2,50,000 x 6/10) + 20%].

ABC Ltd. has acquired PQR Ltd., because it sees high potential in the European market and wishes to exploit it. ABC Ltd. calculates that under current economic conditions and at current prices it could grant a six-year franchise for a price of ` 4,50,000.
How is the license accounted for as part of the business combination?
Solution
Paragraph B51 of Ind AS 103 provides that "the acquirer and acquiree may have a relationship that existed before they contemplated the business combination, referred to here as a 'pre-existing relationship'. A pre-existing relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee) or non-contractual (for example, plaintiff and defendant)."
Further, paragraph B52 of Ind AS 103 provides that "if the business combination in effect settles a pre-existing relationship, the acquirer recognises a gain or loss, measured as follows:
(a) for a pre-existing non-contractual relationship (such as a lawsuit), fair value.
(b) for a pre-existing contractual relationship, the lesser of (i) and (ii):
(i) the amount by which the contract is favourable or unfavourable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavourable contract is a contract that is unfavourable in terms of current market terms. It is not necessarily an onerous contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.)
(ii) the amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavourable.

If (ii) is less than (i), the difference is included as part of the business combination accounting.
The amount of gain or loss recognised may depend in part on whether the acquirer had previously recognised a related asset or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements."
Based on the above in the instant case, the license is recognised at ` 4,50,000, the fair value at market rates of a license based on the remaining contractual life.
The gain or loss on settlement of the contract is the lower of:
• ` 3,00,000, which is the amount by which the right is unfavorable to ABC Ltd. compared to market terms. This is the difference between the amount that ABC Ltd. could receive for granting a similar right, ` 4,50,000, compared to the carrying value (or the unamortised value) that it was granted for, ` 1,50,000 (2,50,000 X 6/10).
• ` 1,80,000, which is the amount that ABC Ltd. would have to pay to terminate the right at the date of acquisition.

The loss on settlement of the contract is ` 1,80,000. Therefore, out of the ` 1 crore paid, ` 98.2 lakh is accounted for as consideration for the business combination and ` 1,80,000 is accounted for separately as a settlement loss on the re-acquired right.

21
On 1st January, 20X1, A Ltd. acquires 80 per cent of the equity interests of B Ltd. in exchange for cash of ` 15 crore. The former owners of B Ltd. were required to dispose off their investments in B Ltd. by a specified date, and accordingly they did not have sufficient time to find potential buyers. A qualified valuation professional hired by the management of A Ltd. measures the identifiable net assets acquired, in

accordance with the requirements of Ind AS 103, at ` 20 crore and the fair value of the 20 per cent non-controlling interest in B Ltd. at ` 4.2 crore. How should A Ltd. recognise the above bargain purchase?

Solution

The amount of B Ltd.'s identifiable net assets i.e., ` 20 crore exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in B Ltd. i.e. ` 19.2 crore. Therefore, A Ltd. should review the procedures it used to identify and measure the net assets acquired and the fair value of non-controlling interest in B Ltd. and the consideration transferred. After the review, A Ltd. decides that the procedures and resulting measures were appropriate. A Ltd. measures the gain on its purchase of the 80 per cent interest at ` 80 lakh, as the difference between the amount of the identifiable net assets which is ` 20 crore and the sum of purchase consideration and fair value of non-controlling interest, which is ` 19.2 crore (cash consideration of ` 15 crore and fair value of non-controlling interest of ` 4.2 crore). Assuming there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the gain on bargain purchase of 80 per cent interest calculated at ` 80 lakh, which will be recognised in other comprehensive income on the acquisition date and accumulated the same in equity as capital reserve. If the acquirer chose to measure the non-controlling interest in B Ltd. on the basis of its proportionate share of identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be ` 4 crore (` 20 crore × 0.20). The gain on the bargain purchase then would be ` 1 crore (` 20 crore – (` 15 crore + ` 4 crore)).

22

Entity X acquired 100% shareholding of Entity Y on 1st April, 20X1 and had complete the preliminary purchase price allocation and accordingly recorded net assets of ` 100 million against the purchase consideration of 150 million. Entity Y had significant carry forward losses on which deferred tax asset was not recorded due to lack of convincing evidence on the acquisition date. However, on 31st March, 20X2, Entity Y won a significant contract which is expected to generate enough taxable income to recoup the losses. Accordingly, the deferred tax asset was recorded on the carry forward losses on 31st March, 20X2. Whether the aforesaid losses can be adjusted with the Goodwill recorded based on the preliminary purchase price allocation?

Solution

No, as per the requirement of Ind AS 103, changes to the net assets are allowed which results from the discovery of a fact which existed on the acquisition date. However, change of facts resulting in recognition and de-recognition of assets and liabilities after the acquisition date will be accounted in accordance with other Ind AS. In the above scenario deferred tax asset was not eligible for recognition on the acquisition date and accordingly the new contract on 31st March, 20X2 will tantamount to change of estimate and accordingly will not impact the Goodwill amount.

23

ABC Ltd. acquires XYZ Ltd. in a business combination on 15th January, 20X1. Few days before the date of acquisition, one of XYZ Ltd.'s customers had claimed that certain amounts were due by XYZ Ltd. under penalty clauses for completion delays included in the contract.

ABC Ltd. evaluates the dispute based on the information available at the date of acquisition and concludes that XYZ Ltd. was responsible for at least some of the delays in completing the contract. Based on the evaluation, ABC Ltd. recognises ` 1 crore towards this liability which is its best estimate of the fair value of the liability to the customer based on the information available at the date of acquisition.

In October, 20X1 (within the measurement period), the customer presents additional information as per which ABC Ltd. concludes the fair value of liability on the date of acquisition to be ` 2 crore.
ABC Ltd. continues to receive and evaluate information related to the claim after October, 20X1. Its evaluation doesn't change till February, 20X2 (i.e. after the measurement period), when it concludes that the fair value of the liability for the claim at the date of acquisition is ` 1.9 crore. ABC Ltd. determines that the amount that would be recognised with respect to the claim under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets as at February, 20X2 is ` 2.2 crore.
How should the adjustment to the provisional amounts be made in the financial statements during and after the measurement period?
Solution
The consolidated financial statements of ABC Ltd. for the year ended 31st March, 20X1 should include ` 1 crore towards the contingent liability in relation to the customer claim.
When the customer presents additional information in support of its claim, the incremental liability of ` 1 crore (` 2 crore – ` 1 crore) will be adjusted as a part of acquisition accounting as it is within the measurement period. In its financial statements for the year ending on 31st March, 20X2, ABC Ltd. will disclose the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, it will disclose that the comparative information for the year ending on 31st March, 20X1 is adjusted retrospectively to increase the fair value of the item of liability at the acquisition date by ` 1 crore, resulting in a corresponding increase in goodwill.
The information resulting in the decrease in the estimated fair value of the liability for the claim in February, 20X2 was obtained after the measurement period. Accordingly, the decrease is not recognised as an adjustment to the acquisition accounting. If the amount determined in accordance with Ind AS 37 subsequently exceeds the previous estimate of the fair value of the liability, then ABC Ltd. recognises an increase in the liability. As the change has occurred after the end of the measurement period, the increase in the liability amounting to ` 20 lakh (I` 2.2 crore – ` 2 crore) is recognised in profit or loss.

24
Progressive Ltd is being sued by Regressive Ltd for an infringement of its Patent. At 31st March, 20X2, Progressive Ltd recognised a ` 10 million liability related to this litigation.
On 30th July, 20X2, Progressive Ltd acquired the entire equity of Regressive Ltd for ` 500 million. On that date, the estimated fair value of the expected settlement of the litigation is ` 20 million.
Solution
In the above scenario the litigation is in substance settled with the business combination transaction and accordingly the ` 20 million being the fair value of the litigation liability will be considered as paid for settling the litigation claim and will be not included in the business combination. Accordingly, the purchase price will reduce by 20 million and the difference between 20 and 10 will be recorded in income statement of the Progressive limited as loss on settlement of the litigation.

25

KKV Ltd acquires a 100% interest in VIVA Ltd, a company owned by a single shareholder who is also the KMP in the Company, for a cash payment of USD 20 million and a contingent payment of USD 2 million. The terms of the agreement provide for payment 2 years after the acquisition if the following conditions are met:

• the EBIDTA margins of the Company after 2 years post acquisition is 21%.

• the former shareholder continues to be employed with VIVA Ltd for at least 2 years after the acquisition. No part of the contingent payment will be paid if the former shareholder does not complete the 2 year employment period.

Solution

In the above scenario the former shareholder is required to continue in employment and the contingent consideration will be forfeited if the employment is terminated or if he resigns. Accordingly, only USD 20 million is considered as purchase consideration and the contingent consideration is accounted as employee cost and will be accounted as per the other Ind AS.

26 : Contingent consideration- Payments to employees who are former owners of acquiree

ABC Ltd. acquires all of the outstanding shares of XYZ Ltd. in a business combination. XYZ Ltd. had three shareholders with equal shareholdings, two of whom were also senior-level employees of XYZ Ltd. and would continue as employee post acquisition of shares by ABC Ltd.

• The employee shareholders each will receive ` 60,00,000 plus an additional payment of ` 1,50,00,000 to 2,00,00,000 based on a multiple of earnings over the next two years.

• The non-employee shareholders each receive ` 1,00,00,000.

The additional payment of each of these employee shareholders will be forfeited if they leave the employment of XYZ Ltd. at any time during the two years following its acquisition by ABC Ltd. The salary received by them is considered reasonable remuneration for their services.

How much amount is attributable to post combination services?

Solution

Paragraph B55(a) of Ind AS 103 provides an indication that a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services.

Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

In accordance with the above, in the instant case, the additional consideration of ` 1,50,00,000 to ` 2,00,00,000 represents compensation for post-combination services, as the same represents that part of the payment which is forfeited if the former shareholder does not remain in the employment of XYZ Ltd. for two years following the acquisition - i.e., only ` 60,00,000 is attributed to consideration in exchange for the acquired business.

27

Green Ltd acquired Pollution Ltd. as a part of the arrangement Green Ltd had to replace the Pollution Ltd.'s existing equity-settled award. The original awards specify a vesting period of five years. At the acquisition date, Pollution Ltd employees have already rendered two years of service. As required, Green Ltd replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to 2 year (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:
• original awards: ` 500
• replacement awards: ` 600.
As of the acquisition date, all awards are expected to vest.
Solution
Pre-combination period The value of the replacement awards will have to be allocated between the pre-combination and post combination period. As of the acquisition date, the fair value of the original award (` 500) will be multiplied by the service rendered upto acquisition date (2 years) divided by greater of original vesting period (5 years) or new vesting period (4 years). Accordingly, 500 x 2/5= 200 will be considered as pre-combination service and will be included in the purchase consideration.

Post- Combination period
The fair value of the award on the acquisition date is 600 which means the difference between the replacement award which is 600 and the amount allocated to pre-combination period (200) is 400 which will be now recorded over the remaining vesting period which is 2 years as an employee compensation cost.

28
P a real estate company acquires Q another construction company which has an existing equity settled share based payment scheme. The awards vest after 5 years of employee service. At the acquisition date, Company Q's employees have rendered 2 years of service. None of the awards are vested at the acquisition date. P did not replace the existing share-based payment scheme but reduced the remaining vesting period from 3 years to 2 year. Company P determines that the market-based measure of the award at the acquisition date is ` 500 (based on measurement principles and conditions at the acquisition date as per Ind AS 102).
Solution
The market based measure or the fair value of the award on the acquisition date of 500 is allocated NCI and post combination employee compensation expense. The portion allocable to pre-combination period is 500 x 2/5 = 200 which will be included in pre-combination period and is allocated to NCI on the acquisition date. The amount is computed based on original vesting period.
The remaining expense which is 500-200= 300 is accounted over the remaining vesting period of 2 years as compensation expenses.

29
Classic Ltd. acquires 60% of the ordinary shares of Natural Ltd. a private entity, for ` 97.5 crore. The fair value of its identifiable net assets is ` 150 crore. The fair value of the 40% of the ordinary shares owned by non-controlling shareholders is ` 65 crore. Carrying amount of Natural Ltd.'s net assets is ` 120 crore.
How will the non-controlling interest be measured?
Solution
Paragraph 19 of Ind AS 103 states that for each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:
(a) fair value; or
(b) the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by Ind AS.
In accordance with above, non-controlling interests will be measured in either of the following manner:
(a) Non-controlling interests are measured at fair value
Under this method, goodwill represents the difference between the fair value of Natural Ltd. and the fair value of its identifiable net assets.
Thus, Classic Ltd. will recognise the business combination as follows:

(₹ in crores)

Identifiable net assets at fair value	Dr	150	
Goodwill*	Dr	12.5	
To Non-controlling interest			65
To Investment in Natural Ltd.			97.5

*Note: Goodwill is calculated as 97.5+65-150 = 12.5 or 162.5-150 = 12.5

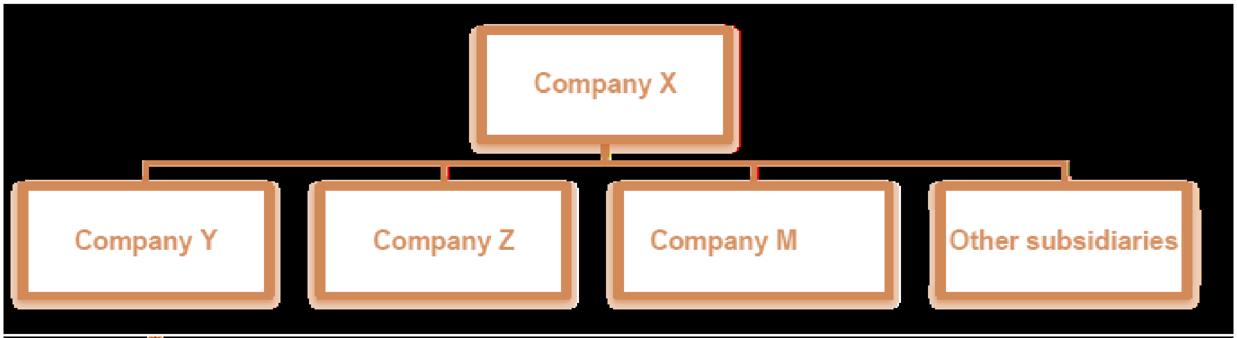
(b) Non-controlling interests are measured at proportionate share of identifiable net assets
Under this method, goodwill represents the difference between the total of the consideration transferred less the fair value of the acquirer's share of net assets acquired and liabilities assumed. The non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the Natural Ltd 's net assets in the event of liquidation (i.e. the ordinary shares) are measured at the non-controlling interest's proportionate share of the identifiable net assets of Natural Ltd.
Thus, Classic will recognise the business combination as follows:

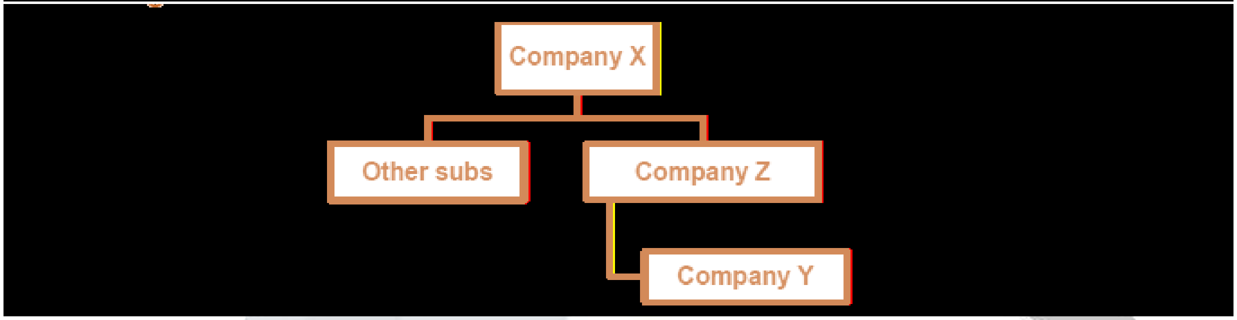
(₹ in Crores)

Identifiable net assets at fair value	Dr	150	
Goodwill*	Dr	7.5	
To Non-controlling interest (40% x 150) Cr			60
To Investment in Natural Ltd. Cr			97.5

*Note: Goodwill is calculated as 97.5+60-150 = 7.5 or 97.5-(150 x 60%) = 7.5

30
Company X, the ultimate parent of a large number of subsidiaries, reorganises the retail segment of its business to consolidate all of its retail businesses in a single entity. Under the reorganisation, Company Z (a subsidiary and the biggest retail company in the group) acquires Company X's shareholdings in its one operating subsidiary, Company Y by issuing its own shares to Company X. After the transaction, Company X will directly control the operating and financial policies of Companies Y.





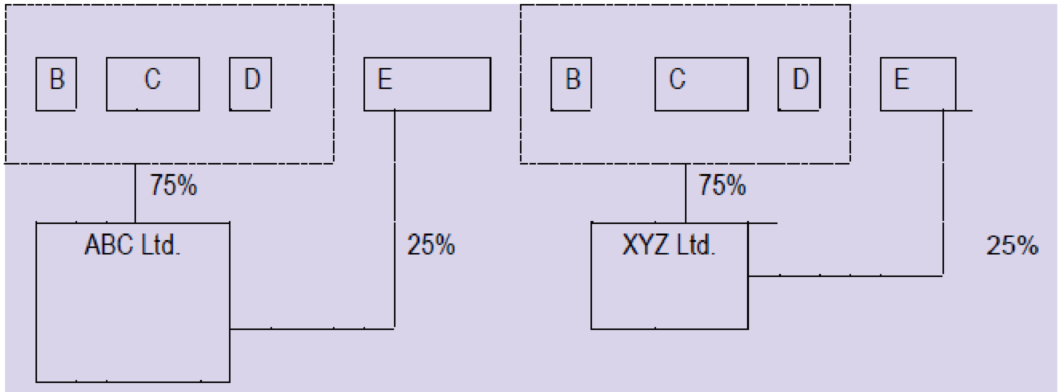
Solution

In this situation, Company Z pays consideration to Company X to obtain control of Company Y. The transaction meets the definition of a business combination. Prior to the reorganisation, each of the parties are controlled by Company X. After the reorganisation, although Company Y is now owned by Company Z, all two companies are still ultimately owned and controlled by Company X. From the perspective of Company X, there has been no change as a result of the reorganisation. This transaction therefore meets the definition of a common control combination and is within the scope of Ind AS 103.

31

ABC Ltd. and XYZ Ltd. are owned by four shareholders B, C, D and E, each of whom holds 25% of the shares in each company. Shareholders B, C and D have entered into a shareholders' agreement in terms of governance of ABC Ltd. and XYZ Ltd. due to which they exercise joint control. Whether ABC Ltd. and XYZ Ltd. are under common control?

Solution

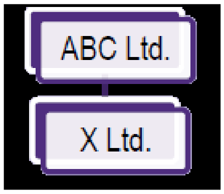


Appendix C to Ind AS 103 defines common control business combination as a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.
As per paragraphs 6 and 7 of Appendix C to Ind AS 103, an entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind AS. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one having entities under common control. Also, a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.
In the instant case, both ABC Ltd. and XYZ Ltd. are jointly controlled by group of individuals (B, C and D) as a result of contractual arrangement. Therefore, in the current scenario, ABC Ltd. and XYZ Ltd. are considered to be under common control.

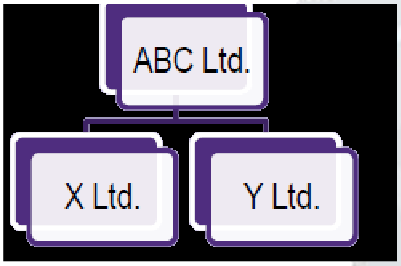
32
ABC Ltd. and XYZ Ltd. are owned by four shareholders B, C, D and E, each of whom holds 25% of the shares in each company. However, there are no agreements between any of the shareholders that they will exercise their voting power jointly.
Whether ABC Ltd. and XYZ Ltd. are under common control?
Solution
Appendix C to Ind AS 103 defines 'Common control business combination' as business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. Further as per paragraphs 6 and 7 of Appendix C to Ind AS 103, an entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind AS. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a control. Also a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory. In the present case, there is no contractual arrangement between the shareholders who exercise control collectively over either company. Thus, ABC Ltd. and XYZ Ltd. are not considered to be under common control even if there is an established pattern of voting

together.

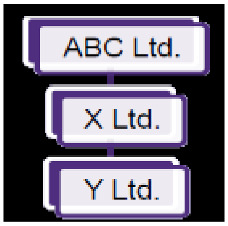
33 ABC Ltd. had a subsidiary, namely, X Ltd. which was acquired on 1st April, 2XX0. ABC Ltd. acquires all of the shares of Y Ltd. on 1st April, 2X17. ABC Ltd. transfers the shares in Y Ltd. to X Ltd. on 2nd April, 2X17. How should the above transfer of Y Ltd. into X Ltd. be accounted for in the consolidated financial statements of X Ltd.? Before:



Intermediate:



After:



Solution

Appendix C to Ind AS 103 defines common control business combination as business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. As per paragraph 7 of Appendix C to Ind AS 103, a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory. The term 'transitory' has been included as part of Appendix C to Ind AS 103. The word 'transitory' has been included in the common control definition to ensure that acquisition accounting applies to those transactions that look as though they are combinations involving entities under common control, but which in fact represent genuine substantive business combinations with unrelated parties. Based on above, if the intermediate step had been omitted and instead X Ltd. had been the ABC group's vehicle for the acquisition of Y Ltd. - i.e. going straight to the 'after' position - then X Ltd. would have been identified as the acquirer. Considering X Ltd. and Y Ltd. are under common control (with common parent), it might seem that acquisition accounting is not required because of the specific requirement for common control business combination.

However, X Ltd. should be identified as the acquirer and should account for its combination with Y Ltd. using acquisition accounting. This is because X Ltd. would have applied acquisition accounting for Y Ltd. if X Ltd. had acquired Y Ltd directly rather than through ABC Ltd. Acquisition accounting cannot be avoided in the financial statements of X Ltd. simply by placing X Ltd. and Y Ltd. under the common control ABC Ltd shortly before the transaction.

34

How will the financial statement of the prior periods be restated under common control in the following scenarios:
a) Common Control period extends beyond the start of comparative period
XYZ Ltd acquired PQR Ltd in a common control transaction on 1 October 20X9. The year-end of XYZ Ltd is 31 March. Both XYZ Ltd and PQR Ltd have been controlled by shareholders since their incorporation.
b) Common Control period started in the comparative period
ABC Ltd acquired DEF Ltd in a common control transaction on 1 October 20X9. The year end of ABC Ltd is 31 March. Both ABC Ltd and DEF Ltd are controlled by shareholder A. A made investment in ABC Ltd in 20X0 and made investment in DEF Ltd on 1 October 20X8.
Solution
Paragraph 9(iii) of Appendix C to Ind AS 103 states that the financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.
a) In accordance with Paragraph 9(iii) above, the entity will be required to restate its financial statements as if the business combination had occurred from the beginning of the preceding period in the financial statements, accordingly in the present case XYZ Ltd will have to restate its comparatives for the financial year 20X8-20X9 as if the acquisition had occurred before 1 April 20X8. Additionally, the results of current year of PQR Ltd will be required to include XYZ's financial statements for the period from 1 April 20X9 to 30 September 20X9.
b) In accordance with paragraph 9(iii) above, ABC Ltd will have to restate its comparatives for the financial year ended 20X8-20X9 as if the acquisition had occurred on 1 October 20X8, but not earlier. Additionally, the results of current year of DEF Ltd will be required to include the financial statements of ABC Ltd for the period from 1 April 20X9 to 1 October 20X9.

35

Entity A owns 100% equity shares of entity B since 01.04.20X1. Entity A arranges loan funding from a financial institution in a new wholly-owned subsidiary called "Entity C". The loan is used by Entity C to acquire 100% shareholding in entity B, for cash consideration of ` 2,00,000. Entity A applies Ind AS 103 to account for common control transactions and Entity C will adopt the same policy. Fair Value of Net identifiable Assets is ` 1,50,000 and Carrying Value of Net Identifiable Assets is ` 1,00,000.
How will Entity C apply acquisition accounting in its consolidated financial statements?
Solution:

As per para 2 of appendix C of Ind AS 103, Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.
In the above scenario, the Entity A controls Entity B before and after the acquisition. After acquisition, entity A controls entity B through entity C.
As per para 8 of appendix C of Ind AS 103, Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method.
As per para 9(i) of appendix C of Ind AS 103, the pooling of interest method is considered to involve the assets and liabilities of the combining entities are reflected at their carrying amounts.
Based on the above analysis, Entity C cannot be the acquirer. Entity A has created Entity C and is the seller, so Entity C has effectively been formed and issued shares to effect the business combination. Entity C is not a business and the transaction between entity B and Entity C is not a business combination. It is a reorganisation of entity B. As a result, entity B’s assets and liabilities are included in Entity C consolidated financial statements at their pre-combination carrying amounts without a fair value uplift.

36
Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.
On 31st March, 20X2, the division-wise draft extract of the Balance Sheet was: (`in crores)

		Laptops	Mobiles	Total
Property, Plant and Equipment cost		250	500	750
Depreciation		(225)	(400)	(625)
Net Property, Plant and Equipment	(A)	25	100	125
Current assets:		200	500	700
Less: Current liabilities		(25)	(400)	(425)
	(B)	175	100	275
Total	(A+B)	200	200	400
Financed by:				
Loan funds		-	300	300
Capital : Equity ₹ 10 each		25	-	25
Surplus		175	(100)	75
		200	200	400

Division Mobiles along with its assets and liabilities was sold for ` 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of ` 10 each at a premium of ` 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Enterprise Ltd. was holding 52% shareholding of the Company.
Assuming that there are no other transactions, you are asked to:
(i) Pass journal entries in the books of Enterprise Ltd.
(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).
(iii) Prepare the Balance Sheet of Turnaround Ltd.

Solution

Journal of Enterprise Ltd.

(₹ in crores)

			Dr.	Cr.
(1)	Loan Funds	Dr.	300	
	Current Liabilities	Dr.	400	
	Provision for Depreciation	Dr.	400	
	To Property, Plant and Equipment			500
	To Current Assets			500
	To Capital Reserve			100
	(Being division Mobiles along with its assets and liabilities sold to Turnaround Ltd. for ₹ 25 crores)			

Notes :

(1) Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.

(2) 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 (Enterprise Ltd).

Enterprise Ltd.

Balance Sheet after reconstruction *(₹ in crores)*

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		25
Current assets		
Other current assets		200
		225
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		25
Other equity (Surplus)		175
Liabilities		

Current liabilities		
Current liabilities		25
		225

Notes to Accounts

		(₹ in crores)
1.	**Other Equity**	
	Surplus (175-100)	75
	Add: Capital Reserve on reconstruction	100
		175

Notes to Accounts:

Consequent on transfer of Division Mobiles to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of ` 10 each at a premium of ` 15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Turnaround Ltd.

(₹ in crores)

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		100
Current assets		
Other current assets		500
		600
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	10
Other equity	2	(110)
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		300
Current liabilities		
Current liabilities		400
		600

Notes to Accounts

		(₹ in crores)
1.	**Share Capital:**	
	Issued and Paid-up capital	
	1 crore Equity shares of ₹ 10 each fully paid up	10
	(All the above shares have been issued for consideration other than cash, to the members of Enterprise Ltd. on takeover of Division Mobiles from Enterprise Ltd.)	
2.	**Other Equity:**	
	Securities Premium	15
	Capital reserve [25- (600 – 700)]	(125)
		(110)

Working Note:

In the given case, since both the entities are under common control, this will be accounted as follows:

• All assets and liabilities will be recorded at book value

• Identity of reserves to be maintained.

• No goodwill will be recorded.

• Securities issued will be recorded as per the nominal value.

37

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 20X2 was as under:

		Maxi division	Mini division	Total (in crores)
Property, Plant and Equipment				
Cost		600	300	900
Depreciation		(500)	(100)	(600)
W.D.V.	*(A)*	100	200	300
Current assets		400	300	700
Less: Current liabilities		(100)	(100)	(200)
	(B)	300	200	500
Total	*(A+B)*	400	400	800

Financed by :			
Loan funds (A)	*–*	*100*	*100*
(secured by a charge on property, plant and equipment)			
Own funds:			
Equity capital			*50*
(fully paid up ₹ 10 per share)			
Other Equity	*-*	*-*	*650*
(B)	*?*	*?*	*700*
Total (A+B)	*400*	*400*	*800*

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division. Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures, the assets and liabilities of that division. Mini Ltd. is to allot 5 crore equity shares of ` 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

(a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 20X2, showing corresponding previous year's figures.

(b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.

(c) Comment on the impact of demerger on "share holders wealth".

Solution

Demerged Company: Mini Division of "Maxi Mini Ltd"

Resulting Company: "Mini Ltd."

(a) Journal of Maxi Mini Ltd. (Demerged Company)

		(₹ in crores)	
		Dr.	**Cr.**
Current liabilities A/c	Dr.	100	
Loan fund (secured) A/c	Dr.	100	
Provision for depreciation A/c	Dr.	100	
Loss on reconstruction (Balancing figure)	Dr.	300	
To Property, Plant and Equipment A/c			300
To Current assets A/c			300
(Being the assets and liabilities of Mini division taken out of the books on transfer of the division to Mini Ltd., the consideration being allotment to the members of the company of one equity share of ₹ 10 each of that company at par for every share held in the company vide scheme of reorganisation)			

Note: **Any other alternatives set of entries, with the same net effect on various accounts, may be given by the students. In the absence of additional information on fair value of the assets transferred it has been assumed that the group of shareholders control both the demerged and the resultant entity. It is expected that students should evaluate all reorganization from common control parameters and aptly highlight the assumptions in the note while solving the question.**

Journal of Mini Ltd.

		(₹ in crores) Dr.	Cr.
Property, Plant and Equipment (300-100) A/c	Dr.	200	
Current assets A/c	Dr.	300	
To Current Liabilities A/c			100
To Secured loan funds A/c			100
To Equity share capital A/c			50
To Capital reserve			250
(Being the assets and liabilities of Mini division of Maxi Mini Ltd. taken over and allotment of 5 crores equity shares of ₹ 10 each at part as fully paid up to the members of Maxi Mini Ltd.)			

Maxi Mini Ltd.

Balance Sheet as at 1st November, 20X2

₹ in crore

ASSETS	Note No.	After Reconstruction	Before Reconstruction
Non-current assets			
Property, Plant and Equipment	2	100	300
Current assets			
Other current assets		400	700
		500	1,000
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of ₹ ₹ 10 each)		50	50
Other equity	1	350	650
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings		-	100
Current liabilities			
Current liabilities		100	200
		500	1,000

Notes to Accounts

		After Reconstruction	Before Reconstruction
1.	**Other Equity**		
	Other Equity	650	650
	Less: Loss on reconstruction	(300)	-
		350	650
2.	**Property, Plant and Equipment**	600	900
	Less: Depreciation	(500)	(600)
		100	300

Notes to Accounts: Consequent on reconstruction of the company and transfer of Mini division to newly incorporated company Mini Ltd., the members of the company have been allotted 5 crores equity shares of ` 10 each at part of Mini Ltd. The demerged entity and the resultant entity are common control and accordingly the transaction has been accounted at book values of the assets transferred in both the entity.

Mini Ltd.

Balance Sheet as at 1st November, 20X2 *₹ in crore*

ASSETS	Note No.	After reconstruction
Non-current assets		
Property, Plant and Equipment		200
Current assets		
Other current assets		300
		500
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		50
Other equity (capital reserve)		250
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		100
Current liabilities		
Current liabilities		100
		500

Notes to Account

	(₹ in crores)
1. **Share Capital:**	
Issued and paid up :	
5 crores Equity shares of ₹ 10 each fully paid up	50
(All the above shares have been issued for consideration other than cash, to the members of Maxi Mini Ltd., on takeover of Mini division from Maxi Mini Ltd.)	

(b) Net asset value of an equity share

(c) Demerger into two companies has had no impact on "net asset value" of shareholding. Pre-demerger, it was ` 140 per share. After demerger, it is ` 80 plus ` 60 i.e. ` 140 per original share.
It is only yield valuation that is expected to change because of separate focusing on two distinct businesses whereby profitability is likely to improve on account of demerger.

38 AX Ltd. and BX Ltd. amalgamated from 1st January, 20X2. A new Company ABX Ltd. with shares of ` 10 each was formed to take over the businesses of the existing companies.

ASSETS	Note No.	AX Ltd	BX Ltd
Non-current assets			
Property, Plant and Equipment		8,500	7,500
Financial assets			
Investment		1,050	550
Current assets			
Inventory		1,250	2,750
Trade receivables		1,800	4,000
Cash and Cash equivalent		450	400
		13,050	15,200
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of ₹ 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

Note:

1.	Other equity	AX Ltd	BX 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

ABX 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 ABX Ltd:

a. Assuming that both the entities are under common control

b. Assuming BX Ltd is a larger entity and their management will take the control of the entity ABX Ltd.

The fair value of net assets of AX and BX limited are as follows:

Assets	AX Ltd. ('000)	BX Ltd. ('000)
Property, Plant and Equipment	9,500	1,000
Inventory	1,300	2,900
Fair value of the business	11,000	14,000

Solution

(a) (Assumption: Common control transaction)

1. Calculation of Purchase Consideration

		AX Ltd.		BX Ltd.
		₹ '000		₹ '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: Other Equity:				
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 AX Ltd =

$$\frac{\text{Net Assets taken over of AX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \text{x Purchase Consideration}$$

No. of shares to be issued to BX Ltd =

$$\frac{\text{Net Assets taken over of BX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \text{x Purchase Consideration}$$

	AX Ltd. *₹ '000*	*BX Ltd.* *₹ '000*
$130{,}00 \times \frac{90{,}50}{187{,}50} = 6{,}27{,}500$ * Equity shares of ₹ 10 each	62,75	
$130{,}00 \times \frac{97{,}00}{187{,}50} = 6{,}72{,}500$ Equity shares of ₹ 10 each		67,25

Balance Sheet of ABX Ltd. as on 1.1.20X2

₹ in '00

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		16,000
Financial assets		
Investments		1,600
Current assets		
Inventory		4,000
Trade receivable		5,800
Cash and Cash equivalent		850
		28,250
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	13,000
Other equity	2	5,750
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings	3	7,000
Current liabilities		
Trade payable		2,500
		28,250

Notes to Accounts

		(₹ 000)	(₹ 000)
1.	**Share Capital**		
	13,00,000 Equity Shares of ₹ 10 each		130,00
2.	**Other Equity**		
	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

(b) Assuming BX Ltd is a larger entity and their management will take the control of the entity ABX Ltd.
In this case BX Ltd. and AX 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 ABX Ltd which is issuing the shares or AX Ltd. or BX 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 ABX Ltd. is issuing the shares but BX Ltd. post-merger will have control and is bigger in size which is a clear indicator that BX Ltd. will be an accounting acquirer. This can be justified by the following table:

(In '000s)

	AX Ltd.	BX 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 ABX Ltd. = 2,500 thousand shares		
Thus, % Held by each Company in Combined Entity	44%	56%

Note: It is a case of Reverse Acquisition.
Accordingly, BX Ltd. assets will be recorded at historical cost in the merged financial statements.
(1) Calculation of Purchase Consideration (All figures are in thousands)

We need to calculate the number of shares to be issued by BX Ltd. to AX Ltd. to maintain the same percentage i.e. 56%:
Thus, 700 thousand shares of BX 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 BX Ltd. would need to issue 550 thousand shares (1,250 less 700) to AX Ltd.
Purchase Consideration = 550 thousand shares x ` 20 per share (ie. 14,000 thousand / 700 thousand shares) = ` 11,000 thousand.

Balance Sheet of ABX Ltd. as on 1.1.20X2

₹ in '000

ASSETS	Note No.	Amount
Non-current assets		
Goodwill (Refer Working Note)		900
Property, Plant and Equipment (9500+7500)		17,000
Financial assets		
Investment (1050+550)		1,600
Current assets		
Inventory (1300+2750)		4,050
Trade receivables (1800+4000)		5,800
Cash and Cash equivalent (450+400)		850
		30,200
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 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

		(₹ 000)	(₹ 000)
1.	**Share Capital**		
	1,250,000 Equity Shares of ₹ 10 each (700,000 to BX Ltd and 550,000 as computed above to AX LTD)		1,25,00
2.	**Other Equity**		
	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 10)	5,500	8,200
3.	**Long Term Borrowings**		
	12% Debentures		70,00

Working Note:

Goodwill Computation:

Assets:	₹ in 000s
Property, Plant and Equipment	9,500
Investment	1,050
Inventory	1,300
Trade Receivable	1,800
Cash & Cash Equivalent	450
Total Assets	14,100
Less : Liabilities:	
Borrowings	3,000
Trade Payable	1,000
Net Assets	10,100
Purchase Consideration	11,000
Goodwill	900

39

On 9th April, 20X2, Shyam Ltd. a listed company started to negotiate with Ram Ltd, which is an unlisted company about the possibility of merger. On 10th May, 20X2, the board of directors of Shyam Ltd. authorized their management to pursue the merger with Ram Ltd. On 15th May, 20X2, management of Shyam Ltd. offered management of Ram Ltd. 12,000 shares of Shyam Ltd. against their total share outstanding. On 31st May, 20X2, the board of directors of Ram Ltd accepted the offer subject to shareholder's vote. On 2nd June, 20X2 both the companies jointly made a press release about the proposed merger.

On 10th June, 20X2, the shareholders of Ram Ltd approved the terms of the merger. On 15th June, the shares were allotted to the shareholders of Ram Ltd.

The market price of the shares of Shyam Ltd was as follows:

Date	Price per share
9th April	70
10th May	75
15th May	60
31st May	70
2nd June	80
10th June	85
15th June	90

What is the acquisition date and what is purchase consideration in the above scenario?

Solution

As per paragraph 8 of Ind AS 103, the acquirer shall identify the acquisition date, which is the date on which it obtains control of the aquiree. In the above scenario, the acquisition date will the date on which the shares were allotted to the shareholders of Ram Ltd. Although the shareholder approval was obtained on 10th June, 20X2 but the shares were issued only on 15th June, 20X2. Accordingly, the purchase consideration will be on the basis of ` 90 ie. the market price on that date. Hence total purchase consideration would be ` 10,80,000 (ie 12,000 shares x ` 90).

40 The balance sheet of Professional Ltd. and Dynamic Ltd. as of 31st March, 20X2 is given below:

₹ in lakhs

Assets	Professional Ltd	Dynamic Ltd
Non-Current Assets:		
Property, plant and equipment	300	500
Investment	400	100
Current assets:		
Inventories	250	150
Financial assets		
Trade 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 ₹ 100 each of Dynamic Ltd. and ₹ 10 each of Professional Ltd.	500	400
Other Equity	810	225
Non-Current liabilities:		
Financial liabilities		
Long term borrowings	250	200
Long term provisions	50	70
Deferred tax	40	35
Current Liabilities:		
Financial liabilities		
Short term borrowings	100	150
Trade payables	250	300
Total	2,000	1,380

Other information

a. Professional Ltd. acquired 70% shares of Dynamic Ltd. on 1st April, 20X2 by issuing its own shares in the ratio of 1 share of Professional Ltd. for every 2 shares of Dynamic Ltd. The fair value of the shares of Professional Ltd was ` 40 per share.

b. The fair value exercise resulted in the following: (all nos in Lakh)

a. Fair value of PPE on 1st April, 20X2 was ` 350 lakhs.

b. Professional 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 Dynamic Ltd. This additional amount will be due after 2 years. Dynamic Ltd has earned ` 10 lakh profit in the preceding year and expects to earn another ` 20 Lakh.

c. In addition to above, Professional Ltd also had agreed to pay one of the founder shareholder a payment of ` 20 lakh provided he stays with the Company for two year after the acquisition.

d. Dynamic Ltd had certain equity settled share based payment award (original award) which got replaced by the new awards issued by Professional Ltd. As per the original term the vesting period was 4 years and as of the acquisition date the employees of Dynamic Ltd have already served 2 years of service. As per the replaced awards the vesting period has been reduced to one year (one year from the acquisition date). The fair value of the award on the acquisition date was as follows:

i. Original award- ` ` 5 lakh

ii. Replacement award-` ` 8 lakh.

e. Dynamic Ltd had a lawsuit pending with a customer who had made a claim of ` 50 lakh. Management reliably estimated the fair value of the liability to be ` 5 lakh.

f. The applicable tax rate for both entities is 30%.

You are required to prepare opening consolidated balance sheet of Professional Ltd as on 1st April, 20X2. Assume 10% discount rate.

Solution

Consolidated Balance Sheet of Professional Ltd as on 1st April, 20X2 (₹ 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 ₹ 100 each	514
Other Equity	1,128.62
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
Trade payables	550
Provision for Law suit Damages	5
Total	3,230

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 ` 350 lakhs.

b. The value of replacement award is allocated between consideration transferred and post combination expense. The 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 Professional 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 Dynamic Ltd over the remaining life, which is 1 year in this scenario.

c. There 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. The 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. The impact of time value on deferred consideration has been given @ 10%.

d. The additional consideration of ` 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 Dynamic Ltd.

Working Notes:

1. Computation for Purchase consideration

Particulars		Amount
Share capital of Dynamic Ltd		4,00,00,000
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value ₹ per share		40
		₹ in lakhs
PC (2,00,000 x 70% x ₹ 40 per share) (A)		56.00
Deferred consideration after discounting ₹ 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

2. **Allocation of Purchase price**

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:			-
Trade 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)	-
Trade 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	

3. **Computation of consolidated amounts of Consolidated financial statements**

	Professional Ltd.	*Dynamic 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

Particulars		Amount
Share capital of Dynamic Ltd		4,00,00,000
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value ₹ per share		40
		₹ in lakhs
PC (2,00,000 x 70% x ₹ 40 per share) (A)		56.00
Deferred consideration after discounting ₹ 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

2. **Allocation of Purchase price**

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:			-
Trade 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)	-
Trade 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	

3. **Computation of consolidated amounts of Consolidated financial statements**

	Professional Ltd.	*Dynamic 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:				
Trade receivables	450	300		750
Cash and cash equivalents	200	100		300
Others	400	230		630
Total	2,000	1,380	(150)	3230

Equity and Liabilities				
Equity				
Share capital- Equity shares of ₹ 100 each	500			
Shares allotted to Dynamic Ltd. (2,00,000 x 70% x ₹ 10 per share)			14	514
Other Equity	810		318.62	1128.62
Replacement award			2.5	2.5
Security Premium (2,00,000 shares x 70% x ₹ 30)			42	42
Capital Reserve			274.12	274.12
Non-controlling interest	0		154.95	154.95
Non-Current liabilities:				
Financial liabilities Long term borrowings	250	200		450
Long term provisions	50	70	28.93	148.93
Deferred tax	40	35	(46.5)	28.5

Current Liabilities:				
Financial liabilities Short term borrowings	100	150		250
Trade payable	250	300	0	550
Liability for lawsuit damages			5	5
Total	2,000	755	475	3230

Questions

1. Company A and Company B are in power business. Company A holds 25% of equity shares of Company B. On 1st November, Company A obtains control of Company B when it acquires a further 65% of Company B's shares, thereby resulting in a total holding of 90%. The acquisition had the following features:

♦ Consideration: Company A transfers cash of ` 59,00,000 and issues 1,00,000 shares on 1st November. The market price of Company A's shares on the date of issue is ` 10 per share.

♦ Contingent consideration: Company A agrees to pay additional consideration of ` 7,00,000 if the cumulative profits of Company B exceed ` 70,00,000 over the next two years. At the acquisition date, it is not considered probable that the extra consideration will be paid. The fair value of the contingent consideration is determined to be ` 3,00,000 at the acquisition date.

♦ Transaction costs: Company A pays acquisition-related costs of ` 1,00,000.

♦ Non-controlling interests (NCI): The fair value of the NCI is determined to be ` 7,50,000 at the acquisition date based on market prices. Company A elects to measure non-controlling interest at fair value for this transaction.

♦ Previously held non-controlling equity interest: Company A has owned 25% of the shares in Company B for several years. At 1st November, the investment is included in Company A's consolidated balance sheets at ` 6,00,000, accounted for using the equity method; the fair value is ` 20,00,000.

The fair value of Company B's net identifiable assets at 1st November is ` 60,00,000, determined in accordance with Ind AS 103.
Determine the accounting under acquisition method for the business combination by Company A.
Answer:
Identify the acquirer
In this case, Company A has paid cash consideration to shareholders of Company B. Further, the shares issued to Company B pursuant to the acquisition do not transfer control of Company A to erstwhile shareholders of Company B. Therefore, Company A is the acquirer and Company B is the acquiree.
Determine acquisition date
As the control over the business of Company B is transferred to Company A on 1st November, that date is considered as the acquisition date.
Determine the purchase consideration

The purchase consideration in this case will comprise the following:

Cash consideration	` 59,00,000
Equity shares issued (1,00,000 x 10 i.e., at fair value)	` 10,00,000
Contingent consideration (at fair value)	` 3,00,000
Fair value of previously held interest	` 20,00,000

As such, the total purchase consideration is ` 92,00,000.
Acquisition cost incurred by and on behalf of the Company A for acquisition of Company B should be recognised in the Statement of profit and loss. As such, an amount of ` 1,00,000 should be recognised in Statement of profit and loss.

Determine fair value of identifiable assets and liabilities

The fair value of identifiable net assets is determined at ` 60,00,000.

Measure NCI

The management has decided to recognise the NCI at its fair value. As such, the NCI will be recognised at ` 7,50,000.

Re-measure previously held interests in case business combination is achieved in stages

In this case, the control has been acquired in stages i.e., before acquisition to control, the Company A exercised significant influence over Company B. As such, the previously held interest should be measured at fair value and the difference between the fair value and the carrying amount as at the acquisition date should be recognised in Statement of Profit and Loss. As such, an amount of ` 14,00,000 (i.e., 20,00,000 less 6,00,000) will be recognised in Statement of profit and loss.

Determination of goodwill or gain on bargain purchase

Goodwill should be calculated as follows:

	(`)
Total consideration	92,00,000
Recognised amount of any non-controlling interest	7,50,000
Less: Fair value of Company B's net identifiable assets	(60,00,000)
Goodwill	**39,50,000**

2. On 31st December, 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 31st December, 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 31st December, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non- current assets at 31st December, 20X1 is ` 1,500.

The balance sheets of Entity A and Entity B immediately before the business combination are:

	Entity A (legal parent, accounting acquiree)	Entity B (legal subsidiary, accounting acquirer)
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		
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

Assume that Entity B's earnings for the annual period ended 31st March, 20X1 were ` 600 and that the consolidated earnings for the annual period ended 31st March, 20X2 were ` 800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31st March, 20X1 and during the period from 1st January, 20X1 to the date of the reverse acquisition on 31st December, 20X1.

Calculate the fair value of the consideration transferred measure goodwill and prepare consolidated balance sheet as on 31st December, 20X1.

Answer:

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 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 balance sheet at 31st December, 20X1

The consolidated balance sheet 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.

3. Scenario 1: New information on the fair value of an acquired loan

Bank F acquires Bank E in a business combination in October, 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives Borrower B's financial statements for the year ended 30th September, 20X1, which indicate significant decrease in Borrower B's income from operations. Basis this, the fair value of the loan to B at the acquisition date is determined to be less than the amount recognised earlier on a provisional basis.

Scenario 2: Decrease in fair value of acquired loan resulting from an event occurring during the measurement period.

Bank F acquires Bank E in a business combination in October, 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives information that

Borrower B has lost its major customer earlier that month and this is expected to have a significant negative effect on B's operations.
Comment on the treatment done by Bank F.
Answer:
Scenario 1: The new information obtained by F subsequent to the acquisition relates to facts and circumstances that existed at the acquisition date. Accordingly, an adjustment (i.e., decrease) to in the provisional amount should be recognised for loan to B with a corresponding increase in goodwill.
Scenario 2: Basis this, the fair value of the loan to B will be less than the amount recognised earlier at the acquisition date. The new information resulting in the change in the estimated fair value of the loan to B does not relate to facts and circumstances that existed at the acquisition date, but rather is due to a new event i.e., the loss of a major customer subsequent to the acquisition date. Therefore, based on the new information, F should determine and recognise an allowance for loss on the loan in accordance with Ind AS 109, Financial Instruments: Recognition and Measurement, with a corresponding charge to profit or loss; goodwill is not adjusted.

4. Company A acquired 90% equity interest in Company B on 1st April, 20X1 for a consideration of ` 85 crores in a distress sale. Company B did not have any instrument recognised in equity. The Company appointed a registered valuer with whose assistance, the Company valued the fair value of NCI and the fair value identifiable net assets at ` 15 crores and ` 100 crores respectively.

Find the value at which NCI has to be shown in the financial statements.
Answer:
In this case, Company A has the option to measure NCI as follows:
♦ Option 1: Measure NCI at fair value i.e., ` 15 crores as derived by the valuer;
♦ Option 2: Measure NCI as proportion of fair value of identifiable net assets i.e., ` 10 crores (100 crores x 10%)

5. On 1st April, 20X1, Company A acquired 5% of the equity share capital of Company B for 1,00,000. A accounts for its investment in B at Fair Value through OCI (FVOCI) under Ind AS 109, Financial Instruments: Recognition and Measurement. At 31st March, 20X2, A carried its investment in B at fair value and reported an unrealised gain of ` 5,000 in other comprehensive income, which was presented as a separate component of equity. On 1st April, 20X2, A obtains control of B by acquiring the remaining 95 percent of B. Comment on the treatment to be done based on the facts given in the question.
Answer:
At the acquisition date A recognises the gain of ` 5,000 in OCI as the gain or loss is not allowed to be recycled to income statement as per the requirement of Ind AS 109. A's investment in B would be at fair value and therefore does not require remeasurement as a result of the business combination. The fair value of the 5 percent investment (1,05,000) plus the fair value of the consideration for the 95 percent newly acquired interest is included in the acquisition accounting.

6. Company A acquires 70 percent of Company S on 1st January, 20X1 for consideration transferred of ` 5 million. Company A intends to recognise the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitably qualified valuation professional, A measures the identifiable net assets of B at ` 10 million. A performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.
State whether the procedures followed by A and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process
Answer:
The amount of B's identifiable net assets exceeds the fair value of the consideration transferred plus the fair value of the NCI in B, resulting in an initial indication of a gain on a bargain purchase. Accordingly, A reviews the procedures it used to identify and measure the identifiable net assets acquired, to measure the fair value of both the NCI and the consideration transferred, and to identify transactions that were not part of the business combination.
Following that review, A concludes that the procedures followed and the resulting measurements were appropriate.

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

7. Entity A and entity B provide construction services in India. Entity A is owned by a group of individuals, none of whom has control and does not have a collective control agreement. Entity B is owned by a single individual, Mr. Ram. The owners of entities A and B have decided to combine their businesses. The consideration will be settled in shares of entity B. Entity B issues new shares, amounting to 40% of its issued share capital, to its controlling shareholder, Mr. Ram. Mr. Ram then transfers the shares to the owners of entity A in exchange for their interest in entity A. At this point Mr. Ram controls both entities A and B, owning 100% of entity A and 71.42% of entity B. Mr. Ram had a controlling interest in both entity A and entity B before and after the contribution. Is the combination of entities A and B a combination of entities under common control?
Answer:
No. This is not a business combination of entities under common control. Mr. Ram's control of both entities before the business combination was transitory. The substance of the transaction is that entity B has obtained control of entity A. Entity B accounts for this transaction as a business combination under Ind AS 103 using acquisition accounting.

8. On 1 April 20X1, Alpha Ltd. acquires 80 percent of the equity interest of Beta Pvt. Ltd. in exchange for cash of ` 300. Due to legal compulsion, Beta Pvt. Ltd. had to dispose of their investments by a specified date. Therefore, they did not have sufficient time to market Beta Pvt. Ltd. to multiple potential buyers. The management of Alpha Ltd. initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirement of Ind AS 103. The identifiable assets are measured at ` 500 and the liabilities assumed are measured at ` 100. Alpha Ltd.

engages on independent consultant, who determined that the fair value of 20 per cent non-controlling interest in Beta Pvt. Ltd. is ` 84.

Alpha Ltd. reviewed the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non controlling interest in Beta Pvt. Ltd. and the consideration transferred. After the review, it decided that the procedures and resulting measures were appropriate.

Calculate the gain or loss on acquisition of Beta Pvt. Ltd. and also show the journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest in Beta Pvt. Ltd. on the basis of proportionate interest method, if alternatively applied?

Answer:

The amount of Beta Pvt. Ltd. identifiable net assets [` 400, calculated as ` 500 - ` 100) exceeds the fair value of the consideration transferred plus the fair value of the non controlling interest in Beta Pvt. Ltd. [` 384 calculated as 300 + 84]. Alpha Ltd. measures the gain on its purchase of the 80 per cent interest as follows:

		₹ in lakh
Amount of the identifiable net assets acquired (₹ 500 - ₹ 100)		400
Less: Fair value of the consideration transferred for Alpha Ltd. 80 per cent interest in Beta Pvt. Ltd.	300	
Add: Fair value of non controlling interest in Beta Pvt. Ltd.	84	(384)
Gain on bargain purchase of 80 per cent interest		16

Journal Entry

		₹ in lakhs	₹ in lakhs
Identifiable assets acquired	Dr.	500	
To Cash			300
To Liabilities assumed			100
To OCI/Equity-Gain on the bargain purchase			16
To Equity-non controlling interest in Beta Pvt Ltd.			84

If the acquirer chose to measure the non controlling interest in Beta Pvt. Ltd. on the basis of its proportionate interest in the identifiable net assets of the acquire, the recognized amount of the non controlling interest would be ` 80 (` 400 x 0.20). The gain on the bargain purchase then would be ` 20 (` 400- (` 300 + ` 80)

9. ABC Ltd. prepares consolidated financial statements upto 31st March each year. On 1st July 20X1, ABC Ltd. acquired 75% of the equity shares of JKL Ltd. and gained control of JKL Ltd. the issued shares of JKL Ltd. is 1,20,00,000 equity shares. Details of the purchase consideration are as follows:

- On 1st July, 20X1, ABC Ltd. issued two shares for every three shares acquired in JKL Ltd. On 1st July, 20X1, the market value of an equity share in ABC Ltd. was ` 6.50 and the market value of an equity share in JKL Ltd. was ` 6.

- On 30th June, 20X2, ABC Ltd. will make a cash payment of ` 71,50,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 20X1. On 1st July, 20X1, ABC Ltd. would have to pay interest at an annual rate of 10% on borrowings.

- On 30th June, 20X3, ABC Ltd. may make a cash payment of ` 3,00,00,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 20X1. This payment is contingent upon the revenues of ABC Ltd. growing by 15% over the two-year period from 1st July, 20X1 to 30th June, 20X3. On 1st July, 20X1, the fair value of this contingent consideration was ` 2,50,00,000. On 31st March, 20X2, the fair value of the contingent consideration was ` 2,20,00,000.

On 1st July, 20X1, the carrying values of the identifiable net assets of JKL Ltd. in the books of that company was ` 6,00,00,000. On 1st July, 20X1, the fair values of these net assets was ` 7,00,00,000. The rate of deferred tax to apply to temporary differences is 20%.
During the nine months ended on 31st March, 20X2, JKL Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 20X2 it was necessary for ABC Ltd. to recognise an impairment of the goodwill arising on acquisition of JKL Ltd., amounting to 10% of its total computed value.
Compute the impairment of goodwill in the consolidated financial statements of ABC Ltd. under both the methods permitted by Ind AS 103 for the initial computation of the non-controlling interest in JKL Ltd. at the acquisition date.

Answer:

Computation of goodwill impairment

	NCI at fair value	NCI at of net assets
	₹ in '000	₹ in '000
Cost of investment		
Share exchange (12,000 x 75% x 2/3 x ₹ 6.50)	39,000	39,000
Deferred consideration (7,150 / 1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Non-controlling interest at date of acquisition:		
Fair value – 3000 x ₹ 6	18,000	
% of net assets – 68,000 (Refer W.N.) x 25%		17,000
Net assets on the acquisition date (Refer W.N.)	(68,000)	(68,000)
Goodwill on acquisition	20,500	19,500
Impairment @ 10%	2,050	1,950

Working Note:

Net assets on the acquisition date	₹ '000
Fair value at acquisition date	70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]	(2,000)
	68,000

10. How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:
(i) On 1 April 20X1, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:
a. an immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;

b. a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds INR 1 crore. i. The fair value of the shares of A Ltd. on the date of acquisition is INR 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is ` 25 lakhs.

ii. During the year ended 31 March 20X2, the profit before interest and tax of B Ltd. exceeded ` 1 crore. As on 31 March 20X2, the fair value of shares of A Ltd. is ` 25 per share.

iii. Continuing with the fact pattern in (a) above except for:

c. The number of shares to be issued after one year is not fixed.
d. Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to ` 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds ` 1 crore. A Ltd. issued shares with ` 40 lakhs after a year.

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 recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.
With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, Financial Instruments: Presentation. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.
(i) In the given case the amount of purchase consideration to be recognized **on initial recognition** shall be as follows:

	`
Fair value of shares issued (10,00,000 x `20)	2,00,00,000
Fair value of contingent consideration	25,00,000
Total purchase consideration	2,25,00,000

Subsequent measurement of contingent consideration payable for business combination
In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:
(a) There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavorable conditions (for the issuer of the instrument).
(b) If the instrument will or may be settled in the issuer's own equity instruments, then it is:
(i) a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.
In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32. As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.
Here, the obligation to pay contingent consideration amounting to `25,00,000 is recognized as a part of equity and therefore not re-measured subsequently or on issuance of shares.
(ii) The amount of purchase consideration to be recognized **on initial recognition** is shall be as follows:

	₹
Fair value of shares issued (10,00,000 x ₹20)	2,00,00,000
Fair value of contingent consideration	25,00,000
Total purchase consideration	2,25,00,000

Subsequent measurement of contingent consideration payable for business combination
The contingent consideration will be classified as liability as per Ind AS 32.
As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognized in profit or loss.
As at 31 March 20X2, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of `15,00,000 (` 40,00,000 – ` 25,00,000) should be recognized in the profit or loss for the period. A Ltd. would recognize issuance of 160,000 (`40,00,000/25) shares at a premium of `15 per share.

11. As part of its business expansion strategy, KK Ltd. is in process of setting up a pharma intermediates business which is at very initial stage. For this purpose, KK Ltd. has acquired on 1st April, 20X1, 100% shares of ABR Ltd. that manufactures pharma intermediates. The purchase consideration for the same was by way of a share exchange valued at ` 35 crores. The fair value of ABR Ltd.' s net assets was ` 15 crores, but does not include:
(i) A patent owned by ABR Ltd. for an established successful intermediate drug that has a remaining life of 8 years. A consultant has estimated the value of this patent to be ` 10 crores. However, the outcome of clinical trials for the same are awaited. If the trials are successful, the value of the drug would fetch the estimated ` 15 crores.
(ii) ABR Ltd. has developed and patented a new drug which has been approved for clinical use. The cost of developing the drug was `12 crores. Based on early assessment of its sales success, the valuer has estimated its market value at ` 20 crores.
(iii) ABR Ltd.'s manufacturing facilities have received a favourable inspection by a government department. As a result of this, the Company has been granted an exclusive five-year license to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is a valuable asset which assures guaranteed sales and the value for the same is estimated at ` 10 crores.
KK Ltd. has requested you to suggest the accounting treatment of the above transaction under applicable

Ind AS.

Answer:

As per para 13 of Ind AS 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. even though 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 acquisition date 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 ` 20 crore on the acquisition date.

(iii) Grant of Licence to ABR Ltd. by the Government: As regards to the five-year license, applying para 18 of Ind AS 103, grant asset will be recognised at fair value on the acquisition date by KK Ltd. On acquisition date, the fair value of the license is Rs. 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, the grant asset (license) would be recognised at ` 10 crore in 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)	30 crore
Add: License	10 crore
Less: Grant for License	(Nil)
	55 crores
Purchase Consideration	(35 crores)
Bargain purchase	20 crore

12. H Ltd. acquired equity shares of S Ltd., a listed company, in two tranches as mentioned in the below table:

Date	Equity stake purchased	Remarks
1st November, 20X6	15%	The shares were purchased based on the quoted price on the stock exchange on the relevant dates.
1st January, 20X7	45%	

Both the above-mentioned companies have Rupees as their functional currency. Consequently, H Ltd. acquired control over S Ltd. on 1st January, 20X7. Following is the Balance Sheet of S Ltd. as on that date:

Particulars	Carrying value (₹ in crore)	Fair value (₹ in crore)
ASSETS:		
Non-current assets		
(a) Property, plant and equipment	40.0	90.0
(b) Intangible assets	20.0	30.0
(c) Financial assets		
- Investments	100.0	350.0
Current assets		
(a) Inventories		
(b) Financial assets	20.0	20.0
- Trade receivables		
- Cash held in functional currency	20.0	20.0
(c) Other current assets	4.0	4.5
Non-current asset held for sale	4.0	4.5
TOTAL ASSETS	208	
EQUITY AND LIABILITIES:		
Equity		
(a) Share capital (face value ₹ 100)	12.0	50.4
(b) Other equity	141.0	Not applicable
Non-current liabilities		
(a) Financial liabilities		
- Borrowings	20.0	20.0
Current liabilities		
(a) Financial liabilities		
- Trade payables	28.0	28.0
(b) Provision for warranties	3.0	3.0
(c) Current tax liabilities	4.0	4.0
TOTAL EQUITY AND LIABILITIES	208.0	

Other information:

Property, plant and equipment in the above Balance Sheet include leasehold motor vehicles having carrying value of ` 1 crore and fair value of ` 1.2 crore. The date of inception of the lease was 1st April, 20X0. On the inception of the lease, S Ltd. had correctly classified the lease as a finance lease. However, if facts and circumstances as on 1st April, 20X7 are considered, the lease would be classified as an operating lease.

Following is the statement of contingent liabilities of S Ltd. as on 1st January, 20X7:

Particulars	Fair value (` in crore)	Remarks
Law suit filed by a customer for a claim of ` 2 crore	0.5	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim. Any amount which would be paid in respect of law suit will be tax deductible.
Income tax demand of ` 7 crore raised by tax authorities; S Ltd. has challenged the demand in the court.	2.0	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim.

In relation to the above-mentioned contingent liabilities, S Ltd. has given an indemnification undertaking to H Ltd. up to a maximum of ` 1 crore.
` 1 crore represents the acquisition date fair value of the indemnification undertaking.
Any amount which would be received in respect of the above undertaking shall not be taxable.
The tax bases of the assets and liabilities of S Ltd. is equal to their respective carrying values being recognised in its Balance Sheet.
Carrying value of non-current asset held for sale of ` 4 crore represents its fair value less cost to sell in accordance with the relevant Ind AS.
In consideration of the additional stake purchased by H Ltd. on 1st January, 20X7, it has issued to the selling shareholders of S Ltd. 1 equity share of H Ltd. for every 2 shares held in S Ltd. Fair value of equity shares of H Ltd. as on 1st January, 20X7 is ` 10,000 per share.
On 1st January, 20X7, H Ltd. has paid ` 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 20X9, H Ltd. will pay ` 30 crore to the selling shareholders of S Ltd. if return on equity of S Ltd. for the year ended 31st March, 20X9 is more than 25% per annum. H Ltd. has estimated the fair value of this obligation as on 1st January, 20X7 and 31st March, 20X7 as ` 22 crore and ` 23 crore respectively. The change in fair value of the obligation is attributable to the change in facts and circumstances after the acquisition date.
Quoted price of equity shares of S Ltd. as on various dates is as follows:

As on November, 20X6 ` 350 per share
As on 1st January, 20X7 ` 395 per share
As on 31st March, 20X7 ` 420 per share
On 31st May, 20X7, H Ltd. learned that certain customer relationships existing as on 1st January, 20X7, which met the recognition criteria of an intangible asset as on that date, were not considered during the accounting of business combination for the year ended 31st March, 20X7. The fair value of such customer relationships as on 1st January, 20X7 was ` 3.5 crore (assume that there are no temporary differences associated with customer relations; consequently, there is no impact of income taxes on customer relations).

On 31st May, 20X7 itself, H Ltd. further learned that due to additional customer relationships being developed during the period 1st January, 20X7 to 31st March, 20X7, the fair value of such customer relationships has increased to ` 4 crore as on 31st March, 20X7.
On 31st December, 20X7, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and that more information is not obtainable.
H Ltd. and S Ltd. are not related parties and follow Ind AS for financial reporting. Income tax rate applicable is 30%.
You are required to provide your detailed responses to the following, along with reasoning and computation notes:
(a) What should be the goodwill or bargain purchase gain to be recognised by H Ltd. in its financial statements for the year ended 31st March, 20X7. For this purpose, measure non-controlling interest using proportionate share of the fair value of the identifiable net assets of S Ltd.

(b) Will the amount of non-controlling interest, goodwill, or bargain purchase gain so recognised in (a) above change subsequent to 31st March, 20X7? If yes, provide relevant journal entries.
(c) What should be the accounting treatment of the contingent consideration as on 31st March, 20X7?

Answer:
(i) As an only exception to the principle of classification or designation of assets as they exist at the acquisition date is that for lease contract and insurance contracts classification which will be based on the basis of the conditions existing at inception and not on acquisition date.
Therefore, H Ltd. would be required to retain the original lease classification of the lease arrangements and thereby recognise the lease arrangements as finance lease.
(ii) The requirements in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', do not apply in determining which contingent liabilities to recognise as of the acquisition date as per Ind AS 103 'Business Combination'. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from

past events and its fair value can be measured reliably. Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Hence H Ltd. will recognize contingent liability of ` 2.5 cr.
Since S Ltd. has indemnified for ` 1 cr., H Ltd. shall recognise an indemnification asset at the same time for ` 1 cr.
As per the information given in the question, this indemnified asset is not taxable. Hence, its tax base will be equal to its carrying amount. No deferred tax will arise on it.
(iii) As per Ind AS 103, non-current assets held for sale should be measured at fair value less cost to sell in accordance with Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'. Therefore, its carrying value as per balance sheet has been considered in the calculation of net assets.
(iv) Any equity interest in S Ltd. held by H Ltd. immediately before obtaining control over S Ltd. is adjusted to acquisition-date fair value. Any resulting gain or loss is recognised in the profit or loss of H Ltd.

Investment in S Ltd.			
On 1st Nov. 20X6	15%	[(12/100) x 395 x 15%]	7.11
On 1st Jan. 20X7	45%		
Own equity given		10,000 x 12% x 45% x 1/2	270
Cash			50
Contingent consideration			22
			349.11

(v) **Calculation of deferred tax on assets and liabilities acquired as part of the business combination, including current tax and goodwill.**

Item	₹ in crore				
	Book value	Fair value	Tax base	Taxable (deductible) temporary difference	Deferred tax assets (liability) @ 30%
Property, plant and equipment	40	90	40	50	(15)
Intangible assets	20	30	20	10	(3)
Investments	100	350	100	250	(75)
Inventories	20	20	20	-	-
Trade receivables	20	20	20	-	-
Cash held in functional currency	4	4	4	-	-
Non-current asset held for sale	4	4	4	-	-
Indemnified asset	-	1	1	-	-
Borrowings	20	20	20	-	-
Trade payables	28	28	28	-	-
Provision for warranties	3	3	3	-	-
Current tax liabilities	4	4	4	-	-
Contingent liability		0.5	-	(0.5)	0.15
Deferred tax Liability					(92.85)

(vi) **Calculation of identifiable net assets acquired**

	₹ in crore	₹ in crore
Property, plant and equipment	90	
Intangible assets	30	
Investments	350	
Inventories	20	
Trade receivables	20	
Cash held in functional currency	4	
Non-current asset held for sale	4	
Indemnified asset	1	
Total asset		519
Less: Borrowings	20	
Trade payables	28	
Provision for warranties	3	
Current tax liabilities	4	
Contingent liability (2 + 0.5)	2.50	
Deferred tax liability (W.N.2)	92.85	(150.35)
Net identifiable assets		368.65

(a) Calculation of NCI by proportionate share of net assets
Net identifiable assets of S Ltd. on 1.1.20X7 (Refer W.N.3) = 372.85 crore
NCI on 1.1.20X7 = 368.65 crore x 40% = 147.46 crore
Calculation of Goodwill as per Ind AS 103
Goodwill on 1.1.20X7 = Purchase consideration + NCI – Net assets
= 349.11 + 147.46 – 368.65
= 127.92 crore

(b) As per para 45 of Ind AS 103 'Business Combination', if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.
During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date.
During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date.
The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

Further, as per para 46 of Ind AS 103, the measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to

identify and measure the following as of the acquisition date in accordance with the requirements of this Ind AS:
(a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;
(b) …..
(c) ……; and
(d) the resulting goodwill or gain on a bargain purchase.
Para 48 states that the acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill.
Para 49 states that during the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date.
Para 50 states that after the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.
On 31st December, 20X7, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and the more information is not obtainable. Therefore, the measurement period for acquisition of S Ltd. ends on 31st December, 20X7.
On 31st May, 20X7 (ie within the measurement period), H Ltd. learned that certain customer

relationships existing as on 1st January, 20X7 which met the recognition criteria of an intangible asset as on that date were not considered during the accounting of business combination for the year ended 31st March, 20X7. Therefore, H Ltd. shall account for the acquisition date fair value of customer relations existing on 1st January, 20X7 as an identifiable intangible asset. The corresponding adjustment shall be made in the amount of goodwill.
Accordingly, the amount of goodwill will be changed due to identification of new asset from retrospective date for changes in fair value of assets and liabilities earlier recognised on provisional amount (subject to meeting the condition above for measurement period). NCI changes would impact the consolidated retained earnings (parent's share). Also NCI will be increased or decreased based on the profit during the post-acquisition period.

Journal entry

Customer relationship	Dr.	3.5 crore		
To NCI			1.4 crore	
To Goodwill				2.1 crore

However, the increase in the value of customer relations after the acquisition date shall not be accounted by H Ltd., as the customer relations developed after 1st January, 20X7 represents internally generated intangible assets which are not eligible for recognition on the balance sheet.
(c) Since the contingent considerations payable by H Ltd is not classified as equity and is within the scope of Ind AS 109 'Financial Instruments', the changes in the fair value shall be recognised in profit or loss. Change in Fair value of contingent consideration (23-22) ` 1 crore will be recognized in the Statement of Profit and Loss.

PAST PAPERS, MOCK TEST PAPERS & REVISION TEST PAPER

1. 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 divisionwise draft extract of the Balance Sheet was as follows: (Rs. 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 Rs. 50 crore to Senovo Limited a new company, who allotted 2 crore equity shares of Rs. 10 each at a premium of Rs. 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 Notorola 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 AS and Schedule III of the Companies Act, 2013. Provide Notes to Accounts, for 'Other Equity' in case of (ii) and 'Share Capital' in case of (iii), only.
(MAY – 2018 10 MARKS)

Answer:

(i) Journal of Notorola Ltd.

(₹ in crore)

		Dr.	Cr.
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		
Current liabilities		50
		450

		(₹ 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	
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		
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)

2. MNC Ltd. is in process of setting up a medicine manufacturing business which is at very initial stage. For this purpose, MNC Ltd. as part of its business expansion strategy acquired on 1st April, 2019, 100% shares of Akash Ltd., a company that manufactures pharmacy products. The purchase consideration for the same was by way of a share exchange valued at Rs. 38 crore. The fair value of Akash Ltd.'s assets and liabilities were Rs. 68 crore and Rs. 50 crore respectively, but the same does not include the following:
(i) A patent owned by Akash Ltd. for an established successful new drug that has a remaining life of 6 years. A consultant has estimated the value of this patent to be Rs. 8 crore. However, the outcome of clinical trails for the same are awaited. If the trails are successful, the value of the drug would fetch the estimated Rs. 12 crore.

(ii) Akash Ltd. has developed and patented another new drug which has been approved for clinical use. The cost of developing the drug was Rs. 13 crore. Based on early assessment of its sales success, a reputed valuer has estimated its market value at Rs. 19 crore. However, there is no active market for the patent.

(iii) Akash 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 on 1st April, 2018 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 valuable asset which assures guaranteed sales and the cost to acquire the license is estimated at Rs. 7 crore of remaining period of life. It is expected to generate at least equivalent revenue. Suggest the accounting treatment of the above transactions with reasoning under applicable Ind AS in the books of MNC Ltd.
[NOV 2019 ⍰ 8 MARKS]

Answer:

As per para 13 of Ind AS 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 Akash Ltd.: The patent owned will be recognised at fair value by MNC Ltd. even though it was not recognised by Akash Ltd. in its financial statements. The patent will be amortised over the remaining useful life of the asset i.e. 6 years. Since the company is awaiting the outcome of the trials, the value of the patent should be valued at Rs. 8 crore. It cannot be estimated at Rs. 12 crore and the extra Rs. 4 crore should only be disclosed as a contingent asset and not recognised.
(ii) Patent internally developed by Akash Ltd.: Further as per para 75 of lnd AS 38 'Intangible Assets', after initial recognition, an intangible asset shall be carried at revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market.

There is no active market for patents since the fair value is based on early assessment of its sale success. Hence it is suggested to use the cost model and recognise the patent at the actual development cost of Rs. 13 crore.

(iii) Grant of Licence to Akash Ltd. by the Government: As regards to the five-year license, para 44 of Ind AS 38 requires to recognize grant asset at fair value by MNC Ltd. It can recognize both the asset (license) and the grant at Rs. 7 crore to be amortised over 4 remaining years of useful life i.e; Rs. 1.75 crore per annum

Hence the revised working would be as follows:

Fair value of net assets of Akash Ltd. (68-50)	₹ 18 crore
Add: Patent (8 + 13)	₹ 21 crore
Add: License	₹ 7 crore
Less: Grant for License	(₹ 7 crore)
	₹ 39 crore
Purchase Consideration	₹ 38 crore
Capital Reserve	₹1 crore

3. 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? [NOV 2019 – 4 MARKS]
Answer:
Reference to be included to Appendix C of Ind AS 103
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.

4. How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:

i) On 1 April 2016, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:

- **an immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;**
- **a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds INR 1 crore.**

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: ▪ The number of shares to be issued after one year is not fixed.

- **Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to Rs. 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds Rs. 1 crore. A Ltd. issued shares with Rs. 40 lakhs after an year.**

[RTP ▪ MAY 2019 | MTP ▪ APRIL 2018 & OCTOBER 2019 ▪ 12 MARKS]
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 x Rs. 20) Rs. 2,00,00,000
Fair value of contingent consideration Rs. 25,00,000
Total purchase consideration Rs. 2,25,00,000
Subsequent measurement of contingent consideration payable for business combination
In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

- There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).
- If 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.

6. Ocean Ltd is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31st March. On 1st July 2014, Ocean Ltd acquired an 80% interest in Pond Ltd. Details of the acquisition were as follows:
– Ocean ltd acquired 800,000 shares in Pond ltd by issuing two equity shares for every five acquired. The fair value of Ocean Ltd's share on 1st July 2014 was Rs. 4 per share

and the fair value of a Pond's share was Rs. 1·40 per share. The costs of issue were 5% per share.
– Ocean ltd incurred further legal and professional costs of Rs. 100,000 that directly related to the acquisition. – The fair values of the identifiable net assets of Pond Ltd at 1st July 2014 were measured at Rs. 1·3 million. Ocean ltd initially measured the non-controlling interest in Pond ltd at fair value. They used the market value of a Pond ltd share for this purpose. No impairment of goodwill arising on the acquisition of Pond ltd was required at 31st March 2015 or 2016.
Pond ltd comprises three cash generating units A, B and C. When Pond ltd was acquired the directors of Ocean ltd estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	*Carrying value (before goodwill allocation)*	*Recoverable amount*
	Rs. '000	Rs. '000
A	600	740
B	550	650
C	450	400

Required:
(i) Compute the carrying value of the goodwill arising on acquisition of Pond Ltd in the consolidated Balance Sheet of Ocean ltd at 31st March 20X4 following the impairment review as per Ind AS.
(ii) Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Pond Ltd.
[MTP · APRIL 2018 · 8 MARKS]

Answer:

1. **Computation of goodwill on acquisition**

Particular		**Amount (Rs. '000)**
Cost of investment (8,00,000 x 2/5 x ' 4)		1,280
Less: Fair value of identifiable net assets acquired by Ocean Ltd.		
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)	(1,020)
Goodwill		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** **(Rs. '000)**

Unit	**Carrying value**			**Recoverable Amount**	**Impairment Loss**
	Before Allocation	**Allocation of goodwill (2:2:1)**	**After Allocation**		
A	600	104	704	740	Nil
B	550	104	654	650	4
C	400*	52	452	400	52

* After writing down assets in the individual CGU to recoverable amount.

3. **Calculation of closing goodwill** **(Rs '000)**

Goodwill arising on acquisition (W1)	260
Impairment loss (W2)	(56)
Closing goodwill	204

4. **Calculation of overall impairment loss** **(Rs. '000)**

On goodwill (W3)	56
On assets in unit C (450 – 400)	50
Total loss	106

20% of total loss i.e. Rs. 21.20 thousand is allocated to the NCI with the balance allocated to the shareholders of Ocean ltd.

7. 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:
(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.
[MTP · AUGUST 2018 · 10 MARKS]
Answer:
Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

Item	Rs. In lakhs				
	Book value	Fair value	Tax base	Taxable (deductible) temporary difference	Deferred tax asset (liability) @ 30%
Cash	780	780[1]	780[1]	-	-
Receivables	5,200	5,200[1]	5,500[3]	(300)	90
Plant and equipment	7,000	8,000[2]	6,000[4]	2,000	(600)
Brands		4,300[2]	-[5]	4,300	(1,290)
Goodwill (Balancing figure)		2,100[9]			
Deferred tax asset	360	3,60[7]			
Total assets		**20,740**			
Payables	(1,050)	(1,050)[1]	(1,050)[1]		
Borrowings	(4,900)	(4,900)[1]	(4,900)[1]		
Employee Entitlement liabilities	(900)	(900)[1]	-[6]	(900)	270
Deferred tax liability	(300)	(1,890)[8]			
Total liabilities		**(8,740)**			
Consideration paid		**12,000**			

Notes

(1) This amount has been derived from Dorman Ltd.'s Balance Sheet as it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in Dorman Ltd.'s Balance Sheet at the acquisition date'.

(2) Stated fair value in the fact pattern (different to the carrying amount i n Dorman Ltd.'s Balance Sheet at the acquisition date).

(3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (Rs. 5,200 + Rs. 300) lakhs allowance account.

(4) Tax written down value of the plant and equipment as stated in the fact pattern.

(5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.

(6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.

(7) The aggregate deferred tax asset is Rs. 360 lakhs, comprised of Rs. 90 lakhs in relation to the receivables and Rs.270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is Rs. 1,890 lakhs calculated as follows:

Rs. In lakhs	DTL amount in Dorman Ltd.'s Balance Sheet	Deferred tax impact of fair value adjustments	Total DTL in Pharma Ltd's consolidated financial statements
Plant and equipment	300 ([7,000-6,000] × 30%)	300 ([1,000 × 30%)	600
Brand names	0	1,290 (4,300 × 30%)	1,290
TOTAL	300	1,590	1,890

(9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements of Ind AS 103, para 32. The consideration transferred is Rs. 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is Rs. 9,900 lakhs.

8. 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 OCTOBER 2018 20 MARKS]
Answer:

(i) **(Assumption: Common control transaction)**

1. Calculation of Purchase Consideration

		X Ltd.		Y Ltd.
		Rs. '000		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 =

$$\frac{\text{Net Assets taken over of X Ltd.}}{\text{Net Assets taken over of X Ltd. and Y Ltd.}} \times \text{Purchase Consideration}$$

No. of shares to be issued to Y Ltd =

$$\frac{\text{Net Assets taken over of Y Ltd.}}{\text{Net Assets taken over of X Ltd. and Y Ltd.}} \times \text{Purchase Consideration}$$

	X Ltd.	Y Ltd.
	Rs. '000	Rs. '000
$130{,}00 \times \frac{90.50}{187{,}50} = 6{,}27{,}500$ * Equity shares of Rs. 10 each	62,75	
$130{,}00 \times \frac{97{,}00}{187{,}50} = 6{,}72{,}500$ 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

9. Sun Ltd. is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31st March. On 1st July 2015 Sun ltd acquired an 80% interest in Pluto ltd. Details of the acquisition were as follows:

– Sun Ltd. acquired 800,000 shares in Pluto Ltd. by issuing two equity shares for every five acquired. The fair value of Sun Ltd.'s share on 1st July 2015 was Rs. 4 per share and the fair value of a Pluto's share was Rs. 1.40 per share. The cost of issue was 5% 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 1st July 2015 were measured at Rs. 1.3 million. Sun Ltd. initially measured the non-controlling interest in Pluto Ltd. at fair value. They used the market value of a Pluto Ltd. share for this purpose. No impairment of goodwill arising on the acquisition of Pluto Ltd. Was required at 31st March 2016 or 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:

Compute the carrying value of the goodwill arising on acquisition of Pluto Ltd. in the consolidated Balance Sheet of Sun Ltd. at 31st March 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 OCTOBER 2018 6 MARKS]

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	600	104	704	740	Nil
B	550	104	654	650	4
C	400*	52	452	400	52

* After writing down assets in the individual CGU to recoverable amount.

3. Calculation of closing goodwill

Goodwill arising on acquisition (W1)	260
Impairment loss (W2)	(56)
So closing goodwill equals	204

4. Calculation of overall impairment loss

On goodwill (W3)	56
On assets in unit C (450 – 400)	50
So total loss equals	106

Rs. 21.2 (20%) of the above is allocated to the NCI with the balance allocated to the shareholders of Sun ltd.

10. H Ltd. acquired equity shares of S Ltd., a listed company, in two tranches as mentioned in the below table:

Date	Equity stake purchased	Remarks
1st November, 2016	15%	The shares were purchased based on the quoted price on the stock exchange on the relevant dates.
1st January, 2017	45%	

Both the above-mentioned companies have INR as their functional currency.
Consequently, H Ltd. acquired control over S Ltd. on 1st January, 2017. Following is the Balance Sheet of S Ltd. as on that date:

Particulars	Carrying value (Rs. in crore)	Fair value (Rs. in crore)
ASSETS:		
Non-current assets		
(a) Property, plant and equipment	40.0	90.0
(b) Intangible assets	20.0	30.0
(c) Financial assets	100.0	350.0
- Investments		
Current assets		
(a) Inventories	20.0	20.0
(b) Financial assets		
- Trade receivables	20.0	20.0
- Cash held in functional currency	4.0	4.5
(c) Other current assets		
Non-current asset held for sale	4.0	4.5
TOTAL ASSETS	208	
EQUITY AND LIABILITIES:		
Equity		
(a) Share capital (face value Rs.100)	12.0	50.4
(b) Other equity	141.0	Not applicable
Non-current liabilities		
(a) Financial liabilities		
- Borrowings	20.0	20.0
Current liabilities		
(a) Financial liabilities	28.0	28.0
- Trade payables	3.0	3.0
(b) Provision for warranties	4.0	4.0
(c) Current tax liabilities		
TOTAL EQUITY AND LIABILITIES	208.0	

Other information:

Property, plant and equipment in the above Balance Sheet include leasehold motor vehicles having carrying value of Rs. 1 crore and fair value of Rs. 1.2 crore. The date of inception of the lease was 1st April, 2010. On the inception of the lease, S Ltd. Had correctly classified the lease as a finance lease. However, if facts and circumstances as on 1st April, 2017 are considered, the lease would be classified as an operating lease.

Following is the statement of contingent liabilities of S Ltd. as on 1st January, 2017:

Particulars	Fair value (Rs. in crore)	Remarks
Law suit filed by a customer for a claim of Rs. 2 crore	0.5	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim. Any amount which would be paid in respect of law suit will be tax deductible.
Income tax demand of Rs. 7 crore raised by tax authorities; S Ltd. has challenged the demand in the court.	2.0	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim.

In relation to the above-mentioned contingent liabilities, S Ltd. has given an indemnification undertaking to H Ltd. up to a maximum of Rs. 1 crore.
Rs. 1 crore represents the acquisition date fair value of the indemnification undertaking.
Any amount which would be received in respect of the above undertaking shall not be taxable. The tax bases of the assets and liabilities of S Ltd. is equal to their respective carrying values being recognised in its Balance Sheet.
Carrying value of non-current asset held for sale of Rs. 4 crore represents its fair value less cost to sell in accordance with the relevant Ind AS.
In consideration of the additional stake purchased by H Ltd. on 1st January, 2017, it has issued to the selling shareholders of S Ltd. 1 equity share of H Ltd. for every 2 shares held in S Ltd. Fair value of equity shares of H Ltd. as on 1st January, 2017 is Rs. 10,000 per share.
On 1st January, 2017, H Ltd. has paid Rs. 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 2019, H Ltd. will pay Rs. 30 crore to the selling shareholders of S Ltd. if return on equity of S Ltd. for the year ended 31st March, 2019 is more than 25% per annum. H Ltd. has estimated the fair value of this obligation as on 1st January, 2017 and 31st March, 2017 as Rs. 22 crore and Rs. 23 crore respectively. The change in fair value of the obligation is attributable to the change in facts and circumstances after the acquisition date.

Quoted price of equity shares of S Ltd. as on various dates is as follows:
As on November, 2016 Rs. 350 per share
As on 1st January, 2017 Rs. 395 per share
As on 31st March, 2017 Rs. 420 per share
On 31st May, 2017, H Ltd. learned that certain customer relationships existing as on 1 st January, 2017, which met the recognition criteria of an intangible asset as on that date, were not considered during the accounting of business combination for the year ended 31st March, 2017. The fair value of such customer relationships as on 1st January, 2017 was Rs. 3.5 crore (assume that there are no temporary differences associated with customer relations; consequently, there is no impact of income taxes on customer relations).

On 31st May, 2017 itself, H Ltd. further learned that due to additional customer relationships being developed during the period 1st January, 2017 to 31st March, 2017, the fair value of such customer relationships has increased to Rs. 4 crore as on 31st March, 2017.

On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and that more information is not obtainable.

H Ltd. and S Ltd. are not related parties and follow Ind AS for financial reporting. Income tax rate applicable is 30%.
You are required to provide your detailed responses to the following, along with reasoning and computation notes:

(a) What should be the goodwill or bargain purchase gain to be recognised by H Ltd. in its financial statements for the year ended 31st March, 2017. For this purpose, measure noncontrolling interest using proportionate share of the fair value of the identifiable net assets of S Ltd.

(b) Will the amount of non-controlling interest, goodwill, or bargain purchase gain so recognised in (a) above change subsequent to 31st March, 2017? If yes, provide relevant journal entries.

(c) What should be the accounting treatment of the contingent consideration as on 31st March, 2017?

[RTP · NOV 2019 | MTP · MARCH 2019 · 20 MARKS]
Answer:

(i) As an only exception to the principle of classification or designation of assets as they exist at the acquisition date is that for lease contract and insurance contracts classification which will be based on the basis of the conditions existing at inception and not on acquisition date Therefore, H Ltd. would be required to retain the original lease classification of the lease arrangements and thereby recognise the lease arrangements as finance lease.

(ii) The requirements in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', do not apply in determining which contingent liabilities to recognise as of the acquisition date as per Ind AS 103 'Business Combination'. Instead, the acquirer shall recognise as of the

acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Hence H Ltd. will recognize contingent liability of Rs. 2.5 cr.
Since S Ltd. has indemnified for Rs. 1 cr., H Ltd. shall recognise an indemnification asset at the same time for Rs. 1 cr.
As per the information given in the question, this indemnified asset is not taxable. Hence, its tax base will be equal to its carrying amount. No deferred tax will arise on it.

(iii) As per Ind AS 103, non-current assets held for sale should be measured at fair value less cost to sell in accordance with Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'. Therefore, its carrying value as per balance sheet has been considered in the calculation of net assets.

(iv) Any equity interest in S Ltd. held by H Ltd. immediately before obtaining control over S Ltd. is adjusted to acquisition-date fair value. Any resulting gain or loss is recognised in the profit or loss of H Ltd.

Calculation of purchase consideration as per Ind AS 103 **Rs.** in lakh

Investment in S Ltd.			
On 1st Nov. 2016	15%	[(12/100) x 395 x 15%]	7.11
On 1st Jan. 2017	45%		
Own equity given		10,000 x 12% x 45% x 1/2	270
Cash			50
Contingent consideration			22
			349.11

(v) Calculation of defer tax on assets and liabilities acquired as part of the business combination, **including current tax and goodwill.**

Item	Rs. in crore				
	Book value	Fair value	Tax base	Taxable (deductible) temporary difference	Deferred tax assets (liability) @ 30%
Property, plant and equipment	40	90	40	50	(15)
Intangible assets	20	30	20	10	(3)
Investments	100	350	100	250	(75)
Inventories	20	20	20	-	-
Trade receivables	20	20	20	-	-
Cash held in functional currency	4	4	4	-	-
Non-current asset held for sale	4	4	4	-	-
Indemnified asset	-	1	1	-	-
Borrowings	20	20	20	-	-
Trade payables	28	28	28	-	-
Provision for warranties	3	3	3	-	-
Current tax liabilities	4	4	4	-	-
Contingent liability		0.5	-	(0.5)	0.15
Deferred tax Liability					(92.85)

(vi) **Calculation of identifiable net assets acquired**

	Rs. in crore	Rs. in crore
Property, plant and equipment	90	
Intangible assets	30	
Investments	350	
Inventories	20	
Trade receivables	20	
Cash held in functional currency	4	
Non-current asset held for sale	4	
Indemnified asset	1	
Total asset		519
Less: Borrowings	20	
Trade payables	28	
Provision for warranties	3	
Current tax liabilities	4	
Contingent liability (2 + 0.5)	2.50	
Deferred tax liability (W.N.2)	92.85	(150.35)
Net identifiable assets		368.65

(a) Calculation of NCI by proportionate share of net assets

Net identifiable assets of S Ltd. on 1.1.2017 (Refer W.N.3) = 372.85 crore

NCI on 1.1.2017 = 368.65 crore x 40% = 147.46 crore

Calculation of Goodwill as per Ind AS 103

Goodwill on 1.1.2017 = Purchase consideration + NCI – Net assets

= 349.11 + 147.46 – 368.65

= 127.92 crore

(b) As per para 45 of Ind AS 103 'Business Combination', if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date.

During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date.

The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

Further, as per para 46 of Ind AS 103, the measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Ind AS:

(a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;

(b) …..

(c) ……; and

(d) the resulting goodwill or gain on a bargain purchase.

Para 48 states that the acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill.

Para 49 states that during the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date.

Para 50 states that after the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with

Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.
On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and the more information is not obtainable. Therefore, the measurement period for acquisition of S Ltd. ends on 31st December, 2017.
On 31st May, 2017 (ie within the measurement period), H Ltd. learned that certain customer relationships existing as on 1st January, 2017 which met the recognition criteria of an intangible asset as on that date were not considered during the accounting of business combination for the year ended 31st March, 2017. Therefore, H Ltd. shall account for the acquisition date fair value of customer relations existing on 1st January, 2017 as an identifiable intangible asset. The corresponding adjustment shall be made in the amount of goodwill.
Accordingly, the amount of goodwill will be changed due to identification of new asset from retrospective date for changes in fair value of assets and liabilities earlier recognised on provisional amount (subject to meeting the condition above for measurement period). NCI changes would impact the consolidated retained earnings (parent's share). Also NCI will be increased or decreased based on the profit during the post-acquisition period.
Journal entry
Customer relationship Dr. 3.5 crore
To NCI 1.4 crore
To Goodwill 2.1 crore
However, the increase in the value of customer relations after the acquisition date shall not be accounted by H Ltd., as the customer relations developed after 1st January, 2017 represents internally generated intangible assets which are not eligible for recognition on the balance sheet.
(c) Since the contingent considerations payable by H Ltd is not classified as equity and is within the scope of Ind AS 109 'Financial Instruments', the changes in the fair value shall be recognised in profit or loss. Change in Fair value of contingent consideration (23-22) Rs. 1 crore will be recognized in the Statement of Profit and Loss.

11. Smart Technologies Inc. is a Company incorporated in India in 1998 having business in the field of development and installation of softwares, trading of computer peripherals and other IT related equipment and provision of cloud computing services along with other services incidental thereto. It is one of the leading brands in India.
After witnessing immense popularity and support in its niche market, Smart Technologies further grew by bringing its subsidiaries namely:

Company Name	Principle Activity
Cloudustries India Private Limited	Provision of cloud computing services.
MicroFly India Private Limited	Trading of computer peripherals like mouse, keyboard, printer etc.

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Smart Technologies started preparing its financial statements based on Ind AS from 1 st April, 2015 on voluntary basis. The Microfly India Pvt. Ltd. is planning to merge the business of Cloudstries India Pvt. Ltd. with its own for which it presented before the members in the meeting the below extract of latest audited Balance Sheet of Cloudustries (prepared on the basis of Ind AS) for the year ended 31st March, 2017:

Balance Sheet as at March 31, 2017 (₹ in Crores)

Assets	
Non-current assets	
Property, plant and Equipment	15.00
	15.00
Current Assets	
(a) Financial assets	
Trade Receivables	10.00
Cash and cash equivalents	10.00
Other current assets	8.00
	28.00
Total	**43.00**
Equity and Liabilities	
Equity	
Equity Share Capital	45.00
Other Equity	
Reserves and Surplus (Accumulated Losses)*	(24.80)
	20.20
Liabilities	
Non-current Liabilities	
Financial liabilities	
Borrowings	2.80
Current Liabilities	20.00
	22.80
Total	**43.00**

***The Tax Loss carried forward of the company is Rs. 27.20 crores**
On September 5, 2017, the merger got approved by the Directors. The purchase consideration payable by MicroFly to Cloudustries was fixed at Rs. 18.00 crores payable in cash and that MicroFly take over all the assets and liabilities of Cloudustries. Present the statement showing the calculation of assets/liabilities taken over as per Ind AS. Also mention the accounting of difference between consideration and assets/liabilities taken over.
[RTP NOV 2018]
Answer:
Before the merger, Cloudustries and MicroFly are the subsidiary of Smart Technologies Inc. As the control is not transitory, the proposed merger will fall under the category of Business combination of entities under common control, it will be accounted as per Appendix C of Ind AS 103 "Business Combination" and Pooling of Interest Method would be applied.
Statement showing the calculation of assets/liabilities taken over and treatment of difference **between consideration and assets/liabilities taken over:**

(a) Net asset taken over: **(₹ in crore)**

Assets taken over:	
Property, Plant and Equipment	15.00
Cash and cash equivalents	10.00
Other current assets	8.00
Trade Receivables	10.00
Total - A	**43.00**
Less: Liabilities taken over:	
Borrowings	2.80
Current Liabilities	20.00
Total - B	**22.80**
Net Asset taken over (A-B)	**20.20**

(b) Treatment of difference between consideration and assets/liabilities taken over: **(₹ in crore)**

Net Asset taken over - A	20.20
Less: Purchase Consideration - B	18.00
Difference (A – B)	**2.20**

The difference between consideration and assets/liabilities taken over of ₹ 2.20 crore shall be transferred to capital reserve.

CHAPTER-14 CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS OF GROUP ENTITIES

UNIT 3: IND AS 110: CONSOLIDATED FINANCIAL STATEMENTS

Illustrations

1: Exception to prepare consolidated financial statements

Scenario A:

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

Company A

100% 60%

Company B Company C

100%

Company X

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

Scenario B:

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

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

Solution:

Scenario A:

Company C is a partly owned subsidiary of Company A. In such case, Company C should inform the other 40% equity shareholders about Company C not preparing consolidated financial statements and if they do not object then only Company C can avail the exemption from preparing consolidated financial statements.

Scenario B:

In this scenario, Company C is 100% held by Company A (60% direct investment and 40% investment through Company B). Hence, Company C is not required to inform to Company B of not preparing consolidated financial statements and can avail the exemption from preparing the consolidated financial statements.

2: Different investors have ability to direct different relevant activities

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

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

3: Determining the relevant activities
A Ltd. is an asset manager of a venture capital fund i.e. Fund X. Out of the total outstanding units of the fund, 10% units are held by A Ltd. and balance 90% units are held by other investors. Majority of the unitholders of the fund have right to appoint a committee which will manage the day to day administrative activities of the fund. However, the decisions related to the investments / divestments to be done by Fund X is taken by asset manager i.e. A Ltd. Based on above, who has power over Fund X?
Solution:
In this case, A Ltd. is able to direct the activities that can most significantly affect the returns of Fund X. Hence A Ltd. has power over the investee. However, this does not mean that A Ltd. Has control over the fund and consideration will have to be given to other elements of control evaluation as well i.e. exposure to variable returns and link between power and exposure to variable returns.

4 Current ability to direct the relevant activities
An investment vehicle (the investee) is created and financed with a debt instrument held by an investor (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual return from the investee. One of the equity investors who holds 30 per cent of the equity is also the asset manager.
The investee uses its proceeds to purchase a portfolio of financial assets, exposing the investee to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investee.
The returns of the investee are significantly affected by the management of the investee's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (ie when the value of the portfolio is such that the equity tranche of the investee has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor.
Based on the above, who has power over the investment vehicle?
Solution:

Managing the investee's asset portfolio is the relevant activity of the investee.
The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value.
The asset manager and the debt investor each need to determine whether they are able to direct the activities that most significantly affect the investee's returns, including considering the purpose and design of the investee as well as each party's exposure to variability of returns.

5: Voting rights are substantive or not

Scenario A:

Following is the voting power holding pattern of B Ltd.

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

All the investors have entered into a management agreement whereby they have granted the decision-making powers related to the relevant activities of B Ltd. to A Ltd. for a period of 5 years.
After 2 years of the agreement, the investors holding 90% of the voting powers have some disputes with A Ltd. and they want to take back the decision-making rights from A Ltd. This can be done by passing a resolution with majority of the investors voting in favour of the removal of rights from A Ltd. However, as per the termination clause of the management agreement, B Ltd. will have to pay a huge penalty to A Ltd. for terminating the agreement before its stated term.

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

Scenario B:

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

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

Solution:
Scenario A:
If the investors holding 90% of the voting power exercise their right to terminate the management agreement, then it will result in B Ltd. having to pay huge penalty which will affect the returns of B Ltd. This is a barrier that prevents such investors from exercising their rights and hence such rights are not substantive.
Scenario B:
To take back the decision-making rights from A Ltd., investors holding majority of the voting power need to vote in favour of removal of rights from A Ltd. However, the investors having disputes with A Ltd. do not have majority voting power and hence the rights held by them are not substantive.

6: Potential voting rights are substantive or not

Scenario A:

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

Scenario B:

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

Scenario C:

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

Solution:

Scenario A:

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

Scenario B:

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

Scenario C:

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

7: Removal rights are substantive or not

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

However, in the present scenario, there is absence of other managers who are willing or able to provide specialised services that the current asset manager is providing and purchase the stake that the current

asset manager is holding in the fund. Whether the removal rights available with other investors are substantive?

Solution:

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

8: Protective rights of a franchisor

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

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

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

Solution:

The activities that most significantly affect the returns of PQR Ltd. are the funding and capital structure of PQR Ltd., hiring of employees and their remuneration, vendors for capital items, etc. which are exercisable by PQR Ltd. Further, the retails outlet is being set up by PQR Ltd. without any financial support from ABC Ltd. The rights available with ABC Ltd. are to protect the brand name of ABC Ltd. and such rights do not affect the ability of PQR Ltd. to take decisions about relevant activities. Hence, the rights held by ABC Ltd. are protective rights.

9: Voting rights of investor are sufficient to give it power

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

Whether the investor holding 45% voting right have power over the investee?

Solution:

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

10: Voting rights of investor are sufficient to give it power

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

Solution:

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

11: Voting patterns at previous shareholders' meetings

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

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

Solution:

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

12: Potential voting rights

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

Solution:

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

13: Purpose and design of the investee

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

Whether PQR Ltd. has power over XYZ Ltd.?

Solution:

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

14: Rights contingent upon future events

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

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

Whether the investor has power over the investee?

Solution:

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

15: Commitment to ensure that an investee operates as designed

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

Solution:

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

16: Link between power and returns

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

- **Within the defined parameters, the fund manager has discretion about the assets in which to invest.**
- **The fund manager has made a 10% pro rata investment in the fund and receives a market- based fee for its services equal to 1% of the net asset value of the fund.**

- **The fees are commensurate with the services provided.**
- **The fund manager does not have any obligation to fund losses beyond its 10% investment.**

The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager but can redeem their interests within particular limits set by the fund.

Whether the fund manager controls the fund?

Solution:

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

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

17: Link between power and returns

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

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

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

Scenario A

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

Scenario B

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

Scenario C

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

Solution:

Scenario A

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

Scenario B

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

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

Scenario C

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

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

18: Link between power and returns

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

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

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

Does the asset manager control the investee?

Solution:

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

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

19: Link between power and returns

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

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

Solution:

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

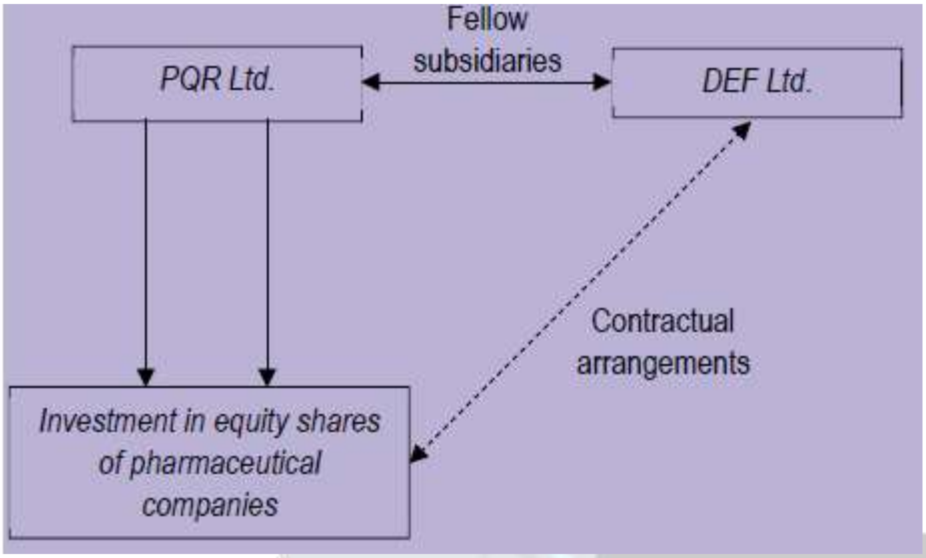
20: Business purpose of an investment entity

An asset manager has set up and investment fund for the purpose of acquiring capital contributions from various investors (by issuing them units in the fund) and investing those contributions in the equity share capital of various entities for the purpose of earning capital appreciation on those investments. Following is the existing structure of the fund. Strategic Advisory Services and financial support Apart from the investments in various entities, the investment fund also provides its investee the strategic advisory services so that it can result in increase in the capital appreciation from investments in those investees. It also provides its investees financial support in the form of loan to provide them with funds for acquiring

capital assets. The investment fund does not hold such investments for a period longer than 5 years. The investment fund measures and evaluate the performance of the investments on fair value basis.
Whether the investment fund can be treated as an investment entity?
Solution:
Out of the three elements of the definition of an investment entity, the investment fund fulfils the two elements very clearly i.e. it obtains fund from more than one investor for providing investment management services and measures and evaluates its investments on fair value basis.
The typical characteristics of an investment entity are also present in the structure of the investment fund i.e. more than one investment, more than one investor, investors are unrelated and investment fund issues units in the fund to the investors.
With respect to the business objective of the investment fund, the objective is to earn capital appreciation from its investments. The strategic advisory services and financial support provided to investees are extended with the intention of earning higher capital appreciation from the investees.
However, judgement should to be applied that these do not represent substantial business activity or a separate substantial source of income for the investment fund. If the investment fund concludes that these services and financial support to investees are not substantial business activity and substantial source of income for the investment fund, then only the investment fund can be treated as an investment entity.

21: Exit strategies of an investment entity
ABC Ltd. Is established with primary objective of investing in the equity shares of various entities across various industries based on the detailed research about each industry and entities within that industry being done by the investment manager of the company.
The investment manager decides the timing as to when the investments should be made considering the current market situation. Sometimes, the investment manager decides to invest the idle funds into short-term to medium-term debt instruments with fixed maturity. The exit strategies are in place for the investments done in equity shares but the same is not there for investments done in debt instruments. Determine whether the entity fulfils the exit strategy condition of being classified as investment entity?
Solution:
The exit strategies are in place for investments done in equity shares. But not in place for investments done in debt instruments. However, it should be noted that the debt instruments have fixed maturity period and they cannot be held for indefinite period. Hence, there is no need for having exit strategies for such instruments. Accordingly, the exit strategy condition is fulfilled for being classified as investment entity.

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



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

Solution:

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

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

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

Solution:

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

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

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

UNIT 4:
CONSOLIDATION PROCEDURE FOR SUBSIDIARIES

1: Determination of goodwill

A Limited acquires 80% of B Limited by paying cash consideration of ` 120 crore. The fair value of non-controlling interest on the date of acquisition is ` 30 crore. The value of subsidiary's identifiable net assets as per Ind AS 103 is ` 130 crore. Determine the value of goodwill and pass the journal entry.

Solution:

The amount of non-controlling interest can be measured as per i) Fair value method or ii) Proportionate share method (i.e. proportionate share in the net identifiable assets of the acquiree). The value of goodwill will be different under both the methods. The goodwill is calculated as per both the methods below:

Fair value method	₹ crore
Fair value of consideration transferred	120
Fair value of non-controlling interest	30
	150
Value of subsidiary's identifiable net assets as per Ind AS 103	(130)
Goodwill	**20**
Proportionate share method	**₹ crore**
Fair value of consideration transferred	120
Proportional share of non-controlling interest in the net identifiable assets of acquiree (130 x 20%)	26
	146
Value of subsidiary's identifiable net assets as per Ind AS 103	(130)
Goodwill	**16**

2: Determination of goodwill

Ram Ltd. Acquires 60% of Raja Ltd. By paying cash consideration of ` 750 lakh (including control premium). The fair value of non-controlling interest on the date of acquisition is ` 480 lakh. The value of subsidiary's identifiable net assets as per Ind AS 103 is ` 1,000 lakh. Determine the value of goodwill and pass the journal entry.

Solution:

The amount of non-controlling interest can be measures wither as per i) Fair value method or ii) Proportionate share method (i.e. proportionate share in the net identifiable assets of the acquiree). The value of goodwill will be different under both the methods. The goodwill is calculated as per both the methods below:

Fair value method	₹ lakh
Fair value of consideration transferred	750
Fair value of non-controlling interest	480
	1,230
Value of subsidiary's identifiable net assets as per Ind AS 103	(1,000)
Goodwill	**230**

Proportionate share method	₹ lakh
Fair value of consideration transferred	750
Proportional share of non-controlling interest in the net identifiable assets of acquiree (1,000 x 40%)	400
	1,150
Value of subsidiary's identifiable net assets as per Ind AS 103	(1,000)
Goodwill	**150**

Journal entries

Fair value method		₹ lakh	
		Dr.	Cr.
Net identifiable assets	Dr.	1,000	
Goodwill	Dr.	230	
To Cash			750
To Non-controlling interest			480

Proportionate share method		₹ lakh	
		Dr.	Cr.
Net identifiable assets	Dr.	1,000	
Goodwill	Dr.	150	
To Cash			750
To Non-controlling interest			400

3: Determination of gain on bargain purchase

X Ltd. Acquires 80% of Y Ltd. By paying cash consideration of ` 400 lakh. The fair value of non- controlling interest on the date of acquisition is ` 100 lakh. The value of subsidiary's identifiable net assets as per Ind AS 103 is ` 520 lakh. Determine the value of gain on bargain purchase and pass the journal entry.

Solution:

The amount of non-controlling interest can be measures wither as per i) Fair value method or ii) Proportionate share method (i.e. proportionate share in the net identifiable assets of the acquiree). The value of gain on bargain purchase will be different under both the methods. The gain is calculated as per both the methods below:

Fair value method	₹ lakh
Fair value of consideration transferred	400
Fair value of non-controlling interest	100
	500
Value of subsidiary's identifiable net assets as per Ind AS 103	(520)
Gain on bargain purchase	**(20)**

Proportionate share method	₹ lakh
Fair value of consideration transferred	400
Proportional share of non-controlling interest in the net identifiable assets of acquiree (520 x 20%)	104
	504
Value of subsidiary's identifiable net assets as per Ind AS 103	(520)
Gain on bargain purchase	**(16)**

Journal entries

Fair value method		₹ lakh	
		Dr.	Cr.
Net identifiable assets	Dr.	520	
To Cash			400
To Gain on bargain purchase*			20
To Non-controlling interest			100

Proportionate share method		₹ lakh	
		Dr.	Cr.
Net identifiable assets	Dr.	520	
To Cash			400
To Gain on bargain purchase*			16
To Non-controlling interest			104

* Gain on bargain purchase is either recognised in OCI or is recognised directly in equity as a capital reserve.

4: Determination of goodwill when there is no non-controlling interest

M Ltd. Acquires 100% of N Ltd. By paying cash consideration of ` 100 lakh. The value of subsidiary's identifiable net assets as per Ind AS 103 is ` 80 lakh. Determine the value of goodwill.

Solution:

The value of goodwill is calculated as follows:

Determination of goodwill	` lakh
Fair value of consideration transferred	100
Value of subsidiary's identifiable net assets as per Ind AS 103	(80)
Goodwill	20

5: Step acquisition

RS Ltd. Holds 30% stake in PQ Ltd. This investment in PQ Ltd. Is accounted as an investment in associate in accordance with Ind AS 28 and the carrying value of such investment in ` 100 lakh. RS Ltd. Purchases the remaining 70% stake for a cash consideration of ` 700 lakh. The fair value of previously held 30% stake is measured to be ` 300 lakh on the date of acquisition of 70% stake. The value of PQ Ltd.'s identifiable net assets as per Ind AS 103 on that date is ` 800 lakh. How should RS Ltd. Account for the business combination?

Solution:

The amount of goodwill is calculated as follows:

Determination of goodwill	₹ lakh
Fair value of consideration transferred	700
Fair value of previously held equity interest	300
	1,000
Value of subsidiary's identifiable net assets as per Ind AS 103	(800)
Goodwill	**200**

RS Ltd. Should record the difference between the fair value of previously held equity interest in the subsidiary and the carrying value of that interest in the profit or loss i.e. ₹ 200 lakh (300 – 100) should be recognised in profit or loss.

Journal entries

Fair value method		₹ lakh	
		Dr.	Cr.
Net identifiable assets	Dr.	800	
Goodwill	Dr.	200	
To Cash			700
To Investment in associate			100
To Gain on fair valuation of previously held equity interest			200

6: Uniform accounting policies

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

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

Solution:

As per paragraph 60 and 61 of Ind AS 16, 'Property, Plant and Equipment', a change in the method of depreciation shall be accounted for as a change in an accounting estimate as per lnd AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

Therefore, the selection of the method of depreciation is an accounting estimate and not an accounting policy. The entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods of estimating depreciation for property, plant and equipment, if their expected pattern of consumption is different. The method once selected in the individual financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

Accordingly, in the given case, the property, plant and equipment of PQR Ltd. (subsidiary company) may be depreciated using straight line method and property, plant and equipment of parent company (MNC Ltd.) may be depreciated using written down value method, if such method closely reflects the expected pattern of consumption of future economic benefits embodied in the respective assets.

7: Uniform accounting policies

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

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

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

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

Solution:

Paragraph 19 of Ind AS 110 states that a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

Paragraph B87 of Ind AS 110 states that if a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

Lt may be noted that the above mentioned paragraphs require an entity to apply uniform accounting policies "for like transactions and events in similar circumstances". If any member of the group follows a

different accounting policy for like transactions and events in similar circumstances, appropriate adjustments are to be made in preparing consolidated financial statements.
Paragraph 5 of Ind AS 8 defines accounting policies as "the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements."
Ind AS 2 requires inventories to be measured at the lower of cost and net realisable value.
Paragraph 25 of Ind AS 2 states that the cost of inventories shall be assigned by using FIFO or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.
Elaborating on the requirements of paragraph 25, paragraph 26 of Ind AS 2 illustrates that inventories used in one operating segment may have a use to the entity different from the same type of inventories used in another operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.
Paragraph 36(a) of Ind AS 2 requires disclosure of "the accounting policies adopted in measuring inventories, including the cost formula used". Thus, as per Ind AS 2, the cost formula applied in valuing inventories is also an accounting policy.
As mentioned earlier, as per Ind AS 2, different cost formulas may be justified for inventories of a different nature or use. Thus, if inventories of S Limited and A Limited differ in nature or use from inventories of H Limited, then use of cost formula (weighted average cost) different from that applied in respect of inventories of H Limited (FIFO) in consolidated financial statements may be justified. In other words, in such a case, no adjustment needs to be made to align the cost formula applied by S Limited and A Limited to cost formula applied by H Limited.

8: Different reporting dates
How should assets and liabilities be classified into current or non-current in consolidated financial statements when parent and subsidiary have different reporting dates?
Solution:
Paragraphs B92 and B93 of Ind AS 110 require subsidiaries with reporting period end different from parent, to provide additional information or details of significant transactions or events if it is impracticable to provide additional information to enable the parent entity to consolidate such financial information at group's reporting period end. The appropriate classification of the assets and liabilities as current or non-current in the consolidated financial statements has to be determined by reference to the reporting period end of the group. Accordingly, when a subsidiary's financial statements are for a different reporting period end, it is necessary to review the subsidiary's balance sheet to ensure that items are correctly classified as current or non-current as at the end of the group's reporting period.
For example, a subsidiary with the financial year end of 31st December, 20X1 has a payable outstanding that is due for payment on 1st January, 20X3, and has accordingly classified it as non- current in its balance sheet. The financial year end of the parent's consolidated financial statements is 31st March 20X2. Due to the time lag, the subsidiary's payable falls due within 12 months from the end of the parent's reporting period. Accordingly, in this case, the payable should be classified as a current liability in the consolidated financial statements of the parent because the amount is repayable within nine months of the end of the parent's reporting period.

9: Different reporting dates

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

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

Solution:

As per paragraph 74 of Ind AS 1, 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.

The above position under Ind AS 1 differs from the corresponding position under IAS 1. As per paragraph 74 of IAS 1, when an entity breaches a 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, it classifies the liability as current, even if the lender agreed, after the reporting period and before the recognized on of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.

Accordingly, the loan liability recognized as current liability by B Inc. in its standalone financial statements prepared as per IFRS, should be aligned as per Ind AS in the consolidated financial statements of A Limited and should be classified as non-current in the consolidated financial statements of A Limited in accordance with Ind AS 1.

10: Dividend proposed by subsidiary

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

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

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

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

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

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

Solution:

XYZ Ltd.'s share of dividend ₹ 30,000 x 80% = ₹ 24,000.

		₹	
		Dr.	Cr.
Bank	Dr.	24,000	
To Profit & Loss A/c			24,000

Calculation of Non- controlling interest and Journal Entry

NCI on 1st April 20X1 = 20% of the fair value on a pre-share basis of the purchased interest.

= 20% x ₹ 1,75,000 (W.N.1) = ₹ 35,000

The journal entry recorded on the acquisition date for the 80% interest acquired is as follows:

		₹	
		Dr.	Cr.
Identifiable net assets	Dr.	1,50,000	
Goodwill (Balancing Figure)	Dr.	25,000	
To Cash			1,40,000
To NCI			35,000

Working Note 1

Fair value on a per-share basis of the purchased interest / Fair Value of Identifiable net assets

= consideration transferred x 100/80

= 1,40,000 x 100/80 = ₹ 1,75,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1- 20X2

= 35,000 + (20,000 X 20%) = ₹ 39,000

Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting.

11: Dividend proposed by subsidiary

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

Also pass a journal entry on the acquisition date.

Solution:

NCI on 1st April 20X1 = 20% of the fair value on identifiable assets.
= 20% x ` 1,50,000 = ` 30,000
The journal entry recorded on the acquisition date for the 80% interest acquired is as follows:

Identifiable net assets	Dr.	1,50,000	
Goodwill (Balancing Figure)	Dr.	20,000	
To Cash			1,40,000
To NCI			30,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1- 20X2
= 30,000 + (20,000 X 20%) = ` 34,000
Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting.

12: Dividend proposed by subsidiary
The facts are same as in the above illustration except that the fair value of net identifiable asset is ` 1,60,000. Calculate NCI and Pass Journal Entry on the acquisition date
Note: Use fair value method for 31st March 20X1.

Solution:

Calculation of Non- controlling interest and Journal Entry
NCI on 1st April 20X1 = 20% of the fair value on a pre-share basis of the purchased interest.
= 20% x ` 1,75,000 (W.N.1) = ` 35,000

		₹	
		Dr.	Cr.
Identifiable net assets	Dr.	1,60,000	
Goodwill (Balancing Figure)	Dr.	15,000	
To Cash			1,40,000
To NCI			35,000

Working Note 1

Fair value on a per-share basis of the purchased interest / Fair Value of Identifiable net assets
= consideration transferred x 100/80
= 1,40,000 x 100/80 = ₹ 1,75,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1- 20X2
= 35,000 + (20,000 x 20%) = ₹ 39,000

Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received.

13: Dividend proposed by subsidiary

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

Solution:

NCI on 1st April 20X1 = 20% of the fair value on identifiable assets.

= 20% x ` 1,60,000 = ` 32,000

The journal entry recorded on the acquisition date for the 80% interest acquired is as follows:

		₹	
		Dr.	Cr.
Identifiable net assets	Dr.	1,60,000	
Goodwill (Balancing Figure)	Dr.	12,000	
To Cash			1,40,000
To NCI			32,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1- 20X2

= 32,000 + (20,000 X 20%) = ` 36,000

Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received.

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

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

Solution:

The parent must eliminate 100% of the unrealized profit on consolidation. The inventory will, therefore, be carried in the group's balance sheet at ` 20,000 (` 35,000 - ` 15,000). The consolidated income statement will show a corresponding reduction in profit of ` 15,000.

		₹' 000	
		Dr.	Cr.
Consolidated revenue	Dr.	35	
To Cost of sales			20
To Inventory			15

The reduction of group profit of ` 15,000 is allocated between the parent company and non- controlling interest in the ratio of their interests 60% and 40%.

15: Elimination of intra-group profit on sale of assets by a parent to its subsidiary
In the above illustration, assume that it is the parent that makes the sale. The parent owns 60% of a subsidiary. The parent sells some inventory to the subsidiary for ` 35,000 and makes a profit of ` 15,000. On the sale the inventory is in the subsidiary's balance sheet at the year end. Examine the treatment of intra-group transaction and pass the necessary journal entry.
Solution:
The parent must eliminate 100% of the unrealized profit on consolidation. The inventory will, therefore, be carried in the group's balance sheet at ` 20,000 (` 35,000 - ` 15,000). The consolidated income statement will show a corresponding reduction in profit of ` 15,000.
The double entry on consolidation is as follows:

		₹' 000	
		Dr.	Cr.
Consolidated revenue	Dr.	35	
To Cost of sales			20
To Inventory			15

In this case, since it is the parent that has made the sale, the reduction in profit of ` 15,000 is allocated entirely to the parent company.

16: Inventories of subsidiary out of purchases from the parent
A Ltd, a parent company sold goods costing ` '200 lakh to its 80% subsidiary B Ltd. At ` 240 lakh. 50% of these goods are lying at its stock. B Ltd. Has measured this inventory at cost i.e. at ` 120 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.
Solution:
A Ltd. shall reduce the inventories of ` 120 lakh of B Ltd., by ` 20 lakh in CFS. This will increase expenses and reduce consolidated profit by ` 20 lakh. Lt shall also create deferred tax asset of ` 6 lakh since accounting base of inventories (` 100 lakh) is lower than its tax base (` 120 lakh).

17: Inventories of parent out of purchases from the subsidiary
Ram Ltd., a parent company purchased goods costing ` 100 lakh from its 80% subsidiary Shyam Ltd. At ` 120 lakh. 50% of these goods are lying at the godown. Ram Ltd. Has measured this inventory at cost i.e. at ` 60 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.
Solution:
Ram Ltd. shall reduce the inventories of ` 60 lakh of Shyam Ltd., by ` 10 lakh in CFS This will increase expenses and reduce consolidated profit by ` 10 lakh. Lt shall also create deferred tax asset of ` 3 lakh since accounting base of inventories (` 50 lakh) is lower than its tax base (` 60 lakh).

18: Property, plant and equipment (PPE) sold by parent to subsidiary
A Ltd. (which is involved in the business of selling capital equipment) a parent company sold a capital equipment costing ` 100 lakh to its 80% subsidiary B Ltd. At ` 120 lakh. The capital equipment is recorded as PPE by B Ltd. The useful life of the PPE on the date of transfer was 10

years. Show the necessary adjustment in the consolidated financial statements (CFS).

Solution:

A Ltd. shall reduce the value of PPE of ` 120 lakh of B Ltd., by ` 20 lakh in CFS This will increase expenses and reduce consolidated profit by ` 20 lakh. Further, A Ltd. should also reduce the depreciation charge of B Ltd. to the extent of value of PPE reduced as above. Hence, A Ltd. should reduce the depreciation by ` 2 lakh (` 20 lakh ÷ 10 years). Further, the sales and cost of goods sold recorded by parent A Ltd. shall also be eliminated. The double entry on consolidation is as follows:

		₹' lakh	
		Dr.	Cr.
Consolidated revenue	Dr.	120	
To Cost of sales			100
To PPE			18
To Depreciation			2

19: Attribution of profit / loss to non-controlling interest

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

Assume that the assets are at fair value.

Solution:

₹

Year	Profit / (Loss)	Non-controlling interest (30%)	Additional consolidated P&L (Dr.) / Cr.	Goodwill
At the time of acquisition in 20X1		3,24,000 (W.N.)		2,44,000(W.N.)
20X1-20X2	(2,50,000)	(75,000)	(1,75,000)	2,44,000
		2,49,000		
20X2-20X3	(4,00,000)	(1,20,000)	(2,80,000)	2,44,000
		1,29,000		
20X3-20X4	(5,00,00)	(1,50,000)	(3,50,000)	2,44,000
		(21,000)		
20X4-20X5	(1,20,000)	(36,000)	(84,000)	2,44,000
		(57,000)		
20X5-20X6	50,000	15,000	35,000	2,44,000
		(42,000)		
20X6-20X7	1,00,000	30,000	70,000	2,44,000
		(12,000)		
20X7-20X8	1,50,000	45,000	1,05,000	2,44,000
		33,000		

Working note:

Calculation of non-controlling interest:	₹
Share capital	10,00,000
Other equity	80,000
Total	10,80,000
NCI (30% x 10,80,000)	3,24,000

NCI is measured at NCI's proportionate share of the acquiree's identifiable net assets. (Considering the carrying amount of share capital & other equity to be fair value)

Calculation of Goodwill:	₹
Consideration	10,00,000
Non-controlling interest	3,24,000
Less: Net Assets	(10,80,000)
Goodwill	2,44,000

20: Non-controlling interest and goodwill

From the following data, determine in each case:

1) Non-controlling interest at the date of acquisition (using proportionate share method) and at the date of consolidation

2) Goodwill or Gain on bargain purchase.

3) Amount of holding company's share of profit in the consolidated Balance Sheet assuming holding company's own retained earnings to be ` 2,00,000 in each case

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

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

Solution:

(1) 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)

	% 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]
Case 1 [100-90]	10%	15,000	17,000
Case 2 [100-85]	15%	19,500	18,000
Case 3 [100-80]	20%	14,000	14,000
Case 4 [100-100]	Nil	Nil	Nil

(2) Calculation of Goodwill or Gain on bargain purchase

	Consideration [G]	Non-controlling interest [H]	Net Identifiable assets [A] + [B] = [I]	Goodwill [G] + [H] – [I]	Gain on bargain Purchase [I] – [G] – [H]
Case 1	1,40,000	15,000	1,50,000	5,000	-
Case 2	1,04,000	19,500	1,30,000	-	6,500
Case 3	56,000	14,000	70,000	Nil	Nil
Case 4	1,00,000	0	90,000	10,000	-

(3) On 31.03.20X2 in each case the following amount shall be added or deducted from the balance of holding Co.'s Retained earnings.

	% Share Holding [K]	Retained earnings as on 31.03.20X1 [L]	Retained earnings as on consolidation Date [M]	Retained earnings post-acquisition [N] = [M] – [L]	Amount to be added/(deducted) from holding's Retained earnings [O] = [K] X [N]
1	90%	50,000	70,000	20,000	18,000
2	85%	30,000	20,000	(10,000)	(8,500)
3	80%	20,000	20,000	Nil	Nil
4	100%	40,000	56,000	16,000	16,000

22: Acquisition of additional stake in a subsidiary

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

12,000 and the carrying amount of the non- controlling interest is ` 4,000.
Pass journal entries to record the transaction.
Solution:
The accounting entry recorded for the purpose of the non- controlling interest is as follows:

		₹	
		Dr.	Cr.
Non-controlling interest (4,000 ÷ 40 x 20)	Dr.	2,000	
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	2,000	
To Cash			4,000

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between amount by which NCI (` 2,000) is adjusted and fair value of consideration received (` 4,000) to be attributed to parent in other equity i.e. ` 2,000.
Note: This illustration mentions two types of fair values:
- Fair value of Entity B, and
- Fair value of net assets of Entity B

It should be borne in mind that the two fair values are different concepts. The former is used only for the purpose of determining the consideration to be paid for purchase of equity interests. It can be seen that for the initial stake purchase, Entity A paid 60% of the "fair value of Entity B" i.e. 60% of ` 10,000 = ` 6,000. Further, for the second purchase transaction, Entity A paid 20% of the "fair value of Entity B" i.e. 20% of ` 20,000 = ` 4,000.
The latter i.e. fair value of net assets of Entity B is used for the purpose of accounting. It can be seen that the goodwill arising on acquisition of Entity B is determined as difference between consideration paid i.e. ` 6,000 and Entity A's share in fair value of net assets of Entity B on date of acquisition i.e. 60% of ` 6,000 = ` 6,000 minus ` 3,600 = ` 2,400. The fair value of net assets after the date of acquisition (i.e. ` 12,000 in this illustration) is not relevant for accounting purposes.

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

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

Solution:

The following accounting entry is passed:

		₹ '000	
		Dr.	Cr.
Non-controlling interest (6,600 ÷ 30 x 10)	Dr.	2,200	
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	400	
To Cash			2,600

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between amount by which NCI (` 22,00,000) is adjusted and fair value of consideration received (` 26,00,000) to be attributed to parent in other equity i.e. ` 4,00,000. Consolidated goodwill is not adjusted.

24: Acquisition of additional stake in a subsidiary

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

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

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

Solution:

₹ lakh

	A	B	Workings	Group
Assets				
Goodwill				10
PPE	627	200		827
Financial assets:				
Investments (150+32)	182			
Cash* (200-32)	168	30	(200+30)-32)	198
Other current assets	23	70		93
	1,000	300		1,128

Equity and liability				
Share capital	200	100		200
Other equity	800	200	870-2	868
Non-controlling interest			90-30	60
	1,000	**300**		**1,128**

*Cash has been adjusted through Individual Balance Sheet.

Journal entry

		₹ lakh	
		Dr.	Cr.
Non-controlling interest (90 ÷ 30 x 10)	Dr.	30	
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	2	
To Cash			32

25: Reduction in interest in subsidiary
Amla Ltd. Purchased a 100% subsidiary for ` 10,00,000 at the end of 20X1 when the fair value of the subsidiary Lal Ltd.'s net asset was ` 8,00, 000.
The parent sold 40% of its investment in the subsidiary in March 20X4 to outside investors for ` 9,00,000. The parent still maintains a 60% controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is ` 18,00,000 (including net assets of ` 16,00,000 & goodwill of ` 2,00,000).
Calculate gain / loss on sale of interest in subsidiary as on 31st March 20X4.
Solution:

As per Ind AS 110, a change in ownership that does not result in a loss of control is equity transaction. The identifiable net assets (including goodwill) remain unchanged and any difference between the amount by which the non-controlling interest is recorded (including the non-controlling interest portion of goodwill) and a fair value of the consideration received is recognized directly in equity and attributed to the controlling interest. For disposals that do not result in the loss of control, the change in the non-controlling interest is recorded at its proportionate interest of the carrying value of the subsidiary.
Gain on the sale of the investment of ` 5,00,000 in parent's separate financial statements calculated as

	₹' 000
Sale proceeds	900
Less: Cost of investment in subsidiary (10,00,000 x 40%)	(400)
Gain on sale in the parent's separate financial statements	500

As discussed above, the group's consolidated income statement for 31st March 20X4 would show no gain on the sale of the interest in the subsidiary. Instead, the difference between the fair value of the consideration received and the amount by which the non-controlling interest is recorded is recognized directly in equity.

	₹' 000
Sale proceeds	900
Less: Recognition of non-controlling interest (18,00,000 x 40%)	(720)
Credit to other equity	180

The entry recognized in the consolidated accounts under Ind AS 110 is:

	₹' 000	
	Dr.	Cr.
Cash Dr.	900	
To Non-controlling interest		720
To Other Equity (Gain on sale of interest in subsidiary)		180

The difference between the gain in the parent's income statement and the increase reported in the group's consolidated equity is ` 3,20,000. This difference represents the share of post- acquisition profits retained in the subsidiary ` 3,20,000 [(that is, 18,00,000 – 10,00,000) x 40%] that have been reported in the group's income statement up to the date of sale.

26: Reduction in interest in subsidiary

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

Solution:

As per paragraph 23 of Ind AS 110, changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). Thus, changes in ownership interest that do not result in loss of control do not impact goodwill associated with the subsidiary or the statement of profit and loss.

Paragraph B96 of Ind AS 110 states that when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Thus, at the time of sale of 30% of its equity interest, consolidated financial statements include an amount of ` 1,500 crore in respect of the subsidiary. Accordingly, in the present case, the accounting entry on the date of sale of the 30% interest would be as follows:

	₹ in crore	
	Dr.	Cr.
Cash Dr.	900	
To Non-controlling interest (1,500 x 30%)		450
To Other Equity (Gain on sale of interest in subsidiary)		50

27: Treatment of goodwill and non-controlling interest where a parent holds an indirect interest in a subsidiary A parent company (entity A) has an 80% owned subsidiary (entity B). Entity B makes an acquisition for cash of a third company (entity C), which it then wholly owns. Goodwill of ` 1,00,000 arises on the acquisition of entity C. How should that goodwill be reflected in consolidated financial statement of entity A? Should it be reflected as

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

b) 80% of the goodwill that arises?

Solution:

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

28: Preparation of consolidated financial statements

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

Balance Sheets (₹ in Lakhs)

	P Ltd.	Q Ltd.
Assets		
Non-current assets		
Property Plant Equipment	1,07,000	44,000
Financial Assets:		
Non-Current Investments	5,000	1,000
Loans	10,000	
Current Assets		
Inventories	20,000	10,000
Financial Assets:		
Trade Receivables	8,000	10,000
Cash and Cash Equivalents	38,000	1,000
Total Assets	1,88,000	66,000
Equity and Liabilities		
Shareholders Fund		
Share Capital	20,000	10,000
Other equity	1,20,000	40,000
Non-Current Liabilities		
Financial Liabilities		
Long term liabilities	30,000	10,000
Deferred tax liabilities	5,000	1,000
Long term provisions	5,000	1,000
Current Liabilities		
Financial Liabilities		
Trade Payables	6,000	2,000
Short term Provisions	2,000	2,000
Total Equity & Liabilities	1,88,000	66,000
Notes to Financial Statements	P Ltd.	Q Ltd
Reserve & Surplus		
General Reserve	1,00,000	30,000
Retained earnings	20,000	10,000
	1,20,000	40,000
Inventories		
Raw Material	10,000	5,000
Finished Goods	10,000	5,000
	20,000	10,000

(₹ in Lakhs)

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

	Notes	P Ltd.	Q Ltd.
i. **Statement of Profit and Loss for the year ended on 31st March 20X2**			
Sales	1	2,00,000	80,000

Other Income	2	3,000	
Total Revenue		2,03,000	80,000
Expenses			
Raw Material Consumed	3	1,10,000	48,000
Change in inventories finished stock	4	(5,000)	(3,000)
Employee benefit expenses		30,000	10,000
Finance Costs	5	2,700	1,000
Depreciation		7,000	4,000
Other Expenses	6	10,350	6,040
Total Expenses		1,55,050	66,040
Profit Before Tax		47,950	13,960
Tax Expense:			
Current Tax	11	15,000	4,000
Deferred Tax		2,000	1,000
		17,000	5,000
Profit after Tax		30,950	8,960
ii. **Statement of Other Comprehensive Income**			
Fair Value gain on investment in subsidiary	8	1,000	0
Fair Value gain on other non-current investments*	8	500	250
		1,500	250

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

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

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

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

Balance Sheet as on 31st March, 20X2	Note	P Ltd	Q Ltd.
Assets			
Non-current assets			
Property Plant Equipment	7	1,17,000	45,000
Financial Assets:			
Non-Current Investments	8	42,500	1,250
Long Term Loans		10,000	
Current Assets			
Inventories		35,000	15,000
Financial Assets:			
Trade Receivables		10,000	8,000
Cash and Cash Equivalents			
(See Statement of Cash Flows)		930	4,200
Total Assets		**2,15,430**	**73,450**
Equity and Liabilities			
Share Capital		20,000	10,000
Other equity (See Statement of changes in Equity)		1,44,780	46,410
		1,64,780	56,410

Non-Current Liabilities			
Financial Liabilities			
Borrowings		30,000	10,000
Deferred tax liabilities		7,000	2,000
Long term provisions	9	4,600	930
		41,600	12,930
Current Liabilities			
Financial Liabilities			
Trade Payables		8,000	4,000
Short term Provisions	10	1,050	110
		9,050	4,110
Total Liabilities		**50,650**	**17,040**
Total Equity & Liabilities		**2,15,430**	**73,450**

Statement of Cash Flows
For the year ended on 31 March 20X2

	P. Ltd.	Q. Ltd
i. Cash Flows from operating activities		
Profit after Tax	30,950	8,960
Add Back:		
Current Tax	15,000	4,000
Deferred Tax	2,000	1,000
Depreciation	7,000	4,000
Finance Costs	2,700	1,000
Change In Provisions	(1,350)	(1,960)
Reversal of Interest Income	(1000)	0
Working Capital Adjustments		
Inventories	(15,000)	(5,000)
Trade Receivables	(2,000)	2,000
Trade Payables	2,000	2,000
	40,300	16,000
Less: Advance Tax	(15,000)	(4,000)
	25,300	12,000
ii. Cash flows from investment activities		
Purchase of Property Plant Equipment	(17,000)	(5,000)

Acquisition of subsidiary	(36,000)	0
Interest Income	1,000	
Dividend Income	1,680	______
	(50,320)	(5,000)
iii. Cash Flow from financing activities		
Dividend Payment	(8,000)	(2,400)
Dividend distribution tax	(1,350)	(400)
Interest payment	(2,700)	(1,000)
	(12,050)	(3,800)
Net Changes in Cash Flows (I + ii + iii)	***(37,070)***	***3,200***
Balance of Cash and Cash Equivalents as on 1.4.20X1	38,000	1,000
Balance of Cash and Cash Equivalents as on 31.3.20X2	930	4,200
Notes	***P Ltd.***	***Q Ltd.***
Note 1 – Sales		
Sales to Q Ltd.	20,000	
Other Sales	1,80,000	80,000
	2,00,000	80,000
Note 2 – Other Income		
Interest from Q Ltd.	1,000	
Royalty from Q Ltd.	2,000	
	3,000	
Note 3 – Raw Material Consumed		
Opening Stock	10,000	5,000
Purchases from P Ltd.		20,000
Other Purchases	1,20,000	30,000
Closing Stock	20,000	7,000
	1,10,000	***48,000***
Note 4 – Change in inventories of finished stock		
Opening Stock	10,000	5,000
Closing Stock	15,000	8,000
	(5,000)	***(3,000)***
Note 5 – Finance Costs		
Interest	2,700	
Interest to P Ltd.	_____	1,000
	2,700	***1,000***

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

On 1.4.20X1, P Ltd. Acquired 70% of equity shares (700 lakhs out of 1,000 lakhs shares) of Q Ltd. At ₹ 36,000 lakhs. The company has adopted an accounting policy to measure Non-controlling

interest at fair value (quoted market price) applying Ind AS 103. Accordingly, the company computed full goodwill on the date of acquisition. Shares of both the companies are of face value ₹ 10 each. Market price per share of Q Ltd. As on 1.4.20X1 is ₹55. Entire long-term borrowings of Q Ltd. Is from P Ltd. The fair value of net identifiable assets is at ₹50,000 lakhs.

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

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

(₹ in lakhs)

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

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

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

Solution:

Consolidated Financial Statement of P. Ltd. Group (₹ in lakhs)

Consolidated Statement of Comprehensive Income For the year ended on 31 March, 20X2					
	Notes	P Ltd.	Q Ltd.	Workings	Group
i. Statement of Profit and loss					
Sales	1	2,00,000	80,000	2,00,000+80,000-20,000	2,60,000
Other Income	2	3,000	0	3,000-3,000	0
Total Revenue		**2,03,000**	**80,000**		**2,60,000**
Expenses					
Raw materials	3	1,10,000	48,000	1,10,000+48,000-	1,38,000

consumed				20,000	
Change in inventories finished stock	4	-5000	-3000	(-5,000-3,000)	-8,000
Employee benefit expenses		30,000	10,000	30,000+10,000	40,000
Finance Costs	5	2,700	1,000	2,700+1,000-1,000	2,700
Depreciation		7,000	4,000	7,000+4,000	11,000
Other expenses	6	10,350	6,040	10,350+6,040-2,000	14,390
Total Expenses		**1,55,050**	**66,040**		**1,98,090**
Profit Before Tax		47,950	13,960		61,910
Tax Expense:					
Current Tax		15,000	4,000	15,000 + 4,000	19,000
Deferred Tax		2,000	1,000	2,000 + 1,000	3,000
		17,000	5,000		22,000
Profit after Tax		**30,950**	**8,960**		**39,910**
Profit attributable to:					
Parent					37,222
Non-controlling interest					2,688
ii. Statement of other comprehensive income					
Fair value gain on investment in subsidiary	8	1,000	0	1,000+0-1,000	0
Fair value gain on other non-current investments	8	500	250	500+250	750
		1,500	**250**		**750**
Other comprehensive income attributable to:					
Parent					675
Non-controlling interests					75

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

	Share Capital	General Reserve	Retained Earnings	Fair Value Reserve	Total	Non-Controll-ing Interest	Group Total
Balance as on 1.4.20X1	20,000	1,00,000	20,000		1,40,000	16,500	1,56,500
Dividend for the year 20X0-20X1			(8,000)		(8,000)		(8,000)
Dividend distribution tax			(1,350)		(1,350)		(1,350)
Dividend received from subsidiary			1,680		1,680		1,680
Profit for the year 20X1-20X2			37,222		37,222	2,688	39,910
Fair Value gain on investment in subsidiary							
Fair value gain on other non-current investments				675	675	75	750
Transfer to reserve		20,000	(20,000)		0		0
Dividend from subsidiary			(1,680)		(1,680)	(720)	(2,400)
Dividend distribution tax of subsidiary			(280)		(280)	(120)	(400)
Balance as on 31.3.20X2	20,000	1,20,000	27,592	675	1,68,267	18,423	1,86,690

Dividend and dividend distribution tax paid by the subsidiary is deducted from profit and non-controlling interest.

Note: As per the response to Issue 1 given in ITFG bulletin 9, in consolidated financial statements of parent company, the dividend income earned by parent company from subsidiary company and dividend recorded by subsidiary company in its equity will both get eliminated as a result of consolidation adjustments. DDT paid by subsidiary company outside the consolidated Group i.e. to the tax authorities should be charged as expense in the consolidated statement of Profit and Loss of holding company. If DDT paid by the subsidiary is allowed as a set off against the DDT liability of its parent (as per the tax laws). Then the amount of such DDT should be recognised in the consolidated statement of changes in equity of parent company.

Consolidated Balance Sheet

As on 31 March 20X2

(Amount in ₹ Lakhs)

	P Ltd.	Q Ltd.	Workings	Group
Assets				
Non-Current Assets				
Fixed Assets				
Property Plant Equipment	1,17,000	45,000	1,17,000+45,000	1,62,000
Goodwill				2,500
Financial Assets:				
Non-current investments	40,820	1,250	5,500+1,250	6,750
Long Term loans	10,000	0	10,000+0-10,000	0
	1,67,820	46,250		1,71,250
Current Assets				
Inventories	35,000	15,000	35,000+15,000	50,000
Financial Assets:				
Trade Receivables	10,000	8,000	10,000+8,000-3,000	15,000
Cash and Cash Equivalents	930	4,200	930+4,200	5,130
	45,930	27,200		70,130
Total Assets	**2,13,750**	**73,450**		**2,41,380**
Equity and Liabilities				
Share Capital	20,000	10,000	SOCE	20,000
Other Equity	1,43,100	46,410	SOCE	1,48,267
Non-controlling interest			SOCE	18,423
	1,63,100	56,410		1,86,690
Non-current liabilities				
Financial Liabilities:				
Borrowings	30,000	10,000	30,000+10,000-10,000	30,000
Deferred tax liabilities	7,000	2,000	7000+2000	9,000
Long Term provisions	4,600	930	4,600+930	5,530
	41,600	12,930		44,530

Current Liabilities				
Financial Liabilities:				
Trade Payables	8,000	4,000	8,000+4,000-3,000	9,000
Short term Provisions	1,050	110	1,050+110	1,160
	9,050	4,110		10,160
Total Liabilities	50,650	17,040		54,690
Total Equity & Liabilities	2,13,750	73,450		2,41,380

Statement of Cash Flows

For the year ended on 31 March 20X2

	P Ltd.	Q Ltd.	Workings	Group
i. Cash flows from operating activities				
Profit after Tax	30,950	8,960		39,910
Add: Back				
Current Tax	15,000	4,000	15,000+4,000	19,000
Deferred Tax	2,000	1,000	2,000+1,000	3,000
Depreciation	7,000	4,000	7,000+4,000	11,000
Finance Costs	2,700	1,000	2,700+1,000-1,000	2,700
Change in provisions	(1,350)	(1,960)	(1,350)-1960	(3,310)
Reversal of interest income	(1000)	0	(1,000)+0+1,000	0
Working capital adjustments				
Inventories	(15,000)	(5,000)	30,000-50,000	-20,000
Trade Receivables	(2,000)	2,000	18,000-15,000	3,000
Trade Payables	2,000	2,000	8,000-9,000	1,000
	40,300	16,000		56,300
Less: Advance Tax	(15,000)	(4,000)	15,000+4,000	(19,000)
	25,300	12,000		37,300
ii. Cash flows from investment activities				
Purchase of Property Plant Equipment	(17,000)	(5,000)	(17,000)-5,000	(22,000)
Acquisition of subsidiary	(36,000)	0	(36,000) + 0	(36,000)
Interest Income	1,000		1,000-1,000	0
Dividend Income	1,680		1,680-1680	0
	(50,320)	(5,000)		(58,000)

iii. Cash flow from financing activities				
Dividend Payment	(8,000)	(2,400)	(8,000)-2,400+1,680	(8,720)
Dividend Distribution Tax	(1,350)	(400)	(1,350)-400	(1,750)
Interest payment	(2,700)	(1,000)	(2,700)-1,000+1,000	(2,700)
	(12,050)	(3,800)		(13,170)
Net Changes in Cash Flows (I + ii + iii)	(37,070)	3,200		(33,870)
Balance of Cash and Cash Equivalents as on 1.4.20X1	**38,000**	**1,000**	**38,000+1,000**	**39,000**
Balance of Cash and Cash Equivalents as on 31.3.20X2	**930**	**4,200**		**5,130**

While preparing Consolidated Statement of Cash flows also intra-group transactions are eliminated.

29: Chain holding

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

₹ in lakhs

	P Ltd.	S Ltd.	SS Ltd.
Assets			
Non-Current Assets			
Property, Plant and Equipment	320	360	300
Investment:			
32 lakh shares in S Ltd.	340		
24 lakh shares in SS Ltd.		280	
Current Assets			
Inventories	220	70	50
Financial Assets			
Trade Receivables	260	100	220
Bills Receivables	72	-	30
Cash in hand and at Bank	228	40	40
	1440	850	640

Equity and Liabilities			
Shareholder's Equity			
Share Capital (₹ 10 per share)	600	400	320
Other Equity			
Reserves	180	100	80
Retained earnings	160	50	60
Current Liabilities			
Financial Liabilities			
Trade Payables	470	230	180
Bills Payable			
P Ltd.		70	
SS Ltd.	30	-	-
	1440	850	640

The following additional information is available:

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

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

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

₹ in Lakhs

	S Limited	SS Limited
Reserves	80	60
Retained earnings	20	30

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

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

Solution:

Consolidated Balance Sheet of the Group as on 31st March, 20X2

Particulars	Note No.	₹ in lakh
ASSETS		
Non-current assets		
Property, plant and equipment	1	980
Current assets		
(a) Inventory	2	338
(b) Financial assets		
Trade receivable	3	580
Bills receivable	4	2
Cash and cash equipment	5	308
Total assets		**2,208**
EQUITY & LIABILITIES		
Equity attributable to owners of parent		
Share Capital		600
Other Equity		
Reserve (W.N.5)		194
Retained Earnings (W.N.5)		179.8
Capital Reserve (W.N.3)		188
Non-controlling interests (W.N.4)		166.2
Total equity		**1328**
LIABILITIES		
Non-current liabilities		Nil
Current liabilities		
(a) Financial Liabilities		
(i) Trade payables	6	880
Total liabilities		880
Total equity and liabilities		2,208

Notes to Accounts (₹ in lakh)

1.	**Property Plant & Equipment**		
	P Ltd.	320	
	S Ltd.	360	
	SS Ltd.	300	980
2.	**Inventories**		
	P Ltd.	220	
	S Ltd. (70-2)	68	

	SS Ltd.	50	338
3.	**Trade Receivable**		
	P Ltd.	260	
	S Ltd.	100	
	SS Ltd.	220	580
4.	**Bills Receivable**		
	P Ltd. (72-70)	2	
	S Ltd. (30-30)	-	2
5.	**Cash & Cash equivalents**		
	P Ltd.	228	
	S Ltd.	40	
	SS Ltd.	40	308
6.	**Trade Payables**		
	P Ltd.	470	
	S Ltd.	230	
	SS Ltd.	180	880

Working Notes:

1. Analysis of Reserves and Surplus (₹ in lakh)

		S Ltd.		SS Ltd.
Reserves as on 31.3.20X1		80		60
Increase during the year 20X1-20X2	20		20	
Increase for the half year till 30.9.20X1		10		10
Balance as on 30.9.20X1 (A)		**90**		**70**
Total balance as on 31.2.20X2		100		80
Post-acquisition balance		**10**		**10**
Retained Earnings as on 31.3.20X1		20		30
Increase during the year 20X1-20X2	30		30	
Increase for the half year till 30.9.20X1		15		15
Balance as on 30.0.20X1 (B)		**35**		**45**
Total balance as on 31.3.20X2		50		60
Post-acquisition balance		15		15

Less: Unrealised Gain on inventories (10 ÷ 100 x 25)		-		(2)
Post-acquisition balance for CFS		**15**		**13**
Total balance on the acquisition date ie.30.9.20X1 (A+B)		**125**		**115**

2. **Calculation of Effective Interest of P Ltd. in SS Ltd.**

Acquisition by P Ltd. In S Ltd. = 80%

Acquisition by S Ltd. In SS Ltd. = 75%

Acquisition by Group in SS Ltd. (80% x 75%) = 60%

Non-controlling Interest = 40%

3. **Calculation of Goodwill / Capital Reserve on the acquisition**

	S Ltd.	SS Ltd.
Investment or consideration	340	(280 x 80%) 224
Add: NCI at Fair value		
(400 x 20%)	80	
(320 x 40%)	-	128
	420	352
Less: Identifiable net assets (Share Capital + Increase in the Reserves and Surplus till acquisition date)	(400+125) (125)	(320+125) (435)
Capital Reserve	105	83
Total Capital Reserve (105 + 83)	188	

4. **Calculation of Non-controlling Interest**

	S Ltd.	SS Ltd.
At Fair Value (See Note 3)	80	128
Add: Post Acquisition Reserves (See Note 1)	(10 x 20%) 2	(10 x 40%) 4
Add: Post Acquisition Retained Earnings (See Note 1)	(15 x 20%) 3	(13 x 40%) 5.2
Less: NCI share of investment in SS Ltd.	(280 x 20%) (56)*	-
	29	137.2
Total (29 + 137.2)	166.2	

*__Note__: The Non-controlling interest in S Ltd. Will take its proportion in SS Ltd. So they have to bear their proportion in the investment by S Ltd. (in SS Ltd.) also.

5. Calculation of Consolidated Other Equity

	Reserves	Retained Earnings
P Ltd.	180	160
Add: Share in S Ltd.	(10 x 80%) 8	(15 x 80%) 12
Add: Share in SS Ltd.	(10 x 60%) 6	(13 x 60%) 7.8
	194	179.8

Note: It is assumed date the sale of goods by SS Ltd. Is done after acquisition of shares by S Ltd. Alternatively, it may be assumed that the sale has either been done before acquisition of shares by S Ltd. In SS Ltd. Or sale has been throughout the year. Accordingly, the treatment for unrealized gain may vary.

30: Subsidiary issues shares to a third party and parent loses control

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

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

Solution:

Shareholdings

		Before		After
	No	%	No	%
Group	30,000	60	30,000	40
Other party	20,000	40	45,000	60
	50,000	100	75,000	100
Net assets	**₹' 000**	%	**₹' 000**	%
Group's share	270	60	300	40
Other party's share	180	40	450	60
	450	100	750	100

Calculation of group gain on deemed disposal	₹' 000
Fair value of 40% interest retained (₹ 12 x 30,000)**	360
Less: Net assets derecognized	(450)
Non-controlling interest derecognized	180
Goodwill	(20)
Gain on deemed disposal	70

** Note: For simplicity, it has been assumed the fair value per share is equal to the subscription price.

As control of the subsidiary is lost, the retained interest is recognized at its fair value at the date control is lost. The resulting remeasurement gain is recognized in profit and loss.

31: Calculation of gain on outright sale of subsidiary

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

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

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

Solution:

The parent's separate statement of profit and loss for 20X3-20X4 would show a gain on the sale of investment of ` 40,000 calculated as follow:

	₹' 000
Sales proceeds	200
Less: Cost of investment in subsidiary	(160)
Gain on sale in parent's account	40

However, the group's statement of profit & loss for 20X3-20X4 would show a gain on the sale of subsidiary of ` 8,000 calculated as follows:

		₹' 000
Sales proceeds		200
Less: Share of net assets at date of disposal (₹ 2,25,000 X 80%)	(180)	
Goodwill on consolidation at date of sale (W.N.)	(12)	(192)
Gain on sale in group's account		8

Working note

The goodwill on consolidation (assuming partial goodwill method) is calculated as follows:

The goodwill on consolidation (assuming partial goodwill method) is calculated as follows:

		₹' 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 consolidation		20
Impairment at 31 March 20X3		(8)
Goodwill at 31 March 20X4		12

32: Partial disposal when subsidiary becomes an associate

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

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

Solution:

AT Ltd.'s standalone statement for profit or loss of 20X2-20X3 would show a gain on the sale of investment of a ` 37,50,000 calculated as follows:

	₹' lakh
Sales proceeds	67.5
Less: Cost of investment in subsidiary (₹ 50,00,000 * 60%)	(30.0)
Gain on sale in parent's account	37.5

In the consolidated financial statements, the group will calculate the gain or loss on disposal differently. The carrying amount of all of the assets including goodwill is derecognized when control is lost. This is compared to the proceeds received and the fair value of the investment retained.

The gain on the disposal will, therefore, be calculated as follows:

	₹' lakh
Sales proceeds	67.5
Fair value of 40%interest retained	45.0
	112.5
Less: Net assets disposed, including goodwill (80,00,000+ 10,00,000)	(90.0)
Gain on sale in the group's financial statements	22.5

The gain on loss of control would be recorded in consolidated statement of profit and loss. The gain or loss includes the gain of ` 13,50,000 [` 67,50,000 – (` 90,00,000 x 60%)] on the portion sold. However, it also includes a gain on remeasurement of the 40% retained interest of
` 9,00,000 (` 36,00,000* to ` 45,00,000). The entity will need to disclose the portion of the gain that is attributable to remeasuring any remaining interest to fair value, that is, ` 9,00,000.

* 90,00,000 x 40%= 36,00,000

33: Partial disposal when 10% investment in former subsidiary is retained

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

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

Solution:

The parent's AT Ltd. income statement in its separate financial statements for 20X2-20X3 would show a gain on the sale of the investment of ` 40,50,000 calculated as follows:

	₹' lakh
Sales proceeds	85.5
Less: Cost of investment in subsidiary (₹ 50,00,000 * 90%)	(45.0)
Gain on sale in parent's account	40.5

In the consolidated financial statements, all of the assets, including goodwill are derecognized when control is lost. This is compared to the proceeds received and the fair value of the investment retained.

	₹' lakh
Sales proceeds	85.5
Fair value of 10%interest retained	9.5
	95.0
Less: Net assets disposed, including goodwill (80,00,000 + 10,00,000)	(90.0)
Gain on sale in the group's financial statements	5.0

The gain on loss of control would be recorded in profit or loss. The gain or loss includes the gain of ` 4,50,000 related to the 90% portion sold [` 85,50,000 – (` 90,00,000 x 90%)] as well as ` 50,000 related to the remeasurement of fair value of 10% retained interest (` 9,00,000 to ` 9,50,000).

34: Loss control of a subsidiary in two transactions

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

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

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

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

How MN Ltd. should account the transaction?

Solution:

MN Ltd. will account for the transaction as follows:

		₹
Recognise:		
Fair value of consideration (2,50,000 + 5,50,000)		8,00,000
Derecognise:		
Net assets of UV Ltd.	(9,00,000)	
Non-controlling interest	1,80,000	(7,20,000)
Gain to be recorded in profit or loss		80,000

If MN Ltd. loses control over UV Ltd. on the date of transaction 1, then the above gain is recorded on the date of transaction 1 and MN Ltd. will stop consolidating UV Ltd. from that date. The consideration of ` 5,50,000 receivable in transaction 2 will be shown as consideration receivable.

If MN Ltd. loses control over UV Ltd. on the date of transaction 2, then the above gain is recorded on the date of transaction 2 and MN Ltd. will stop consolidating UV Ltd. from that date. The consideration of ` 2,50,000 received in transaction 1 will be shown as advance consideration received.

35: An entity ceases to be an investment entity

A Limited ceased to be in investment entity from 1st April 20X1 on which date it was holding 80% of B Limited. The carrying value of such investment in B Limited (which was measured at fair value through profit or loss) was ` 4,00,000. The fair value of non-controlling interest on the date of change in status was ` 1,00,000. The value of subsidiary's identifiable net assets as per Ind AS 103 was ` 4,50,000 on the date of change in status. Determine the value of goodwill and pass the journal entry on the date of change in status of investment entity. (Assume that non-controlling interest is measured at fair value method)

Solution:

Goodwill calculation:	₹
Deemed consideration (i.e. fair value of subsidiary on the date of change in status)	4,00,000
Fair value of non-controlling interest	1,00,000
	5,00,000
Value of subsidiary's identifiable net assets as per Ind AS 103	(4,50,000)
Goodwill	**50,000**

Journal entry		₹	
		Dr.	Cr.
Net identifiable assets	Dr.	4,50,000	
Goodwill	Dr.	50,000	
To Investment in B Limited (on date of change in status)			4,00,000
To Non-controlling interest			1,00,000

36: An entity becomes an investment entity

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

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

Solution:

The gain on the disposal will be calculated as follows:

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

UNIT 5:
IND AS 111: JOINT ARRANGEMENTS

Illustrations

1: Joint control

ABC Ltd. and DEF Ltd. have entered into a contractual arrangement to manufacture a product and sell that in retail market. As per the terms of the arrangement, decisions about the relevant activities require consent of both the parties. The parties share the returns of the arrangement equally amongst them. Whether the arrangement can be treated as joint arrangement?

Solution:

The arrangement is a joint arrangement since both the parties are bound by the contractual arrangement and the decisions about relevant activities require unanimous consent of both the parties.

2: Implicit joint control

PQR Ltd. and XYZ Ltd. established an arrangement in which each has 50% of the voting rights and the contractual arrangement between them specifies that at least 51% of the voting rights are required to make decisions about the relevant activities. Whether the arrangement can be treated as joint arrangement?

Solution:

In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.

3: Implicit joint control

A Ltd., B Ltd. and C Ltd. established an arrangement whereby A Ltd. has 50% of the voting rights in the arrangement, B Ltd. has 30% and C has 20%. The contractual arrangement between A Ltd., B Ltd. and C Ltd. specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Whether the arrangement can be treated as joint arrangement?

Solution:

In this case, even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their contractual arrangement requiring at least 75% of the voting rights to make decisions about the relevant activities imply that A Ltd. and B Ltd. Have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A Ltd. and B Ltd. agreeing.

4: Explicit joint control

An arrangement has three parties: X Ltd. has 50% of the voting rights in the arrangement and Y Ltd. and Z Ltd. each have 25%. The contractual arrangement between them specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Whether the arrangement can be treated as joint arrangement?

Solution:

In this case, even though X Ltd. can block any decision, it does not control the arrangement because it needs the agreement of either Y Ltd. or Z Ltd. In this question, X Ltd., Y Ltd. and Z Ltd. collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75% of the voting rights (i.e. either X Ltd. and Y Ltd. or X Ltd. and Z Ltd.). In such a situation, to be a joint arrangement the contractual arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement.

5: Explicit joint control

An arrangement has A Ltd. and B Ltd. each having 35% of the voting rights in the arrangement with the remaining 30% being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights. Whether the arrangement can be treated as joint arrangement?

Solution:

A Ltd. and B Ltd. have joint control of the arrangement only if the contractual arrangement specifies that decisions about the relevant activities of the arrangement require both A Ltd. and B Ltd. agreeing.

6: Joint control through board representation

Electronics Ltd. is established by two investors R Ltd. and S Ltd. The investors are holding 60% and 40% of the voting power of the investee respectively.

As per the articles of association of Electronics Ltd., both the investors have right to appoint 2 directors each on the board of Electronics Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority. Determine whether Electronics Ltd. is controlled by a single investor or is jointly controlled by both the investors.

Solution:

The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 4 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by any one investor cannot take the decisions independently without the consent of at least one director appointed by other investor. Hence, Electronics Ltd. is jointly controlled by both the investors. R Ltd. holding majority of the voting rights is not relevant in this case since the voting rights do not given power over the relevant activities of the investee.

7: Chairman with casting vote

MN Software Ltd. is established by two investors M Ltd. and N Ltd. Both the investors are holding 50% of the voting power each of the investee.

As per the articles of association of MN Software Ltd., both the investors have right to appoint 2 directors each on the board of the company. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. The decision about relevant activities of the entity will be taken by board of directors through simple majority. Articles of association also provides that M Ltd. has right to appoint the chairman of the board who will have right of a casting vote in case of a deadlock situation.

Determine whether MN Software Ltd. is jointly controlled by both the investors.

Solution:

The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 4 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by any one investor cannot take the decisions independently without the consent of at least one director appointed by other investor. However, the chairman of the board has right for a casting vote in case of a deadlock in the board. Hence, M Ltd. has the ability to take decisions related to relevant activities through 2 votes by directors and 1 casting vote by chairman of the board. Therefore, M Ltd. individually has power over MN Software Ltd. and there is no joint control.

8: Equal voting rights but no joint control
ABC Ltd. is established by two investors AB Ltd. and BC Ltd. Each investor is holding 50% of the voting power of the investee.
As per the articles of association of ABC Ltd., AB Ltd. and BC Ltd. have right to appoint 3 directors and 2 directors respectively on the board of ABC Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority.
Determine whether ABC Ltd. is jointly controlled by both the investors.
Solution:
The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 5 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by AB Ltd. can take the decisions independently without the consent of any of the directors appointed by BC Ltd. Hence, ABC Ltd. is not jointly controlled by both the investors. Equal voting rights held by both the investors is not relevant in this case since the voting rights do not given power over the relevant activities of the investee.

9: Joint control over specific asset
X Ltd. and Y Ltd. entered into a contractual arrangement to buy a piece of land to construct residential units on the said land and sell to customers.
As per the arrangement, the land will be further divided into three equal parts. Out of the three parts, both the parties will be responsible to construct residential units on one part each by taking decision about relevant activities independently and they will entitled for the returns generated from their own part of land. The third part of the land will be jointing managed by both the parties requiring unanimous consent of both the parties for all the decision making.
Determine whether the arrangement is a joint arrangement or not.
Solution:
The two parts of the land which are required to be managed by both the parties independently on their own would not fall within the definition of a joint arrangement. However, the third part of the land which is required to be managed by both the parties with unanimous decision making would meet the definition of a joint arrangement.

10: Multiple relevant activities directed by different investors

Entity R and entity S established a new entity RS Ltd. to construct a national highway and operate the same for a period of 30 years as per the contract given by government authorities.

As per the articles of association of RS Ltd, the construction of the highway will be done by entity R and all the decisions related to construction will be taken by entity R independently. After the construction is over, entity S will operate the highway for the period of 30 years and all the decisions related to operating of highway will be taken by entity S independently. However, decisions related to funding and capital structure of RS Ltd. will be taken by both the parties with unanimous consent.

Determine whether RS Ltd. is a joint arrangement between entity R and entity S?

Solution:

In this case, the investors should evaluate which of the decisions about relevant activities can most significantly affect the returns of RS Ltd. If the decisions related to construction of highway or operating the highway can affect the returns of the RS Ltd. most significantly then the investor directing those decision has power over RS Ltd. and there is no joint arrangement. However, if the decisions related to funding and capital structure can affect the returns of the RS Ltd. most significantly then RS Ltd. is a joint arrangement between entity R and entity S.

11: Informal agreement for sharing of control

An entity has four investors A, B, C and D holding 10%, 20%, 30% and 40% voting power respectively. The articles of association requires decisions about relevant activities to be taken by majority voting rights. However, investor A, B and C have informally agreed to vote together. This informal agreement has been effective in recent meetings of the investors to take decisions about relevant activities. Whether A, B and C have joint control over the entity?

Solution:

In this case, three investors have informally agreed to make unanimous decisions. These three investors together also have majority voting rights in the entity. Hence, investor A, B and C have joint control over the entity. The agreement between investor A, B and C need not be formally documented as long as there is evidence of its existence in recent meetings of the investors.

It should be noted that if the requirement for unanimous consent relates only to decisions that give a party protective rights and not to decisions about the relevant activities of an arrangement, that party is not a party with joint control of the arrangement. This is explained in below illustration:

12: Party with protective rights

D Ltd., E Ltd. and F Ltd. have established a new entity DEF Ltd. As per the arrangement, unanimous consent of all three parties is required only with respect to decisions related to change of name of the entity, amendment to constitutional documents of the entity to enter into a new business, change in the registered office of the entity, etc. Decisions about other relevant activities require consent of only D Ltd. and E Ltd. Whether F Ltd. is a party with joint control of the arrangement?

Solution:

Consent of F Ltd. is required only with respect to the fundamental changes in DEF Ltd. Hence these are protective rights. The decisions about relevant activities are taken by D Ltd. and E Ltd. Hence, F Ltd. is not a party with joint control of the arrangement.

13: Resolution of disputes without unanimous consent

Entity A and Entity B established a contractual arrangement whereby the decision related to relevant activities are required to be taken by unanimous consent of both the parties. However, in case of any dispute with any vendor or customer of the arrangement, entity A has right to take necessary decisions for the resolution of disputes including decisions of going for the arbitration or filing a suit in court of law. Whether the arrangement is a joint arrangement?

Solution:

The arrangement is a joint arrangement since the contractual arrangement requires decisions about relevant activities to be taken by unanimous consent of both the parties. The right available with entity A to take decisions for resolution of disputes will not prevent the arrangement from being a joint arrangement.

14: Joint operation

P Ltd. and Q Ltd. are two construction entities and they have entered into a contractual arrangement to jointly construct a metro rail project.

The construction of metro rail project involves various activities such as construction of infrastructure (like metro station, control room, pillars at the centre of the road, etc.) for the metro, laying of the tracks, acquiring of the coaches of the metro, etc. The total length of the metro line to be constructed is 50 kms. As per the arrangement, both the parties are responsible to construct 25 kms each. Each party is required to incur its own cost, use its own assets, incur the liability and has right to the revenue from their own part of the work.

Determine whether the arrangement is a joint operation or not?

Solution:

The arrangement is a joint operation since the arrangement is not structured through a separate vehicle and each party has rights to the assets, and obligations for the liabilities relating to their own part of work in the joint arrangement.

15: Joint operation by sharing an asset

RS Ltd. and MN Ltd. entered into a contractual arrangement to run a business of providing cars of hire. The cars will be owned by both the parties jointly. The expenses to run the car (like driver salary, petrol, maintenance, insurance, etc.) and revenues from the business will be shared between both the parties as agreed in the contractual arrangement. Determine whether the arrangement is a joint operation or not?

Solution:

The arrangement is a joint operation since the arrangement is not structured through a separate vehicle.

16: Legal form indicates the arrangement to be a joint venture

Entity X and Entity Y are engaged in the business of Engineering, Procurement and Construction (EPC) for its customers. Both the parties have jointly won a contract from a customer for executing an EPC contract and

for that the parties have established a new entity XY Ltd. The contract will be executed through XY Ltd. All the assets required for the execution of the contract will be acquired and liabilities relating to the execution will be incurred by XY Ltd. in its own name. Entity X and entity Y will have share in the net profits of XY Ltd. in the ratio of their shareholding i.e. 50% each. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

Solution:

The legal form of the separate vehicle is a company. The legal form of the separate vehicle causes the separate vehicle to be considered in its own right. Hence, it indicates that the arrangement is a joint venture. In this case, the parties should further evaluate the terms of contractual arrangements and other relevant facts and circumstance to conclude whether the arrangement is a joint venture or a joint operation.

17: Legal form indicates the arrangement to be a joint operation

Two entities have established a partnership firm with each party having 50% share in the net profits of the firm. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

Solution:

In this case, the parties to the arrangement should evaluate whether the legal form creates separation between the partners and the partnership firm. If the parties conclude that they have rights in the assets and obligations for the liabilities relating to the partnership firm then this would be a joint operation. If the assessment of legal form of the partnership firm indicates that the firm is a joint operation then there is no need to evaluate any other factors and it is concluded that the partnership firm is a joint operation.

18: Assessing the terms of the contractual arrangement

Continuing with the illustration 16 above, assume that Entity X and Entity Y have entered into a separate agreement whereby they have agreed that each party has an interest in the assets of the XY Ltd. and each party is liable for the liabilities of XY Ltd. in a specified proportion. Determine whether the joint arrangement is a joint operation or a joint venture?

Solution:

In this case, the terms of the separate agreement may cause the arrangement to be a joint operation.

19: Assessing other facts and circumstances

Two parties structure a joint arrangement in an incorporated entity i.e. Entity A in which each party has a 50% ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties. The legal form of Entity A (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in Entity A are the assets and liabilities of Entity A. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of Entity A. There are following other relevant facts and circumstances applicable in this case:

- **The parties agreed to purchase all the output produced by Entity A in a ratio of 50:50. Entity A cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material.**
- **The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by Entity A. On the basis of this operating model, the arrangement is intended to operate at a break-even level.**

Based on the above fact pattern, determine whether the arrangement is a joint operation or a joint venture?

Solution:

The legal form of Entity A and the terms of the contractual arrangement indicate that the arrangement is a joint venture. However, the other relevant facts and circumstances mentioned above indicates that:

- the obligation of the parties to purchase all the output produced by Entity A reflects the exclusive dependence of Entity A upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of Entity A.
- the fact that the parties have rights to all the output produced by Entity A means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of Entity A.

These facts and circumstances indicate that the arrangement is a joint operation. The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in a subsequent manufacturing process, the parties sold their share of the output to third parties.

If the parties changed the terms of the contractual arrangement so that the arrangement was able to sell output to third parties, this would result in Entity A assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require reassessment of the classification of the joint arrangement. Such facts and circumstances would indicate that the arrangement is a joint venture.

20: Multiple joint arrangements under single framework agreement

AB Ltd. and CD Ltd. have entered into a framework agreement to manufacture and distribute a new product i.e. Product X. The two activities to be performed as per the framework agreement are i) Manufacture of Product X and ii) Distribution of Product X. The manufacturing of the product will not be done through a separate vehicle. The parties will purchase the necessary machinery in their joint name. For the distribution of the product, the parties have established a new entity ABCD Ltd. All the goods manufactured will be sold to ABCD Ltd. as per price mutually agreed by the parties. Then ABCD Ltd. will do the marketing and distribution of the product. Both the parties will have joint control over ABCD Ltd.

The legal form of ABCD Ltd. causes it to be considered in its own right (ie the assets and liabilities held in ACD Ltd. are the assets and liabilities of ABC Ltd. and not the assets and liabilities of the parties). Further, the contractual arrangement and other relevant facts and circumstances also do not indicate otherwise.

Determine whether various arrangements under the framework agreement are joint operation or joint venture?

Solution:

The manufacturing of Product X is not done through a separate vehicle and the assets used to manufacture the product are jointly owned by both the parties. Hence, the manufacturing activity is a joint operation. The distribution of Product X is done through a separate vehicle i.e. ABCD Ltd. Further, AB Ltd. and CD Ltd. do not have rights to the assets, and obligations for the liabilities, relating to ABCD Ltd. Hence ABCD Ltd. is a joint venture.

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21: Accounting of interest in joint operation

P and Q form a joint arrangement PQ using a separate vehicle. P and Q each own 50% of the capital of PQ. However, the contractual terms of the joint arrangement states that P has the rights to all of Machinery and the obligation to pay Bank Loan in PQ. P and Q have rights to all other assets in PQ and obligations for all other liabilities in PQ in proportion to their share of capital (i.e. 50% each).

PQ's balance sheet is as follows:

Balance sheet

Liabilities	₹	Assets	₹
Capital	1,50,000	Machinery	2,50,000
Bank Loan	75,000	Cash	50,000
Other Loan	75,000		
	3,00,000		3,00,000

How should P record in its financial statements its rights and obligations in PQ?

How should P record in its financial statements its rights and obligations in PQ?

Solution:

Under Ind AS 111, P should record the following in its financial statements, to account for its rights in the assets of PQ and its obligations for the liabilities of PQ.

Machinery	2,50,000
Cash	25,000
Capital	75,000
Bank Loan	75,000
Other Loan	37,500

22: Accounting of interest in joint operation

AB Ltd. and BC Ltd. have established a joint arrangement through a separate vehicle PQR. The legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture.

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Ltd. has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owned by PQR to a lender XYZ. AB Ltd. and BC Ltd. have rights to all other assets of

PQR and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each)

Balance sheet

Liabilities	₹	Assets	₹
Debt owed to XYZ	240	Cash	40
Employee benefit plan obligation	100	Building 1	240
Equity	140	Building 2	200
	480		480

How should AB Ltd. record in its financial statements its rights and obligations in PQR?

How should AB Ltd. record in its financial statements its rights and obligations in PQR?

Solution:

Under Ind AS 111, AB Ltd. should record the following in its financial statements, to account for its rights in the assets of PQR and its obligations for the liabilities of PQR.

	₹
Assets	
Cash	20
Building 1 *	240
Building 2	100
Liabilities	
Debt (third party) ^	240
Employee benefit plan obligation	50
Equity	70

* Since AB Ltd. has the rights to all of Building No. 1, it records the amount in its entirety.

^ AB Ltd. has obligation for the debt owed by PQR to XYZ in its entirety

23: Accounting for sales or contributions of assets to a joint operation

A Ltd. is one of the parties to a joint operation holding 60% interest in a joint operation and the balance 40% interest is held by another joint operator. A Ltd. has contributed an asset held by it to the joint operation for the activities to be conducted in joint operation. The carrying value of the asset sold was ` 100 and the asset was actually sold for ` 80 i.e. at a loss of ` 20. How should A Ltd. account for the sale of asset to joint operation in its books?

Solution:

A Ltd. should record the loss on the transaction only to the extent of other party's interest in the joint operation.

The total loss on the transaction is ` 20. Hence, A Ltd. shall record loss on sale of asset to the extent of ` 8 (` 20 x 40%) which is the loss pertaining to the interest of other party to the joint operation. The loss of ` 12 (` 20 - ` 8) shall not be recognised as that is unrealised loss.

Further, while accounting its interest in the joint operation, A Ltd. shall record its share in that asset at value of ` 60 [A Ltd. share of asset ` 48 (` 80 x 60%) plus unrealised loss of ` 12].

The journal entry for the transaction would be as follows:

Bank	Dr.	₹ 32	
Loss on sale	Dr.	₹ 8	
To Asset			₹ 40

24: Accounting for purchases of assets from a joint operation

A Ltd. is one of the parties to a joint operation holding 60% interest in the joint operation and the balance 40% interest is held by another joint operator. A Ltd. has purchased an asset from the joint operation. The carrying value of the asset in the books of joint operation was ` 100 and the asset was actually purchased for ` 80 i.e. at a loss of ` 20. How should A Ltd. account for the purchase of asset from joint operation in its books?

Solution:

A Ltd. should not record its share of the loss until the asset is resold to a third party.

The joint operation has sold the asset at ` 80 by incurring a loss of ` 20. Hence, A Ltd. shall record the asset at ` 92 [Purchase price ` 80 + A Ltd.'s share in loss ` 12 (` 20 x 60%)].

Further, while accounting its interest in the joint operation, A Ltd. shall not record any share in the loss incurred in sale transaction by the joint operation.

The journal entry for the transaction would be as follows:

Asset	Dr.	` 32	
To Bank			` 32

UNIT 6: IND AS 28: INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

Illustrations

1: Significant influence

E Ltd. holds 25% of the voting power of an investee. The balance 75% of the voting power is held by three other investors each holding 25%.

The decisions about the financing and operating policies of the investee are taken by investors holding majority of the voting power. Since, the other three investors together hold majority voting power, they generally take the decisions without taking the consent of E Ltd. Even if E Ltd. proposes any changes to the financing and operating policies of the investee, the other three investors do not vote in favour of those changes. So, in effect the suggestions of E Ltd. are not considered while taking decisions related to financing and operating policies.

Determine whether E Ltd. has significant influence over the investee?

Solution:

Since E Ltd. is holding more than 20% of the voting power of the investee, it indicates that E Ltd. might have significant over the investee. However, the other investors in the investee prevent E Ltd. from participating in the financing and operating policy decisions of the investee. Hence, in this case, E Ltd. is not in a position to have significant influence over the investee.

2: Representation on board

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

Solution:

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

3: Participation in policy-making processes

M Ltd. holds 10% of the voting power an investee. The balance 90% voting power is held by nine other investors each holding 10%.

The decisions about the relevant activities (except decision about taking borrowings) of the investee are taken by the members holding majority of the voting power. The decisions about taking borrowings are required to be taken by unanimous consent of all the investors. Further, decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee.

Determine whether M Ltd. has significant influence over the investee?

Solution:

In this case, though M Ltd. is holding less than 20% of the voting power of the investee, M Ltd.'s consent is required to take decisions about taking borrowings which is one of the relevant activities. Further, since the decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee, it cannot be said that all the investors have joint control over the investee.
Hence, it can be said that M Ltd. has significant influence over the investee.

4: Material transactions between the entity and its investee
RS Ltd. is an entity engaged in the business of pharmaceuticals. It has invested in the share capital of an investee XY Ltd. and is holding 15% of XY Ltd.'s total voting power. XY Ltd. is engaged in the business of producing packing materials for pharmaceutical entities. One of the incentives for RS Ltd. to invest in XY Ltd. was the fact that XY Ltd. is engaged in the business of producing packing materials which is also useful for RS Ltd. Since last many years, XY Ltd.'s almost 90% of the output is procured by RS Ltd.
Determine whether RS Ltd. has significant influence over XY Ltd.?
Solution:
Since 90% of the output of XY Ltd. is procured by RS Ltd., XY Ltd. would be dependent on RS Ltd. for the continuation of its business. Hence, even though RS Ltd. is holding only 15% of the voting power of XY Ltd. it has significant influence over XY Ltd.

5: Interchange of managerial personnel
Entity X and entity Y operate in the same industry, but in different geographical regions. Entity X acquires a 10% shareholding in entity Y as a part of a strategic agreement. A new production process is key to serve a fundamental change in the strategic direction of entity Y. The terms of agreement provide for entity Y to start a new production process under the supervision of two managers from entity X. The managers seconded from entity X, one of whom is on entity X's board, will oversee the selection and recruitment of new staff, the purchase of new equipment, the training of the workforce and the negotiation of new purchase contracts for raw materials. The two managers will report directly to entity Y's board and as well as to entity X. Analyse.
Solution:
The secondment of the board member and a senior manager from entity X to entity Y gives entity X a range of power over a new production process and may evidence that entity X has significant influence over entity Y. This assessment takes into the account what are the key financial and operating policies of entity Y and the influence this gives entity X over those policies.

6: Provision of essential technical information
R Ltd. is a tyre manufacturing entity. The entity has entered into a technology transfer agreement with another entity Y Ltd. which is also involved in the business of tyre manufacturing. R Ltd. is an established entity in this business whereas Y Ltd. is a relatively new entity.
As per the agreement, R Ltd. has granted to Y Ltd. a license to use its the technical information and know-how which are related to the processes for the manufacture of tyres. Y Ltd. is dependent on the technical information and know-how supplied by R Ltd. because of its lack of expertise and experience in this business. Further, R Ltd. has also invested in 10% of the equity share capital of Y Ltd.
Determine whether R Ltd. has significant influence over Y Ltd.?
Solution:
Y Ltd. obtains essential technical information for the running of its business from R Ltd. Hence R Ltd. has significant influence over Y Ltd. despite of holding only 10% of the equity share capital of Y Ltd.

7: Potential voting rights

An entity which is currently holding 10% of the voting power of an entity has an option of purchase additional 15% voting power of the investee from other investors. However, the entity currently does not have financial ability to purchase additional 15% voting power of the investee. Determine whether the entity has significant influence over the investee?

Solution:

Considering the potential voting rights, the entity can have more than 20% of the voting power of the investee and hence it is presumed that the entity has significant influence over the investee. The fact that the entity does not have financial ability to purchase such additional voting power is not considered in such assessment (It should be noted that under Ind AS 110, potential voting rights which an entity cannot exercise because of its financial ability are not considered as substantive and hence not factored in the assessment. However, under Ind AS 28, there is no such requirement given. Hence the potential voting rights, even if they are not substantive as per Ind AS 110, are included in the assessment of significant influence.)

8: Accounting entries related investment in associate / joint venture

On the first day of a financial year, A Ltd. invested in the equity share capital of B Ltd. at a cost of ` 1,00,000 to acquire 25% share in the voting power of B Ltd. A Ltd. has concluded that B Ltd. is an associate of A Ltd. At the end of the year, B Ltd. earned profit of ` 10,000 and other comprehensive income of ` 2,000. In that year, B Ltd. also declared dividend to the extent of ` 4,000. Pass necessary entries in the books of A Ltd. to account for the investment in associate.

Solution:

Following entries would be passed in the books of A Ltd.:

1)	**Initial entry to record investment done in associate**			
	Investment in B Ltd. A/c	Dr.	1,00,000	
	To Bank A/c			1,00,000
2)	**Recording of share in the profit of the associate**			
	Investment in B Ltd. A/c	Dr.	2,500	
	To Share in profit of investee (P&L)			2,500
	[A Ltd. share in profit would be ₹ 2,500 (₹ 10,000 x 25%)]			
3)	**Recording of share in the other comprehensive income (OCI) of the associate**			
	Investment in B Ltd. A/c	Dr.	500	
	To Share in OCI of investee (OCI)			500
	[A Ltd. share in OCI would be ₹ 500 (₹ 2,000 x 25%)]			
4)	**Recording of dividend distributed by associate**			
	Dividend income A/c (P&L)	Dr.	1,000	
	To Investment in B Ltd. A/c			1,000
	[A Ltd. share in dividend would be ₹ 1,000 (₹ 4,000 x 25%)]			

9: Exemption from applying equity method

MNO Ltd. holds 15% of the voting power of DEF Ltd. PQR Mutual Fund (which is a subsidiary of MNO Ltd.) also holds 10% voting power of DEF Ltd. Hence, MNO Ltd. holds total 25% voting power of DEF Ltd. (15%

held by own and 10% held by subsidiary) and accordingly has significant influence over DEF Ltd. How should MNO Ltd. account for investment in DEF Ltd. in its consolidated financial statements?

Solution:

The 15% interest which is held directly by MNO Ltd. should be measured as per equity method of accounting. However, with respect to the 10% interest which is held through a mutual fund, MNO Ltd. can avail the exemption from applying the equity method to that 10% interest and instead measure that investment at fair value through profit or loss. To summarise, the total interest of 25% in DEF Ltd. should be measured as follows:

- 15% interest held directly by MNO Ltd.: Measure as per equity method of accounting
- 10% interest held indirectly through a mutual fund: Measure as per equity method of accounting or at fair value thorough profit or loss as per Ind AS 109

10: Acquisition of interest in an associate

Blue Ltd. acquired 25% of the equity share capital of Green Ltd. on the first day of the financial year for ` 1,25,000. As of that date, the carrying value of the net assets of Green Ltd. was ` 3,00,000 and the fair value was ` 4,00,000. The excess of fair value over the carrying value was attributable to one of the buildings owned by Green Ltd. having a remaining useful life of 20 years. Green Ltd. earned profit of ` 40,000 and other comprehensive income of ` 10,000 during the year. Calculate the goodwill / capital reserve on the date of acquisition, Blue Ltd.'s share in the profit and other comprehensive income for the year and closing balance of investment at the end of the year.

Solution:

(1) Goodwill / capital reserve on the date of acquisition

The cost of the investment is higher than the net fair value of the investee's identifiable assets and liabilities. Hence there is goodwill. Amount of goodwill is calculated as follows

Cost of acquisition of investment	1,25,000
Blue Ltd.'s share in fair value of net assets of Green Ltd. on the date of acquisition (4,00,000 *25%)	(1,00,000)
Goodwill	25,000

Above goodwill will be recorded as part of carrying amount of the investment.

(2) Share in profit and other comprehensive income of Gren Ltd.

Share in profit of Green Ltd. (40,000 x 25%)	10,000
Adjustment for depreciation based on fair value (1,00,000 ÷ 20) x 25%	(1,250)
Share in profit after adjustment	8,750
Share in other comprehensive income (10,000 x 25%)	2,500

(3) Closing balance of investment at the end of the year

Cost of acquisition of investment (including goodwill of ` 25,000)	1,25,000
Share in profit after adjustments	8,750
Share in other comprehensive income	2,500
Closing balance of investment	1,36,250

11: Cumulative preference shares issued by associate or joint venture

KL Ltd. has invested in 50% voting power of a joint venture MN Ltd. MN Ltd. has also issued 10% cumulative preference shares to other investors worth ` 10,00,000. During the year, MN Ltd. earned profit of ` 4,00,000. Also, MN Ltd. has not declared any dividend on the preference shares for current year. Calculate KL Ltd.'s share in the net profit of MN Ltd. for the year.

Solution:

If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity should compute its share of profit or loss after adjusting for dividend on such shares, whether or not the dividends have been declared.

In current case, KL Ltd.'s share in net profit of MN Ltd. would be as follows.

Profit of MN Ltd. for the year 4,00,000

Dividend on cumulative preference shares (10,00,000*10%) (1,00,000)

Net profit attributable to the holders of equity share 3,00,000

KL Ltd.'s 50% share in net profit of MN Ltd. 1,50,000

12: Share in the consolidated financial statements of associate

Entity A holds a 20% equity interest in Entity B (as associate) that in turn has a 100% equity interest in Entity C. Entity B recognised net assets relating to Entity C of ` 1,000 in its consolidated financial statements. Entity B sells 20% of its interest in Entity C to a third party (a non-controlling shareholder) for ` 300 and recognises this transaction as an equity transaction in accordance with paragraph 23 of Ind AS 110, resulting in a credit in Entity B's equity of ` 100.

The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

Before

A's consolidated financial statements

Assets	₹	Liabilities	₹
Investment in B	200	Equity	200
Total	200	Total	200

B's consolidated financial statements

Assets	₹	Liabilities	₹
Assets (from C)	1,000	Equity	1,000
Total	1,000	Total	1,000

The financial statements of B after the transaction are summarised below:

After

B's consolidated financial statements

Assets	₹	Liabilities		₹
Assets (from C)	1,000	Equity	1,000	
Cash	300	Equity transaction with non-controlling interest	100	
		Equity attributable to owners		1,100
		Non-controlling interest		200
Total	1,300	Total		1,300

Although Entity A did not participate in the transaction, Entity A's share of net assets in Entity B increased as a result of the sale of B's 20% interest in C. Effectively, A's share in B's net assets is now ` 220 (20% of ` 1,100) i.e. ` 20 in addition to its previous share. How is an equity transaction that is recognised in the financial statements of Entity B reflected in the consolidated financial statements of Entity A that uses the equity method to account for its investment in Entity B?

Solution:

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 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 A recognises ` 20 as change in other equity instead of in statement of profit and loss and maintains the same classification as of its associate, Entity B, i.e., a direct credit to equity as in its consolidated financial statements.

13: Upstream and downstream transaction between an entity and its associate

Scenario A

M Ltd. has invested in 40% share capital of N Ltd. and hence N Ltd. is an associate of M Ltd. During the year, N Ltd. sold inventory to M Ltd. for a value of ` 10,00,000. This included profit of 10% on the transaction price i.e. profit of ` 1,00,000. Out the above inventory, M Ltd. sold inventory of ` 6,00,000 to outside customers. Hence, the inventory of ` 4,00,000 purchased from N Ltd. is still lying with M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Scenario B

Assume the same facts as per Scenario A except that the inventory is sold by M Ltd. to N Ltd. instead of N Ltd. selling to M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Solution:

Scenario A

Firstly, as part of its equity method accounting for investment in N Ltd., M Ltd. will pass this journal entry:

Investment in N Ltd. Dr. 40,000
To Share in profit of N Ltd. 40,000

Out of the inventory of ` 10,00,000, M Ltd. has sold inventory worth ` 6,00,000 to outside customers. Hence, the profit of ` 60,000 (6,00,000 *10% profit margin) on such inventory is realised. However, the inventory worth ` 4,00,000 is still held by M Ltd. which consists profit of ` 40,000 (4,00,000*10%). Hence, M Ltd.'s share in such profit i.e. ` 16,000 (40,000*40%) is considered as unrealised.

Accordingly, after recording of share in total profit of N Ltd., M Ltd. should pass following adjustment entry to reverse the unrealised profit margin:

Share in profit of N Ltd. Dr. 16,000
To Inventory 16,000

In subsequent period, when this inventory of ` 4,00,000 is sold by N Ltd. to an outside customer then the above profit margin of ` 16,000 will be treated as realised and hence the above entry will be reversed in that period.

[Note: in the separate financial statements of M Ltd., inventory is carried at ` 4,00,000 whereas in its consolidated financial statements, inventory is carried at ` 3,84,000 (due to elimination entry above in respect of unrealized profit). In the subsequent period, when the inventory is sold, Inventory Account is credited by ` 4,00,000 whereas for the purpose of consolidated financial statements, it should have been credited by only ` 3,84,000. The difference is adjusted by debiting back ` 16,000 to the Inventory Account and a corresponding recognition of share in profit of associate.]

Scenario B

Out of the inventory of ` 10,00,000, N Ltd. has sold inventory worth ` 6,00,000 to outside customers. Hence, the profit of ` 60,000 (6,00,000 x 10% profit margin) on such inventory is realised. However, the inventory worth ` 4,00,000 is still held by N Ltd. which consists profit of
` 40,000 (4,00,000*10%). Out of this profit of ` 40,000, profit to the extent of other investor's interest in the investee is treated as realised profit i.e. ` 24,000 (40,000*60%) is treated as realised profit. Balance profit of ` 16,000 (40,000*40%) is considered as unrealised. Hence, M Ltd. should pass following adjustment entry to reverse the unrealised profit:

Sales Dr. 160,000
To Cost of material consumed 144,000
To Investment in N Ltd. 16,000

In subsequent period, when this inventory of ` 4,00,000 is sold by N Ltd. to an outside customer then the above profit margin of ` 16,000 will be treated as realised and hence the above entry will be reversed in that period.

14: Impairment loss on downstream and upstream transaction between an entity and its joint venture
Scenario A
X Ltd. has invested in a joint venture Y Ltd. by holding 50% of its equity share capital. During the year, X Ltd. sold an asset to Y Ltd. at its market value of ` 8,00,000. The asset's carrying value in X Ltd.'s books was ` 10,00,000. Determine how should X Ltd. account for the sale transaction in its books.

Scenario B
Assume the same facts as per Scenario A except that the asset is sold by Y Ltd. to X Ltd. instead of X Ltd. selling to Y Ltd. Determine how should X Ltd. account for the above transaction in its books.

Solution:
Scenario A
X Ltd. should record full loss of ` 2,00,000 (10,00,000 – 8,00,000) in its books as that would represent the impairment loss because the market value has actually declined. This loss would have been recorded even if X Ltd. would have first impaired the asset and then sold to Y Ltd. at zero profit / loss. Following entry should be passed in the books of X Ltd.

Bank A/c	Dr.	8,00,000	
Loss on sale of asset	Dr.	2,00,000	
To Asset		10,00,000	

Scenario B
X Ltd. should record loss to the extent of its share in Y Ltd. Hence, X Ltd.'s share in loss i.e. ` 1,00,000 [(10,00,000 – 8,00,000) x 50%] should be recorded by X Ltd. in its books. The loss should be recorded since the market value of the asset has actually declined and this would represent impairment. This loss would have been recorded even if Y Ltd. would have first recorded an impairment loss of ` 2,00,000 and then sold to X Ltd. at zero profit / loss. Following entry should be passed in the books of X Ltd.

Asset	Dr.	8,00,000	
Share in loss of Y Ltd.	Dr.	1,00,000	
To Bank		8,00,000	
To Investment in Y Ltd.			1,00,000

15: Loss making associate and long-term interests
An entity has following three type interests in an associate:
- **Equity shares: 25% of the equity shares to which equity method of accounting is applied**
- **Preference shares: Non-cumulative preference shares that form part of net investment in the associate. Such preference shares are measured at fair value as per Ind AS 109.**
- **Long-term loan: The loan carrying interest of 10% p.a. The interest income is received at the end of each year. The long-term loan is accounted as per amortised cost as per Ind AS 109. This loan also forms part of net investment in the associate.**

At the start of year 1, the carrying value of each of the above interests is as follows:
- **Equity shares – ` 10,00,000**
- **Preference shares – ` 5,00,000**
- **Long-term loan – ` 3,00,000**

Following table summarises the changes in the fair value of preference shares as per Ind AS 109, impairment loss on long-term loan as per Ind AS 109 and entity's share in profit / loss of associate for year 1-5.

End of Year	Increase / (Decrease) in fair value of preference shares as per Ind AS 109	Impairment loss / (reversal) on long-term loan as per Ind AS 109	Entity's share in profit / (loss) of associate
1	(50,000)	(50,000)	(16,00,000)
2	(50,000)	-	(2,00,000)
3	1,00,000	50,000	-
4	50,000	-	10,00,000
5	30,000	-	10,00,000

Throughout year 1 to 5, there has been no objective evidence of impairment in the net investment in the associate. The entity does not have any legal or constructive obligation to share the losses of the associate beyond its interest in the associate.

Based on above, determine the closing balance of each of the above interests at the end of each year.

Solution:

Year 1

Below table summarises the closing balance of each of the interest at the end of year 1:

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	10,00,000	NA	10,00,000	(10,00,000)	-
Preference shares	5,00,000	(50,000)	4,50,000	(4,50,000)	-
Long-term loan	3,00,000	(50,000)	2,50,000	(1,50,000)	1,00,000
Total	**18,00,000**	**(1,00,000)**	**17,00,000**	**(16,00,000)**	**1,00,000**

The entire loss of ` 16,00,000 is recognised. Hence, there is no unrecognised loss at the end of year 1.

Year 2

Below table summarises the closing balance of each of the interest at the end of year 2:

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	-	-
Preference shares	-	(50,000)	(50,000)	50,000 *	-
Long-term loan	1,00,000	-	1,00,000	(1,00,000)	-
Total	**1,00,000**	**(1,00,000)**	**17,00,000**	**(50,000)**	**-**

Recognition of changes in fair value as per Ind AS 109 has resulted in the carrying amount of Preference shares being negative ` 50,000. Consequently, the entity shall reverse a portion of the associate's losses previously allocated to Preference shares.
Out of the total loss of ` 2,00,000 for the year, loss of only ` 50,000 is recognized. Hence, there is recognized loss to the extent of ` 1,50,000 at the end of year 2.

Year 3
Below table summarises the closing balance of each of the interest at the end of year 3:

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	-	-
Preference shares	-	1,00,000	1,00,000	(1,00,000)	-
Long-term loan	-	50,000	50,000	(50,000)	-
Total	**-**	**1,50,000**	**1,50,000**	**(1,50,000)**	**-**

Year 4
Below table summarises the closing balance of each of the interest at the end of year 4:

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Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	2,00,000	2,00,000
Preference shares	-	50,000	50,000	5,00,000	5,50,000
Long-term loan	-	-	-	3,00,000	3,00,000
Total	**-**	**50,000**	**50,000**	**10,00,000**	**10,50,000**

The entity's share in profit of associate for the year is ` 10,00,000. The entity shall allocate such profit to each of the instruments in order of their seniority in liquidation. The entity should limit the amount of profit to be allocated to preference shares and long-term loan to the extent of losses previously allocated to them. Hence, the entity has allocated ` 5,00,000 to preference shares and ` 3,00,000 to long-term debt.
There is no unrecognised loss at the end of year 4.

Year 5
Below table summarises the closing balance of each of the interest at the end of year 5:

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	2,00,000	NA	2,00,000	10,00,000	12,00,000
Preference shares	5,50,000	30,000	5,80,000	-	5,80,000
Long-term loan	3,00,000	-	3,00,000	-	3,00,000
Total	**10,50,000**	**30,000**	**10,80,000**	**10,00,000**	**20,80,000**

Year 1 to 5
The interest accrual on long-term loan would be done in each year at 10% p.a. This will be done without taking into account any adjustment done in the carrying value of long-term loan as per Ind AS 28. Hence, the entity will accrue interest of ` 30,000 (3,00,000 x 10%) in each year.

16: Recording in profit or loss of the gain / loss on discontinuation of equity method
CD Ltd. held 50% of the voting power of RS Ltd. which is a joint venture of CD Ltd. The carrying value of the investment in RS Ltd. is ` 1,00,000. Now out of the 50% stake, CD Ltd. has sold 20% stake in RS Ltd. to a third party for a consideration of ` 80,000. The fair value of the retained 30% interest is ` 1,20,000. Determine how much gain / loss should be recorded in profit or loss of CD Ltd.
Solution:

CD Ltd. Shall record in profit or loss difference between below:

- the fair value of any retained interest (i.e. ` 1,20,000) and any proceeds from disposing of a part interest in the joint venture (i.e. ` 80,000); and
- the carrying amount of the investment at the date the equity method was discontinued (i.e. ` 1,00,000).

Hence, CD Ltd. Shall record gain of ` 1,00,000 in profit or loss.

17: Investment in joint venture held for sale

Ram Ltd. holds 50% of the equity share capital of Shyam Ltd. The balance 50% equity share capital is held by another investor. Ram Ltd. has joint control over Shyam Ltd. and it is a joint venture of Ram Ltd., accounted using equity method. Now Ram Ltd. is planning to sell 10% of the equity share capital of Shyam Ltd. to a third party. Such 10% investment meets the criteria of an asset held for sale and has been measured and disclosed accordingly. Now determine how should Ram Ltd. account 40% interest retained in Shyam Ltd.

Solution:

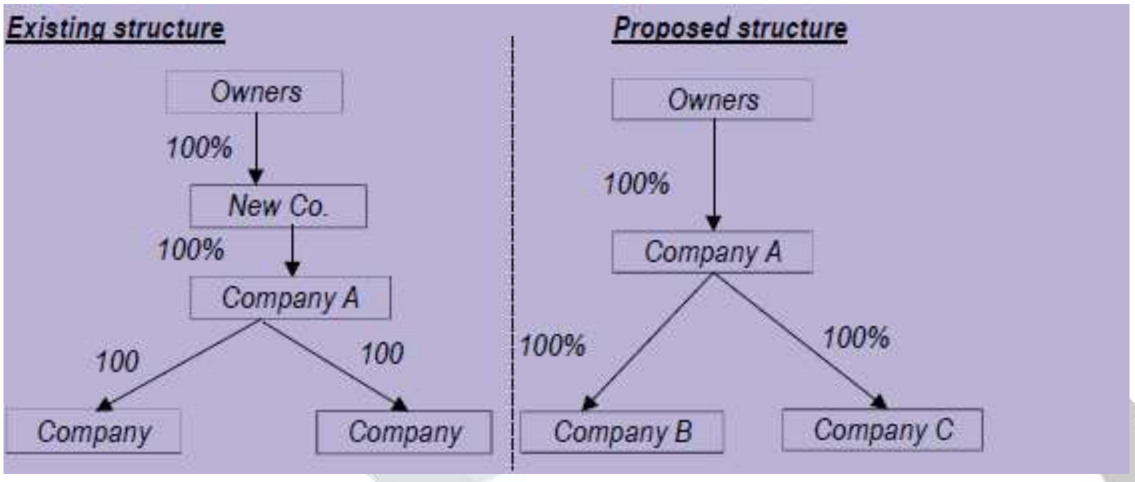
Till the time 10% stake is sold, Ram Ltd. shall account for the retained interest of 40% as per equity method. After the sale of 10% investment, if Ram Ltd. still has joint control over Shyam Ltd. (e.g. through contractual arrangement) then it shall continue to measure that investment using equity method. However, if Ram Ltd. is not going to have joint control over Shyam Ltd. post the disposal of 10% investment then retained investment of 40% shall be accounted as per Ind AS 109.

UNIT 7: IND AS 27: SEPARATE FINANCIAL STATEMENTS

Illustrations

1. Reorganisation of the group structure

Following is the existing and proposed group structure of an original parent A Ltd.



As per the above structure, the Owners of Company A will transfer all their shareholding in Company A to New Co. In exchange of such shares, New Co. will issue its equity shares to the Owners. New Co. will issue the shares to the owners in the same ratio of their existing holding in Company A so that they have same absolute and relative interests in the net assets of the group immediately before and after the reorganisation. The assets and liabilities of the group immediately before the and after the proposed restructuring will also be the same.

The cost of the investment in Company A in the books of the Owners is ` 10 lakh. Total equity of Company A (i.e. equity share capital and other equity attributable to the owners) as per its separate financial statements on the date of proposed restructuring is ` 15 lakh.

After the proposed restructuring, New Co. wants to record its investment in Company A at cost. Determine how it should measure the cost of investment in Company A?

Solution:

In current case, New Co. should measure the cost of investment in Company A at the carrying amount of its share of the equity items shown in the separate financial statements of Company A at the date of the restructuring because:

a) New Co. obtains control of Company A by issuing equity instruments to the Owners in exchange for their existing equity instruments of Company A;

b) the assets and liabilities of the group immediately before and the proposed restructuring will be same; and

c) the Owners will have the same absolute and relative interests in the net assets of the group immediately before and after the proposed restructuring.

Hence, New Co. will measure the cost of investment in Company A at ` 15 lakh.

Questions

1. X Limited was holding 100% of the equity share capital of Y Limited and Y Limited was treated as a subsidiary by X Limited. Now, Y Limited issues convertible preference shares to Z Limited. As per the issue document of convertible preference shares, Z Limited also gets the rights to participate in the relevant activities of Y Limited whereby Z Limited's consent is also necessary to pass any decision by the equity shareholder of Y Limited (i.e. X Limited). Determine how should X Limited account for its investment in Y Limited in its consolidated financial statements after the issue of convertible preference shares by Y Limited to Z Limited?

Answer:

As per the issue document of convertible preference shares, unanimous consent of both X Limited and Z Limited are required to pass any decision about the relevant activities of Y Limited. Hence, Y Limited is jointly controlled by X Limited and Z Limited and thereby, Y Limited becomes a joint arrangement between X Limited and Z Limited Y Limited is structured through a separate vehicle. The legal form of Y Limited, terms of the contractual arrangement or other facts and circumstances do not give X Limited and Z Limited rights to the assets, and obligations for the liabilities, relating to Y Limited. Hence, Y Limited is a joint venture between X Limited and Z Limited.

When the convertible preference shares are issued to Z Limited, X Limited losses control over Y Limited. Hence X Limited should derecognise the assets and liabilities of Y Limited from its consolidated financial statements. 100% equity shares in Y Limited is still held by X Limited. Hence such investment would be accounted at fair value on the date of loss of control by X Limited. The difference between the fair value of 100% equity shares retained in Y Limited and the carrying value of assets and liabilities of Y Limited derecognised is recognised in profit or loss of X Limited. After the loss of control, the investment in Y Limited is accounted as per equity method of accounting by X Limited whereby the investment value in Y Limited will be adjusted for the change in the X Limited's share of the net assets Y Limited post the date of loss of control. Also, the difference between the fair value of investment in Y Limited and fair value of net identifiable assets of Y Limited shall be goodwill or capital reserve

2. M Limited holds 90% interest in subsidiary N Limited. N Limited holds 25% interest in an associate O Limited. As at 31 March 20X1, the net assets of O Limited was ` 300 lakhs including profit of ` 40 lakhs for the year ended 31 March 20X1. Calculate how the investment in O Limited will be accounted in the consolidated financial statements of M Limited?

Answer:

Since N Limited is a subsidiary of M Limited, the consolidated financial statements of M Limited will include 100% amounts of the consolidated financial statements of N Limited (including investment in O Limited accounted for using equity method). Accordingly, the investment in O Limited will be accounted as follows in the consolidated financial statements of M Limited:

		₹' lakh
Investment in O Limited (300 x 25%)		75
Share in profit of O Limited		
Attributable to M Limited (40 x 25% x 90%)	9	
Attributable to Non-controlling interest of N Limited (50 x 25% x 10%)	1	10

3. AB Limited holds 30% interest in an associate which it has acquired for a cost of ` 300 lakhs. On the date of acquisition of that stake, the fair value of net assets of the associate was ` 900 lakh. The value of goodwill on acquisition was ` 30 lakhs. After the acquisition, AB Limited accounted for the investment in the associate as per equity method of accounting and now the carrying value of such investment in the consolidated financial statements of AB Limited is ` 360 lakhs. The associate has now issued equity shares to some investors other than AB Limited for a consideration of ` 800 lakhs. This has effectively reduced the holding of AB Limited to 20%. Determine how AB Limited should account for such reduction in interest in the associate?

Answer:

Because of the issue of shares by associate to other investors, AB Limited has effectively sold 10% (30 – 20) of its interest in the associate. The gain / loss on reduction in interest in associate in calculated as follows:

	₹' lakhs
AB Limited's share in the consideration received by the associate for issue of shares (800 x 20%) (1)	160
Less: Carrying value of interest sold (360 x 1/3)(2)	(120)
Gain on reduction in interest in associate(3)	**40**

Notes:

(1) The share in the consideration received by associate on issue of shares (i.e. ` 160 lakhs) would be recorded as part of investment in associate.

(2) The carrying amount of interest sold (i.e. ` 120 lakhs) will be derecognised, including proportionate goodwill of ` 10 lakhs (30 * 1/3).

(3) Gain of ` 40 lakhs will be recorded in the profit or loss.

4. DEF Ltd. acquired 100% ordinary shares of ` 100 each of XYZ Ltd. on 1st October 20X1. On March 31, 20X2 the summarised Balance Sheets of the two companies were as given below:

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

The retained earnings of XYZ Ltd. showed a credit balance of ` 3,00,000 on 1st April 20X1 out of which a dividend of 10% was paid on 1st November; DEF Ltd. has recognised the dividend received to profit or loss account; Fair Value of P&M as on 1st October 20X1 was ` 20,00,000. 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	1,00,000	Land & Buildings	10,00,000
		Inventories	1,50,000

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 of both the companies as on 31st March 20X2 are the same as was on 1st April 20X1.

III. All fair value adjustments have not yet started impacting consolidated post-acquisition profits.

Prepare consolidated Balance Sheet as on March 31, 20X2.

Answer:

Consolidated Balance Sheet of DEF Ltd. and its subsidiary, XYZ Ltd. as on 31st March, 20X2

Particulars	Note No.	₹
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	86,00,000
(2) Current Assets		
(i) Inventories	2	17,14,000
(ii) Financial Assets		
(a) Trade Receivables	3	9,98,000
(b) Cash & Cash equivalents	4	2,25,000
Total Assets		**1,15,37,000**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	5	50,00,000
(ii) Other Equity	6	49,92,000
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	7	7,45,000
(b) Short term borrowings	8	8,00,000
Total Equity & Liabilities		**1,15,37,000**

Notes to Accounts

			₹
1.	**Property Plant & Equipment**		
	Land & Building	43,00,000	
	Plant & Machinery	43,00,000	86,00,000

2.	**Inventories**		
	DEF Ltd.	12,00,000	
	XYZ Ltd.	5,14,000	17,14,000
3.	**Trade Receivables**		
	DEF Ltd.	5,98,000	
	XYZ Ltd.	4,00,000	9,98,000
4.	**Cash & Cash equivalents**		
	DEF Ltd.	1,45,000	
	XYZ Ltd.	80,000	2,25,000
7.	**Trade payable**		
	DEF Ltd.	4,71,000	
	XYZ Ltd.	2,74,000	7,45,000
8.	**Shorter-term borrowings**		
	Bank overdraft		8,00,000

Statement of Changes in Equity:

5. 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
50,00,000	0	50,00,000

6. Other Equity

	Share application money pending allotment	Equity component of compound financial instrument	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Other Reserves	
Balance at the beginning				0	24,00,000	24,00,000
Total comprehensive income for the year			0	5,72,000		5,72,000
Dividends			0	(2,00,000)		(2,00,000)
Total comprehensive						

income attributable to parent			0	3,35,000		3,35,000
Gain on Bargain purchase			18,85,000			18,85,000
Balance at the end of reporting period			18,85,000	7,07,000	24,00,000	49,92,000

It is assumed that there exists no clear evidence for classifying the acquisition of the subsidiary as a bargain purchase and, hence, the bargain purchase gain has been recognized directly in capital reserve. If, however, there exists such a clear evidence, the bargain purchase gain would be recognized in other comprehensive income and then accumulated in capital reserve. In both the cases, closing balance of capital reserve will be ` 18,85,000.

Working Notes:

1. Adjustments of Fair Value

The Plant & Machinery of XYZ Ltd. would stand in the books at ` 14,25,000 on 1st October, 20X1, considering only six months' depreciation on ` 15,00,000 total depreciation being ` 1,50,000. The value put on the assets being ` 20,00,000 there is an appreciation to the extent of ` 5,75,000.

2. Acquisition date profits of XYZ Ltd.

Reserves on 1.4. 20X1	10,00,000
Profit & Loss Account Balance on 1.4. 20X1 Profit for 20X2: Total ₹ 8,20,000 less ₹ 1,00,000 (3,00,000 – 2,00,000) i.e. ₹ 7,20,000; for 6 months i.e. up to 1.10.20X1	3,00,000
Total Appreciation including machinery appreciation (10,00,000 1,50,000 + 5,75,000 – 1,00,000)	3,60,000
Share of DEF Ltd.	16,25,000
	32,85,000

3. Post-acquisition profits of XYZ Ltd.

Profit after 1.10. 20X1 [8,20,000-1,00,000]x 6/12	3,60,000
Less: 10% depreciation on ₹ 20,00,000 for 6 months less depreciation already charged for 2nd half of 20X1-20X2 on ₹ 15,00,000 (1,00,000-75,000)	(25,000)
Share of DEF Ltd.	3,35,000

4. Consolidated total comprehensive income ₹

DEF Ltd.	
Retained earnings on 31.3.20X2	5,72,000
Less: Retained earnings as on 1.4.20X1	(0)
Profits for the year 20X1-20X2	5,72,000
Less: Elimination of intra-group dividend	(2,00,000)
Adjusted profit for the year	3,72,000
XYZ Ltd.	
Adjusted profit attributable to DEF Ltd. (W.N.3)	3,35,000
Consolidated profit or loss for the year	7,07,000

5. No Non-controlling Interest as 100% shares of XYZ Ltd. are held by DEF Ltd.

6. Gain on Bargain Purchase ₹

Amount paid for 20,000 shares		34,00,000
Par value of shares	20,00,000	
DEF Ltd.'s share in acquisition date profits of XYZ Ltd.	32,85,000	(52,85,000)
Gain on Bargain Purchase		18,85,000

7. Value of Plant & Machinery ₹

DEF Ltd.		24,00,000
XYZ Ltd.	13,50,000	
Add: Appreciation on 1.10. 20X1	5,75,000	
	19,25,000	
Add: Depreciation for 2nd half charged on pre-revalued value	75,000	
Less: Depreciation on ₹ 20,00,000 for 6 months	(1,00,000)	19,00,000
		43,00,000

8. Consolidated retained earnings ₹

	DEF Ltd.	XYZ Ltd.	Total
As given	5,72,000	8,20,000	13,92,000
Consolidation Adjustments:			
(i) Elimination of pre-acquisition element [3,00,000 + 3,60,000]	0	(6,60,000)	(6,60,000)
(ii) Elimination of intra-group dividend	(2,00,000)	2,00,000	0
(iii) Impact of fair value adjustments	0	(25,000)	(25,000)
Adjusted retained earnings consolidated	3,72,000	3,35,000	7,07,000

Assumptions:

1. Investment in XYZ Ltd is carried at cost in the separate financial statements of DEF Ltd.
2. Appreciation of `10 lakhs in land & buildings is entirely attributable to land element only.
3. Depreciation on plant and machinery is on WDV method.
4. Acquisition-date fair value adjustment to inventories of XYZ Ltd. existing at the balance sheet date does not result in need for any write-down

5. Ram Ltd. acquired 60% ordinary shares of ` 100 each of Krishan Ltd. on 1st October 20X1. On March 31, 20X2 the summarised Balance Sheets of the two companies were as given below:

	Ram Ltd.	Krishan Ltd.
Assets		
Property, Plant 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 P&M 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 March 31, 20X2.

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	1,65,800
(2) Current Assets		
(i) Inventories	3	3,42,800
(ii) Financial Assets		
(a) Trade Receivables	4	1,99,600
(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	7,30,600
(2) Non-controlling Interest (WN 5)		4,33,600
(3) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	1,49,000
(b) Short term borrowings	9	1,60,000
Total Equity & Liabilities		**24,73,200**

Notes to accounts

			₹
1.	**Property Plant & Equipment**		
	Land & Building	8,60,000	

5. **Goodwill:**

Amount paid for 2,400 shares		8,00,000
Par value of shares	2,40,000	
Acquisition date profits share of Ram Ltd.	3,94,200	(6,34,200)
Goodwill		1,65,800

6. **Value of Plant & Machinery:**

Ram Ltd.		4,80,000
Krishan Ltd.	2,70,000	
Add: appreciation on 1.10. 20X1	1,15,000	
	3,85,000	
Add: Depreciation for 2nd half charged on pre-revalued value	15,000	
Less: Depreciation on ₹ 4,00,000 for 6 months	(20,000)	3,80,000
		8,60,000

7. **Profit & Loss account consolidated**

Ram Ltd. (as given)	1,14,400	
Less: Dividend	(24,000)	90,400
Share of Ram Ltd. in post-acquisition profits		40,200
		1,30,600

6. Blue Heavens Ltd. consolidated balance sheet at 31 March 20X2 will be calculated as follows: **(in lakhs)**

	Blue Heavens Ltd.	Orange County Ltd.	Consolidation adjustments	Consolidated Blue Heavens Ltd.
	Carrying amount	Carrying amount		
Assets **Non-current assets** Goodwill			1,300 (WN 1)	1,300
Buildings and other PPE	7,000	3,000	300	10,300
Financial Assets				
Investment in Orange County Ltd.	6,000		(6,000)	
Current assets				
Inventories	700	500	100	1,300
Financial Assets				
Trade receivables	300	250		550

Cash	1,500	700		2,200
Total assets	**15,500**	**4,450**		**15,650**
Equity and liabilities				
Equity				
Share capital	5,000	2,000	(2,000)	5,000
Other Equity	10,200	2,300	(2,300)	10,200
Trade payable	300	150		450
Total liabilities and equity	**15,500**	**4,450**		**15,650**

Consolidation involves:

- Adding the balance sheet of the parent and its subsidiary together line by line.
- Eliminating the carrying amount of the parent's investment in the subsidiary (becaus it is replaced by the goodwill and the fair value of the assets, liabilities ar contingent liabilities acquired) and the pre-acquisition equity of the subsidia (because that equity was not earned or contributed by the group but is part of wh was purchased) and recognising the fair value adjustments together with the goodw asset that arose on acquisition of the subsidiary.

1.	Working for goodwill:	(₹ in lakhs
	Consideration paid	6,00
	Less: Acquisition date fair value of Orange County Ltd. net assets	(4,700
	Goodwill	1,30

2. Working for the acquisition date fair value of Orange County Ltd. net asset Acquisition date fair value of acquiree (Orange County Ltd.) assets

Buildings and other PPE	3,300
Inventories	600
Trade receivables	250
Cash	700
Less: fair value of trade payables	(150)
Fair value of net assets acquired	4,700

comprehensive income attributable to parent			0	40,200		40,20
Gain on Bargain purchase				0		(
Balance at the end of reporting period				1,30,600	6,00,000	7,30,60

Working Notes:

1. **Adjustments of Fair Value**

The Plant & Machinery of Krishan Ltd. would stand in the books at ₹ 2,85,000 1st October, 20X1, considering only six months' depreciation on ₹3,00,000 tc depreciation being ₹ 30,000. The value put on the assets being ₹ 4,00,000 there is appreciation to the extent of ₹ 1,15,000.

2. **Acquisition date profits of Krishan Ltd.**

Reserves on 1.4. 20X1		2,00,000
Profit & Loss Account Balance on 1.4. 20X1		60,000
Profit for 20X1-20X2: Total (₹ 1,64,000 less ₹ 20,000) x 6/12 i.e. ₹ 72,000; upto 1.10. 20X1		72,000
Total Appreciation		3,25,000
		6,57,000
Holding Co. Share (60%)		3,94,200

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)	(5,000)
Total	67,000
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)	2,46,800
Add: 2/5 Post-acquisition profits [WN 4]	26,800
	4,33,600

6. On 31 March 20X2, Blue Heavens Ltd. acquired 100% ordinary shares carrying voting rights of Orange County Ltd. for ` 6,000 lakh in cash and it controlled Orange County Ltd. from that date. The acquisition-date statements of financial position of Blue Heavens Ltd. and Orange County Ltd. and the fair values of the assets and liabilities recognised on Orange County Ltd. balance sheet were:

	Blue Heavens Ltd.	Orange County Ltd.	
	Carrying Amount (₹ in lakh)	Carrying Amount (₹ in lakh)	Fair Value (₹ in lakh)
Assets			
Non-current assets			
Building and other PPE	7,000	3,000	3,300
Investment in Orange County Ltd.	6,000		
Current assets			
Inventories	700	500	600
Trade receivables	300	250	250
Cash	1,500	700	700
Total assets	**15,500**	**4,450**	
Equity and liabilities			
Equity			
Share capital	5,000	2,000	
Retained earnings	10,200	2,300	
Current liabilities			
Trade payables	300	150	150
Total liabilities and equity	**15,500**	**4,450**	

Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd.

Answer:

Blue Heavens Ltd. consolidated balance sheet at 31 March 20X2 will be calculated as follows:

(in lakhs)

	Blue Heavens Ltd.	Orange County Ltd.	Consolidation adjustments	Consolidated Blue Heavens Ltd.
	Carrying amount	Carrying amount		
Assets				
Non-current assets				
Goodwill			1,300 (WN 1)	1,300
Buildings and other PPE	7,000	3,000	300	10,300
Financial Assets				
Investment in Orange County Ltd.	6,000		(6,000)	
Current assets				
Inventories	700	500	100	1,300
Financial Assets				
Trade receivables	300	250		550
Cash	1,500	700		2,200
Total assets	15,500	4,450		15,650
Equity and liabilities				
Equity				
Share capital	5,000	2,000	(2,000)	5,000
Other Equity	10,200	2,300	(2,300)	10,200
Trade payable	300	150		450
Total liabilities and equity	15,500	4,450		15,650

Consolidation involves:

• Adding the balance sheet of the parent and its subsidiary together line by line.

• Eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets, liabilities and contingent liabilities acquired) and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased) and recognising the fair value adjustments together with the goodwill asset that arose on acquisition of the subsidiary.

1.	Working for goodwill:	(₹ in lakhs)
	Consideration paid	6,000
	Less: Acquisition date fair value of Orange County Ltd. net assets	(4,700)
	Goodwill	1,300

2. Working for the acquisition date fair value of Orange County Ltd. net assets Acquisition date fair value of acquiree (Orange County Ltd.) assets

Buildings and other PPE	3,300
Inventories	600
Trade receivables	250
Cash	700
Less: fair value of trade payables	(150)
Fair value of net assets acquired	4,700

7. The facts are the same as in Question 6 above. However, Blue Heavens Ltd. acquires only 75% of the ordinary shares, to which voting rights are attached of Orange County Ltd. Blue Heavens Ltd. pays ` 4,500 lakhs for the shares. Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd.

Answer:

Non-controlling interest

= 25 % × Orange County Ltd. identifiable net assets at fair value of ` 4,700

= ` 1,175.

Blue Heavens Ltd.'s consolidated balance sheet at 31 March 20X2 will be calculated as follows: **(in lakhs)**

	Blue Heavens Ltd.	Orange County Ltd.	Consolidation adjustments	Consolidated Blue Heavens Ltd.
	Carrying amount	Carrying amount		
Assets				
Non-current assets				
Goodwill			975 (WN 1)	975
Buildings and other PPE	7,000	3,000	300	10,300
Financial Assets				
Investment in Orange County Ltd.	4,500		(4,500)	
Current assets				
Inventories	700	500	100	1,300
Financial Assets				
Trade receivables	300	250		550
Cash	3,000	700		3,700
Total assets	**15,500**	**4,450**		**16,825**
Equity and liabilities				
Equity				
Share capital Other	5,000	2,000	(2,000)	5,000
Equity	10,200	2,300	(2,300)	10,200
			1,175	1,175
Non-controlling interest				
Current liabilities				
Financial Liabilities				
Trade payables	300	150		450
Total liabilities and equity	**15,500**	**4,450**		**16,825**

Note: In this question, Blue Heavens Ltd.'s (and consequently the group's) cash balance is ₹ 1,500 lakh higher than in Question above because, here Blue Heavens Ltd. paid ₹ 1,500 less to acquire Orange County Ltd. (i.e. ₹ 6,000 less ₹ 4,500).

1. **Working for goodwill:** (₹ in lakhs)

Consideration paid	4,500
Non- controlling interest	1,175
Less: Acquisition date fair value of Orange County Ltd. net assets (cal. as above)	4,700
Goodwill	975

(Goodwill recognized in the consolidated balance sheet relates solely to the acquirer's proportion of the subsidiary; it does not include the non-controlling interest's share).

8. Facts are same as in Question 6 &7, Blue Heavens Ltd. acquires 75% of Orange County Ltd. Blue Heavens Ltd. pays ` 4,500 lakhs for the shares. At 31 March 20X3, i.e one yea after Blue Heavens Ltd. acquired Orange County Ltd., the individual statements of financial position and statements of comprehensive income of Blue Heavens Ltd. and Orange County Ltd. are:

	Blue Heavens Ltd. Carrying Amount (₹ in lakh)	Orange County Ltd. Carrying Amount (₹ in lakh)
Assets		
Non-current assets		
PPE (Building and others)	6,500	2,750
Investment in Orange County Ltd.	4,500	
	11,000	2,750
Current assets		
Inventories	800	550
Financial Asset - Trade receivables	380	300
Cash	4,170	1,420
	5,350	2,270
Total assets	**16,350**	**5,020**
Equity and liabilities		
Equity		
Share capital	5,000	2,000
Retained earnings	11,000	2,850
	16,000	4,850
Current liabilities		
Financial Liabilities-Trade payables	350	170
	350	170
Total liabilities and equity	**16,350**	**5,020**

Statements of Profit and Loss for the year ended 31 March 20X3:

	Blue Heavens Ltd. Carrying Amount (₹ in lakh)	Orange County Ltd. Carrying Amount (₹ in lakh)
Revenue	3,000	1,900
Cost of sales	(1,800)	(1,000)
Administrative expenses	(400)	(350)
Profit for the year	**800**	**550**

Note: Blue Heavens Ltd. estimates that goodwill has impaired by 98. The fair value adjustment to buildings and other PPE is in respect of a building; all buildings have an estimated remaining useful life of 20 years from 31 March 20X2 and estimated residual values of zero. Blue Heavens Ltd. uses the straight-line method for depreciation of PPE. All the inventory held by Orange County Ltd. at 31 March 20X2 was sold during 20X3.

Prepare the Consolidated Balance Sheet as on March 31, 20X3 of group of entities Blue Heavens Ltd. and Orange County Ltd.

Answer:

Alternative I for calculation of Non-controlling Interest:

The Non-controlling Interest proportion of Orange County Ltd. is 25%.

At 31 March 20X3, the NCI in the consolidated balance sheet would be calculated as:

NCI at date of acquisition (31 March 20X2) (see solution to Question 7)	1,175
NCI's share of profit for the year ended 31 March 20X3, being 25%	
Of ₹ 435 lakh (being ₹ 550 profit of Orange County Ltd. as per	
Orange County Ltd. financial statements less ₹ 100 group inventory	
Fair value adjustment less ₹ 15 group depreciation on building	
fair value adjustment)*	109
NCI as at 31 March 20X3	1,284

*In calculating the NCI's share of profit for the year ended 31 March 20X3, no deduction is made for goodwill amortization because, as explained above, the goodwill arising on consolidation relates solely to the acquirer's proportion of the subsidiary and does not include the non-controlling interest's share.

Alternative II for calculation of Non-controlling Interest:

As an alternative to the above three-step approach, at 31 March 20X3 the NCI in the consolidated balance sheet is calculated as 25% (the NCI's proportion) of ` 5,135, which is ` 1,284. ` 5,135 is Orange County Ltd. net assets at 31 March 20X3 as shown in Orange County Ltd. balance sheet (` 4,850, being ` 5,020 assets less ` 170 liabilities) plus the fair value adjustment to those assets as made in preparing the group balance sheet (` 285, being the fair value adjustment in respect of Orange County Ltd. building, ` 300, less one year's depreciation of that adjustment, ` 15).

Blue Heavens Ltd. consolidated statement of comprehensive income for the year ended 31 March 20X3 will be computed as follows:

	Blue Heavens Ltd.	Orange County Ltd.	Consolidate adjustments	Consolidated
Revenue	3,000	1,900		4,900
Cost of sales	(1,800)	(1,000)	(100) (WN 1)	(2,900)
Profit for the year	1,200	900		2,000
Administrative expenses	(400)	(350)	(113) (WN 2)	(863)
Total comprehensive income for the year	800	550		1,137

Total comprehensive income attributable to:

Owners of the parent (75%)	1,028
Non-controlling interest (25%)	109
	1,137

Consolidation involves:

- Adding the statement of comprehensive income of the parent and its subsidiary together line by line
- Recognising the fair value adjustments and/ or amortisation thereof together with amortisation of the goodwill asset that arose on acquisition of the subsidiary.

Blue Heavens Ltd. consolidated balance sheet at 31 March 20X3 will be computed as follows:

	Blue Heavens Ltd.	Orange County Ltd.	Consolidation adjustments	Consolidated Blue Heavens Ltd.
	Carrying amount	Carrying amount		
Assets				
Non-current assets				
Goodwill			975-98 (WN 3)	877
Buildings and other PPE	6,500	2,750	285 (WN 4)	9,535
Financial Assets				
Investment in Entity B	4,500		(4,500)	
Current assets				
Inventories	800	550		1,350
Financial Assets				
Trade receivables	380	300		680
Cash	4,170	1420		5,590
Total assets	**16,350**	**5,020**		**18,032**
Equity and liabilities Equity				
Share capital	5,000	2,000	(2,000)	5,000
Other Equity	11,000	2,850	(2,622) (WN 5)	11,228
Non-controlling interest			1,284	1,284
Current liabilities Financial Liabilities				
Trade payables	350	170		520
Total liabilities and equity	**16,350**	**5,020**		**18,032**

Consolidation involves:

• Adding the balance sheet of the parent and its subsidiary together line by line.

• Eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets, liabilities and contingent liabilities acquired) and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased), and recognising the fair value adjustments together with the goodwill asset that arose on acquisition of the subsidiary as adjusted to reflect the first year post-acquisition

• Recognising the non-controlling interest in the net assets of Entity B.

Working Notes:

(1) Cost of sales adjustment:

` 100 = fair value adjustment in respect of inventories at 31 March 20X2.

(2) Administrative expenses adjustment:

` 113 = Impairment of goodwill ` 98 (WN 3) + additional depreciation on building ` 15 (WN 4).

For simplicity it is assumed that all the goodwill impairment and the additional depreciation on buildings (on account of fair value adjustment) is adjusted against administrative expenses.

(3) Working for goodwill:

Goodwill at the acquisition date, ` 975, less accumulated impairment, ` 98 = ` 877.

(4) Working for building consolidation adjustment:

The fair value adjustment at 31 March 20X2 in respect of Orange County Ltd. building was ` 300, that is, the carrying amount at 31 March 20X2 was ` 300 lower than was recognized in the group's consolidated balance sheet. The building is being depreciated over 20 years from 31 March 20X2. Thus, at 31 March 20X3 the adjustment required on consolidation to the balance sheet will be ` 285, being ` 300 × 19/20 years' estimated useful life remaining. The additional depreciation recognized in the consolidated statement of comprehensive income is ` 15 (being ` 300 x 1/20).

(5) Reserves adjustment:

` 2,300 adjustment at the acquisition date (Illustration 7)
plus ` 98 (WN 3) impairment of goodwill
plus ` 15 (WN 4) additional depreciation on building
plus ` 100 (WN 1) fair value adjustment in respect of inventories plus ` 109 NCI's share of Orange County Ltd. profit for the year (as included in the consolidated statement of comprehensive income)
= ` 2,622.

9. P Pvt. Ltd. has a number of wholly-owned subsidiaries including S Pvt. Ltd. at 31st March 20X2. P Pvt. Ltd.'s consolidated balance sheet and the group carrying amount of S Pvt. Ltd.'s assets and liabilities (ie the amount included in the consolidated balance sheet in respect of S Pvt. Ltd.'s assets and liabilities) at 31st March 20X2 are as follows:

Particulars	Consolidated (₹ in millions)	Group carrying amount of S Pvt. Ltd. asset and liabilities Ltd. (₹ in millions)
Assets		
Non-Current Assets		
Goodwill	380	180
Buildings	3,240	1,340
Current Assets		
Inventories	140	40
Trade Receivables	1,700	900
Cash	3,100	1000
Total Assets	8,560	3,460
Equities & Liabilities		
Equity		
Share Capital	1600	
Other Equity		
Retained Earnings	4,260	
Current liabilities		
Trade Payables	2,700	900
Total Equity & Liabilities	8,560	900

Prepare consolidated Balance Sheet after disposal as on 31st March, 20X2 when P Pvt. Ltd. group sold 100% shares of S Pvt. Ltd. to independent party for ` 3,000 millions.

Answer:

When 100% shares sold to independent party Consolidated Balance Sheet of P Pvt. Ltd. and its remaining subsidiaries as on 31st March, 20X2

Particulars	Note No.	(₹ in millions)
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	1,900
(ii) Goodwill	2	200
(2) Current Assets		
(i) Inventories	3	100
(ii) Financial Assets		
(a) Trade Receivables	4	800
(b) Cash & Cash equivalents	5	5,100
Total Assets		**8,100**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	6	1,600
(ii) Other Equity	7	4,700
(2) Non-controlling Interest		
(3) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	1,800
Total Equity & Liabilities		**8,100**

Notes to accounts:

			(₹ in millions)
1.	**Property Plant & Equipment**		
	Land & Building	3,240	
	Less: S Pvt. Ltd.	(1,340)	1,900
2.	**Goodwill**	380	
	Less: S Pvt. Ltd.	(180)	200
3.	**Inventories**		
	Group	140	
	Less: S Pvt. Ltd.	(40)	100

4.	**Trade Receivables**		
	Group	1,700	
	Less: S Pvt. Ltd.	(900)	800
5.	**Cash & Cash equivalents**		
	Group (WN 2)	5,100	5,100
6.	**Trade Payables**		
	Group	2,700	
	Less: S Pvt. Ltd.	900	1,800

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
1600	0	1600

7. **Other Equity**

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				4,260		4,260
Total comprehensive income for the year			0			
Dividends			0			
Total comprehensive income attributable to parent			0			
Gain on disposal of S Pvt. Ltd.				440		440
Balance at the end of reporting period			0	4,700		4,700

Working Notes:

1. When sold, the carrying amount of all assets and liabilities attributable to S Pvt. Ltd. were eliminated from the consolidated balance sheet.

2. Cash on hand (in millions):

Cash before disposal of S Pvt. Ltd.	3,100
Less: S Pvt. Ltd. Cash	(1,000)
Add: Cash realized from disposal	3,000
Cash on Hand	5,100

3. Gain/ Loss on disposal of entity (in millions):

Proceeds from disposal	3,000
Less: Net assets of S Pvt. Ltd.	(2,560)
Gain on disposal	440

4. Retained Earnings (in millions):

Retained Earnings before disposal	4,260
Add: Gain on disposal	440
Retained earnings after disposal	4,700

10. Reliance Ltd. has a number of wholly-owned subsidiaries including Reliance Jio Infocomm Ltd. at 31st March 20X2. Reliance Ltd.'s consolidated balance sheet and the group carrying amount of Reliance Jio Infocomm Ltd. assets and liabilities (ie the amount included in that consolidated balance sheet in respect of Reliance Jio Infocomm Ltd. assets and liabilities) at 31st March 20X2 are as follows:

Particulars	Consolidated (₹ In '000)	Group carrying amount of Reliance Jio Infocomm Ltd. asset and liabilities Ltd. (₹ In '000)
Assets		
Non-current Assets		
Goodwill	190	90
Buildings	1,620	670
Current Assets		
Inventories	70	20
Financial Assets		
Trade Receivables	850	450
Cash	1,550	500
Total Assets	**4,280**	**1,730**
Equity & Liabilities		
Equity		
Share Capital	800	
Other Equity		
Retained Earnings	2,130	
	2,930	
Current liabilities		
Financial liabilities		
Trade Payables	1,350	450
Total Equity & Liabilities	**4,280**	**450**

Prepare consolidated Balance Sheet after disposal as on 31st March, 20X2 when Reliance Ltd. group sold 90% shares of Reliance Jio Infocomm Ltd. to independent party for ` 1000 thousand.

Answer:

When 90% shares sold to independent party Consolidated Balance Sheet of Reliance Ltd. and its remaining subsidiaries as on 31st March, 20X2

Particulars	Note No.	(₹ 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	2,050
Total Assets		**3,678**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	7	800
(ii) Other Equity	8	1,978
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	9	900
Total Equity & Liabilities		**3,678**

Notes to accounts:

			(₹ In '000)
1.	**Property Plant & Equipment**		
	Land & Building	1620	
	Less: Reliance Jio Infocomm Ltd.	(670)	950
2.	Goodwill	190	
	Less: Reliance Jio Infocomm Ltd.	(90)	100
3.	**Investments**		
	Investment in Reliance Jio Infocomm Ltd. (WN 2)	128	128
4.	**Inventories**		
	Group	70	
	Less: Reliance Jio Infocomm Ltd.	(20)	50
5.	**Trade Receivables**	850	
	Group	(450)	400
	Less: Reliance Jio Infocomm Ltd.		
6.	**Cash & Cash equivalents**	2,050	2,050
	Group (WN 3)		
9.	**Trade Payables**	1,350	
	Group	450	900
	Less: Reliance Jio Infocomm Ltd.		

Statement of changes in Equity:

7. 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
800	0	800

8. Other Equity

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				2,130		2,130
Total comprehensive income for the year			0			
Dividends			0			

Total comprehensive Income attributable to parent			0			
Loss on disposal of Reliance Jio Infocomm Ltd.				(152)		(152)
Balance at the end of reporting period			0	1,978		1,978

Working Notes:

1. When 90% being sold, the carrying amount of all assets and liabilities attributable to Reliance Jio Infocomm Ltd. were eliminated from the consolidated balance sheet and further financial asset is recognized for remaining 10%.
2. Carrying value of remaining investment (in '000):

Net Assets of Reliance Ltd.	1,280
Less: 90% disposal	(1152)
Financial Asset	128

3. Cash on hand (in '000):

Cash before disposal of Reliance Jio Infocomm Ltd.	1,550
Less: Reliance Jio 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	1,000
Less: Proportionate (90%) Net assets of Reliance Jio Infocomm Ltd. (90% of 1,280)	(1,152)
Loss on disposal	(152)

5. Retained Earnings (in '000):

Retained Earnings before disposal	2,130
Less: Loss on disposal	(152)
Retained earnings after disposal	1,978

11. Airtel Telecommunications Ltd. owns 100% share capital of Airtel Infrastructures Pvt. Ltd. On 1 April 20X1 Airtel Telecommunications Ltd. acquired a building from Airtel Infrastructures Pvt. Ltd., for ` 11,00,000 that the group plans to use it as its new headquarters office. Airtel Infrastructures Pvt. Ltd. had purchased the building from a third party on 1 April 20X0 for ` 10,25,000. At that time the building was assessed to have a useful life of 21 years and a residual value of ` 5,00,000. On 1 April 20X1 the carrying amount of the building was ` 10,00,000 in Airtel Infrastructures Pvt. Ltd.'s individual accounting records.

The estimated remaining useful life of the building measured from 1 April 20X1 is 20 years and the residual value of the building is now estimated at ` 3,50,000. The method of depreciation is straight-line. Pass necessary accounting entries in individual and consolidation situations.

Answer:

Journal Entries in Airtel Infrastructures Pvt. Ltd.

1.	Assets (Building) A/c	Dr.	10,25,000	
	To Cash			10,25,000

2.	Depreciation (P/L) A/c	Dr.	25,000	
	To Asset (Building)			25,000
3.	Cash A/c	Dr.	11,00,000	
	To Asset (Building)			10,00,000
	To Gain on sale of asset (P/L)			1,00,000

Journal Entries in Airtel Telecommunications Ltd.

1.	Asset (Building) A/c	Dr.	11,00,000	
	To Cash			11,00,000
2.	Depreciation (P/L) A/c	Dr.	37,500	
	To Assets (Building)			37,500

Journal entry for consolidation:

1.	Gain on sale of asset (P/L)	Dr.	1,00,000	
	To Asset (Building) A/c			1,00,000
2.	Asset (Building) A/c	Dr.	5,000 (WN 1)	
	To Consolidated P&L			5,000

Working Note:

To be depreciated on original value	(10,00,000-3,50,000)/20	32,500
Depreciation charged	(11,00,000-3,50,000)/20	37,500
Reversal of depreciation		**5,000**

Particulars	Consolidated financial statements	Individual Financial statements	
		Airtel Telecommunications Ltd.	Airtel Infrastructures Pvt. Ltd.
31st March 20X1	10,00,000	0	10,00,000
1st April 20X1 purchase sale	0	11,00,000	(10,00,000)
Depreciation	(32,500)	(37,500)	0
31st March 20X2	9,67,500	10,62,500	0

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

These net assets include the following:

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

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

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

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

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

What would be the accounting treatment on loss of control in the consolidated financial statements of AB Limited?

Answer:

Paragraph 25 of Ind AS 110 states that if a parent loses control of a subsidiary, the parent:

(a) derecognises the assets and liabilities of the former subsidiary from the consolidated balance sheet.

(b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind ASs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest."

Paragraph B98(c) of Ind AS 110 states that on loss of control over a subsidiary, a parent shall reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind AS, the amounts recognized in other comprehensive income in relation to the subsidiary on the basis specified in paragraph B99.

As per paragraph B99, if a parent loses control of a subsidiary, the parent shall account for all amounts previously recognized in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities.

Therefore, if a gain or loss previously recognized in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognized in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

In view of the basis in its consolidated financial statements, AB Limited shall:
(a) re-classify the FVOCI reserve in respect of the debt investments of ` 5.4 crore (90% of ` 6 crore) attributable to the owners of the parent to the statement of profit or loss in accordance with paragraph B5.7.1A of Ind AS 109, Financial Instruments which requires that the cumulative gains or losses previously recognised in OCI shall be recycled to profit and loss upon derecognition of the related financial asset. This is reflected in the gain on disposal. Remaining 10% (i.e., ` 0.6 crore) relating to non-controlling interest (NCI) is included as part of the carrying amount of the non-controlling interest that is derecognised in calculating the gain or loss on loss of control of the subsidiary;
(b) transfer the reserve relating to the net measurement losses on the defined benefit liability of ` 2.7 crore (90% of ` 3 crore) attributable to the owners of the parent within equity to retained earnings. It is not reclassified to profit or loss. The remaining 10% (i.e., ` 0.3 crore) attributable to the NCI is included as part of the carrying amount of NCI that is derecognised in calculating the gain or loss on loss of control over the subsidiary. No amount is reclassified to profit or loss, nor is it transferred within equity, in respect of the 10% attributable to the non-controlling interest.

(c) reclassify the cumulative gain on fair valuation of equity investment of ` 3.6 crore (90% of ` 4 crore) attributable to the owners of the parent from OCI to retained earnings under equity as per paragraph B5.7.1 of Ind AS 109, Financial Instruments, which provides that in case an entity has made an irrevocable election to recognise the changes in the fair value of an investment in an equity instrument not held for trading in OCI, it may subsequently transfer the cumulative amount of gains or loss within equity. Remaining 10% (i.e., ` 0.4 crore) related to the NCI are derecognised along with the balance of NCI and not reclassified to profit and loss.
(d) reclassify the foreign currency translation reserve of ` 7.2 crore (90% × ` 8 crore) attributable to the owners of the parent to statement of profit or loss as per paragraph 48 of Ind AS 21, The Effects of Changes in Foreign Exchange Rates, which specifies that the cumulative amount of exchange differences relating to the foreign operation, recognised in OCI, shall be reclassified from equity to profit or loss on the disposal of foreign operation. This is reflected in the gain on disposal. Remaining 10% (i.e., ` 0.8 crore) relating to the NCI is included as part of the carrying amount of the NCI that is derecognised in calculating the gain or loss on the loss of control of subsidiary, but is not reclassified to profit or loss in pursuance of paragraph 48B of Ind AS 21, which provides that the cumulative exchange differences relating to that foreign operation attributed to NCI shall be derecognised on disposal of the foreign operation, but shall not be reclassified to profit or loss.
The impact of loss of control over BC Limited on the consolidated financial statements of AB Limited is summarized below:

(₹ in crore)

Particular		Amount (Dr)	Amount (Cr)	PL Impact	RE Impact
Gain/Loss on Disposal on Investments					
Bank	Dr.	56			
Non-controlling interest (Derecognised)	Dr.	6			
Investment at FV (20% Retained)	Dr.	16			
To Gain on Disposal (PL) - ***balancing figure***			18	18	
To De-recognition of total net assets of subsidiary			60		
Reclassification of FVTOCI reserve on debt instruments to profit or loss					
FVTOCI reserve on debt instruments (6 cr. x 90%)	Dr.	5.4			
To Profit and loss			5.4	5.4	
Reclassification of net measurement loss reserve to profit or loss					
Retained Earnings	Dr.	2.7			-2.7
To Net measurement loss reserve (FVTOCI) [(3 cr. x 90%)]			2.7		
Reclassification of FVTOCI reserve on equity instruments to retained earnings					
FVTOCI reserve on equity instruments (4 cr.x 90%)	Dr.	3.6			
To Retained earnings			3.6		3.6
Foreign currency translation reserve reclassified to profit or loss					
Foreign currency translation reserve (FVOCI) [8 cr. x 90%]	Dr.	7.2			
To Profit and loss			7.2	7.2	
Total				30.6	0.9

PAST PAPERS, MOCK TEST PAPERS & REVISION TEST PAPER

1. Hold Limited acquired 100% ordinary shares of Rs. 100 each of Sub Limited on 1 st October, 2017. On 31st March, 2018 the summarized Balance Sheets of the two companies were as given below:

	Particulars	Hold Limited (₹)	Sub Limited (₹)
I.	**Assets**		
	(1) Non-current Assets		
	(i) Property, Plant & Equipment		
	(a) Land & Building	30,00,000	36,00,000
	(b) Plant & machinery	48,00,000	27,00,000
	(ii) Investment in Sub Limited	68,00,000	
	(2) Current Assets		
	(i) Inventory	24,00,000	7,28,000
	(ii) Financial Assets		
	(a) Trade Receivables	11,96,000	8,00,000
	(b) Cash & Cash Equivalents	2,90,000	1,60,000
	Total	**1,84,86,000**	**79,88,000**
II	**Equity and Liabilities**		
	(1) Equity		
	(i) Equity Share Capital (Shares of ₹ 100 each fully paid)	1,00,00,000	40,00,000
	(ii) Other Equity		
	(a) Other Reserves	48,00,000	20,00,000
	(b) Retained Earnings	11,44,000	16,40,000
	(2) Current Liabilities		
	Financial Liabilities		
	(a) Bank Overdraft	16,00,000	-
	(b) Trade Payable	9,42,000	3,48,000
	Total	**1,84,86,000**	**79,88,000**

The retained earnings of Sub Limited showed a credit balance of Rs. 6,00,000 on 1 st April, 2017 out of which a dividend of 10% was paid on 1st November 2017. Hold Limited has credited the dividend received to retained earnings account. There was no fresh addition to other reserves in case of both companies during the current financial year. There was no opening balance in the retained earnings in the books of Hold Limited. Following are the changes in fair value as per respective Ind AS from the book value as on 1st October, 2017 in the books of Sub Limited which is to be considered while consolidating the Balance Sheets.

(i) Fair value of Plant and Machinery was Rs. 40,00,000. (Rate of depreciation on Plant and Machinery is 10% p.a.)
(ii) Land and Building appreciated by Rs. 20,00,000.
(iii) Inventories increased by Rs. 3,00,000.
(iv) Trade payable increased by Rs. 2,00,000.
Prepare Consolidated Balance Sheet as on 31st March, 2018. The Balance Sheet should comply with the relevant Ind AS and Schedule III of the Companies Act, 2013.
(MAY – 2018 15 MARKS)
Answer:

Consolidated Balance Sheet of Hold Ltd. and its subsidiary, Sub Ltd. as on 31st March, 2018

Particulars	Note No.	₹
I. Assets		
(1) Non-current assets		
Property, Plant & Equipment	1	1,72,00,000
(2) Current Assets		
Inventories	2	34,28,000
Financial Assets		
Trade Receivables	3	19,96,000
Cash & Cash equivalents	4	4,50,000
Total Assets		2,30,74,000
II. Equity and Liabilities		
(1) Equity		
Equity Share Capital	5	1,00,00,000
Other Equity	6	99,84,000
(2) Current Liabilities		
Financial Liabilities		
Short term borrowings	7	16,00,000
Trade Payables	8	14,90,000
Total Equity & Liabilities		2,30,74,000

It may be noted that the consolidation adjustments in respect of tax effect, in particular, deferred tax effect of temporary differences associated with fair value adjustments, determined in accordance with Ind AS 12 'Income Taxes', will affect the above consolidated balance sheet.

Notes to accounts

			₹
1.	**Property Plant & Equipment**		
	Land & Building	86,00,000	
	Plant & Machinery	86,00,000	1,72,00,000
2.	**Inventories**		
	Hold Ltd.	24,00,000	
	Sub Ltd.	10,28,000	34,28,000
3.	**Trade Receivables**		
	Hold Ltd.	11,96,000	
	Sub Ltd.	8,00,000	19,96,000

4.	**Cash & Cash equivalents**		
	Hold Ltd.	2,90,000	
	Sub Ltd.	1,60,000	4,50,000
7.	**Short-term borrowings**		
	Bank overdraft of Hold Ltd.		16,00,000
8.	**Trade Payables**		
	Hold Ltd.	9,42,000	
	Sub Ltd.	5,48,000	14,90,000

Statement of changes in Equity:

5. **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
1,00,00,000	0	1,00,00,000

6. **Other Equity**

	Reserves & Surplus			Total
	Capital Reserve	**Other reserves**	**Retained Earnings**	
Balance at the beginning		48,00,000	0	48,00,000
Profit or loss for the year (W.N.4)		0	14,14,000	14,44,000
Other comprehensive income for the year		0	0	0
Total comprehensive income for the year		0	14,14,000	14,14,000
Dividends		0	0	0
Gain on Bargain purchase on acquisition of a subsidiary* (W.N.5)	37,70,000			37,70,000
Balance at the end of reporting period	37,70,000	48,00,000	14,14,000	99,84,000

* It is assumed that there exists no clear evidence for classifying the acquisition of the subsidiary as a bargain purchase and, hence, the bargain purchase gain has been recognised directly in capital reserve. If, however, there exists such a clear evidence, the bargain purchase gain would be recognised in other comprehensive income and then accumulated in capital reserve. In both the cases, closing balance of capital reserve will be Rs. 37,70,000.

Working Notes:

1. **Adjustments of Fair Value- Total Appreciation**

	₹
Plant & Machinery (W.N.7)	11,50,000
Land and Building	20,00,000
Inventories	3,00,000
Less: Trade Payables	(2,00,000)
	32,50,000

2. Pre-acquisition reserves of Sub Ltd.

		₹
Other Reserves on 1.4.2017		20,00,000
Retained earnings Balance on 1.4.2017		6,00,000
Retained earnings balance as on 31.3.2018	16,40,000	
Less: Retained earnings balance as on 1.4.2017	(6,00,000)	
Add back: Dividend	4,00,000	
Profit for the year 2017-2018	14,40,000	
Profit for 6 months (14,40,000 x 6/12)		7,20,000
Share of Hold Ltd.		33,20,000

There will be no Non-controlling Interest as 100% shares of Sub Ltd. are held by Hold Ltd.

3. Post-acquisition profits of Sub Ltd.

	₹
Profit for 6 months from 1.10.2017 to 31.3.2018 (14,40,000 x 6/12)	7,20,000
Less: Additional depreciation on account of revaluation of Plant and Machinery for 6 months [(40,00,000 x 10% x 6/12) – (30,00,000 x 10% x 6/12)]	(50,000)
Adjusted post-acquisition profit attributable to Hold Ltd.	6,70,000

4. Consolidated profit or loss for the year

	₹
Hold Ltd.	
Retained earnings on 31.3.2018	11,44,000
Less: Retained earnings as on 1.4.2017	(0)
Profits for the year 2017-2018	11,44,000
Less: Elimination of intra-group dividend	(4,00,000)
Adjusted profit for the year	7,44,000
Sub Ltd.	
Adjusted profit attributable to Hold Ltd. (W.N.3)	6,70,000
Consolidated profit or loss for the year	14,14,000

5. Goodwill/Gain on bargain purchase

		₹
Amount paid for 40,000 shares of Sub Ltd.		68,00,000
Less: Share of Hold Ltd. in pre-acquisition equity of Sub Ltd.		
Share capital	40,00,000	
Pre-acquisition reserves of Sub Ltd. (W.N.2)	33,20,000	
Fair value adjustments (W.N.1)	32,50,000	(1,05,70,000)
Gain on Bargain Purchase		37,70,000

6. Value of Plant & Machinery

		₹
Hold Ltd.		48,00,000
Sub Ltd. Book value as on 31.3.2018 27,00,000		
Book value as on 1.4.2017 (27,00,000/90%)	30,00,000	
Less: Depreciation @ 10% for 6 months	(1,50,000)	
	28,50,000	
Add: Appreciation on 1.10.2017 (Balancing fig. i.e., 40,00,000 – 28,50,000)	11,50,000	
Revalued amount (given)	40,00,000	
Less: Depreciation on ₹ 40,00,000 @ 10% for 6 months	(2,00,000)	38,00,000
		86,00,000

7. **Consolidated retained earnings**

	Hold Ltd.	Sub Ltd.	Total
As given	11,44,000	16,40,000	27,84,000
Consolidation Adjustments:			
(i) Elimination of pre-acquisition element [6,00,000 + 7,20,000]	0	(13,20,000)	(13,20,000)
(ii) Elimination of intra-group dividend	(4,00,000)	4,00,000	0
(iii) Impact of fair value adjustments	0	(50,000)	(50,000)
Adjusted retained earnings consolidated	7,44,000	6,70,000	14,14,000

Note: The above solution has been drawn by making following assumptions, at required places:
(i) Hold Ltd. measures the investment in Sub Ltd. at cost (less impairment, if any) in its separate financial statements as permitted in Ind AS 27, Separate Financial Statements.

(ii) Increase in land and buildings represents only land element.

(iii) Depreciation on plant and machinery is on WDV method.

(iv) Fair value adjusted trade payables continue to exist on 31.3.2018.

(v) Inventories are valued at cost, being lower than NRV and that application of cost formula for the purposes of consolidated financial statements results in entire fair value adjustment to be included in the carrying amount of inventories of Sub Ltd. on 31.3.2018.

2. XYZ Limited acquired 70% of equity shares of TUV Limited on 1st April, 2010 at cost of Rs.20,00,000 when TUV Limited had an equity share capital of Rs. 20,00,000 and reserveand surplus of Rs. 1,60,000. In the four consecutive years, TUV Limited, fared badly and suffered losses of Rs. 5,00,000, Rs. 8,00,000, Rs. 10,00,000 and Rs. 2,40,000 respectively. Thereafter in 2014-15, TUV Limited, experienced turnaround and registered an annual profit of Rs. 1,00,000. In the next two years i.e. 2015-16 and 2016-17, TUV Limited recorded annual profits of Rs. 2,00,000 and Rs. 3,00,000 respectively. Calculate the minority interests and cost of control at the end of each year for the purpose of consolidation, as per AS 21 "Consolidated Financial Statements".
(MAY – 2018 ⍰ 10 MARKS)
Answer:
Calculation of Minority interests and cost of control at the end of each year, as per AS 21

Year	Profit / (Loss)	Minority Interest (30%)	Consolidated P & L (Dr.) Cr.	Minority's Share of losses borne by XYZ Ltd.		Cost of Control
				₹	Balance	
At the time of acquisition in 2010		6,48,000 (W.N.)	-			
2010-2011	(5,00,000)	(1,50,000) 4,98,000	(3,50,000)			4,88,000 (W.N.)
2011-2012	(8,00,000) -	(2,40,000) 2,58,000	(5,60,000)			4,88,000
2012-2013	(10,00,000)	(3,00,000) (42,000)	(7,00,000)			4,88,000
	Loss of minority borne by Holding Co.	42,000 Nil	(42,000) (7,42,000)	42,000	42,000	
2013-2014	(2,40,000)	- (on application of AS 21) Nil	(2,40,000)	72,000	1,14,000	4,88,000
2014-2015	1,00,000	- (on application of AS 21) Nil	1,00,000	(30,000)	84,000	4,88,000
2015-2016	2,00,000	- (on application of AS 21) Nil	2,00,000	(60,000)	24,000	4,88,000
2016-2017	3,00,000	90,000 (24,000) (application of AS 21) 66,000	2,10,000 24,000 2,34,000	(24,000)	Nil	4,88,000

Working Note:

Calculation of Minority interest and Cost of control on 1.1.2010

		Share of Holding Co.	Minority Interest
	100%	**70%**	**30%**
	(₹)	**(₹)**	**(₹)**
Share Capital	20,00,000	14,00,000	6,00,000
Reserve	1,60,000	1,12,000	48,000
		15,12,000	6,48,000
Less: Cost of investment		(20,00,000)	
Goodwill		4,88,000	

3. Prepare the Consolidated Balance Sheet as on 31st March, 2018 of a group of companies comprising Usha Limited, Nisha Limited and Sandhya Limited. Their summarized balance sheets on that date are given below: Amounts Rs. in lakh

	Usha Ltd.	Nisha Ltd.	Sandhya Ltd.
Equity and Liabilities			
Shareholder's Equity			
Share capital (₹ 10 per share)	300	200	160
Reserves	90	50	40
Retained earnings	80	25	30
Current Liabilities			
Trade Payables	235	115	90
Bills Payable			
Usha Ltd.	-	35	-
Sandhya Ltd.	15	-	-
	720	425	320
Assets			
Non-Current Assets			
Tangible assets	160	180	150
Investment:			
16 lakh shares in Nisha Ltd.	170	-	-
12 lakh shares in Sandhya Ltd.	-	140	-
Current Assets			
Cash in hand and at Bank	114	20	20
Bills Receivable	36	-	15
Trade Receivables	130	50	110
Inventories	110	35	25
	720	425	320

The following additional information is available:

(i) Usha Ltd. holds 80% shares in Nisha Ltd. and Nisha Ltd. holds 75% shares in Sandhya Ltd. Their holdings were acquired on 30th September, 2017.

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

(iii) On 1st April, 2017, the following balances stood in the books of Nisha Limited and Sandhya Limited.

₹ in lakh

	Nisha Limited	Sandhya Limited
Reserves	40	30
Retained earnings	10	15

(iv) Rs. 5 Lakh included in the inventory figure of Nisha Limited, is inventory which has

been purchased from Sandhya Limited at cost plus 25%.
(v) The parent company has adopted an accounting policy to measure Noncontrolling interest at fair value (quoted market price) applying Ind AS 103.
Assume market prices of Nisha Limited and Sandhya Limited are the same as respective face values.
(vi) The capital profit preferably is to be adjusted against cost of control.
Note: Analysis of profits and notes to accounts must be a part of your answer
[NOV 2018 ⍰ 16 MARKS]
Answer:

Consolidated Balance Sheet of the Group as on 31st March, 2018

Particulars	Note No.	(₹ in lakh)
ASSETS		
Non-current assets		
Property, plant and equipment	1	490
Current assets		
(a) Inventories	2	169
(b) Financial assets		
Trade receivables	3	290
Bills receivable	4	1
(c) Cash and cash equivalents	5	154
Total assets		1,104
EQUITY & LIABILITIES		
Equity attributable to owners of the parent		
Share capital		300
Other Equity		
Reserves (W.N.5)		97
Retained Earnings (W.N.5)		89.9
Capital Reserve (W.N.3)		94
Non-controlling interests (W.N.4)		83.10
Total equity		664
LIABILITIES		
Non-current liabilities		Nil
Current liabilities		
(a) Financial Liabilities		
(i) Trade payables	6	440
Total liabilities		440
Total equity and liabilities		1,104

Notes to Accounts (₹ in lakh)

1.	**Property Plant & Equipment**		
	Parent	160	
	Nisha Ltd.	180	
	Sandhya Ltd.	150	490
2.	**Inventories**		
	Parent	110	
	Nisha Ltd. (35-1)	34	
	Sandhya Ltd.	25	169
3.	**Trade Receivables**		
	Parent	130	
	Nisha Ltd.	50	
	Sandhya Ltd.	110	290
4.	**Bills Receivable**		
	Parent (36-35)	1	
	Sandhya Ltd. (15-15)	-	1
5.	**Cash & Cash equivalents**		
	Parent	114	
	Nisha Ltd.	20	
	Sandhya Ltd.	20	154
6.	**Trade Payables**		
	Parent	235	
	Nisha Ltd.	115	
	Sandhya Ltd.	90	440

Working Notes:

1. Analysis of Reserves and Surplus (₹ in lakh)

		Nisha Ltd.		Sandhya Ltd.
Reserves as on 31.3.2017		40		30
Increase during the year 2017-2018	10		10	
Increase for the half year till 30.9.2017		5		5
Balance as on 30.9.2017 (A)		45		35
Total balance as on 31.3.2018		50		40
Post-acquisition balance		5		5

		Nisha Ltd.		Sandhya Ltd.
Retained Earnings as on 31.3.2017		10		15
Increase during the year 2017-2018	15		15	
Increase for the half year till 30.9.2017		7.5		7.5
Balance as on 30.9.2017 (B)		17.5		22.5
Total balance as on 31.3.2018		25		30
Post-acquisition balance		7.5		7.5
Less: Unealised gain on inventories (5 x 25%)		-		(1)
Post-acquisition balance for CFS		7.5		6.5
Total balance on the acquisition date ie.30.9.2017 (A+B)		62.5		57.5

2. Calculation of Effective Interest of Parent company ie. Usha Ltd. in Sandhya Ltd.

Acquisition by Usha Ltd. in Nisha Ltd.	= 80%
Acquisition by Nisha Ltd. in Sandhya Ltd.	= 75%
Acquisition by Group in Sandhya Ltd. (80% x 75%)	= 60%
Non-controlling Interest	= 40%

3. Calculation of Goodwill / Capital Reserve on the acquisition date

	Nisha Ltd.	Sandhya Ltd.
Investment or consideration	170	(140 × 80%)112
Add: NCI at Fair value		
(200 x 20%)	40	
(160 x 40%)		64
	210	176
Less: Identifiable net assets (Share capital + Increase in the Reserves and Surplus till acquisition date)	(200+62.5)(262.5)	(160+57.5)(217.5)
Capital Reserve	52.5	41.5
Total Capital Reserve (52.5 + 41.5)	94	

4. Calculation of Non Controlling Interest

	Nisha Ltd.	Sandhya Ltd.
At Fair Value (See Note 3)	40	64
Add: Post Acquisition Reserves (See Note 1)	(5× 20%) 1	(5 × 40%) 2
Add: Post Acquisition Retained Earnings (See Note 1)	(7.5 × 20%) 1.5	(6.5 × 40%) 2.6
Less: NCI share of investment in Sandhya Ltd.*	(140x20%) (28)*	
	14.5	68.6
Total (14.5 + 68.6)	83.1	

***Note:** The Non-controlling interest in Nisha Ltd. will take its proportion in Sandhya Ltd. So they have to bear their proportion in the investment made by Nisha Ltd. (as a whole) in Sandhya Ltd.

5. Calculation of Consolidated Other Equity

	Reserves	Retained Earnings
Usha Ltd.	90	80
Add: Share in Nisha Ltd.	(5 x 80%) 4	(7.5 × 80%) 6
Add: Share in Sandhya Ltd.	(5 ×60%) 3	(6.5 ×60%) 3.9
	97	89.9

Note: In the above solution, it is assumed date the sale of goods by Sandhya Ltd. is done after acquisition of shares by Nisha Ltd. Alternatively, one may assume that the sale has either been done before acquisition of shares by Nisha Ltd. in Sandhya Ltd. or sale has been throughout the year. Accordingly, there treatment for unrealized gain may vary.

4. Moon Ltd. acquires 75% of Star Limited on 1st April, 2017 for consideration transferred Rs. 60 lakh. Moon Limited intends to recognize the Non-Controlling Interest (NCI) at proportionate share of fair value of identifiable assets. With the assistance of a suitably qualified valuation professional, Moon Limited measures the identifiable net assets of Star Limited at Rs. 90 lakh. Moon Limited performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.
State whether the procedures followed by Moon Limited and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process.
[NOV 2018 4 MARKS]
Answer:
The amount of Star Ltd.'s identifiable net assets exceeds the fair value of the consideration transferred plus the fair value of the NCI in Star Ltd.'s, resulting in an initial indication of a gain on a bargain purchase. Accordingly, Moon Ltd. reviews the procedures it used to identify and measure the identifiable net assets acquired, to measure the fair value of both the NCI and the consideration transferred, and to identify transactions that were not part of the business combination. Following that review, Moon Ltd. can conclude that the procedures followed and the resulting measurements were appropriate.

Identifiable net assets	90,00,000
Less: Consideration transferred	(60,00,000)
NCI (90,00,000 x 25%)	(22,50,000)
Gain on bargain purchase	7,50,000

5. Summarise d Balance Sheets of PN Ltd. and SR Ltd. as on 31st March, 2018 were given as below: (Amount is Rs.)
(i) PN Ltd. acquired 70% equity shares of Rs. 100 each of SR Ltd. on 1st October, 2017.
(ii) The Retained Earnings of SR Ltd. showed a credit balance of Rs. 93,600 on 1st April, 2017 out of which a dividend of 12% was paid on 15th December, 2017.
(iii) PN Ltd. has credited the dividend received to its Retained Earnings.
(iv) Fair value of Plant & Machinery of SR Ltd. as on 1st October, 2017 was Rs. 6,24,000.

The rate of depreciation on Plant & Machinery was 10% p.a.
(v) Following are the increases on comparison of Fair Value as per respective Ind AS with book value as on 1st October, 2017 of SR Ltd. which are to be considered while consolidating the Balance Sheets:
(a) Land & Buildings Rs. 3,12,000
(b) Inventories Rs. 46,800
(c) Trade Payables Rs. 31,200.
(vi) The inventory is still unsold on Balance Sheet date and the Trade Payables are not yet settled.
(vii) Other Reserves as on 31st March, 2018 are the same as was on 1st April, 2017.
(viii) The business activities of both the company are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.
Prepare the Consolidated Balance Sheet as on 31st March, 2018 of the group of entities PN Ltd. and SR Ltd. as per Ind AS.
[MAY 2019 15 MARKS/MTP-OCT 2020]
Answer:

Consolidated Balance Sheet of PN Ltd. and its subsidiary SR Ltd. as on 31st March, 2018

Particulars	Note No.	₹
I. Assets		
(1) Non-current assets		
(i) Property, Plant & Equipment	1	26,83,200
(ii) Goodwill	2	89,402
(2) Current Assets		
(i) Inventories	3	5,34,800
(ii) Financial Assets		
(a) Trade Receivables	4	3,11,300
(b) Cash & Cash equivalents	5	70,100
Total Assets		36,88,802
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	6	15,60,000
(ii) Other Equity	7	11,39,502
(2) Non-controlling Interest (W.N.3)		5,07,300
(3) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	2,12,400
(b) Short term borrowings	9	2,69,600
Total Equity & Liabilities		36,88,802

			₹
1.	**Property, Plant & Equipment**		
	Land & Building (4,68,000 + 5,61,600 + 3,12,000)	13,41,600	
	Plant & Machinery (W.N.5)	13,41,600	26,83,200
2.	**Goodwill**		89,402
3.	**Inventories**		
	PN Ltd.	3,74,400	
	SR Ltd. (1,13,600 +46,800)	1,60,400	5,34,800
4.	**Trade Receivables**		
	PN Ltd.	1,86,500	
	SR Ltd.	1,24,800	3,11,300
5.	**Cash & Cash equivalents**		
	PN Ltd.	45,200	
	SR Ltd.	24,900	70,100
8.	**Trade Payables**		
	PN Ltd.	1,46,900	
	SR Ltd. (34,300 + 31,200)	65,500	2,12,400
9.	**Short-term borrowings**		
	PN Ltd.	2,49,600	
	SR Ltd.	20,000	2,69,600

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 ₹
15,60,000	0	15,60,000

7. Other Equity

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve ₹	Retained Earnings ₹	Other Reserves ₹	₹
Balance at the beginning of the reporting period				0	9,36,000	9,36,000
Total comprehensive income for the year			0	1,78,400		1,78,400
Dividends			0	(52,416)		(52,416)
Total comprehensive income attributable to parent			0	77,518		77,518
Gain on Bargain purchase				0		0
Balance at the end of reporting period				2,03,502	9,36,000	11,39,502

Working Notes:

1. **Adjustments of Fair Value**

The Plant & Machinery of SR Ltd. would stand in the books at ₹ 4,44,600 on 1st October, 2017, considering only six months' depreciation on ₹ $\left(\frac{4,21,200}{90\%}\right)=$ 4,68,000; total depreciation being ₹ $4,68,000 \times 10\% \times \frac{6}{12} = 23,400$. The value put on the assets being ₹ 6,24,000 there is an appreciation to the extent of ₹ 1,79,400.

Acquisition date profits of SR Ltd. ₹

	₹
Reserves on 1.4.2017	3,12,000
Profit& Loss Account Balance on 1.4.2017	93,600
Profit for 2017-2018: Total [₹ 2,55,800-(93,600-74,880)]x 6/12 i.e. ₹ 1,18,540 upto 1.10.2017	1,18,540
Total Appreciation	5,07,000*
Total	10,31,140
Holding Co. Share (70%)	7,21,798

*Appreciation = Land & Building ₹ 3,12,000 + Inventories ₹ 46,800 + Plant & Machinery ₹ 1,79,400 – Trade Payables ₹ 31,200 = ₹ 5,07,000

2. **Post-acquisition profits of SR Ltd.** ₹

	₹
Profit after 1.10.2017 [2,55,800 - (93,600-74,880)] x 6/12	1,18,540
Less: 10% depreciation on ₹ 6,24,000 for 6 months less depreciation already charged for 2nd half of 2017-2018 on ₹ 4,68,800 (ie 31,200 - 23,400)	(7,800)
Total	1,10,740
Share of holding Co. (70%)	77,518
Share of NCI (30%)	33,222

3. **Non-controlling Interest** ₹

	₹
Par value of 1872 shares	1,87,200
Add: 30% Acquisition date profits [(10,31,140 – 74,880) x 30%]	2,86,878
30% Post-acquisition profits [W.N.2]	33,222
	5,07,300

4. **Goodwill** ₹

		₹
Amount paid for 4,368 shares		12,48,000
Less : Par value of shares	4,36,800	
Acquisition date profits-share of PN Ltd.	7,21,798	(11,58,598)
Goodwill		89,402

5. **Value of Plant & Machinery:** ₹

		₹
PN Ltd.		7,48,800
SR Ltd.	4,21,200	
Add: Appreciation on 1.10.2017	1,79,400	
	6,00,600	
Add: Depreciation for 2nd half charged on pre-revalued value	23,400	
Less: Depreciation on ₹ 6,24,000 for 6 months	(31,200)	5,92,800
		13,41,600

6. Consolidated Profit & Loss account ₹

PN Ltd. (as given)	1,78,400	
Less: Dividend	(52,416)	1,25,984
Share of PN Ltd. in post-acquisition profits (W.N.2)		77,518
		2,03,502

Note: Alternatively, the solution can be done on Net Assets approach on the date of acquisition. In such a situation, answer in substance will be same. However, presentation of working notes will be as below:

1. Net assets of SR Ltd. on the date of acquisition ₹

Share Capital	6,24,000
Reserves on 1.4.2017	3,12,000
Profit & Loss Account Balance on 1.4.2017	93,600
Profit for 2017-2018: Total [₹ 2,55,800-(93,600-74,880)] x 6/12 i.e. ₹ 1,18,540 upto 1.10.2017	1,18,540
Total Appreciation	5,07,000*
Total	16,55,140
Holding Co. Share (70%)	11,58,598
Non-controlling Interest (30)	4,96,542

*Appreciation = Land and Building ₹ 3,12,000 + Inventories ₹ 46,800+ Plant & Machinery ₹ 1,79,400 – Trade Payables ₹ 31,200 = ₹ 5,07,000

3. Non-controlling Interest ₹

30% Share in net assets of SR Ltd on 1st October, 2017	4,96,542
30% Post-acquisition profits [WN 2]	33,222
Less: Dividend received (30% x 12% x 6,24,000)	(22,464)
	5,07,300

4. Goodwill ₹

Amount paid for 4,368 shares	12,48,000
Acquisition date profits share of PN Ltd.	(11,58,598)
Goodwill	89,402

6. The Balance Sheet of David Ltd. and Parker Ltd. as of 31st March, 2019 is given below: (Rs. in lakh)

Assets	David Ltd.	Parker Ltd.
Non-current assets:		
Property, plant and equipment	400	600
Investment	300	200
Current assets:		
Inventories	300	100
Financial assets		
Trade receivables	400	200
Cash and cash equivalents	150	200
Others	300	300
Total	1,850	1,600
Equity and Liabilities		
Equity		
Share capital - Equity shares of ₹ 100 each for Parker Ltd. & ₹ 10 each for David Limited	500	400
Other Equity	700	275
Non-current liabilities:		
Long term borrowings	200	300
Long term provisions	100	80
Deferred tax	20	55
Current liabilities:		
Short term borrowings	130	170
Trade payables	200	320
Total	1,850	1,600

Other Information :

(i) David Ltd. acquired 70% shares of Parker Ltd. on 1st April, 2019·by issuing its own shares in the ratio of 1 share of David Ltd. for every 2 shares of Parker Ltd. The fair value of the shares of David Ltd. was Rs. 50 per share.

(ii) The fair value exercise resulted in the following :

(3) Fair value of property, plant and equipment (PPE) on 1st April, 2019 was Rs. 450 lakh.

(4) David Ltd. agreed to pay an additional payment as consideration that is higher of Rs. 30 lakh and 25% of any excess profits in the first year after acquisition, over its profits in the preceding 12 months made by Parker Ltd. This additional amount will be due after 3 years. Parker Ltd. has earned Rs. 20 lakh profit in the preceding year and expects to earn another Rs. 10 lakh.

(5) In addition to above, David Ltd. also has agreed to pay one of the founder shareholder-Director a payment of Rs. 25 lakh provided he stays with the Company for two years after the acquisition.

(6) Parker Ltd. had certain equity settled share-based payment award (original award) which got replaced by the new awards issued by David Ltd. As per the original term, the vesting period was 4 years and as of the acquisition date the employees of Parker 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: Original award - Rs. 6 lakh Replacement award - Rs. 9 lakh

(7) Parker Ltd. had a lawsuit pending with a customer who had made a claim of Rs. 35 lakh. Management reliably estimated the fair value of the liability to be Rs. 10 lakh.

(8) The applicable tax rate for both entities is 40%.

You are required to prepare opening consolidated balance sheet of David Ltd. as on 1 st April, 2019 along with workings. Assume discount rate of 8%.

[NOV 2019 16 MARKS]

Answer:

Consolidated Balance Sheet of David Ltd as on 1st April, 2019 (₹ in lakh)

	Amount
Assets	
Non-current assets:	
Property, plant and equipment	850.00
Investment	500.00
Current assets:	
Inventories	400.00
Financial assets:	
Trade receivables	600.00
Cash and cash equivalents	350.00
Others	600.00
Total	3,300.00
Equity and Liabilities	
Equity	
Share capital - Equity shares of ₹ 100 each	514.00
Other Equity	1,067.49
Non Controlling Interest	173.70
Non-current liabilities:	
Financial liabilities:	
Long term borrowings	500.00
Long term provisions (100+80+23.81)	203.81
Deferred tax	11.00

Current liabilities:		
Financial liabilities:		
Short term borrowings		300.00
Trade payables		520.00
Provision for law suit damages		10.00
	Total	3,300.00

Working 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. 450 lakh.

b. The value of replacement award is allocated between consideration transferred and post combination expense. The 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, Rs. 3 lakh (6 x 2/4) is considered as a part of purchase consideration and is credited to David Ltd equity as this will be settled in its own equity. The balance of Rs. 3 lakh will be recorded as employee expense in the books of Parker Ltd over the remaining life, which is 1 year in this scenario.

c. There is a difference between contingent consideration and deferred consideration. In the given case, Rs. 30 lakh is the minimum payment to be paid after 3 years and accordingly will be considered as deferred consideration. The other element is if company meet certain target then they will get 25% of that or Rs. 30 lakh whichever is higher. In the given case, since the criteria is the minimum what is expected to be paid, the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 8%.

d. The additional consideration of Rs. 25 lakh 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 Parker Ltd.

Working Notes:

1. Computation of Purchase Consideration Rs. in lakh

Particulars		Amount
Share capital of Parker Ltd.		400
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value per share		50
Purchase consideration (2,00,000x70%x₹ 50 per share) (A)		70.00
Deferred consideration after discounting ₹ 30 lakh for 3 years @ 8% (B)		23.81
Replacement award - Market based measure of the acquiree award ie Fair value of original award (6) 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 (6 x 2 / 4) (C)		3.00
Purchase consideration (A+B+C)		96.81

2. Allocation of Purchase consideration

Particulars	Book value (A)	Fair value (B)	FV adjustment (A-B)
Property, plant and equipment	600	450	(150)
Investment	200	200	-
Inventories	100	100	-
Financial assets:			-
Trade receivables	200	200	-
Cash and cash equivalents	200	200	-
Others	300	300	
Less: Financial Liabilities			
Long term borrowings	(300)	(300)	-
Long term provisions	(80)	(80)	-
Deferred tax	(55)	(55)	-
Financial Liabilities			
Short term borrowings	(170)	(170)	-
Trade payables	(320)	(320)	-
Contingent liability	-	(10)	(10)
Net assets (X)	675	515	(160)
Deferred tax asset on fair value adjustment (160 x 40%) (Y)		64	160
Net assets (X+Y)		579	
Non-controlling interest (NCI) (579 x 30%) rounded off		173.70	
Capital reserve (Net assets – NCI – PC)		308.49	
Purchase consideration (PC)		96.81	

3. Computation of Consolidated amounts of consolidated financial statements

	David Ltd.	*Parker Ltd. (pre-acquisition)*	*PPA Allocation*	*Total*
Assets				
Non-current assets:				
Property, plant and equipment	400	600	(150)	850
Investment	300	200		500
Current assets:				
Inventories	300	100		400
Financial assets:				
Trade receivables	400	200		600
Cash and cash equivalents	150	200		350
Others	300	300		600
Total	1,850	1,600	(150)	3300

Equity and Liabilities				
Equity				
Share capital- Equity shares of ₹ 100 each	500			
Shares allotted to Parker Ltd. (2,00,000 x 70% x ₹ 10 per share)			14	514
Other Equity				
Other Equity	700			700
Replacement award			3	3
Security premium (2,00,000 shares x 70% x ₹ 40)			56	56
Capital reserve			308.49	308.49
Non-controlling interest	0		173.70	173.70
Non-current liabilities:				
Financial Liabilities				
Long term borrowings	200	300		500
Long term provisions	100	80	23.81	203.81
Deferred tax	20	55	(64)	11
Current liabilities:				
Financial Liabilities				
Short term borrowings	130	170		300
Trade payable	200	320	0	520
Liability for lawsuit damages			10	10
Total	1,850	925	525	3,300

7. The following information relates to the results of the parent and subsidiary (jointly) and the investment in associate and joint venture: (All figures are in rupees)

Summarised Balance Sheet as at 31.3.20X1

	Holding and subsidiary	*Associate*	*Joint Venture*
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
Minority Interest	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 Venture*
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 Rs. 17,000. There are no signs of impairment of the goodwill.
(b) The parent company entered into a joint venture to access a lucrative 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 – 16 MARKS]
Answer:

Consolidated Balance Sheet as on 31.3.20X1

Particulars	*Note No.*	₹
I. 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

II. 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

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 Venture (50%)	3,000	23,000
4.	Short term provisions		
	Provisions for Tax		
	Holding & Subsidiary	19,000	
	Joint Venture (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 Venture	Nil	83,000
Share of Joint Venture (50%)		41,500

2. Calculation of Goodwill/Capital Reserve

	Associate		Joint Venture	
		₹		₹
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 Venture (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.

8. 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 Rs. 40. The quoted market price of Entity A's ordinary shares at that date is Rs. 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 (legal parent, accounting acquiree)	Entity B (legal subsidiary, accounting acquirer)
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		
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 · 12 MARKS]

Answer:

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)].

9. On 10th May, 2016, A Ltd. acquired 40% shares of B Ltd. for Rs. 45,00,000. By such an acquisition Rohtas Ltd. can exercise significant influence over B Ltd. During the financial year ending on 31st March, 2016, B Ltd. earned profits Rs. 11,54,000 and declared a dividend of Rs. 2,48,000 on 16th September, 2016. B Ltd. reported earnings of Rs. 26,26,000 for the financial year ending on 31st March, 2017 and declared dividend of Rs. 9,85,000 on 17th August, 2017.
You are required to calculate the carrying amount of investments in Separate Financial Statements of A Ltd. as on 31st March, 2017 and also in Consolidated Financial Statements of A Ltd. as on 31st March, 2017. What will be the carrying amount of Investments in Consolidated Financial Statements of A Ltd. if prepared on 31st August 2017 on the basis of Accounting Standards?
[MTP ? APRIL 2018 ? 6 MARKS]
Answer:

(i) Carrying amount of investment in Separate Financial Statement of A Ltd. as on 31.03.2017

	Rs.
Amount paid for investment in Associate (on 10.5.2016)	45,00,000
Less: Pre-acquisition dividend (` 2,48,000 x 40%)	(99,200)
Carrying amount as on 31.3.2017	44,00,800

(ii) Carrying amount of investment in Consolidated Financial Statements of A Ltd. as on 31.3.2017 as per AS 23

	Rs.
Carrying amount as per separate financial statements	44,00,800
Add: Proportionate share of profit of investee as per equity method (40% of ` 26,26,000)	10,50,400
Carrying amount as on 31.3.2017 as per AS 23	54,51,200

(iii) Carrying amount of investment in Consolidated Financial Statement of A Ltd. as on 31.8.2017 as per AS 23

	Rs.
Carrying amount as on 31.3.2017	54,51,200
Less: Dividend received (` 9,85,000 x 40%)	(3,94,000)
Carrying amount as on 31.8.2017 as per AS 23	50,57,200

10. Preet Pvt. Ltd. has a number of wholly-owned subsidiaries including Stuti Pvt. Ltd. at 31st March, 2018. Preet Pvt. Ltd.'s consolidated balance sheet and the carrying amount of assets and liabilities of Stuti Pvt. Ltd., included in the respective amount of respective

grouped assets and liabilities of the consolidated balance sheet as at 31st March, 2018 are as follows:

Particulars	Consolidated balance sheet (Rs. in million)	Carrying amount of asset and liabilities of Stuti Pvt. Ltd. included in the CFS (Rs. in million)
Assets		
Non-current Assets		
Goodwill	380	180
Buildings	3,240	1,340
Current Assets		
Inventories	140	40
Trade Receivables	1,700	900
Cash and cash equivalents	3,100	1000
Total Assets	**8,560**	**3,460**
Equities & Liabilities		
Equity		
Share Capital	1600	
Other Equity		
Retained Earnings	4,260	
Current liabilities		
Trade Payables	2,700	900
Total Equity & Liabilities	**8,560**	**900**

Prepare Consolidated Balance Sheet after disposal as on 31st March, 2018 when Preet Pvt. Ltd. group sold 100% shares of Stuti Pvt. Ltd. to independent party for Rs. 3,000 millions.
[MTP ⍰ APRIL 2018 ⍰ 16 MARKS]

Answer:

When 100% shares sold to independent party
Consolidated Balance Sheet of Preet Pvt. Ltd. and its remaining subsidiaries as on 31st March, 2018

Particulars	Note No.	(Rs. in million)
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	1,900
(ii) Goodwill	2	200
(2) Current Assets		
(i) Inventories	3	100
(ii) Financial Assets		
(a) Trade Receivables	4	800
(b) Cash & Cash equivalents	5	5,100
Total Assets		**8,100**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	6	1,600
(ii) Other Equity	7	4,700
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	1,800
Total Equity & Liabilities		**8,100**

Notes to Financial Statements:

			(Rs. in million)
1.	**Property Plant & Equipment**		
	Land & Building		
	Group	3,240	
	Less: Stuti Pvt. Ltd.	(1,340)	1,900
2.	Intangible Assets		
	Goodwill		
	Group	380	
	Less: Stuti Pvt. Ltd.	(180)	200
3.	**Inventories**		
	Group	140	
	Less: Stuti Pvt. Ltd.	(40)	100
4.	**Trade Receivables**		
	Group	1,700	
	Less: Stuti Pvt. Ltd.	(900)	800
5.	**Cash & cash equivalents**		
	Group (WN 2)	5,100	5,100
8.	**Trade Payables**		
	Group	2,700	
	Less: Stuti Pvt. Ltd.	900	1,800

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
1600	0	1600

7. Other Equity

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				4,260		4,260
Total comprehensive income for the year			0			
Dividend			0			
Total comprehensive income attributable to the parent			0			
Gain on disposal of Stuti Pvt. Ltd.				440		440
Balance at the end of the reporting period			0	4,700		4,700

Working Notes:

1. When sold, the carrying amount of all assets and liabilities attributable to Stuti Pvt. Ltd. were eliminated from the consolidated statement of financial position.

2. Cash in hand (in million)

Cash before disposal of Stuti Pvt. Ltd. *Less:* Stuti Pvt. Ltd. Cash Add: Cash realized from disposal	3,100 (1,000) 3,000
Cash in hand	5,100

3. Gain / Loss on disposal of entity (in million)

Proceeds from disposal *Less:* Net assets of Stuti Pvt. Ltd.	3,000 (2,560)
Gain on disposal	440

4. Retained Earnings (in million)

Retained earnings before disposal *Add:* Gain on disposal	4,260 440
Retained earnings after disposal	4,700

11. 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	1,620	670
Current Assets		
Inventories	70	20
Trade Receivables	850	450
Cash	1,550	500
Total Assets	**4,280**	**1,730**
Equity & Liabilities	800	
Equity		
Share Capital		
Other Equity	2,130	
Retained Earnings	2,930	
Current liabilities		
Trade Payables	1,350	450
Total Equity & Liabilities	**4,280**	**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 – OCTOBER 2018 – 12 MARKS]

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	2,050
Total Assets		**3,678**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	7	800
(ii) Other Equity	8	1,978
(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	850	
	Less: Trust Infocomm Ltd.	(450)	400
8.	**Cash & Cash equivalents**		
	Group (WN 3)	2,050	2,050
	Trade Payables		
	Group	1,350	
	Less: Trust Infocomm Ltd.	450	900

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**
800	0	800

7. Other Equity

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				2,130		2,130
Total comprehensive income for the year			0			
Dividends			0			
Total comprehensive income attributable to parent			0			
Loss on disposal of Trust Infocomm Ltd.				(152)		(152)
Balance at the end of reporting period			0	1,978		1,978

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.	1,280
Less: 90% disposal	(1152)
Financial Asset	128

3. Cash on hand (in '000):

Cash before disposal of Trust Infocomm Ltd.	1,550
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	1,000
Less: Proportionate (90%) Net assets of Trust Infocomm Ltd. (90% of 1,280)	(1,152)
Loss on disposal	(152)

5. Retained Earnings (in '000):

Retained Earnings before disposal	2,130
Less: Loss on disposal	(152)
Retained earnings after disposal	1,978

12. The 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		
Trade 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
Trade 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. The fair value of the shares of P Ltd. was Rs. 40 per share.

(b) The 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. This additional amount will be due after 2 years. D Ltd. has earned Rs. 10 lakh profit in the preceding 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 vesting 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 1 st April, 20X2. Assume 10% discount rate.
[MTP □ APRIL 2019 □ 20 MARKS]
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
Trade 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. The value of replacement award is allocated between consideration transferred and post combination expense. The 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. There 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. The 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. The impact of time value on deferred consideration has been given @ 10%.

d. The 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:			-
Trade 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)	-
Trade 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:				
Trade receivables	450	300		750
Cash and cash equivalents	200	100		300
Others	400	230		630
Total	2,000	1,380	(150)	3,230
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	40	35	(46.5)	28.5
Current Liabilities:				
Short term borrowings	100	150		250
Trade payable	250	300	0	550
Liability for lawsuit damages			5	5
Total	2,000	755	475	3,230
Other Equity				
Other Equity	810			810
Replacement award			2.5	2.5
Security Premium Reserve (2,00,000 shares x 70% x Rs.30)			42	42
Capital Reserve			274.12	274.12
	810		318.62	1,128.62

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

carrying value. The parent carried the investment in the subsidiary at cost, as permitted by Ind AS 27. Calculate gain or loss on disposal of subsidiary in parent's separate and consolidated financial statements as on 31st March 20X4.
[MTP APRIL 2019 6 MARKS]

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 investment in subsidiary	(160)
Gain on sale in parent's account	40

However, the group's statement of profit & loss for 20X3-20X4 would show a gain on the sale of subsidiary of Rs. 8,000 calculated as follows:

		Rs.'000
Sale proceeds		200
Less: share of net assets at date of disposal (Rs. 2,25,000 X 80%)	(180)	
Goodwill on consolidation at date of sale (W.N 1)	(12)	(192)
Gain on sale in the group's account		8

Working Note

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 consolidation		20
Impairment at 31 March 20X3		(8)
Goodwill at 31 March 20X4		12

14. 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 6 MARKS]
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 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.3.20X2 as per AS 23

	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 as per AS 23

	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

15. Tee 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.

[MTP · OCTOBER 2019 · 5 MARKS]

Answer:

As per para 7 of Ind AS 110 / 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 relevant 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 a result 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) Tee limited has acquired 48% in Kay Limited. The purpose of acquiring the shares by Tee limited in it is to substantiate their position in the industry. Kay Limited is a specialist entity that is engaged in advanced research in weapons. Acquiring Kay Limited will help Tee limited to gain access to their research which would complement Tee limited's operations and business of developing light weight and medium weight guns.
The key management personnel who holds 52% shares of Kay Limited are key 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 key management personnel may leave the organisation and in such a situation Tee limited will not enjoy any economic benefit or infact will lose the benefit of unique technical knowledge of those 11 experts.
Hence, Tee 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 Tee limited on Kay Limited.

(b) Even though Tee limited has acquired 51% stake in Kay Limited yet it does not have power over Kay Limited as it would not be able 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 Tee 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. Thus regulations prevent Tee limited to direct the relevant activity of Kay Limited which ultimately lead to prevent Tee Limited to have control.

16. Sumati Ltd. acquired 100% (50,00,000) equity shares of Rs. 10 each in Sheetal Ltd. on 1 st April, 2014. Sheetal Ltd. was incorporated on 1st April, 2014.
Sumati Ltd. acquired 80% (24,00,000) equity shares in Dharam Ltd. for Rs. 600 lakh on 1 st April, 2014 when Dharam Ltd. had share capital of Rs. 300 lakh and Reserves and Surplus of Rs. 300 lakh.
The company amortizes goodwill on consolidation on a SLM basis over a period of 5 years. A full year's amortization is considered if the goodwill exists for more than 6 months.

On 1st April, 2017, Sumati Ltd. sold 12,00,000 equity shares of Dharam Ltd. for cash consideration of Rs. 360 lakh with recognition of profit arising out of this sale.
The net assets of Dharam Ltd. on 31st March, 2017 were Rs. 700 lakh. The amount of Reserves and Surplus was Rs. 880 lakh, Rs. 720 lakh and Rs. 400 lakh respectively of Sumati Ltd., Sheetal Ltd. and Dharam Ltd. on 31st March, 2017.
The Balance Sheet extracts of the companies as on 31st March, 2018 were as follows:

(₹ in lakh)

	Sumati Ltd.	Sheetal Ltd.	Dharam Ltd.
Share Capital (₹ 10 each)	1000	500	300
Reserves and Surplus	1240	910	640
Current Liabilities	460	490	560
	2700	1900	1500
Fixed Assets	640	420	380
50,00,000 equity shares in Sheetal Ltd.	500		
12,00,000 equity shares in Dharam Ltd.	300		
Current Assets	1260	1480	1120
	2700	1900	1500

You are required to prepare for Sumati Ltd. Group Balance Sheet as on 31st March, 2018 following AS 21 and AS 23. Notes to Accounts and working notes should form part of your answer.
[RTP NOV 2018]
Answer:

Consolidated Balance Sheet as on 31.3.2018

Particulars	*Note No.*	*(₹ in lakh)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,000
(b) Reserves and Surplus	2	2,206
(2) Current Liabilities	3	950
Total		4,156
II. Assets		
(1) Non-current assets		
Fixed Assets	4	1,060
Non-current investment (Investment in Associate Dharam Ltd.)	5	356
(2) Current assets	6	2,740
Total		4,156

Notes to Accounts

			₹ in lakh
1.	Share Capital		
	100 lakh Equity shares of ₹ 10 each fully paid up		1,000
2.	Consolidated Reserves and Surplus as on 31.3.2018		
	Balance of Reserves and surplus of Sumati Ltd. as on 31.3.2018	1,240	
	Add: Post-acquisition reserves and surplus of Sheetal Ltd. (subsidiary)	910	
	Profit accumulated over the years on investment of Sumati Ltd. (304-300)	4	
	Post-acquisition reserves and surplus of Dharam Ltd. (640-480) x 40%	64	
	Less: Goodwill amortised for the period (24/2)	(12)	2,206
3.	Current Liabilities		
	Sumati Ltd.	460	
	Sheetal Ltd.	490	950
4.	Fixed Assets		
	Sumati Ltd.	640	
	Sheetal Ltd.	420	1,060
5.	Non-current investment (Investment in Associate Dharam Ltd.)		
	Carrying amount of Investment in Associate. [W.N.2]	304	
	(Identified goodwill included in the above ₹ 24 lakh) [W.N.3]		
	Add: Increase in reserves and surplus during the year (640-480) x 40%	64	
	Less: Goodwill written off in the fourth year (₹ 24 lakh x ½)	(12)	356
6.	Current assets		
	Sumati Ltd.	1,260	
	Sheetal Ltd.	1,480	2,740

Working Notes:

1. **Cost of Control on acquisition of shares in Dharam Ltd. and amortization of goodwill**

	₹ in lakh
Investment by Sumati Ltd.	600
Less: Share capital (300 x 80%)	(240)
Capital profit (pre-acquisition) (300 x 80%)	(240)
Goodwill	120
Less: Amortization for 3 years [(120/5) x3]	(72)
Carrying value of goodwill after 3 years	48

2. **Ascertainment of carrying value of investment in Dharam Ltd. disposed off and retained**

	₹ *in lakh*
Net Assets of Dharam Ltd. on the date of disposal	700
Less: Minority's interest in Dharam Ltd. on the date of disposal (700 x 20%)	(140)
Share of Sumati Ltd. in Net Assets	560
Add: Carrying value of Goodwill (Refer W.N.1)	48
Total value of investment in Dharam Ltd. as on 1.4.2017	608
Less: Carrying Value of investment disposed off [₹ 608 lakh x (12 lakh /24 lakh)]	(304)
Carrying Value of investment retained by Sumati Ltd.	304

3. **Goodwill arising on the Carrying Value of Unsold Portion of the Investment**

	₹ *in lakh*
Carrying value of retained 40% holdings in Dharam Ltd. as on 1st April, 2017	304
Less: Share in value of equity of Dharam Ltd., as at date of investment when its subsidiary relationship is transformed to an associate (700 x 40%)	(280)
Goodwill arising on such investment under Equity method as per AS 23	(24)

17. Angel Ltd. has adopted Ind AS with a transition date of 1st April, 2017. Prior to Ind AS adoption, it followed Accounting Standards notified under Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as "IGAAP").
It has made investments in equity shares of Pharma Ltd., a listed company engaged in the business of pharmaceuticals. The shareholding pattern of Pharma Ltd. is given below:

Shareholders (refer Note 1)	Percentage shareholding as on 1st April, 2017
Angel Ltd.	21%
Little Angel Ltd. (refer Note 2)	24%
Wealth Master Mutual Fund (refer Note 3)	3%
Individual public shareholders (refer Note 4)	52%

Notes:
(1) None of the shareholders have entered into any shareholders' agreement.
(2) Little Angel Ltd. is a subsidiary of Angel Ltd. (under Ind AS) in which Angel Ltd. Holds 51% voting power.
(3) Wealth Master Mutual Fund is not related party of either Little Angel Ltd. or Pharma Ltd.
(4) Individual public shareholders represent 17,455 individuals. None of the individual shareholders hold more than 1% of voting power in Pharma Ltd.

All commercial decisions of Pharma Ltd. are taken by its directors who are appointed by a simple majority vote of the shareholders in the annual general meetings ("AGM"). The following table shows the voting pattern of past AGMs of Pharma Ltd.:

Shareholders	AGM for the financial year:		
	2013-14	2014-15	2015-16
Angel Ltd.	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions
Little Angel Ltd.	Attended and voted as per directions of Angel Ltd.	Attended and voted as per directions of Angel Ltd	Attended and voted as per directions of Angel Ltd
Wealth Master Mutual Fund	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors
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 Rs. 5 per share. However, when the CFO of Pharma Ltd. approached the bank for obtaining their approval, the bank rejected the proposal citing concerns over the short-term cash liquidity of Pharma Ltd. Having learned about the developments, the Directors of Angel Ltd. along with the Directors of Little Angel Ltd. approached the bank with a request to re-consider its decision. The Directors of Angel Ltd. and Little Angel Ltd. urged the bank

to approve a reduced dividend of at least Rs. 2 per share. However, the bank categorically refused to approve any payout of dividend. Under IGAAP, Angel Ltd. has classified Pharma Ltd. as its associate. As the CFO of Angel Ltd., you are required to comment on the correct classification of Pharma Ltd. on transition to Ind AS.
[RTP MAY 2019]
Answer:
To determine whether Pharma Limited can be continued to be classified as an associate on transition to Ind AS, we will have to determine whether Angel Limited controls Pharma Limited as defined under Ind AS 110. An investor controls an investee if and only if the investor has all the following:
(a) Power over investee
(b) Exposure, or rights, to variable returns from its involvement with the investee
(c) Ability to use power over the investee to affect the amount of the investor's returns.
Since Angel Ltd. does not have majority voting rights in Pharma Ltd. we will have to determine whether the existing voting rights of Angel Ltd. are sufficient to provide it power over Pharma Ltd.
Analysis of each of the three elements of the definition of control:

Elements / conditions	Analysis
Power over investee	Angel Limited along with its subsidiary Little Angel Limited (hereinafter referred to as "the Angel group") does not have majority voting rights in Pharma Limited. Therefore, in order to determine whether Angel group have power over Pharma Limited. we will need to analyse whether Angel group, by virtue of its non-majority voting power, have _practical ability to unilaterally direct the relevant activities_ of Pharma Limited. In other words, we will need to analyse whether Angel group has **_de facto_ power** over Pharma Limited. Following is the analysis of *de facto* power of Angel over Pharma Limited: - The public shareholding of Pharma Limited (that is, 52% represents thousands of shareholders none individually holding material shareholding, - The actual participation of Individual public shareholders in the general meetings is minimal (that is, in the range of 6% to 8%). - Even the public shareholders who attend the meeting do not consult with each other to vote. - Therefore, as per guidance of Ind AS 110, the public shareholders will not be able to outvote Angel group (who is the largest shareholder group) in any general meeting. Based on the above-mentioned analysis, we can conclude that Angel group has *de facto* power over Pharma Limited.
Exposure, or rights, to variable returns from its involvement with the investee	Angel group has exposure to variable returns from its involvement with Pharma Limited by virtue of its equity stake.

Ability to use power over the investee to affect the amount of the investor's returns	Angel group has ability to use its power (in the capacity of a principal and not an agent) to affect the amount of returns from Pharma Limited because it is in the position to appoint directors of Pharma Limited who would take all the decisions regarding relevant activities of Pharma Limited. Here, it is worthwhile to evaluate whether certain rights held by the bank would prevent Angel Limited's ability to use the power over Pharma Limited to affect its returns. It is to be noted that, all the rights held by the bank in relation to Pharma Limited are protective in nature as they do not relate to the relevant activities (that is, activities that significantly affect he Pharma Limited's returns) of Pharma Limited. As per 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 lnd AS, Angel Limited shall classify Pharma Limited as its subsidiary.

18. What will be the accounting treatment of dividend distribution tax in the consolidated financial statements in case of partly-owned subsidiary in the following scenarios:
Scenario 1:
H Limited (holding company) holds 12,000 equity shares in S Limited (Subsidiary of H Limited) with 60% holding. Accordingly, S Limited is a partly-owned subsidiary of H Limited. During the year 20X1, S Limited paid a dividend @ Rs. 10 per share and DDT @ 20% on it. Should the share of H Limited in DDT paid by S Limited amounting to Rs. 24,000 (60% x Rs. 40,000) be charged as expense in the consolidated profit and loss of H Limited?
Scenario 2 (A):
Extending the situation given in scenario 1, H Limited also pays dividend of Rs. 300,000 to its shareholders and DDT liability @ 20% thereon amounts to Rs. 60,000. As per the tax laws, DDT paid by S Ltd. of Rs. 24,000 is allowed as set off against the DDT liability of H Ltd., resulting in H Ltd. paying Rs. 36,000 (Rs. 60,000 – Rs. 24,000) as DDT to tax authorities.
Scenario 2(B)
If in (A) above, H Limited pays dividend amounting to Rs. 100,000 with DDT liability @ 20% amounting to Rs. 20,000.
Scenario 3:
Will the answer be different for the treatment of dividend distribution tax paid by associate in the consolidated financial statement of investor, if as per tax laws the DDT paid by associate is not allowed set-off against the DDT liability of the investor?
[RTP NOV 2019]

Answer:

Scenario 1: Since H Limited is holding 12,000 shares it has received Rs. 1,20,000 as dividend from S Limited. In the consolidated financial statements of H Ltd., dividend income earned by H Ltd. and dividend recorded by S Ltd. in its equity will both get eliminated as a result of consolidation adjustments. Dividend paid by S Ltd. to the 40% non-controlling interest (NCI) shareholders will be recorded in the Statement of Changes in Equity as reduction of NCI balance (as shares are classified as equity as per Ind AS 32).

DDT of Rs. 40,000 paid to tax authorities has two components- One Rs. 24,000 (related to H Limited's shareholding and other Rs. 16,000 (40,000 x 40%) belong to non controlling interest (NCI) shareholders of S Limited). DDT of Rs. 16,000 (pertaining to non-controlling interest (NCI) shareholders) will be recorded in the Statement of Changes in Equity along with dividend. DDT of Rs. 24,000 paid outside the consolidated Group shall be charged as tax expense in the consolidated statement of profit and loss of H Ltd.

In accordance with the above, in the given case, CFS of H limited will be as under:

Transactions	H Ltd.	S Ltd.	Consol Adjustments	CFS H Ltd
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity by way of reduction of NCI)	-	(200,000)	120,000	(80,000)
DDT (in Statement of Changes in Equity by way of reduction of NCI)	-	(40,000)	24,000	(16,000)
DDT (in Statement of P&L)	-	-	(24,000)	(24,000)

Scenario 2 (A): If DDT paid by the subsidiary S Ltd. is allowed as a set off against the DDT liability of its parent H Ltd. (as per the tax laws), then the amount of such DDT should be recognised in the consolidated statement of changes in equity of parent H Ltd.

In the given case, share of H Limited in DDT paid by S Limited is Rs. 24,000 and entire Rs. 24,000 was utilised by H Limited while paying dividend to its own shareholders.

Accordingly, DDT of Rs. 76,000 (Rs. 40,000 of DDT paid by S Ltd. (of which Rs.16,000 is attributable to NCI) and Rs. 36,000 of DDT paid by H Ltd.) should be recognised in the consolidated statement of changes in equity of parent H Ltd. No amount will be charged to consolidated statement of profit and loss. The basis for such accounting would be that due to Parent H Ltd's transaction of distributing dividend to its shareholders (a transaction recorded in Parent H Ltd's equity) and the related DDT set-off, this DDT paid by the subsidiary is effectively a tax on distribution of dividend to the shareholders of the parent company.

In accordance with the above, in the given case, CFS of H limited will be as under:

Transactions	H Ltd	S Ltd	Consol Adjustments	CFS H Ltd
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity)	(300,000)	(200,000)	120,000	(380,000)*
DDT (in Statement Changes in Equity)	(36,000)	(40,000)	-	(76,000)*

*Dividend of Rs. 80,000 and DDT of Rs. 16,000 will be reflected as reduction from noncontrolling interest.

Scenario 2(B): In the given case, share of H Limited in DDT paid by S Limited is Rs. 24,000 out of which only Rs. 20,000 was utilised by H Limited while paying dividend by its own. Therefore, balance Rs. 4,000 should be charged in the consolidated statement of profit and loss.

In accordance with the above, in the given case, CFS of H limited will be as under:

Transactions	H Ltd	S Ltd	Consol Adjustments	CFS H Ltd
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity)	(100,000)	(200,000)	120,000	(180,000)*
DDT (in Statement of Changes in Equity)	-	(40,000)	4,000	(36,000)*
DDT (in Statement of P&L)	-	-	(4000)	(4000)

*Dividend of Rs. 80,000 and DDT of Rs. 16,000 will be reflected as reduction from noncontrolling interest.

Scenario (3): Considering that as per tax laws, DDT paid by associate is not allowed set off against the DDT liability of the investor, the investor's share of DDT would be accounted by the investor company by crediting its investment account in the associate and recording a corresponding debit adjustment towards its share of profit or loss of the associate.

19. 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 above except that G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited, then explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements.

[RTP MAY 2020]

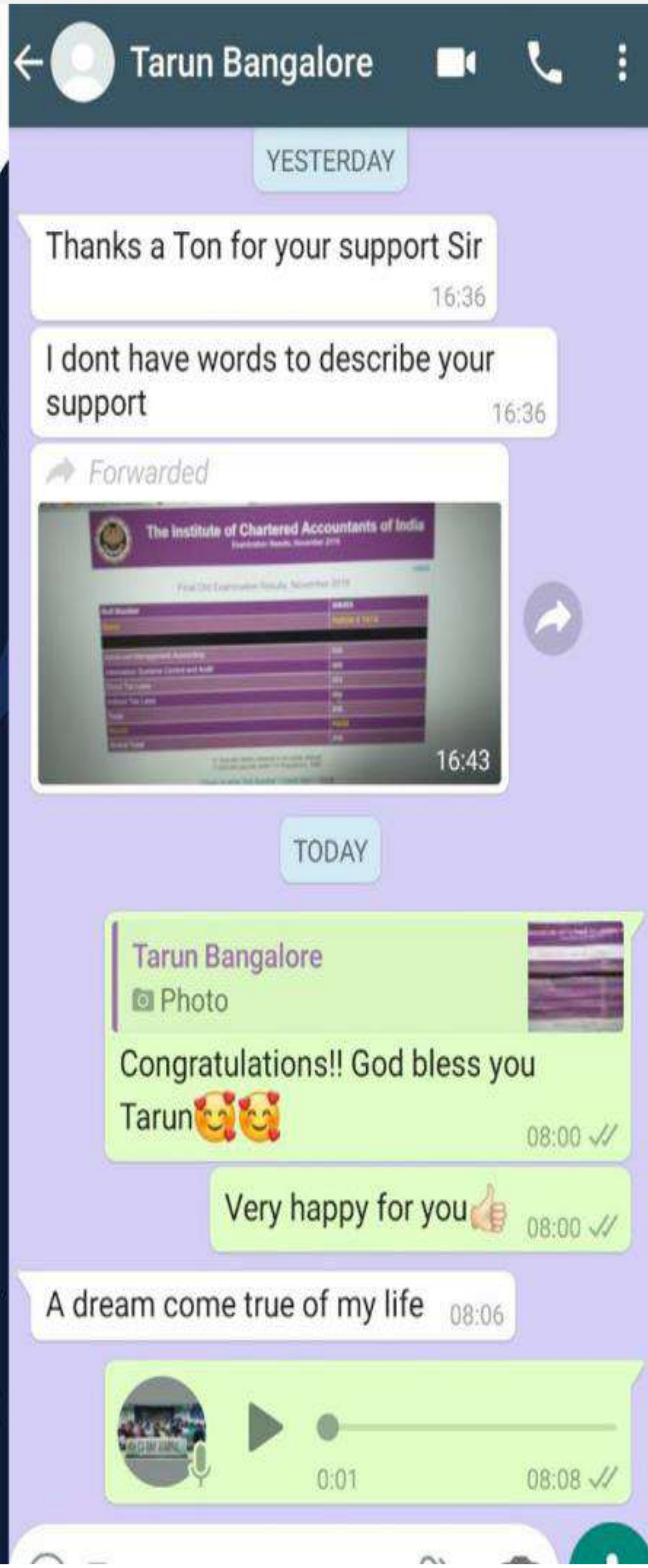
Answer:

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 entitled to 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, GD Limited 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, where both 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.


Tarun Bangalore
YESTERDAY
Thanks a Ton for your support Sir
16:36
I dont have words to describe your support
16:36
Forwarded
The Institute of Chartered Accountants of India
16:43
TODAY
Tarun Bangalore
Photo
Congratulations!! God bless you Tarun
08:00
Very happy for you
08:00
A dream come true of my life
08:06
0:01
08:08

942

20. 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.

Acquisitions	Book values `'000	Tax base `'000	Fair values `'000
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 2020)

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, plant and 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

	₹'000	₹'000
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 tax liability	(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 be reversed.

21. Veera Limited and Zeera Limited are both in the business 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's shareholders and 50 shares to Zeera Limited's shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also respective company's shareholders 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-NOV2020)
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 combined entity after the business combination - The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. Based on above mentioned para, acquirer shall be 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's shareholder gets 66.67% share (100 / 150 x 100) and Zeera Limited's shareholder gets 33.33% share in Meera Limited. Hence, Veera Limited is acquirer as per the principles of Ind AS 103.

22. 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 rate for 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 2020)
ANSWER:

Computation of amounts to be recognized in the P&L and OCI:

Particulars	USD	Exchange rate	₹
Cost of the bond	1,000	40	40,000
Interest accrued @ 10% p.a.	100	42	4,200
Interest received (USD 1,250 x 4.7%)	(59)	45	(2,655)
Amortized cost at year-end	1,041	45	46,845
Fair value at year end	1,060	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

23. On 1 April 2019, Shelter Ltd. issued 5,000, 8% debentures maturing on 31 March 2024. The debentures are convertible at the option of the holder into equity shares of Shelter Ltd. at a conversion price of ` 105 per share or redeemable at face value of Rs. 100 each. Interest is payable annually in cash. At the date of issue, Shelter Ltd. could have issued non-convertible debt with a 5 year term bearing a coupon interest rate of 12%. On 1 April 2022, the convertible debentures have a fair value of ` 5,25,000. Shelter Ltd. makes a tender offer to debenture holders to repurchase the debentures for ` 5,25,000, which the holders accepted. At the date of repurchase, Shelter Ltd. could have issued non-convertible debt with a 2 year term bearing a coupon interest rate of 9%.
Show accounting entries in the books of Shelter Ltd. for recording of equity and liability component:
(i) At the time of initial recognition and

(ii) At the time of repurchase of the convertible debentures.

The following present values of ` 1 at 8%, 9% & 12% are supplied to you: (MTP-OCT 2020)

Interest Rate	Year 1	Year 2	Year 3	Year 4	Year 5
8%	0.926	0.857	0.794	0.735	0.681
9%	0.917	0.842	0.772	0.708	0.650
12%	0.893	0.797	0.712	0.636	0.567

Answer:

(i) At the time of initial recognition

	₹
Liability component	
Present value of 5 yearly interest payments of ₹ 40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of ₹ 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	
(₹ 5,00,000 – ₹ 4,27,700)	72,300
Total proceeds	5,00,000

Note: Since ₹ 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ ₹ 100 each only.

Journal Entry

	₹	₹
Bank Dr.	5,00,000	
To 8% Debentures (Liability component)		4,27,700
To 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 ₹ 40,000, discounted at 12% and 9%, respectively	67,600	70,360	
Present value of ₹ 5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively	3,98,500	4,21,000	
Liability component	4,66,100	4,91,360	(25,260)
Equity component	72,300	33,640*	38,660
Total	**5,38,400**	**5,25,000**	**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	
To Bank A/c		33,640
To Reserves and Surplus A/c		38,660
(Being the cash paid for the equity component recognised)		

CHAPTER-15 ANALYSIS OF FINANCIAL STATEMENTS

CASE STUDIES BASED ON IND AS

Case Study 1

On 1st April, 20X1, Pluto Ltd. has advance a loan for Rs.10 lakhs to one of its employees for an interest rate at 4% per annum (market rate 10%) which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit.

The accountant of the company has recognised the staff loan in the balance sheet equivalent to the amount disbursed i.e. Rs.10 lakhs. The interest income for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs.40,000 (Rs.10 lakhs x 4%).

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment along with working for the same.

Solution

The above treatment needs to be examined in the light of the provisions given in Ind AS 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 recognised the staff loan in the balance sheet at Rs.10 lakhs being the amount disbursed and Rs.40,000 as interest income for the period is recognised at the contracted rate in the

statement of profit and loss which is not correct and not in accordance with Ind AS 19, Ind AS 32 and Ind AS 109.
Accordingly, the staff advance being a financial asset shall be initially measured at the fair value and subsequently at the amortised cost. The interest income is calculated by using the effective interest method. The difference between the amount lent and fair value is charged as Employee benefit expense in statement of profit and loss.

a) **Calculation of Fair Value of the Loan**

Year	Cash Inflow	Discounting Factor (10%)	Present Value
1	2,40,000	0.909	2,18,160
2	2,32,000	0.826	1,91,632
3	2,24,000	0.751	1,68,224
4	2,16,000	0.683	1,47,528
5	2,08,000	0.621	1,29,168
		Total	**8,54,712**

Staff loan should be initially recorded at Rs.8,54,712.

b) **Employee Benefit Expense**
Loan Amount – Fair Value of the loan = Rs.10,00,000 – Rs.8,54,712 = Rs.1,45,288
Rs.1,45,288 shall be charged as Employee Benefit expense in Statement of Profit and Loss for the year ended 31.03.20X2.

Amortisation table:

Year	Opening balance of Staff Advance (a)	Interest (10%) (b)= (a x 10%)	Repayment (c)	Closing balance of Staff Advance (d) = a + b -c
1	8,54,712	85,471	2,40,000	7,00,183
2	7,00,183	70,018	2,32,000	5,38,201
3	5,38,201	53,820	2,24,000	3,68,021
4	3,68,021	36,802	2,16,000	1,88,823
5	1,88,823	19,177 (b.f.)	2,08,000	Nil

Balance Sheet extracts showing the presentation of staff loan as at 31st March, 20X2
Ind AS compliant Division II of Sch III needs to be referred for presentation requirement in Balance Sheet on Ind AS.

Assets	
Non-Current Assets	
Financial Assets	
(i) Loan	5,38,201
Current Assets	
Financial Assets	
(i) Loans (7,00,183 - 5,38,201)	1,61,982

Case Study 2

Pluto Ltd. has purchased a manufacturing plant for Rs.6 lakhs on 1st April, 20X1. The useful life of the plant is 10 years. On 30th September, 20X3, Pluto temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of Pluto ltd. decided to treat the plant as held for sale until the demands picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell.

Also, the accountant has also stopped charging the depreciation for the rest of period considering the plant as held for sale. The fair value less cost to sell on 30th September, 20X3 and 31st March, 20X4 was Rs.4 lakhs and Rs.3.5 lakhs respectively.

The accountant has performed the following working: ₹

Carrying amount on initial classification as held for sale		
Purchase Price of Plant	*6,00,000*	
Less: Accumulated dep (6,00,000/ 10 Years) x 2.5 years	*(1,50,000)*	*4,50,000*
Fair Value less cost to sell as on 30th September, 20X3		*4,00,000*
The value will be lower of the above two		*4,00,000*

Balance Sheet extracts as on 31st March, 20X4

Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	*3,50,000*

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment alongwith the necessary workings.

Solution

The above treatment needs to be examined in the light of the provisions given in Ind AS 16 'Property, Plant and Equipment' and Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'.
Para 6 of Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' states that:
"An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use".
Paragraph 7 of Ind AS 105 states that:
"For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable. Thus, an asset (or disposal group) cannot be classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a distant future".
Further, paragraph 8 of Ind AS 105 states that:
"For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn."
Paragraph 13 of Ind AS 105 states that:
"An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use."
Paragraph 14 of Ind AS 105 states that:
"An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned."
Paragraph 55 of Ind AS 16 states that:
"Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated."
Going by the guidance given above,
The Accountant of Pluto Ltd. has treated the plant as held for sale and measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.
Accordingly, the manufacturing plant should neither be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use. Pluto Ltd. shall not stop charging depreciation or treat the plant as held for sale because its carrying amount will be recovered principally through continuing use to the end of their economic life.
The working of the same for presenting in the balance sheet is given as below:

Calculation of carrying amount as on 31st March, 20X4	
Purchase Price of Plant	6,00,000
Less: Accumulated depreciation (6,00,000/ 10 Years) x 3 Years	(1,80,000)
	4,20,000
Less: Impairment loss	(70,000)
	3,50,000

Balance Sheet extracts as on 31st March, 20X4

Assets	
Non-Current Assets	
Property, Plant and Equipment	3,50,000

Working Note:
Fair value less cost to sell of the Plant = Rs.3,50,000
Value in Use (not given) or = Nil (since plant has temporarily not been used for manufacturing due to decline in demand)
Recoverable amount = higher of above i.e. Rs.3,50,000
Impairment loss = Carrying amount – Recoverable amount
Impairment loss = Rs.4,20,000 - Rs.3,50,000 = Rs.70,000.

Case Study 3
On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March, 20X2 costing Rs.8 lakhs. The net realisable value of the inventory prior to the damage was estimated at Rs.9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of Rs.2 lakhs on repairing and re-packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of Rs.9 lakhs.
The accountant of Jupiter Ltd treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows:
Rs.lakhs

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

Analyse whether the above accounting treatment made by the accountant in regard to financial year ending on 31.0.20X2 is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.
Solution

The above treatment needs to be examined in the light of the provisions given in Ind AS 10 'Events after the Reporting Period' and Ind AS 2 'Inventories'.
Para 3 of Ind AS 10 'Events after the Reporting Period' defines "Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:
(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).
Further, paragraph 10 of Ind AS 10 states that:
"An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period".
Further, paragraph 6 of Ind AS 2 defines:
"Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale".
Further, paragraph 9 of Ind AS 2 states that:
"Inventories shall be measured at the lower of cost and net realisable value".
Accountant of Jupiter Ltd. has re-measured the inventories after adjusting the event in its financial statement which is not correct and nor in accordance with provision of Ind AS 2 and Ind AS 10.
Accordingly, the event causing the damage to the inventory occurred after the reporting date and as per the principles laid down under Ind AS 10 'Events After the Reporting Date' is a non-adjusting event as it does not affect conditions at the reporting date. Non-adjusting events are not recognised in the financial statements, but are disclosed where their effect is material.
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:

	₹ lakhs
Cost	8.00
Net realisable value	9.60
Inventories (lower of cost and net realisable value)	8.00

Case Study 4
On 1st April, 20X1, Sun Ltd. has acquired 100% shares of Earth Ltd. for Rs.30 lakhs. Sun Ltd. has 3 cash-generating units A, B and C with fair value of Rs.12 lakhs, Rs.8 lakhs and Rs.4 lakhs respectively. The company recognizes goodwill of Rs 6 lakhs that relates to CGU 'C' only.
During the financial year 20X2-20X3, the CFO of the company has a view that there is no requirement of any impairment testing for any CGU since their recoverable amount is comparatively higher than the carrying amount and believes there is no indicator of impairment.
Analyse whether the view adopted by the CFO of Sun Ltd is in compliance of the Ind AS. If not, advise the correct treatment in accordance with relevant Ind AS

Solution

The above treatment needs to be examined in the light of the provisions given in Ind AS 36: Impairment of Assets.

Para 9 of Ind AS 36 'Impairment of Assets' states that "An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."

Further, paragraph 10(b) of Ind AS 36 states that:

"Irrespective of whether there is any indication of impairment, an entity shall also test goodwill acquired in a business combination for impairment annually."

Sun Ltd has not tested any CGU on account of not having any indication of impairment is partially correct i.e. in respect of CGU A and B but not for CGU C. Hence, the treatment made by the Company is not in accordance with Ind AS 36.

Accordingly, impairment testing in respect of CGU A and B are not required since there are no indications of impairment. However, Sun Ltd shall test CGU C irrespective of any indication of impairment annually as the goodwill acquired on business combination is fully allocated to CGU 'C'.

Case Study 5

Deepak started a new company Softbharti Pvt. Ltd. with Iktara Ltd. wherein investment of 55% is done by Iktara Ltd. and rest by Deepak. Voting powers are to be given as per the proportionate share of capital contribution. The new company formed was the subsidiary of Iktara Ltd. with two directors, and Deepak eventually becomes one of the directors of company. A consultant was hired and he charged Rs.30,000 for the incorporation of company and to do other necessary statuary registrations. Rs.30,000 is to be charged as an expense in the books after incorporation of company. The company, Softbharti Pvt. Ltd. was incorporated on 1st April 20X1.

The financials of Iktara Ltd. are prepared as per Ind AS.

An accountant who was hired at the time of company's incorporation, has prepared the draft financials of Softbharti Pvt. Ltd. for the year ending 31st March, 20X2 as follows:

Statement of Profit and Loss

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income	1,00,000
Total Revenue (a)	**11,00,000**
Expenses:	
Purchase of stock in trade	5,00,000
(Increase)/Decrease in stock in trade	(50,000)

Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses (b)	**7,45,000**
Profit before tax (c) = (a)-(b)	**3,55,000**
Current tax	1,06,500
Deferred tax	6,000
Total tax expense (d)	**1,12,500**
Profit for the year (e) = (c) – (d)	**2,42,500**

Balance Sheet

Particulars	Amount (₹)
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	1,00,000
(b) Reserves & Surplus	2,27,500
(2) Non-Current Liabilities	
(a) Long Term Provisions	25,000
(b) Deferred tax liabilities	6,000
(3) Current Liabilities	
(a) Trade Payables	11,000
(b) Other Current Liabilities	45,000
(c) Short Term Provisions	1,06,500
TOTAL	5,21,000
ASSETS	
(1) Non Current Assets	
(a) Property, plant and equipment (net)	1,00,000
(b) Long-term Loans and Advances	40,000
(c) Other Non Current Assets	50,000
(2) Current Assets	
(a) Current Investment	30,000
(b) Inventories	80,000
(c) Trade Receivables	55,000
(d) Cash and Bank Balances	1,15,000
(e) Other Current Assets	51,000
TOTAL	5,21,000

Additional information of Softbharti Pvt Ltd.:
i. Deferred tax liability of Rs.6,000 is created due to following temporary difference:

Difference in depreciation amount as per Income tax and Accounting profit
ii. There is only one property, plant and equipment in the company, whose closing balance as at 31st March, 20X2 is as follows:

Asset description	As per Books	As per Income tax
Property, plant and equipment	Rs.1,00,000	Rs.80,000

iii. Pre incorporation expenses are deductible on straight line basis over the period of five years as per Income tax. However, the same are immediately expensed off in the books.

iv. Current tax is calculated at 30% on PBT - Rs.3,55,000 without doing any adjustments related to Income tax. The correct current tax after doing necessary adjustments of allowances / disallowances related to Income tax comes to Rs.1,25,700.

v. After the reporting period, the directors have recommended dividend of Rs.15,000 for the year ending 31st March, 20X2 which has been deducted from reserves and surplus. Dividend payable of Rs.15,000 has been grouped under 'other current liabilities' alongwith other financial liabilities.

vi. There are 'Government statuary dues' amounting to Rs.15,000 which are grouped under 'other current liabilities'.

vii. The capital advances amounting to Rs.50,000 are grouped under 'Other non-current assets'.

viii. Other current assets of Rs.51,000 comprise Interest receivable from trade receivables.

ix. Current investment of Rs.30,000 is in shares of a company which was done with the purpose of trading; current investment has been carried at cost in the financial statements. The fair value of current investment in this case is Rs.50,000 as at 31st March, 20X2.

x. Actuarial gain on employee benefit measurements of Rs.1,000 has been omitted in the financials of Softbharti private limited for the year ending 31st March, 20X2.
The financial statements for financial year 20X1-20X2 have not been yet approved.
You are required to ascertain that whether the financial statements of Softbharti Pvt. Ltd. are correctly presented as per the applicable financial reporting framework. If not, prepare the revised financial statements of Softbharti Pvt. Ltd. after the careful analysis of mentioned facts and information.

Solution
If Ind AS is applicable to any company, then Ind AS shall automatically be made applicable to all the subsidiaries, holding companies, associated companies, and joint ventures of that company, irrespective of individual qualification of set of standards on such companies.
In the given case it has been mentioned that the financials of Iktara Ltd. are prepared as per Ind AS. Accordingly, the results of its subsidiary Softbharti Pvt. Ltd. should also have been prepared as per Ind AS. However, the financials of Softbharti Pvt. Ltd. have been presented as per accounting standards (AS). Hence, it is necessary to revise the financial statements of Softbharti Pvt. Ltd. as per Ind AS after the incorporation of necessary adjustments mentioned in the question.
The revised financial statements of Softbharti Pvt. Ltd. as per Ind AS and Division II to Schedule III of the Companies Act, 2013 are as follows:

STATEMENT OF PROFIT AND LOSS

for the year ended 31st March, 20X2

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income (1,00,000 + 20,000) (refer note -1)	1,20,000
Total Revenue	**11,20,000**
Expenses:	
Purchase of stock in trade	5,00,000
(Increase) / Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses	**7,45,000**
Profit before tax	**3,75,000**
Current tax	1,25,700
Deferred tax (W.N.1)	4,800
Total tax expense	**1,30,500**
Profit for the year (A)	**2,44,500**
OTHER COMPREHENSIVE INCOME	
Items that will not be reclassified to Profit or Loss:	
Remeasurements of net defined benefit plans	1,000

Tax liabilities relating to items that will not be reclassified to Profit or Loss	
Remeasurements of net defined benefit plans (tax) [1000 x 30%]	(300)
Other Comprehensive Income for the period (B)	**700**
Total Comprehensive Income for the period (A+B)	**2,45,200**

BALANCE SHEET

as at 31st March, 20X2

Particulars	(₹)
ASSETS	
Non-current assets	
Property, plant and equipment	1,00,000
Financial assets	
Other financial assets (Long-term loans and advances)	40,000
Other non-current assets (capital advances) (refer note-2)	50,000
Current assets	
Inventories	80,000
Financial assets	
Investments (30,000 + 20,000) (refer note -1)	50,000
Trade receivables	55,000
Cash and cash equivalents/Bank	1,15,000
Other financial assets (Interest receivable from trade receivables)	51,000
TOTAL ASSETS	**5,41,000**
EQUITY AND LIABILITIES	
Equity	
Equity share capital	1,00,000
Other equity	2,45,200
Non-current liabilities	
Provision (25,000 – 1,000)	24,000
Deferred tax liabilities (4800 + 300)	5,100
Current liabilities	
Financial liabilities	
Trade payables	11,000
Other financial liabilities (Refer note 5)	15,000

Other current liabilities (Govt. statuary dues) (Refer note 3)	15,000
Current tax liabilities	1,25,700
TOTAL EQUITY AND LIABILITIES	**5,41,000**

STATEMENT OF CHANGES IN EQUITY

For the year ended 31st March, 20X2

A. EQUITY SHARE CAPITAL

	Balance (₹)
As at 31st March, 20X1	-
Changes in equity share capital during the year	1,00,000
As at 31st March, 20X2	1,00,000

B. OTHER EQUITY

	Reserves & Surplus
	Retained Earnings (₹)
As at 31st March, 20X1	-
Profit for the year	2,44,500
Other comprehensive income for the year	700
Total comprehensive income for the year	2,45,200
Less: Dividend on equity shares (refer note – 4)	-
As at 31st March, 20X2	2,45,200

DISCLOSURE FORMING PART OF FINANCIAL STATEMENTS:
Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance Sheet date. (refer note 4)

Notes:
1. Current investment are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, Rs.20,000 (Rs.50,000 – Rs.30,000) increase in fair value of financial asset will be recognised in profit and loss. However, it will attract deferred tax liability on increased value (Refer W.N).
2. Assets for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.
3. Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities.

4. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.
5. Other current financial liabilities:

	(₹)
Balance of other current liabilities as per financial statements	45,000
Less: Dividend declared for FY 20X1 – 20X2 (Note – 4)	(15,000)
Reclassification of government statuary dues payable to 'other current liabilities'	(15,000)
Closing balance	15,000

Working Note:

Calculation of deferred tax on temporary differences as per Ind AS 12 for financial year 20X1 – 20X2

Item	Carrying amount (₹)	Tax base (₹)	Difference (₹)	DTA / DTL @ 30% (₹)
Property, Plant and Equipment	1,00,000	80,000	20,000	6,000-DTL
Pre-incorporation expenses	Nil	24,000	24,000	7,200-DTA
Current Investment	50,000	30,000	20,000	6,000-DTL
			Net DTL	4,800-DTL

Case Study 6

Mumbai Challengers Ltd., a listed entity, is a sports organization owning several cricket and hockey teams. The issues below pertain to the reporting period ending 31 March 20X2.

(a) Owing to the proposed schedules of Indian Hockey League as well as Cricket Premier Tournament, Mumbai Challengers Ltd. needs a new stadium to host the sporting events. This stadium will form a part of the Property, Plant and Equipment of the company. Mumbai Challengers Ltd. began the construction of the stadium on 1 December, 20X1. The construction of the stadium was completed in 20X2-20X3. Costs directly related to the construction amounted to ₹ 140 crores in December 20X1. Thereafter, ₹ 350 crores have been incurred per month until the end of the financial year. The company has not taken any specific borrowings to finance the construction of the stadium, although it has incurred finance costs on its regular overdraft during the period, which were avoidable had the stadium not been constructed. Mumbai Challengers Ltd. has calculated that the weighted average

cost of the borrowings for the period 1 December 20X1 to 31 March 20X2 amounted to 15% per annum on an annualized basis.

The company seeks advice on the treatment of borrowing costs in its financial statements for the year ending 31 March 20X2.

(b) Mumbai Challengers Ltd. acquires and sells players' registrations on a regular basis. For a player to play for its team, Mumbai Challengers Ltd. must purchase registrations for that player. These player registrations are contractual obligations between the player and the company. The costs of acquiring player registrations include transfer fees, league levy fees, and player agents' fees incurred by the club.

At the end of each season, which happens to also be the reporting period end for Mumbai Challengers Ltd., the club reviews its contracts with the players and makes decisions as to whether they wish to sell/transfer any players' registrations. The company actively markets these registrations by circulating with other clubs a list of players' registrations and their estimated selling price. Players' registrations are also sold during the season, often with performance conditions attached. In some cases, it becomes clear that a player will not

play for the club again because of, for example, a player sustaining a career threatening injury or being permanently removed from the playing squad for any other reason. The playing registrations of certain players were sold after the year end, for total proceeds, net of associated costs, of ₹ 175 crores. These registrations had a net book value of ₹ 49 crores.
Mumbai Challengers Ltd. seeks your advice on the treatment of the acquisition, extension, review and sale of players' registrations in the circumstances outlined above.
(c) Mumbai Challengers Ltd. measures its stadiums in accordance with the revaluation model. An airline company has approached the directors offering ₹ 700 crores for the property naming rights of all the stadiums for five years. Three directors are on the management boards of both Mumbai Challengers Ltd. and the airline. Additionally, statutory legislations regulate the financing of both the cricket and hockey clubs. These regulations prevent contributions to the capital from a related party which 'increases equity without repayment in return'. Failure to adhere to these legislations could lead to imposition of fines and withholding of prize money.

Mumbai Challengers Ltd. wants to know how to take account of the naming rights in the valuations of the stadium and the potential implications of the financial regulations imposed by the legislations.
Solution
(a) Borrowing Costs

As per Ind AS 23 Borrowing Costs, an entity shall capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (i.e. an asset that necessarily takes a substantial period of time to get ready for its intended use or sale) as part of the cost of that asset. The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. 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 capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period.
The capitalization rate of the borrowings of Mumbai Challengers Ltd. during the period of construction is 15% per annum (as given in the question), and therefore, the total amount of borrowing costs to be capitalized is the expenditures incurred on the asset multiplied by the capitalization rate, which is as under:

Particulars	**₹ in crores**
Costs incurred in December 20X1: (₹ 140 crores x 15% x 4/12)	7.000
Costs incurred in January 20X2: (₹ 350 crores x 15% x 3/12)	13.125
Costs incurred in February 20X2: (₹ 350 crores x 15% x 2/12)	8.750
Costs incurred in March 20X2: (₹ 350 crores x 15% x 1/12)	4.375
Borrowing Costs to be capitalized in 20X1-X2	**33.250**

OR
Weighted average carrying amount of the stadium during 20X1-X2 is:
₹ (140 + 490 + 840 + 1,190) crores/4 = ₹ 665 crores
Applying the weighted average rate of borrowings of 15% per annum, the borrowing cost to be capitalized is computed as:
₹ 665 crores x (15% x 4/12) = ₹ 33.25 crores
(b) Players' Registrations

Acquisition
As per Ind AS 38 Intangible Assets, an entity should recognize an intangible asset where it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably. Accordingly, the **costs** associated with the acquisition of players' registrations would need to be **capitalized which would be the amount of cash or cash equivalent paid or the fair value of other consideration given to acquire such registrations**. In line with Ind AS 38 Intangible Assets, costs would include transfer fees, league levy fees, and player agents' fees incurred

by the club, along with other directly attributable costs, if any. Amounts capitalized would be fully amortized over the period covered by the player's contract.
Sale of registrations
Player registrations would be classified as assets held for sale under Ind AS 105 Non-Current Assets Held for Sale and Discontinued Operations when their carrying amount is expected to be recovered principally through a sale transaction and a sale is considered to be highly probable. To consider a sale to be 'highly probable', the assets (in this case, player registrations) should be actively marketed for sale at a price that is reasonable in relation to its current fair value. In the given case, it would appear that the management is committed to a plan to sell the registration, that the asset is available for immediate sale and that an active plan to locate a buyer is already in place by circulating clubs. Ind AS 105 stipulates that it should be unlikely that the plan to sell the registrations would be significantly changed or withdrawn. To fulfil this requirement, it would be prudent if only those registrations are classified as held for sale where unconditional offers have been received prior to the reporting date.
Once the conditions for classifying assets as held for sale in accordance with Ind AS 105 have been fulfilled, the player registrations would be stated at lower of carrying amount and fair value less costs to sell, with the carrying amount stated in accordance with Ind AS 38 prior to application of Ind AS 105, subjected to impairment, if any.
Profits and losses on sale of players' registrations would be computed by deducting the carrying amount of the players' registrations from the fair value of the consideration receivable, net of transactions costs. In case a portion of the consideration is receivable on the occurrence of a future performance condition (i.e. contingent consideration), this amount would be recognized in the Statement of Profit and Loss only when the conditions are met.
The players registrations disposed of, subsequent to the year end, for ₹ 175 crores, having a corresponding book value of ₹ 49 crores would be disclosed as a non-adjusting event in accordance with Ind AS 10 Events after the Reporting Period.
Impairment review
Ind AS 36 Impairment of Assets requires companies to **annually test their assets for impairment**. An asset is said to be impaired if the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is higher of the asset's fair value less costs to sell and its value in use (which is the present value of

future cash flows expected to arise from the use of the asset). In the given scenario, it is not easy to determine the value in use of any player in isolation as that player cannot generate cash flows on his/her own unless via a sale transaction or an insurance recovery. Whilst any individual player cannot really be separated from the single cash-generating unit (CGU), being a cricket team or a hockey team in the instant case, there may be certain instances where a player is taken out of the CGU when it becomes clear that he/she will not play for the club again. If such circumstances arise, the **carrying amount of the player should be assessed against the best estimate of the player's fair value less any costs to sell and an impairment charge should be recognized in the profit or loss**, which reflects any loss arising.

(c) Valuation of stadiums

In terms of Ind AS 113 Fair Value Measurement, stadiums would be valued at the **price which would be received to sell the asset in an orderly transaction between market participants** at the measurement date (i.e. exit price). The price would be the one which **maximizes the value of the asset** or the group of assets using the principle of the highest and best use. The price would essentially use Level 2 inputs which are inputs other than quoted market prices included within Level 1 which are observable for the asset or liability, either directly or indirectly. Property naming rights present complications when valuing property. The status of the property indicates its suitability for inviting sponsorship attached to its name. It has nothing to do with the property itself but this can be worth a significant amount. Therefore, Mumbai Challengers Ltd. could include the property naming rights in the valuation of the stadium and write it off over three years.

Ind AS 24 Related Party Disclosures lists the criteria for two entities to be treated as related parties. Such criteria include being members of the same group or where a person or a close member of that person's family is related to a reporting entity if that person has control or joint control over the reporting entity. Ind AS 24 deems that parties are not related simply because they have a director or a key manager in common. In this case, there are three directors in common and in the absence of any information to the contrary, it appears as though the entities are not related. However, the regulator will need to establish whether the sponsorship deal is a related party transaction for the purpose of the financial control provisions. There would need to be demonstrated that the airline may be expected to influence, or be influenced by, the club or a related party of the club. If the deal is deemed to be a related party transaction, the regulator will evaluate whether the sponsorship is at fair value or not.

Case Study 7

(a) Neelanchal Gas Refinery Ltd. (hereinafter referred to as Neelanchal), a listed company, is involved in the production and trading of natural gas and oil. Neelanchal jointly owns an underground storage facility with another entity, Seemanchal Refineries Ltd. (hereinafter referred to as Seemanchal). Both the companies are engaged in extraction of gas from offshore gas fields, which they own and operate independently of each other. Neelanchal owns 60% of the underground facility and Seemanchal owns 40%. Both the companies have agreed to share services and costs accordingly, with decisions relating to the storage facility requiring unanimous agreement of the parties. The underground facility is pressurised so that the gas is pushed out when extracted. When the gas pressure is reduced to a certain level, the remaining gas is irrecoverable and remains in the underground storage facility until it is decommissioned. As per the laws in force, the storage facility should be decommissioned at the end of its useful life.

Neelanchal seeks your advice on the treatment of the agreement with Seemanchal as well as the accounting for the irrecoverable gas.

(b) Neelanchal has entered into a ten-year contract with Uttaranchal Refineries Pvt. Ltd. (hereinafter referred to as Uttaranchal) for purchase of natural gas. Neelanchal has paid an advance to Uttaranchal equivalent to the total quantity of gas contracted for ten years based on the forecasted price of gas. This advanced amount carries interest at the rate of 12.5% per annum, which is settled by Uttaranchal way of supply of extra gas. The contract requires fixed quantities of gas to be supplied each month. Additionally, there is a price adjustment mechanism in the contract whereby the difference between the forecasted price of gas and the prevailing market price is settled in cash on a quarterly basis. If Uttaranchal does not deliver the gas as agreed, Neelanchal has the right to claim compensation computed at the current market price of the gas.

Neelanchal wants to account for the contract with Uttaranchal in accordance with Ind AS 109 Financial Instruments and seeks your inputs in this regard.
Solution
(a) Joint Arrangement

As per Ind AS 111 Joint Arrangements, a joint arrangement is an arrangement of which two or more parties have joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. The structure and form of the arrangement determines the nature of the relationship. However, irrespective of the purpose, structure or form of the arrangement, the classification of joint arrangements depends upon the parties' rights and obligations arising from the arrangement. Accordingly, a joint arrangement could be classified as a joint operation or as a joint venture. A joint arrangement which is NOT structured through a separate vehicle is a joint operation. In such cases, the contractual arrangement establishes the parties' rights and obligations. A joint operator accounts for the assets, liabilities, revenues and expenses relating to its involvement in a joint operation in accordance with the relevant Ind AS. Based on the information provided, the arrangement with Seemanchal Refineries Ltd. is a joint operation as no separate vehicle is formed and the companies have agreed to share services and costs with decisions regarding the storage facility requiring unanimous agreement of the parties. Neelanchal Gas Refinery Ltd. should recognize its share of the asset as Property, Plant and Equipment.
As per Para 16 of Ind AS 16 Property, Plant and Equipment, 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. Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets provides guidance on measuring decommissioning, restoration and similar liabilities. Para 45 of Ind AS 37 provides that where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation. Thus, costs incurred by an entity in respect of obligations for dismantling, removing and restoring the site on which an item of property, plant and equipment is situated are recognized and measured in accordance with Ind AS 16 and Ind AS 37, with the journal entry being as under:
Property, Plant and Equipment Dr. xxx
To Provision for Dismantling, Removal and Restoration xxx
Neelanchal Gas Refinery Ltd. should recognize 60% of the cost of decommissioning of the underground storage facility. However, in line Para 29 of Ind AS 37 where an entity is jointly and severally liable for an obligation, **the part of the obligation that is expected to be met by other parties is treated as a contingent liability**. Accordingly, Neelanchal Gas Refinery Ltd. should also disclose 40% of the cost of decommissioning of the underground facility as a contingent liability, should there arise future events that prevent Seemanchal Refineries Ltd. from fulfilling its obligations under the arrangement.

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.

Thus, Neelanchal Gas Refinery Ltd. should classify and account for its share of irrecoverable gas as property, plant and equipment, as the irrecoverable gas is necessary for the storage facility to perform its function. Therefore, the **irrecoverable gas, being a part of the storage facility, should be capitalized as a component of the storage facility asset**, and should be depreciated to its residual value over the life of the storage facility. However, if the gas is recoverable in full upon decommissioning of the storage facility, then depreciation against the irrecoverable gas component will be recorded only if the estimated residual value of the gas decreases below cost during the life of the facility. Upon decommissioning of the storage facility, when the cushion gas is extracted and sold, the sale of irrecoverable gas is accounted as a disposal of an item of property, plant and equipment in accordance with Ind AS 16 and the resulting gain or loss is recognized in the Statement of Profit and Loss. The natural gas in excess of the irrecoverable gas which is injected into the facility would be treated as inventory in accordance with Ind AS 2 Inventories.
(b) Contract with Uttaranchal Refineries Pvt. Ltd.

As per para 2.4 of Ind AS 109 Financial Instruments, this standard applies to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, **with the exception** of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity’s expected purchase, sale or usage requirements (i.e. own use contracts). This contract will result in physical delivery of the commodity i.e. extra gas.
Para 2.5 of Ind AS 109 further provides that a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contract was a financial instrument, may be irrevocably designated as measured at fair value through profit or loss even if it was entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the entity’s expected purchase, sale or usage requirements. This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an ‘accounting mismatch’) that would otherwise arise from not recognising that contract because it is excluded from the scope of this Standard.
There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:
(a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

(c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer’s margin; and

(d) when the non-financial item that is the subject of the contract is readily convertible to cash.

A written option to buy or sell a non-financial item, such as a commodity, that can be settled net in cash or another financial instrument, or by exchanging financial instruments, is within the scope of Ind AS 109. Such a contract is accounted as a derivative. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements. Judgment would be required in this area as net settlements caused by unique events beyond management's control may not necessarily prevent the entity from applying the 'own use' exemption to all similar contracts.
In the given case, the contract with Uttaranchal Refineries Pvt. Ltd. will result in physical delivery of extra gas (which is a commodity and not cash, or a financial instrument) for the use of Neelanchal Gas Refinery Ltd. Accordingly, it appears that this contract would be an own use contract falling outside the scope of Ind AS 109 and therefore, would be treated as an executory contract. However, arguments could be placed that the contract is net settled due to the penalty mechanism requiring Uttaranchal Refineries Pvt. Ltd. to compensate Neelanchal Gas Refinery Ltd. at the current prevailing market price. Further, if natural gas is readily convertible into cash at the location of delivery, the contract could be considered net settled. Additionally, if there is volume flexibility, the contract could be regarded as a written option which falls within the scope of Ind AS 109.
However, the contract will probably continue to be regarded as 'own use' as long as it has been entered into and continues to be held for expected counterparties' sale / usage requirements. Additionally, the entity has not irrevocably designated the contract as measured at fair value through profit or loss, thus emphasizing the 'own use' designation.

Questions
1. Venus Ltd. is a multinational entity that owns three properties. All three properties were purchased on 1st April, 20X1. The details of purchase price and market values of the properties are given as follows:

Particulars	Property 1	Property 2	Property 3
Factory	Factory	Let-Out	
Purchase price	15,000	10,000	12,000
Market value 31.03.20X2	16,000	11,000	13,500
Life	10 Years	10 Years	10 Years
Subsequent Measurement	Cost Model	Revaluation Model	Revaluation Model

Property 1 and 2 are used by Venus Ltd. as factory building whilst property 3 is let-out to a non-related party at a market rent. The management presents all three properties in balance sheet as 'property, plant and equipment'.
The Company does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognise the difference between purchase price and fair value in Statement of Profit and Loss.
Required:
Analyse whether the accounting policies adopted by the Venus Ltd. in relation to these properties is in accordance with Ind AS. If not, advise the correct treatment alongwith working for the same.
Answer:
The above issue needs to be examined in the umbrella of the provisions given in Ind AS 1 'Presentation of Financial Statements', Ind AS 16 'Property, Plant and Equipment' in relation to property '1' and '2' and Ind AS 40 'Investment Property' in relation to property '3'.

Property '1' and '2'
Para 6 of Ind AS 16 'Property, Plant and Equipment' defines:
"Property, plant and equipment are tangible items that:
(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
(b) are expected to be used during more than one period."
Paragraph 29 of Ind AS 16 states that:
"An entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment".
Further, paragraph 36 of Ind AS 16 states that:
"If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued".
Further, paragraph 39 of Ind AS 16 states that:
"If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss".
Further, paragraph 52 of Ind AS 16 states that:
"Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount".
Property '3'
Para 6 of Ind AS 40 'Investment property' defines:
"Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:
(a) use in the production or supply of goods or services or for administrative purposes; or
(b) sale in the ordinary course of business".

Further, paragraph 30 of Ind AS 40 states that:
"An entity shall adopt as its accounting policy the cost model to all of its investment property".
Further, paragraph 79 (e) of Ind AS 40 requires that:
"An entity shall disclose the fair value of investment property".
Further, paragraph 54 (2) of Ind AS 1 'Presentation of Financial Statements' requires that:
"As a minimum, the balance sheet shall include line items that present the following amounts:
(a) property, plant and equipment;
(b) investment property;

As per the facts given in the question, Venus Ltd. has
(a) presented all three properties in balance sheet as 'property, plant and equipment';

(b) applied different accounting policies to Property '1' and '2';
(c) revaluation is charged in statement of profit and loss as profit; and
(d) applied revaluation model to Property '3' being classified as Investment Property.
These accounting treatment is neither correct nor in accordance with provision of Ind AS 1, Ind AS 16 and Ind AS 40.

Accordingly, Venus Ltd. shall apply the same accounting policy (i.e. either revaluation or cost model) to entire class of property being property '1' and '2". It also required to depreciate these properties irrespective of that, their fair value exceeds the carrying amount. The revaluation gain shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.
There is no alternative of revaluation model in respect to property '3' being classified as Investment Property and only cost model is permitted for subsequent measurement. However, Venus ltd. is required to disclose the fair value of the property in the Notes to Accounts. Also the property '3' shall be presented as separate line item as Investment Property.
Therefore, as per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet is as follows:

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

Balance Sheet extracts as at 31st March, 20X2 ₹

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	13,500	
Property '2'	9,000	22,500
Investment Properties		
Property '3'		10,800

Case 2: Venus Ltd. has applied the Revaluation Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March, 20X2 ₹

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	16,000	
Property '2'	11,000	27,000
Investment Properties		
Property '3'		10,800
Equity and Liabilities		
Other Equity		
Revaluation Reserve		
Property '1'	2,500	
Property '2'	2,000	4,500

The revaluation reserve should be routed through Other Comprehensive Income (subsequently not reclassified to Profit and Loss) in Statement of Profit and Loss and Shown as a separate column in Statement of Changes in Equity.

2. On 1st January, 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September, 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March, 20X2, that there was a 75% probability they would have to pay damages of Rs.10 lakhs to the customer.
However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of Rs.12 lakhs to the customer on 15th May, 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May, 20X2. 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.
Answer:
The above treatment needs to be examined in the light of the provisions given in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' and Ind AS 10 'Events After the Reporting Period'.
Para 10 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' defines:
"Provision is a liability of uncertain timing or amount.
Liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits".
Further, paragraph 14 of Ind AS 37, states:
"A provision shall be recognised when:
(a) an entity has a present obligation (legal or constructive) as a result of a past event;
(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) a reliable estimate can be made of the amount of the obligation".

Further, paragraph 36 of Ind AS 37, states:
"The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period".
Further, paragraph 3 of Ind AS 10 'Events after the Reporting Period' defines:
"Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding
approving authority in case of any other entity for issue. Two types of events can be identified:
(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 8 of Ind AS 10 states that:
"An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period."
The Accountant of Sun Ltd. has not recognised the provision and accordingly not adjusted the amounts recognised in its financial statements to reflect adjusting events after the reporting period is not correct and nor in accordance with provision of Ind AS 37 and Ind AS 10.

As per given facts, the potential payment of damages to the customer is an obligation arising out of a past event which can be reliably estimated. Therefore, following the provision of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' – a provision is required. The provision should be for the best estimate of the expenditure required to settle the obligation at 31st March, 20X2 which comes to Rs.7.5 lakhs (Rs.10 lakhs x 75%).
Further, following the principles of Ind AS 10 'Events After the Reporting Period' evidence of the settlement amount is an adjusting event. Therefore, the amount of provision created shall be increased to Rs.12 lakhs and accordingly be recognised as a current liability.

3. Mercury Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April, 20X1, the company has received a government grant for Rs.10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years. Eucalyptus trees are not considered as bearer plant in this case.
The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus tree for specified period of five years and accordingly it recognises proportionate grant for Rs.2 lakhs in Statement of Profit and Loss as income following the principles laid down under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.
Analyse whether the above accounting treatment made by the management is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.
Answer:
As per given facts, the company is engaged in plantation and farming. Hence Ind AS 41 Agriculture shall be applicable to this company.
The above facts need to be examined in the light of the provisions given in Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance' and Ind AS 41 'Agriculture'.
Para 2(d) of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance' states:
"This Standard does not deal with government grants covered by Ind AS 41, Agriculture".
Further, paragraph 1 (c) of Ind AS 41 'Agriculture', states:
"This Standard shall be applied to account for the government grants covered by paragraphs 34 and 35 when they relate to agricultural activity".
Further, paragraph 1 (c) of Ind AS 41 'Agriculture', states:
"If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met".
Understanding of the given facts, The Company has recognised the proportionate grant for Rs.2 lakhs in Statement of Profit and Loss before the conditions attaching to government grant are met which is not correct and nor in accordance with provision of Ind AS 41 'Agriculture'.
Accordingly, the accounting treatment of government grant received by the Mercury Ltd. is governed by the provision of Ind AS 41 'Agriculture' rather Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance'.
Government grant for Rs.10 lakhs shall be recognised in profit or loss when, and only when, the conditions attaching to the government grant are met i.e. after the expiry of specified period of five years of continuing engagement in the plantation of eucalyptus tree.

Balance Sheet extracts showing the presentation of Government Grant

as on 31st March, 20X2 ₹

Liabilities	
Non-Current liabilities	
Other Non-Current Liabilities	
Government Grants	10,00,000

4. 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.

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)	Present value factor	Present value of consideration
Time of sale	3,33,333	-	3,33,333
End of 1st year	3,33,333	0.949	3,16,333
End of 2nd year	3,33,334	0.901	3,00,334
	10,00,000		9,50,000

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

970

Initial recognition of sale of goods		₹	₹
Cash	Dr.	3,33,333	
Trade Receivable	Dr.	6,16,667	
To Sale			9,50,000
Recognition of interest expense and receipt of second installment			
Cash	Dr.	3,33,333	
To Interest Income			33,053
To Trade Receivable			3,00,280
Recognition of interest expense and payment of final installment			
Cash	Dr.	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	XXX

5. Deepak started a new company Softbharti Pvt. Ltd. with Iktara Ltd. wherein investment of 55% is done by Iktara Ltd. and rest by Deepak. Voting powers are to be given as per the proportionate share of capital contribution. The new company formed was the subsidiary of Iktara Ltd. with two directors, and Deepak eventually becomes one of the directors of company. A consultant was hired and he charged ` 30,000 for the incorporation of company and to do other necessary statuary registrations. ` 30,000 is to be charged as an expense in the books after incorporation of company. The company, Softbharti Pvt. Ltd. was incorporated on 1st April 2019.
The financials of Iktara Ltd. are prepared as per Ind AS.
An accountant who was hired at the time of company's incorporation, has prepared the draft financials of Softbharti Pvt. Ltd. for the year ending 31st March, 2020 as follows: (RTP- NOV 2020)

Statement of Profit and Loss

Particulars	Amount (`)
Revenue from operations	10,00,000
Other Income	1,00,000
Total Revenue (a)	11,00,000
Expenses:	
Purchase of stock in trade	5,00,000
(Increase)/Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses (b)	7,45,000
Profit before tax (c) = (a)-(b)	3,55,000
Current tax	1,06,500
Deferred tax	6,000
Total tax expense (d)	1,12,500
Profit for the year (e) = (c) – (d)	2,42,500

Balance Sheet

Particulars	Amount (`)
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	1,00,000
(b) Reserves & Surplus	2,27,500
(2) Non-Current Liabilities	
(a) Long Term Provisions	25,000
(b) Deferred tax liabilities	6,000
(3) Current Liabilities	

(a) Trade Payables	11,000
(b) Other Current Liabilities	45,000
(c) Short Term Provisions	1,06,500
TOTAL	5,21,000
ASSETS	
(1) Non Current Assets	
(a) Property, plant and equipment (net)	1,00,000
(b) Long-term Loans and Advances	40,000
(c) Other Non Current Assets	50,000
(2) Current Assets	
(a) Current Investment	30,000
(b) Inventories	80,000
(c) Trade Receivables	55,000
(d) Cash and Bank Balances	1,15,000
(e) Other Current Assets	51,000
TOTAL	5,21,000

Additional information of Softbharti Pvt Ltd.:
Deferred tax liability of ` 6,000 is created due to following temporary difference:

Difference in depreciation amount as per Income tax and Accounting profit
II. There is only one property, plant and equipment in the company, whose closing balance as at 31st March, 2020 is as follows:

Asset description	As per Books	As per Income tax
Property, plant and equipment	` 1,00,000	` 80,000

iii. Pre incorporation expenses are deductible on straight line basis over the period of five years as per Income tax. However, the same are immediately expensed off in the books.
iv. Current tax is calculated at 30% on PBT - ` 3,55,000 without doing any adjustments related to Income tax. The correct current tax after doing necessary adjustments of allowances / disallowances related to Income tax comes to ` 1,25,700.
v. After the reporting period, the directors have recommended dividend of ` 15,000 for the year ending 31st March, 2020 which has been deducted from reserves and surplus. Dividend payable of ` 15,000 has been grouped under 'other current liabilities' alongwith other financial liabilities.

vi. There are 'Government statuary dues' amounting to ` 15,000 which are grouped under 'other current liabilities'.
vii. The capital advances amounting to ` 50,000 are grouped under 'Other non-current assets'.
viii. Other current assets of ` 51,000 comprise Interest receivable from trade receivables.
ix. Current investment of ` 30,000 is in shares of a company which was done with the purpose of trading; current investment has been carried at cost in the financial statements. The fair value of current investment in this case is ` 50,000 as at 31st March, 2020.
x. Actuarial gain on employee benefit measurements of ` 1,000 has been omitted in the financials of Softbharti private limited for the year ending 31st March, 2020.
The financial statements for financial year 2019-2020 have not been yet approved.
You are required to ascertain that whether the financial statements of Softbharti Pvt. Ltd. are correctly presented as per the applicable financial reporting framework. If not, prepare the revised financial statements of Softbharti Pvt. Ltd. after the careful analysis of mentioned facts and information.
Answer:

If Ind AS is applicable to any company, then Ind AS shall automatically be made applicable to all the subsidiaries, holding companies, associated companies, and joint ventures of that company, irrespective of individual qualification of set of standards on such companies.
In the given case it has been mentioned that the financials of Iktara Ltd. are prepared as per Ind AS. Accordingly, the results of its subsidiary Softbharti Pvt. Ltd. should also have been prepared as per Ind AS. However, the financials of Softbharti Pvt. Ltd. have been presented as per accounting standards (AS). Hence, it is necessary to revise the financial statements of Softbharti Pvt. Ltd. as per Ind AS after the incorporation of necessary adjustments mentioned in the question.
The revised financial statements of Softbharti Pvt. Ltd. as per Ind AS and Division II to Schedule III of the Companies Act, 2013 are as follows:

STATEMENT OF PROFIT AND LOSS
for the year ended 31st March, 2020

Particulars	Amount (`)
Revenue from operations	10,00,000
Other Income (1,00,000 + 20,000) (refer note -1)	1,20,000
Total Revenue	11,20,000
Expenses:	
Purchase of stock in trade	5,00,000
(Increase) / Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000

Total Expenses	**7,45,000**
Profit before tax	**3,75,000**
Current tax	1,25,700
Deferred tax (W.N.1)	4,800
Total tax expense	**1,30,500**
Profit for the year (A)	**2,44,500**
OTHER COMPREHENSIVE INCOME	
Items that will not be reclassified to Profit or Loss: Remeasurements of net defined benefit plans	**1,000**
Tax liabilities relating to items that will not be reclassified to Profit or Loss Remeasurements of net defined benefit plans (tax) [1000 x 30%]	(300)
Other Comprehensive Income for the period (B)	**700**
Total Comprehensive Income for the period (A+B)	**2,45,200**

BALANCE SHEET
as at 31st March, 2020

Particulars	(`)
ASSETS	
Non-current assets	
Property, plant and equipment	1,00,000
Financial assets	
Other financial assets (Long-term loans and advances)	40,000
Other non-current assets (capital advances) (refer note-2)	50,000
Current assets	
Inventories	80,000
Financial assets	

Investments (30,000 + 20,000) (refer note -1)	50,000
Trade receivables	55,000
Cash and cash equivalents/Bank	1,15,000
Other financial assets (Interest receivable from trade receivables)	51,000
TOTAL ASSETS	**5,41,000**
EQUITY AND LIABILITIES	
Equity	
Equity share capital	1,00,000
Other equity	2,45,200
Non-current liabilities	
Provision (25,000 – 1,000)	24,000
Deferred tax liabilities (4800 + 300)	5,100
Current liabilities	
Financial liabilities	
Trade payables	11,000
Other financial liabilities (Refer note 5)	15,000
Other current liabilities (Govt. statuary dues) (Refer note 3)	15,000
Current tax liabilities	1,25,700
TOTAL EQUITY AND LIABILITIES	**5,41,000**

STATEMENT OF CHANGES IN EQUITY
For the year ended 31st March, 2020
A. EQUITY SHARE CAPITAL

	Balance (₹)
As at 31st March, 2019	-
Changes in equity share capital during the year	1,00,000
As at 31st March, 2020	1,00,000

B. OTHER EQUITY

	Reserves & Surplus
	Retained Earnings (₹)
As at 31st March, 2019	-
Profit for the year	2,44,500
Other comprehensive income for the year	700
Total comprehensive income for the year	2,45,200
Less: Dividend on equity shares (refer note – 4)	-
As at 31st March, 2020	2,45,200

DISCLOSURE FORMING PART OF FINANCIAL STATEMENTS:
Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance Sheet date. (refer note-4)

Notes:

1. Current investment are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, ` 20,000 (50,000 – 30,000) increase in fair value of financial asset will be recognised in profit and loss. However, it will attract deferred tax liability on increased value (Refer W.N).

2. Assets for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.

3. Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities.

4. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.

5. Other current financial liabilities:

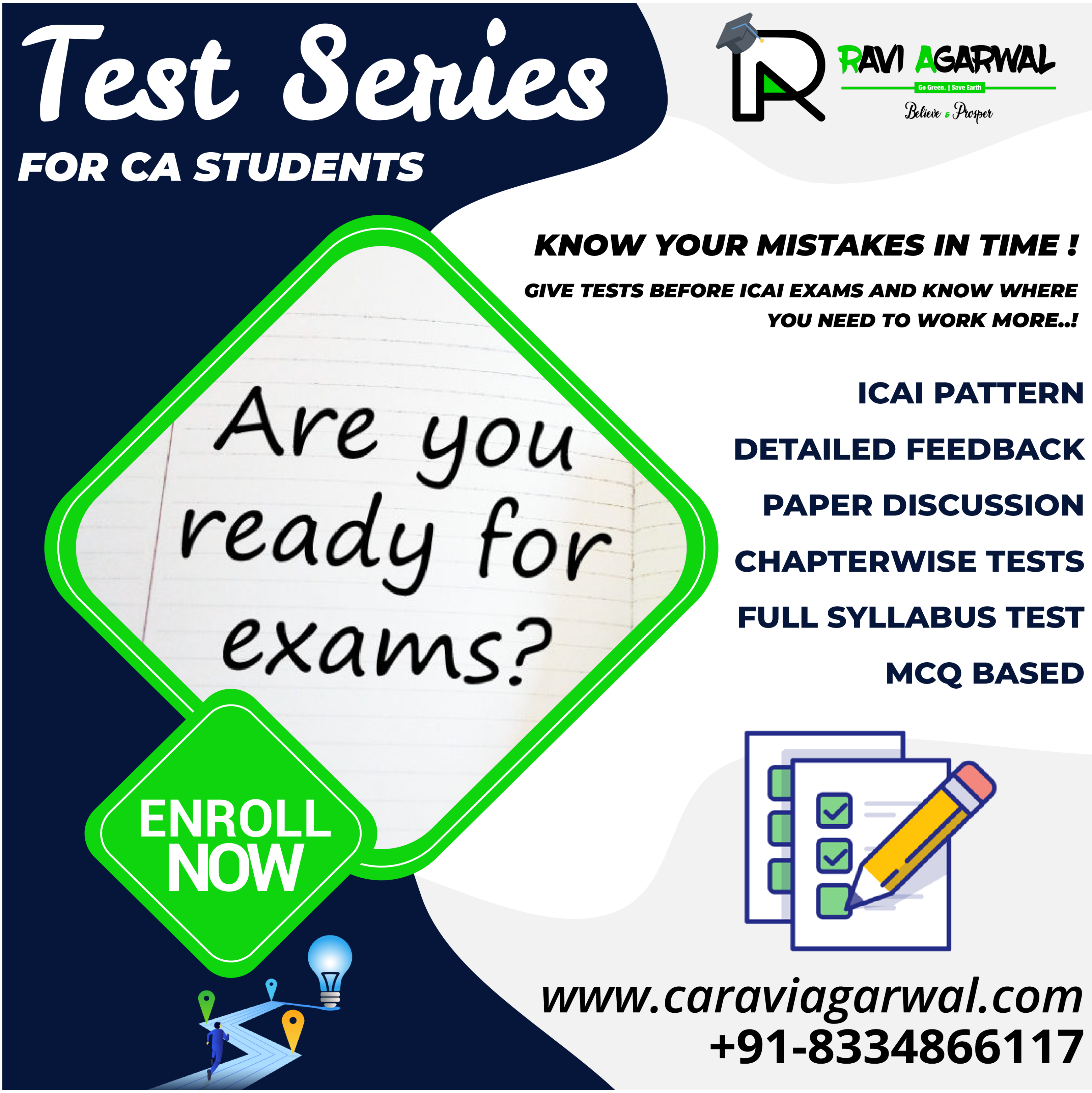
	(₹)
Balance of other current liabilities as per financial statements	45,000
Less: Dividend declared for FY 2019 - 2020 (Note – 4)	(15,000)

Reclassification of government statuary dues payable to 'other current liabilities'	(15,000)
Closing balance	15,000

Working Note:

Calculation of deferred tax on temporary differences as per Ind AS 12 for financial year 2019 - 2020

Item	Carrying amount (₹)	Tax base (₹)	Difference (₹)	DTA / DTL @ 30% (₹)
Property, Plant and Equipment	1,00,000	80,000	20,000	6,000-DTL
Pre-incorporation expenses	Nil	24,000	24,000	7,200-DTA
Current Investment	50,000	30,000	20,000	6,000-DTL
			Net DTL	4,800-DTL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CHAPTER-16 INTEGRATED REPORTING

Questions

1. State the categories defined in the International IR Framework for capitals. Comment whether an organisation has to follow these categories rigidly.
Answer:
Various categories of capital are:

- Financial
- Manufactured
- Intellectual
- Human
- Social and Relationship
- Natural

Organizations preparing an integrated report are not required to adopt this categorization or to structure their report along the above lines of the capitals.

2 Can a Not-for Profit organisation do the Integrated Reporting as per the Framework?
Answer:
The Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

3 Can an Integrated reporting be done in compliance to the requirements of the local laws to prepare a management commentary or other reports?
Answer:
An integrated report may be prepared in response to existing compliance requirements. For example, an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework, it can be considered an integrated report. If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.

4.What are the guiding principles for preparation and presentation of Integrated Report?
[MTP MARCH 2018 6 MARKS]
Answer:
The following Guiding Principles underpin the preparation and presentation of an integrated report, informing the content of the report and how information is presented:
1. Strategic Focus and Future Orientation
An integrated report should provide insight into the organization's strategy and how it relates to the organization's ability to create value and to its use of and effects on the capitals in short, medium and long term period. The report should clearly show the linkages between strategy, risks and opportunities, current performance, as well as future outlook and targets.

2. Connectivity of Information

An integrated report shows the connections between the different components:

- Organisation's business model
- External factors that affect the organisation
- Various resources and relationships on which the organisation and its performance are dependent upon

3. Stakeholder Relationships

An integrated report should provide insight into nature and quality of the organization's relationships with its key stakeholders including how and to what extent the organization understands, takes into account and responds to their legitimate needs and inte rests.

4. Materiality

A focus on materiality should assist in avoiding irrelevant and detailed information from cluttering the report. The integrated report is a high-level, concise report that contains only the most material matters and information affecting the organisation and its ability to create value over time. Additional information can be placed in supporting reports.

5. Conciseness

An integrated report should be concise. It implies that the information should be accessible through crisp presentation, the omission of immaterial information, and a logical easy-tofollow structure.

6. Reliability and Completeness

An integrated report should include all material matters, both positive and negative, in a balanced way and without material error. Integrated reporting requires that consideration is given to both good and bad news and performance. Furthermore, both the increases and reductions in the value of the important capitals should be reflected.

CHAPTER-17 CORPORATE SOCIAL RESPONSIBILITY

Illustrations

1

ABC Ltd. is a company which is formed with charitable objects under Section 8 of the Companies Act, 2013. As a result, the management of the company believes that as all the activities of the company will be with the intent of charity, the CSR provisions are not applicable to ABC Ltd. as these activities are activities in normal course of business.

Whether the provisions of CSR are applicable to ABC Ltd. provided it fulfils the criteria of Section 135 of the Act?

Solution

Section 135 of the Companies Act is applicable to every company meeting the specified criteria. As per section 2(20) of the Companies Act, 'company' means a company incorporated under the Companies Act or under any other previous company law. This would imply that companies set up for the purposes of CSR/public welfare are also required to comply with the provisions of CSR.

2

ABC Ltd. is a company which has a net worth of Rs.200 crore, it manufactures rubber parts for automobiles. The sales of the company are affected due to low demand of its products.

Required financial details of the following financial years are as follows (Rs.in crore)

	March 31, 20X4 (Current year) projected	March 31, 20X3	March 31, 20X2	March 31, 20X1
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

Does ABC Ltd. has an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year?

Solution

A company which meets the net worth, turnover or net profits criteria in immediate preceding financial year will need to constitute a CSR Committee and comply with provisions of sections 135(2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee -

1) Net worth greater than or equal to Rs.500 Crore: This criterion is not satisfied.

2) Sales greater than or equal to Rs.1000 Crore: This criterion is not satisfied.

3) Net profit greater than or equal to Rs.5 crore: This criterion is satisfied in financial year ended March 31, 20X3 ie immediate preceding financial year.

Hence, the Company will be required to form a CSR committee.

3

ABC Ltd. manufactures consumable goods like bath soap, tooth brushes, soap cases etc. As part of its CSR policy, it has decided that for every pack of these goods sold, Rs.0.80 will go towards the 'Save Trees Foundation' which will qualify as a CSR spend as per Schedule VII. Consequently, at the year end, the company sold 25,000 such packs and a total of Rs.20,000 was recognised as CSR expenditure. However, this amount was not paid to the Foundation at the end of the financial year.

Will the amount of Rs.20,000 qualify to be a CSR expenditure?

Solution

By earmarking the amount from such sale for CSR expenditure, the company cannot show it as CSR expenditure. To qualify the amount to be CSR expenditure, it has to be spent. Hence, Rs.20,000 will not be automatically considered as CSR expenditure until and unless it is spent on CSR activities.

4

Due to immense loss to Nepal in the recent earthquake, one FMCG Company undertakes various commercial activities with considerable discounts and concessions at the related affected areas of Nepal for a continuous period of 3 months after earthquake. In the Financial Statements for the year 20X1-X2, the Management has shown the expenditure incurred on such activity as expenditure incurred to discharge Corporate Social Responsibility.

State whether the treatment done by the management of management is correct. Explain with reasons.

Solution

The statutory guidelines relating to CSR require the deployment of funds for the benefit of the local area of the Company. Since Nepal is another country the expenditure done there i.e. in Nepal shall not qualify to be accounted as CSR expenditure.

Further, it is presumed that the commercial activities performed at concessional rates are not permissible as CSR activities. Therefore, the treatment done by the Management by showing the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

5

ABC Ltd. is a company which is covered under the ambit of CSR rules. As part of its CSR contribution an amount of Rs.15,00,000 was spent as CSR expense towards the education of girl child. The average net profit of the company for the past three years was Rs.7 crore. As the company incurred a CSR expense in excess of what is required by the rules, it decided to utilise this expense as a carry forward to the next year and reduce next year's CSR spend by Rs.1,00,000.

Can the excess expenditure towards CSR be carried forward to next financial year?

Solution

As per the current law of land, carry forward of excess amount over 2% of average profits, will be allowed, if the company decides to adjust such excess against future obligation.

If the company decides not to carry forward such excess spend in full or in part, the same to the extent not carried forward is to be recognized as expense.

6.

After the havoc caused by flood in Jammu and Kashmir, a group of companies undertakes during the period from October, 20X1 to December, 20X1 various commercial activities, with considerable concessions/discounts, along the related affected areas. The management intends to highlight the expenditure incurred on such activities as expenditure incurred on activities undertaken to discharge corporate social responsibility, while publishing its financial statements for the year 20X1-20X2.

State whether the management's intention is correct or not and why?

Solution

Corporate Social Responsibility (CSR) Reporting is an information communiqué with respect to discharge of social responsibilities of corporate entity. Through 'CSR Report' the corporate enterprises disclose the manner in which they are discharging their social responsibilities. More specifically, it is addressed to the public or society at large, although it can be squarely used by other user groups also. Section 135 of the Companies Act, 2013 mandated the companies fulfilling the criteria mentioned in the said section to spend certain amount of their profit on activities as specified in the Schedule VII to the Act. Companies not falling within that criteria can also spend on CSR activities voluntarily. However, besides the requirements of constitution of a CSR committee and a CSR policy, the corporate entities should also take care that expenditure incurred for CSR should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

Here, it is assumed that the commercial activities performed at concessional rates are the activities done in the ordinary course of business of the companies. Therefore, the intention of the management to highlight the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

7

ABC Ltd. carries out CSR activities from rented premises in Pune. The rent paid for such premises is disclosed as CSR expenditure and subsequently ABC Ltd. also claimed deduction of the same under the Income-tax Act. Is this permissible?

Solution

CSR expenditure which is of the nature described under the section 30 to 36 of the Income-tax Act shall be allowed as a deduction. Rent expenses can be claimed under section 30 of the Act and hence it can be claimed as a deduction.

Questions

1. A property is being constructed to operate CSR activities by a company. At the balance sheet date, the cost of construction is treated as revenue expenditure. Are there any additional disclosures required in the financials regarding this?

Answer:

General Instructions for Preparation of Statement of Profit and Loss under Schedule III to the Companies Act, 2013, requires that in case of companies covered under Section 135, the amount of expenditure incurred on 'Corporate Social Responsibility Activities' shall be disclosed by way of a note to the statement of profit and loss. The note should also disclose the details with regard to the expenditure incurred in construction of a capital asset under a CSR project.

2. In the year 20X1, XYZ Ltd. falls within the purview of CSR provisions as per the Companies Act, 2013 since its net profit for the financial year exceeded Rs.5 crore. The company discharged CSR obligations in the year 20X2. However, the net profit of the year 20X2 was less than Rs.5 crores. Also, it was also not satisfying the other two criteria of the section 135 for CSR compliance. Therefore, the company stopped performing CSR activities from the year 20X3 onwards. Comment on the company's accountability for CSR.

Answer:

Once a company has fulfilled the net worth / turnover / net profit criterion for one year it has to fulfil its CSR obligations for the subsequent three financial years, even if it does not fulfil any of these criteria in those years.

In the given case, XYZ Ltd. falls in the ambit of CSR obligations by fulfilling the criteria of net profit exceeding Rs.5 crores in the year 20X1. So it has to discharge its CSR obligations by spending two percent of its average profit every year starting from 20X2 till 20X4. It cannot stop spending on CSR activities as per the Act after 20X2.

PAST EXAMINATION PAPERS, MOCK TEST PAPERS & REVISION TEST PAPER

1. What are the provisions of section 135 of the Companies Act, 2013 regarding constitution of a Corporate Social Responsibility (CSR) Committee. Also explain the role of Corporate Social Responsibility (CSR) Committee and Board. XYZ Limited is a company which has net worth of Rs. 250 crore. It manufactures parts for automobiles. The sales of the company are affected due to low demand of the products. The previous year's financial state of company are as below: Examine, whether the company has an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year.

[MAY 2018 8 Marks]

Answer:

A. As per section 135 of the Companies Act 2013

Every company having either

❖ net worth of Rs. 500 crore or more, or

❖ turnover of Rs. 1,000 crore or more or

❖ a net profit of Rs. 5 crore or more

during any financial year shall constitute a Corporate Social Responsibility (CSR) Committee of the Board consisting of three or more directors (including at least one independent director).

B. Role of Corporate Social Responsibility (CSR) Committee

The CSR Committee shall—

(a) formulate and recommend to Board

a. a CSR Policy indicating the activities to be undertaken by the company as specified in Schedule VII;

b. the amount of expenditure to be incurred on the above activities and

(b) monitor the CSR Policy of the company from time to time.

C. Role of Board

Board shall disclose-

(a) The composition of CSR Committee in its report

(b) Approve the recommended CSR Policy for the company

(c) Disclose the contents of such Policy in its report and place it on the company's website

(d) Ensure that the activities included in CSR Policy of the company are duly executed by the company

(e) Ensure that the company spends, in every financial year, at least two percent of the average net profits of the company made during the three immediately preceding financial years by giving preference to the local area and areas around it where it operates
(f) In case the company fails to spend such amount, the Board shall specify the reasons for not spending the amount.
D. In the given scenario
The MCA has clarified that 'any financial year' referred to under sub-section (1) of section 135 of the Act read with Rule 3(2) of Companies CSR Rule, 2014, implies 'any of the three preceding financial years'.
A company which meets the 'net worth', 'turnover' or 'net profits' criteria in any of the preceding three financial years, but which does not meet the criteria in the relevant financial year, is still required to constitute a CSR Committee and comply with provisions of sections 135 of the Companies Act, 2013.
As per the criteria to constitute CSR committee –
1) Net worth greater than or equal to Rs. 500 Crore: This criterion is not satisfied.
2) Sales greater than or equal to Rs. 1000 Crore: This criterion is not satisfied.
3) Net Profit greater than or equal to Rs. 5 Crore: This criterion is satisfied in financial year ended March 31, 2017 when the net profit was Rs. 8 crore.
Hence, the XYZ Ltd. is required to form a CSR committee.

2. Baby Limited manufactures consumable goods for infants like bath soap, cream, powder, oil etc. As part of its CSR policy, it has decided that for every pack of these goods sold, Rs. 0.75 will go towards the "Swachh Bharat Foundation" which will qualify as a CSR spend as per Schedule VII. Consequently, at the year end, the company sold 40,000 such packs and a total of Rs. 30,000 was recognized as CSR expenditure. However, this amount was not paid to the Foundation at the end of the financial year. Will the amount of Rs. 30,000 qualify to be CSR expenditure?
[NOV 2018 4 Marks]
Answer:
Baby Ltd. has earmarked 75 paise per pack to spend as CSR activities. However, only by earmarking the amount from such sale for CSR expenditure, the company cannot show it as CSR expenditure. To qualify the amount as CSR expenditure, it has to be spent. Hence, Rs. 30,000 will not be automatically considered as CSR expenditure till the time it is spent on CSR activities i.e it is deposited to 'Swachh Bharat Foundation'.

3. Discuss whether any unspent amount of CSR expenditure is to be provided for?
[MTP APRIL 2018 6 Marks]
Answer:
Section 135 (5) of the Companies Act, 2013, requires that the Board of every eligible company, "shall ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy". A proviso to this Section states that "if the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount". Further, Rule 8(1) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, prescribes that the Board Report of a company under these Rules shall include an Annual Report on CSR, in the prescribed format.

The above provisions of the Act/Rules clearly lay down that the expenditure on CSR activities is to be disclosed only in the Board's Report in accordance with the Rules made thereunder. In view of this, no provision for the amount which is not spent, (i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period) may be made in the financial statements. The proviso to section 135 (5) of the Act, makes it clear that if the specified amount is not spent by the company during the year, the Directors' Report should disclose the reasons for not spending the amount. However, if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, then in accordance with the generally accepted principles of accounting, a provision for the amount representing the extent to which the CSR activity was completed during the year, needs to be recognised in the financial Sstatements.

4. State whether any unspent amount of CSR expenditure (any shortfall in the amount that was expected to be spent as per the provisions of the Companies Act on CSR activities) at the reporting date shall be provided for? Also state in case the excess amount has been spent (ie more than what is required as per the provisions of the Companies Act on CSR activities), can it be carry forward to set-off against future CSR expenditure.
[MTP AUGUST 2018 5 Marks]
Answer:
i. Treatment of any unspent amount of CSR expenditure
Since the expenditure on CSR activities is to be disclosed only in the Board's Report, no provision for the amount which is not spent, (i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period) may be made in the financial statements. The Act requires that if the specified amount is not spent by the company during the year, the Directors' Report should disclose the reasons for not spending the amount. However, if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, then in accordance with the generally accepted principles of accounting, a provision for the amount representing the extent to which the CSR activity was completed during the year, needs to be recognised in the financial statements.
ii. Treatment of excess amount spent on CSR Activities
Since 2% of average net profits of immediately preceding three years is the minimum amount which is required to be spent under section 135 (5) of the Act, the excess amount cannot be carried forward for set off against the CSR expenditure required to be spent in future.

5. ABC Ltd. is a company which has a net worth of Rs. 200 crores, it manufactures rubber parts for automobiles. The sales of the company are affected due to low demand of its products.
The previous year's financials state: (Rs. in Crores)

	March 31, 20X4 (Current year)	March 31, 20X3	March 31, 20X2	March 31, 20X1
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

Required
Does the Company have an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year?
[RTP MAY 2019 | MTP OCTOBER 2019 6 Marks]

Answer:

A company which meets the net worth, turnover or net profits criteria in immediate preceding financial year will need to constitute a CSR Committee and comply with provisions of sections 135 (2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee –

1) Net worth greater than or equal to Rs. 500 Crores: This criterion is not satisfied.
2) Sales greater than or equal to Rs. 1000 Crores: This criterion is not satisfied.
3) Net Profit greater than or equal to Rs. 5 Crores: This criterion is satisfied in financial year ended March 31, 20X3 ie immediate preceding financial year.

Hence, the Company will be required to form a CSR committee.

6.

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 for as expenses of the current accounting period?

Also show its impact on deferred tax, if any. (RTP- NOV 2020)

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 31st March, 2020 by way of an Ordinance and hence, it is most unlikely for any entity to have a present obligation on 31st March, 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 31st March, 2020 as it does not meet the criteria of a present obligation as at the balance sheet date. However, the expected spend may 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 subsequent to 31st March, 2020, recognise Deferred Tax Liability as there would