PAPER – 18

CORPORATE FINANCIAL REPORTING

CMA FINAL

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Aman Mahajan (CA AIR 19)

I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test serieshelped a lot in improving my writing speed and presentation skills.

Sundar Sri Renganathan B (AIR 33)

I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

Dwarakesh

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

Yug Manoj Kumar Bhattad

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at Indigolearn.

Prakash Bhatt

Superb, one stop solution for All CA and Accountancy students they serve real Education at very very reasonable price

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Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

Bhagyasree Chougule

It was only because of Indigolearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

Mohd Thayyab

Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

Lalit Chetan Sanpal

Indigolearn has been fantastic and brilliant. Helped me alot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at Indigolearn. Really grateful. Will go for CA Finals at Indigolearn For sure. Thank you so much Indigolearn.

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Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result) because only in Accounting I got exemption. Thank you IndigoLearn.

Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from Indigolearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well.Special thanks to the FM faculty, I studied only 2 chapters in economics,and still managed to score excemption in the 8th paper.

Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

Rajalaxmi
CA Inter

Can't believe I cleared.Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

Priyanka Udeshi

All the faculties have excellent knowledge of the subject and deliver it in very crisp & effective manner. Also, quick response at Forums never let any of my doubts go unresolved no matter how small they were. Thank you once again to all the teachers & staff at IndigoLearn!

Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the facilities and forum friends who support me a lot.

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Ind AS 8
Accounting Policies, changes in Accounting Estimates and Errors

1. Introduction

1.1 Objective

- To prescribe the criteria for selecting and changing accounting policies.
- To prescribe the accounting treatment and disclosure of
  - changes in accounting policies
  - changes in accounting estimates
  - corrections of errors.
- To provide better base for inter-firm and intra-firm comparison.

1.2 Scope

The standard shall be applied in

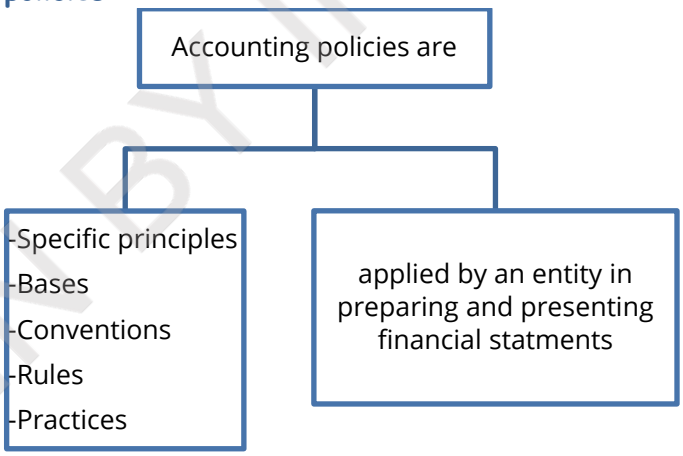
- selecting and applying accounting policies
- accounting for changes in accounting policies
- accounting changes in accounting estimates
- accounting for corrections of prior period errors.

The standard does not deal with the following

(a)	Tax effects of changes in accounting policy and correction of prior period errors	Dealt as per Ind AS 12
(b)	Disclosure of accounting policies	Dealt as per Ind AS 1

2. Definitions

2.1 Accounting policies



2.2 Accounting Estimate

Accounting estimates are monetary amounts in financial statements that are subject to material uncertainty.

2.3 Prior period errors

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

was available when financial statements for those periods were approved for issue, and

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

Errors include

- Effects of mathematical mistakes
- Mistakes in applying accounting policies
- Oversights or misrepresentations of facts
- Fraud

2.4 Retrospective application

Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

2.5 Retrospective restatement

Correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

2.6 Prospective application

Change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

- applying the new accounting policy to transactions, other events, and conditions occurring after the date as at which the policy is changed; and
- recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.

2.7 Impracticable

Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

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The effects of the retrospective application or retrospective restatement are not determinable

The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period

The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectivity information about those estimates that:

- provides evidence of circumstance that existed on the date as at which those amounts are to be recognised, measured or disclosed, and

- would have been available when the financial statements for that prior period were approved for issue from other information

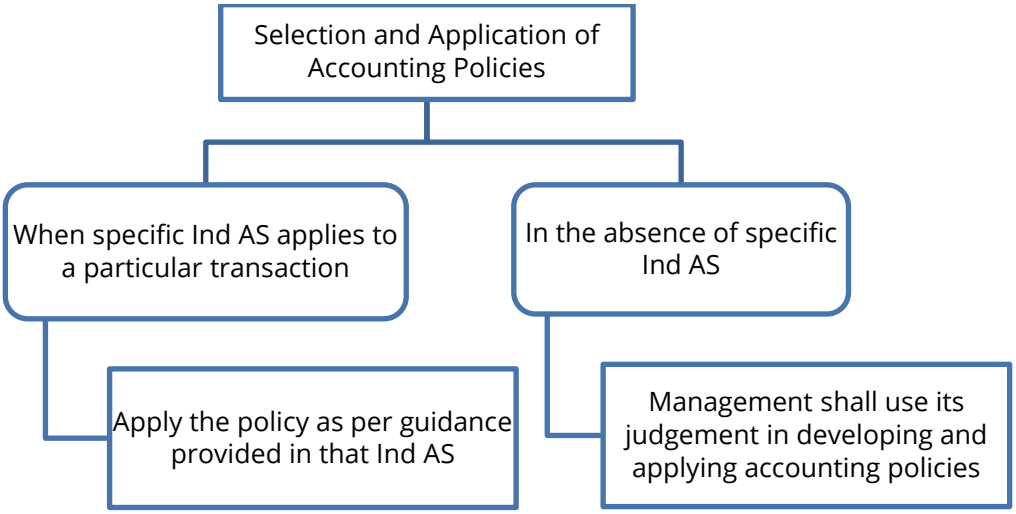
2.8 Material

- As per Ind AS 1 Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.
- Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.
- Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information.
- The following are examples of circumstances that may result in material information being obscured:
    - information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear,
    - information regarding a material item, transaction or other event is scattered throughout the financial statements,
    - dissimilar items, transactions or other events are inappropriately aggregated,
    - similar items, transactions or other events are inappropriately disaggregated, and
    - the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.

3. Accounting Policies

3.1 Selection and Application of Accounting Policies

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3.2 Selection and Application of Accounting Policies when specific Ind AS not available

Management shall use its judgement in developing and applying accounting policies that results in information that is:

- Relevant to the economic decision-making needs of users; and
- Reliable, in that the financial statements:
  - represent faithfully the financial position, financial performance and cash flows of the entity
  - reflect the economic substance of transactions, other events and conditions, and not merely the legal form
  - are neutral
  - are prudent
  - are complete in all material respects.

In making judgement, management shall refer and consider the applicability of the following sources in descending order:

Any other Ind AS available which are dealing with related and similar issues

Basic Framework of Ind AS, which provides the general principles

Pronouncements of International Accounting Standards Board

Pronouncements of other standard setting bodies having similar conceptual framework

Accounting literature and accepted industry practices

3.3 Consistency of accounting policies

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Ind AS not specifically requires or not permits categorisation of items for which different policies are apropriate	• An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions
Ind AS specifically requires or permits categorisation of items for which different policies are apropriate	• An appropraiate accounting policy shall be selected and applied consistently to each category

3.4 Changes in accounting policies

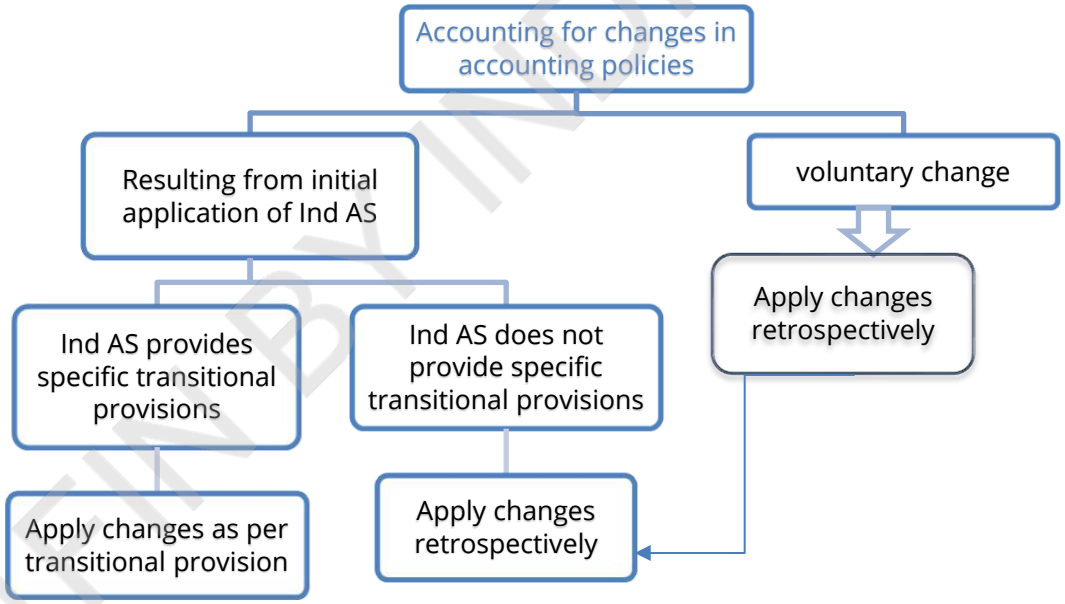
An entity shall change an accounting policy only if the change:

- Required by an Ind AS, or
- Results in the financial statements providing reliable and more relevant information.

Following are not changes in accounting policy:

- The application of an accounting policy for transactions, other events or conditions that-
  - Differ in substance
  - Did not previously occur
  - Are immaterial .

3.5 Accounting for changes in accounting policies



- Early application of Ind AS is not a voluntary change in accounting policy.
- In the absence of any specific Ind AS that specifically applies to a transaction, other event or condition, accounting policy applied from relevant IFRS, or the most recent pronouncements of International Accounting Standards Board, and subsequently there is an amendment in such IFRS or pronouncements, company may change its accounting policy, that change is considered as voluntary change and accordingly it shall apply the change retrospectively.

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3.5.1 Retrospective application

- when a change in accounting policy is applied retrospectively, the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.
- As per Ind AS1 present a third balance sheet as at the beginning of previous year if it applies accounting policy retrospectively.

3.5.2 Limitations of Retrospective application

Changes in accounting policy shall not be applied retrospective if it is impracticable to determine either the period specific effects or the cumulative effect of the change

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The entity shall apply the accounting policy as at the beginning of the earliest period for which retrospective application is practicable

3.6 Disclosure regarding the changes in Accounting Policies

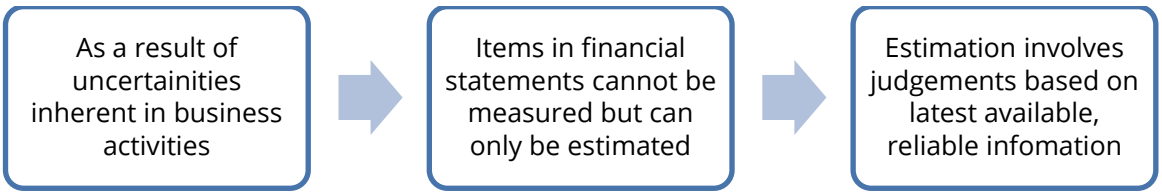
Initial application of Ind AS	•Title of Ind As •changes made in accordance with transitional provision •Natue of change in accounting policy •Transitional provision that may have effect on future periods •Description of transitional provision •Adjustments to each financial line item affected and Ind AS 33 •If retrospective application is impracticable the circumstances led to that condition and description from when changes applied
Voluntary change in accounting policy	•Nature of change •Reasons for change and whether it is reliable and relevant •Adjustments to each financial line item affected and Ind AS 33 •If retrospective application is impracticable the circumstances led to that condition and description from when changes applied

- When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:
  - This fact, and
  - 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.

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4. Accounting Estimate

4.1 Meaning



Accounting estimates are used when monetary amounts cannot be observed directly and must be estimated.

Examples:

- Loss allowance for expected credit losses as per Ind AS 109 (Bad debts),
- NRV of Inventory under Ind AS 2
- Fair value of financial assets or financial liabilities,
- Useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets,
- Depreciation expense
- Warranty obligations etc.

4.2 Change in accounting estimate

change in accounting estimate results from	•new information •more experience
Can change in estimate be related to prior periods?	•does not relate to prior periods and is not the correction of an error.
change in the measurement basis?	•change in an accounting policy, and it is not a change in an accounting estimate.
When it is difficult to distinguish a change in an accounting policy and accounting estimate	•change is treated as a change in an accounting estimate.

4.3 Accounting treatment for a change in estimate

The effect of change in an accounting estimate shall be recognised prospectively by including it in profit or loss in:

- The period of the change, if the change affects that period only
- The period of the change and future periods, if the change affects both.

4.4 Disclosure of changes in estimates

- Effect of change in estimate on the current period

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- If applicable and practicable, effect of change in estimate on future periods
- If applicable but impracticable, the fact it is impracticable to estimate the effect on future periods.

5. Errors

5.1 Meaning

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

was available when financial statements for those periods were approved for issue, and

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

5.2 Common types of Errors

Mathematical Mistakes	•Errors are called as error of commission •Examples: Wrong calculations, Carry forward of wrong balances, Errors in totals.
Mistakes in applying policies	•Assets and Liabilities and income and expenses should not be offset, unless otherwise specifically required or permitted in an Ind AS.
Misrepresentations of facts	•Whether the event is an adjusting event or a non-adjusting event if not dealt it properly may result into misrepresentation of fact.
Omissions	•The mistakes that happened due to omission to record a material transaction, perhaps, due to oversight.
Frauds	•Major theft undetected in the past.

5.3 Accounting treatment for Errors

Potential Errors of Current Period

•corrected before the financial statements are approved for issue

Prior period errors discovered subsequently

•corrected in the comparative information presented in the financial statements for that subsequent period

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Error discovered relates to the comparative prior period presented	Error discoverd relates to period before the earliest comparative prior period presented
•Unless impracticable, correct material prior period errors retrospectively by restating the comparative amounts for the prior period presented in which the error occured.	•Unless impracticable, correct the same retrospectively by restating the opening balances of assets, liabilities and equity for the earliest prior period presented •As per Ind AS 1 whenever there is a requirement of retrospective effect, an entity shall prepare previous year opening balancesheet .

5.4 Limitations on retrospective restatement

A prior period error shall be corrected by retrospective restatement if it is practicable to determine both the period specific effects or the cumulative effect of the change

The entity restates the comparative information prospectively from the earliest date practicable

5.5 Disclosure of prior period errors

- Nature of prior period error.
- Adjustments to each financial line item affected and Ind AS 33.
- If retrospective restatement is impracticable the circumstances, led to that condition and description from when errors has been corrected.

6. Difference between Ind AS 8 and AS 5

Particulars	Ind AS 8	AS 5
Objective	To prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors	To prescribe the classification and disclosure of certain items in the statement of profit or loss for uniform preparation and presentation of financial statements
Extraordinary items	Does not deal with extraordinary items	Deals with extraordinary items
Definition of Accounting policies	Broadens the definition to include bases, conventions, rules and practices	Restricts the definition to specific accounting principles and methods of applying those
Change in accounting policies	Does not deal	Allows if required by statute
Accounting for changes in accounting policies	Retrospective effect with limited exceptions	Does not specify
Errors	States that errors include frauds	Silent
Rectification of material prior period errors	Retrospective effect with limited exceptions	Prospective effect
Disclosure	More	Less

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requirements		

Illustrations

1. Illustration

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 Rs. 25,000
- Depreciation Rs. 14,000
- Net book value Rs. 11,000

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

(iv) Some results of the engineering survey:

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

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

Hint: Adoption of the new policy has no effect on prior years. Current Year – PPE Increase Rs.6,000; Deferred tax increase 1,800; Revaluation surplus – 4,200; Depreciation increase 500; Tax expense reduction 150

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2. Illustration

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?

Hint: No effect on the balance sheet at the beginning of the preceding period (1st April, 20X0). Hence, no requirement to present a third balance sheet.

3. Illustration

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?

Hint: Restate the comparative amounts (year ended 31st March, 20X2) in the statement of profit and loss; Present a third balance sheet as at 1st April, 20X1

4. Illustration

ABC Ltd has an investment property with an original cost of Rs. 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.

Hint: Revaluation to be in accordance with Ind AS 16 or Ind AS 38. Change in amortisation method should be accounted for as a change in accounting estimate

5. Illustration

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 Rs. 10 million
- 31st March, 20X2 - Increase of Rs. 15 million
- 31st March, 20X3 - Increase of Rs. 20 million

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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 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.

Hint: Change in accounting policy.

Retained earnings: 1st April 20X1- 433; 31st March 20X2 – 496; 31st March 20X3 - 569

6. Illustration

During 20X4-X5, Cheery Limited discovered that some products that had been sold during 20X3-X4 were incorrectly included in inventory at 31st March, 20X4 at Rs. 6,500.

Cheery Limited's accounting records for 20X4-X5 show sales of Rs. 104,000, cost of goods sold of Rs. 86,500 (including Rs. 6,500 for the error in opening inventory), and income taxes of Rs. 5,250.

In 20X3-X4, Cheery Limited reported:

	Rs.
Sales	73,500
Cost of goods sold	(53,500)
Profit before income taxes	20,000
Income taxes	(6,000)
Profit	14,000
Basic and diluted EPS	2.8

The 20X3-X4 opening retained earnings was Rs. 20,000 and closing retained earnings was Rs. 34,000. Cheery Limited's income tax rate was 30% for 20X4-X5 and 20X3-X4. It had no other income or expenses.

Cheery Limited had Rs. 50,000 (5,000 shares of Rs. 10 each) of share capital throughout, and no other components of equity except for retained earnings.

State how the above will be treated /accounted in Cheery Limited's Statement of profit and loss, statement of changes in equity and in notes wherever required for current period and earlier period(s) as per relevant Ind AS.

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Hint: No effect on the balance sheet at the beginning of the preceding period i.e. 1st April, 20X3 i.e No Third balance sheet required.

Financial statements of 20X3-X4 restated :

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

7. Illustration

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

Analyse the above situation in accordance with relevant Ind AS.

Hint: Understatement of the warranty provision is not a prior period errors. Additional costs are expensed in calculating profit or loss for 20X3-20X4.

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Ind AS 12

Income Taxes

1. Introduction

1.1 Objective

The objective of this Standard is to prescribe the accounting treatment for income taxes. Income taxes for the purpose of this Standard includes:

- all domestic and foreign taxes which are based on taxable profits;
- taxes, such as withholding taxes (Tax Deducted at Source), which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity

1.2 Key Terms

- **Accounting profit** is profit or loss for a period before deducting tax expense.
- **The tax base** of an asset or liability is the amount attributed to that asset or liability for tax purposes.
- **Taxable profit (tax loss)** is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).
- **Tax expense (tax income)** is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.
- **Current tax** is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.
- **Deferred tax liabilities** are the amounts of income taxes payable in future periods in respect of taxable temporary differences.
- **Deferred tax assets** are the amounts of income taxes recoverable in future periods in respect of:
    - deductible temporary differences;
    - the carry forward of unused tax losses; and
    - the carry forward of unused tax credits.

2. Recognition

2.1 Current Tax Liability

- Current tax for current and prior periods shall, to the extent unpaid, be recognised as a liability.
- The liability is estimated at the time of preparation of financial statement and actual liability is known once the assessment is completed.
- Any excess of this liability over the prepaid taxes (advance tax) and withhold taxes (TDS) is to be treated as current liability.
- This liability may be for the current reporting period or may relate to earlier reporting periods.

2.2 Current Tax Asset

If the amount paid for taxes by way of advance taxes and withholding taxes (tds), the excess is recognised as an asset.

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2.3 Measurement

Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantially enacted (e.g budget approved)

3. Deferred Taxes

A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

- the initial recognition of goodwill; or
- the initial recognition of an asset or liability in a transaction which:
  - is not a business combination; and
  - at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).
  - At the time of the transaction does not give rise to equal taxable and deductible temporary differences.

A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is **probable that taxable profit will be available** against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- is not a business combination; and
- at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).
- At the time of the transaction, does not give rise to equal taxable and deductible temporary differences

Deferred Tax is not recognised for permanent differences.

4. Carrying Amount & Tax Base

4.1 Computation of carrying amount

Carrying amount is the amount as computed in the books i.e ledger account balance. All adjustments like depreciation, impairment, revaluation must be given effect to.

4.2 Computation of Tax Base of an asset

- Tax base is the amount attributed to the asset or liability as per income tax for tax purposes.
- The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.

Example

- WDV of a capital asset would be the tax base which would be deductible subsequently as depreciation. If an asset is sold, the WDV would be deductible while computing capital gains.
- Carrying amount of an inventory is deductible as cost of goods sold when inventory is sold.

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- If economic benefit from an asset is not taxable then the tax base is equal to the carrying amount. Hence in such cases difference would be zero and there would not be any deferred tax.

4.3 Computation of Tax Base of a liability

- The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods.
  Example
  - Current liabilities include accrued expenses with a carrying amount of Rs. 100. The related expense will be deducted for tax purposes on a cash basis.
    The tax base of the accrued expenses is nil.
  - Current liabilities include accrued expenses with a carrying amount of Rs. 100. The related expense has already been deducted for tax purposes.The tax base of the accrued expenses is Rs. 100.
- If liabilities are not deductible, the tax base of liability is equal to carrying amount.

4.4 Computation of Tax base where carrying amount is Nil

In such cases the tax base is the amount that would be allowed as deduction in future. Preliminary expenses are expensed fully in accounts but are allowed over a period of 5 years under Income Tax Act, 1961. So the carrying amount would be Nil and the tax base at end of first year would be $4/5^{th}$ of the amount.

5. Temporary Differences

Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

Taxable	Deductible
that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled;	that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled
Carrying Amount of Asset > Tax Base	Carrying Amount of Asset < Tax Base
Carrying Amount of Liability < Tax Base	Carry Amount of Liability > Tax Base
Deferred Tax Liability	Deferred Tax Asset

Differences may arise due to –

- Difference in depreciation calculation
- Expenses being allowed differently under tax provisions
- Revaluation of assets in books but the income tax reporting is done using historical cost
- Income being taxed on cash basis or expenses being allowed on cash basis.
- Fair valuation during business combination (Refer Ind AS 103)
- Goodwill arising due to business combination

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5.1 Exceptions

5.1.1 Goodwill arising on business combination

- No deferred Tax Liability is recognised on taxable temporary differences which arises on Goodwill which is not tax deductible
- If Goodwill is tax deductible, deferred tax liability or asset is recognised.

5.1.2 Initial recognition of asset or liability

Deferred Tax Asset/Liability is not recognised in case of

- A transaction which is not a business combination &
- It does not affect accounting profit or taxable profit.

Example - Entity A acquires a foreign made vehicle for Rs. 1,00,000 directly from the vehicle manufacturer. The transaction is not a part of any business combination. The tax laws do not permit any depreciation thereon. Also, any profits at the time of sale are not taxable or losses are not tax deductible. This vehicle thus has a tax base of Nil. There is a taxable temporary difference of Rs. 1,00,000. Assuming a tax rate of 30%, the entity should create a deferred tax liability of Rs. 30,000. But the Standard does not permit recognition of DTA/DTL in such cases.

5.1.3 Temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures

Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest.

No DTL recognised if	DTA is recognised if
the parent, investor or venturer is able to control the timing of the reversal of the temporary difference	the temporary difference will reverse in the foreseeable future;
it is probable that the temporary difference will not reverse in the foreseeable future.	Taxable profit will be available against which the temporary difference would be utilised.

5.2 Assessment of future profits for DTA

An entity should recognise deferred tax assets only when it is probable (> 50% chance) that sufficient taxable profits will be available against which the deductible temporary differences can be utilised. This is based on the principle of prudence and conservatism.

5.3 Unused Tax Losses and Tax Credits

- A deferred tax asset shall be recognised for the carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

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- The reason for recognising deferred tax asset is that the tax liability would be lesser in future
- the existence of unused tax losses is strong evidence that future taxable profit may not be available.
- If the entity has history of losses, deferred tax asset should be recognised only to the extent of amount that the entity has as taxable temporary differences or strong evidence that there would be taxable profits in future.
- At the end of each reporting period, the entity should reassess unrecognised deferred tax assets. It may need to recognise a previously unrecognised deferred tax asset to the extent it has now become probable that future taxable profits will be available for deferred tax assets to be recovered

6. Tax Rates

Deferred tax assets and liabilities shall be measured:

- at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled;
- based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.
- Enacted – Already in force
- Substantively enacted – Formalities are completed but not yet enacted. Like budget presented and passed but president has not yet assented.
- If different tax rates are applicable for different types/slabs of income, use the appropriate tax rates at which recovery would be done.

7. Accounting Entries

Current Tax	Dr. Income Tax expense – Current Cr. Income Tax Payable
Deferred Tax Asset	Dr. Deferred Tax Asset Cr. Income tax benefit – Deferred
Deferred Tax Liability	Dr. Income Tax expense – Deferred Cr. Deferred Tax Liability
Tax Expense (PL)	Current Tax + Deferred Tax Expense – Deferred Tax Benefit
Deferred Tax (BS)	Shown at Net Amount

- Deferred Taxes are not discounted.
- Deferred Taxes are always shown as non current
- Deferred Tax expense/benefit are reported in P&L or OCI depending upon the items which have resulted the deferred tax.

8. Offsetting Deferred Tax Asset & Liabilities

An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

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- the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
- the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
    - the same taxable entity; or
    - different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously.

9. Practical Application

9.1 Business Combination

- an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date.
- an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill (because of circular computation)
  [Recognising DTL will reduce net assets which will again increase goodwill]
- As a result of a business combination, the probability of realising a pre-acquisition deferred tax asset of the acquirer could change. An acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised before the business combination.
- The potential benefit of the acquiree's income tax loss carry forwards or other deferred tax assets might not satisfy the criteria for separate recognition when a business combination is initially accounted for but might be realised subsequently.
    - If the new information is obtained in the measurement period (refer IndAS 103), adjustments would be made in assets/liabilities and goodwill/bargain purchase capital reserve.
    - All other adjustments are recognised in P&L or OCI subsequently.

9.2 Share Based Payments

- Share based payments are recognised as expense as per Ind AS 102.
- The deduction for the purpose of taxation would be available when employees exercise the share options.
- The amount that would be available as deduction in the future would be the tax base and carrying amount would be Nil.
- An entity recognises deferred tax asset for the temporary difference.
- If the deductible amount is greater than the expense recognised in P&L, the balance reprsents amount attributable to equity. Deferred tax should be recognised in P&L and Equity accordingly.

9.3 Change in Tax Status

- A change in the tax status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised outside profit or loss.
- The current and deferred tax consequences of a change in tax status shall be included in profit or loss for the period,

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- unless those consequences relate to transactions and events that result,in the same or a different period,
- in a direct credit or charge to the recognised amount of equity or in amounts recognised in other comprehensive income.

- Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in profit or loss), shall be charged or credited directly to equity.
- Those tax consequences that relate to amounts recognised in other comprehensive income shall be recognised in other comprehensive income

10. Presentation

10.1 Presentation - Offset

An entity shall offset current tax assets and current tax liabilities if, and only if, the entity:

- has a legally enforceable right to set off the recognised amounts; and
- intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

- the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
- the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
  - the same taxable entity; or
  - different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

10.2 Tax expense

- The tax expense (income) related to profit or loss from ordinary activities shall be presented as part of profit or loss in the statement of profit and loss
- the aggregate current and deferred tax relating to items that are charged or credited directly to equity
- the amount of income tax relating to each component of other comprehensive income

11. Disclosures

The major components of tax expense (income) shall be disclosed separately.

(a) current tax expense (income);

(b) any adjustments recognised in the period for current tax of prior periods;

(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;

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(e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;
(f) the amount of the benefit from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce deferred tax expense;
(g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 56; and
(h) the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with Ind AS 8, because they cannot be accounted for retrospectively

Relationship between tax expense (income) and accounting profit in either or both of the following forms:

- a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s)
- a numerical reconciliation between the average effective tax rate and the applicable tax rate

Other Disclosures

- an explanation of changes in the applicable tax rate(s) compared to the previous accounting period;
- the amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet;
- the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint arrangements, for which deferred tax liabilities have not been recognised
- in respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:
- the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;
- the amount of the deferred tax income or expense recognised in profit or loss, if this is not apparent from the changes in the amounts recognised in the balance sheet;
- in respect of discontinued operations, the tax expense relating to:
- the gain or loss on discontinuance; and
- the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented;
- the amount of income tax consequences of dividends to shareholders of the entity that were proposed or declared before the financial statements were approved for issue, but are not recognised as a liability in the financial statements;
- if a business combination in which the entity is the acquirer causes a change in the amount recognised for its pre- acquisition deferred tax asset, the amount of that change; and
- if the deferred tax benefits acquired in a business combination are not recognised at the acquisition date but are recognised after the acquisition date, a description of the event or change in circumstances that caused the deferred tax benefits to be recognised.

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An entity shall disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

(a) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and

(b) the entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

12. Ind AS 12 vs AS 22

Ind AS 12 is based on balance sheet approach. It requires recognition of tax consequences of differences between the carrying amounts of assets and liabilities and their tax base.	AS 22 is based on income statement approach. It requires recognition of tax consequences of differences between taxable income and accounting income. For this purpose, differences between taxable income and accounting income are classified into permanent and timing differences.
As per Ind AS 12, current and deferred tax are recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction or event which is recognised outside profit or loss, either in other comprehensive income or directly in equity, in those cases tax is also recognised in other comprehensive income or in equity, as appropriate.	AS 22 does not specifically deal with this aspect.
Ind AS 12 provides guidance as to how an entity should account for the tax consequences of a change in its tax status or that of its shareholders.	AS 22 does not deal with this aspect.
Since the concept of virtual certainty does not exist in Ind AS 12, this explanation is not included.	AS 22 explains virtual certainty supported by convincing evidence.
Ind AS 12 does not provide guidance on tax holiday	AS 22 specifically provides guidance regarding recognition of deferred tax in the situations of Tax Holiday

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Illustrations

1. Illustration

Given,

- Cost of Machine – Rs.1,00,000
- Useful life – 5 years
- Deprecation for Tax – 25% on SLM
- Tax Rate – 30%

Based on the above, compute

(i) Carrying amount as per books

(ii) Tax base

(iii)Check if there is any deferred tax asset or liability and compute deferred tax impact.

2. Illustration

An entity has a deductible temporary difference of Rs. 50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profits up to Rs. 60,000. The cost of implementing this tax planning strategy is Rs. 12,000. The tax rate is 30%. Compute the deferred tax asset that should be recognised.

3. Illustration

A Limited recognises interest income in its books on accrual basis. However, for income tax purposes the method is 'cash basis'. On December 31, 20X1, it has interest receivable of Rs. 10,000 and the tax rate was 25%. On 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.

4. Illustration

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 Rs. 9,000. These are expected to reverse equally over next 3 years.

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

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on 31st March, 20X1.

5. Illustration

On 1st April 20X1, S Ltd. leased a machine over a 5 year period. The present value of lease liability is Rs. 120 Cr (discount rate of 8%) and is recognized as lease liability and corresponding Right of

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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 Rs. 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 .

6. Illustration

On 1 April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of Rs. 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 Rs. 2.00.

On 1 April 20X1, the individual financial statements of B Ltd. showed the net assets at Rs. 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 Rs. 15 Cr at 1 April 20X1 had an estimated market value of Rs. 18 Cr at that date.
- Plant and equipment having a carrying value of Rs. 11 Cr at 1 April 20X1 had an estimated market value of Rs. 13 Cr at that date.
- Inventory in the books of B Ltd. is shown at a cost of Rs. 2.50 Cr. The fair value of the inventory on the acquisition date is Rs. 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.

7. Illustration

On 1st April 20X1, ABC Ltd acquired 100% shares of XYZ Ltd for Rs. 4,373 crore. By 31st March, 20X5, XYZ Ltd had made profits of Rs. 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.

8. Illustration

A Ltd. acquired B Ltd. The following assets and liabilities are acquired in a business combination:

'000

	Fair Value	Carrying amount	Temporary Difference
Plant and Equipment	250	260	(10)
Inventory	120	125	(5)
Debtors	200	210	(10)

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	570	**595**	**(25)**
9% Debentures	(100)	(100)	
	470	**495**	
Consideration paid	500	500	
Goodwill	**30**	**5**	**(25)**

Calculate Deferred Tax Asset.

9. Illustration

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

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

(ii) Just before 31st March, 2018, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore, X Ltd. recognised a provision for closure costs of Rs. 20,00,000 in its statement of financial position as at 31st March, 2018. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31st March 2019, X Ltd. expects to make taxable profits which are well in excess of Rs. 20,00,000. On 31st March, 2018, X Ltd. had taxable temporary differences from other sources which were greater than Rs. 20,00,000.

(iii) During the year ended 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 Rs. 16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January, 2018. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 2018.

(iv) On 1st April, 2017, X Ltd. borrowed Rs. 1,00,00,000. The cost to X Ltd. of arranging the borrowing was Rs. 2,00,000 and this cost qualified for a tax deduction on 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 Rs. 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of Rs. 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31st March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%.

10. Illustration

On 1 January 2020, entity H acquired 100% share capital of entity S for Rs.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.

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Acquisitions	Book values Rs.'000	Tax base Rs.'000	Fair values Rs.'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.

11. Illustration

In 20X2, an entity has accounting profit in its own jurisdiction (country A) of Rs. 1,500 (20X1: Rs. 2,000) and in country B of Rs. 1,500 (20X1: Rs. 500). The tax rate is 30% in country A and 20% in country B. In country A, expenses of Rs. 100 (20X1: Rs. 200) are not deductible for tax purposes.
Compute the tax expense combined under both the jurisdictions.

Hint: 20X2 - 780 & 20X1 - 760

12. Illustration

A's Ltd. profit before tax according to Ind AS for Year 20X1-20X2 is Rs. 100 thousand and taxable profit for year 20X1-20X2 is Rs. 104 thousand. The difference between these amounts arose as follows:
1. On 1st February, 20X2, it acquired a machine for Rs. 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 10 years according to Ind AS as well as for tax purposes.
2. In the year 20X1-20X2, expenses of Rs. 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.

13. Illustration

A Ltd prepares financial statements to 31 March each year. The rate of income tax applicable to A Ltd is 25%. 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 Rs. 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

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Ltd's investment in L Ltd was Rs. 70 Cr on 31 March 20X1 and Rs. 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 Rs. 40 Cr and its tax base was Rs. 22 Cr. During the year ended 31 March 20X2, A Ltd charged depreciation in its statement of profit or loss of Rs. 2 Cr and claimed a tax deduction for tax depreciation of Rs. 1.25 Cr. On 31 March 20X2, the building was revalued to Rs. 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

14. Illustration

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 Rs. 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 Rs. 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 Rs. 80,000. The goods had cost to K Ltd for Rs. 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 Rs. 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 Rs. 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, Rs. 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%.

15. Illustration

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:

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Deferred tax asset Rs. 80,000
Deferred tax liability Rs. 60,000

Of the deferred tax asset balance, Rs. 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.

16. Illustration – Nov 22 [8 Marks]

Following is the summarized Statement of Profit and Loss of New Age Ltd. as per Ind AS for the year ended 31.3.2022:

Particulars	Rs. in lakhs
Revenue from operations	1,450.00
Other income	70.00
(A) Total income	1,520.00
Purchase of stock in trade	50.00
Changes in inventories of stock in trade	20.00
Employee benefit expenses	145.00
Finance costs	180.00
Other expenses	375.00
(B) Total expenses	770.00
(C) Profit before tax (A - B)	750.00
(D) Current tax expense	211.65
(E) Profit after tax (C - D)	538.35

Additional information:
(1) Consider that Income tax rate applicable to New Age Ltd. in India is 30%.
(2) 'Other expenses' include the following expenses which are not deductible for income tax purposes:
(i) Penalties Rs. 1.50 lakh
(ii) Donations Rs. 55.00 lakhs
(iii) Impairment of goodwill Rs. 7.00 lakhs
(3) 'Other expenses' also include expenditure on Scientific Research amounting to Rs. 10 lakhs in respect of which a 150% weighted deduction is available under income tax laws.
(4) 'Other income' includes:
(i) Dividends of Rs. 5 lakhs, which is exempt from tax.
(ii) Long term capital gains of Rs. 12 lakhs which are taxable at the rate of 10%.
(5) 'Profit before tax of Rs. 750 lakhs' includes:
(i) Agriculture income of Rs. 65 lakhs which is exempt from tax; and

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(ii) Profit of Rs. 75 lakhs earned in USA on which New Age Ltd. has paid tax at the rate of 20%.

During review of financial statements of New Age Ltd., the CFO multiplied profit before tax by the income tax rate and arrived at Rs. 225 lakhs as the tax expenses. However, the actual income tax expenses appearing in the summarized Statement of Profit and Loss is Rs. 211.65 lakhs.
You are required to help the CFO of the company in reconciling the difference between the tax expense amount.

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Ind AS 16
PROPERTY, PLANT AND EQUIPMENT

1. Introduction

1.1 Objective

- To prescribe accounting treatment of property, plant and equipment.
- Recognition of assets.
- Determination of carrying amont and depreciation charges
- Depreciation, retirement and disposal accounting.

1.2 Scope

PPE are generally grouped into various classes like land and buildings, machinery, ships, aircrafts, furniture, bearer plants etc.

This standard does NOT deal with the following.

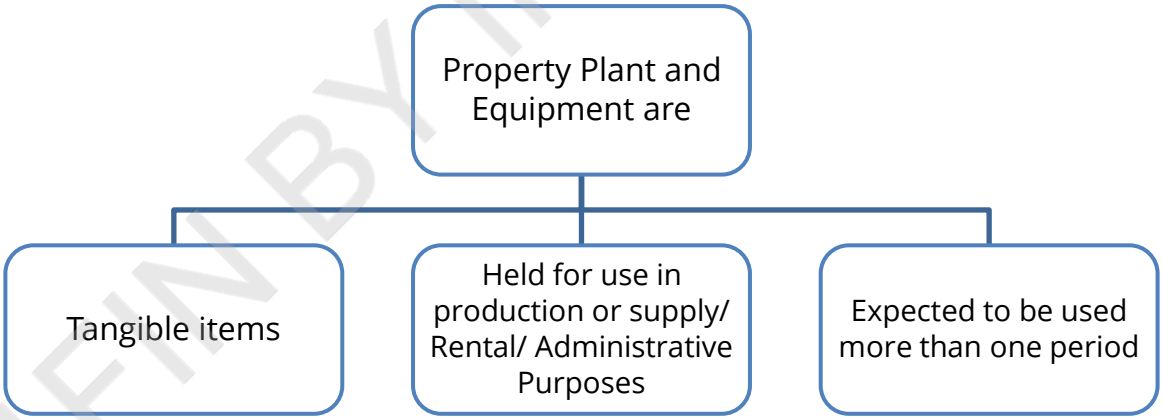
(a)	PPE classified as held for sale	Dealt as per Ind AS 105
(b)	Biological assets related to agricultural activity other than bearer plants	Dealt as per Ind AS 41
(c)	Recognition and measurement of exploration and evaluation assets	Dealt as per Ind AS 106
(d)	Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources	No Ind AS exists. Industry rules and regulations are followed.

This Standard applies to property, plant and equipment used to **develop or maintain** the assets described in (b)-(d).

Investment property under Ind AS 40 shall use the cost model under this standard for owned investment property.

2. Definitions

2.1 Property, Plant and Equipment



2.2 Bearer Plant

Bearer plant is a living plant that

(a) Is used in the production/supply of agricultural produce

(b) Is expected to bear produce for more than a period of twelve months

(c) Has a remote likelihood of being sold as an agricultural produce, except for incidental scrap sales.

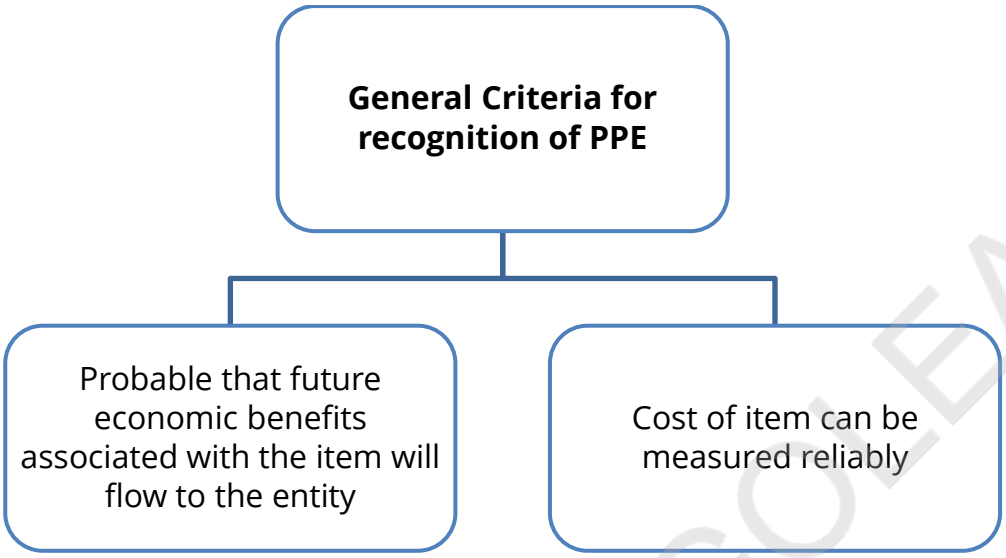


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2.3 Carrying Amount

Gross Book Value	xxx
(-) Accumulated Depreciation	xxx
(-) Accumulated Impairment Loss	xxx
Carrying Amount	**xxx**

3. Recognition



Spare parts, stand-by equipment, and servicing equipment:

Recognised in accordance with this Ind AS when they meet the definition of PPE. Otherwise, such items are classified as inventory (Ind AS 2) and charged to statement of profit or loss when it is issued for usage.

Aggregation of individually insignificant items:

It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the recognition criteria to the aggregate value.

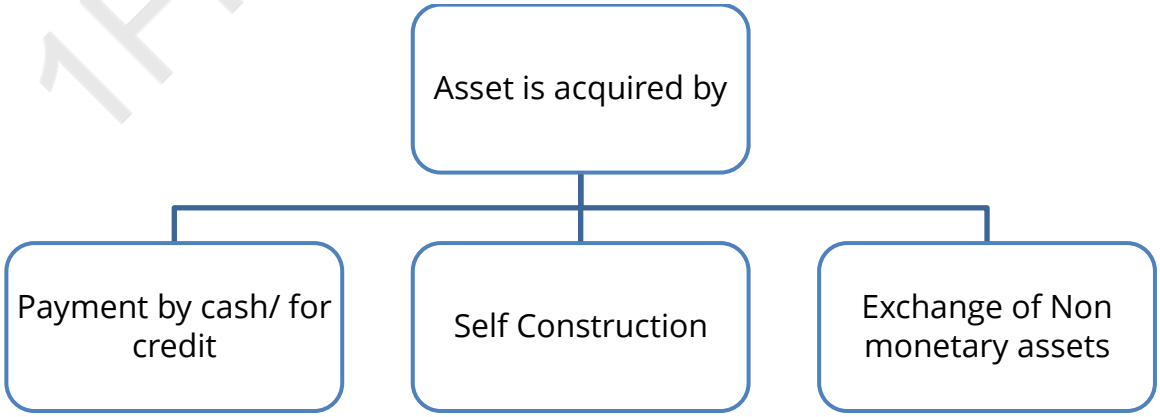
Other important points:

Items of PPE may be acquired for safety or environmental reasons. These may be necessary for an entity to obtain the future economic benefits from its other assets. (Indirect benefits)

Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets more than what could be derived had those items not been acquired.

4. Measurement at Recognition

An item of property, plant and equipment that qualifies for recognition as an asset should **be initially measured at its cost**. Amount to be capitalised is based on the nature of consideration paid for the asset.



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4.1 If asset is purchased by payment of cash or credit.

The cost of an item of PPE comprises

Purchase Price	xxx
Add:	
Non-refundable taxes and duties	xxx
Initial delivery and handling charges	xxx
Cost of site preparation	xxx
Installation & Assembly costs	xxx
Professional Fees	xxx
Borrowing costs (If permitted by Ind AS 23)	xxx
Costs of testing – Net Sale Proceeds *If net sale proceeds is greater than cost of testing, the amount is deducted from the cost.	xxx
Present Value of Decommissioning, restoration costs (In accordance with Ind AS 37)	xxx
Any directly attributable cost to bring the asset to the location and condition, necessary to **operate for its purpose intended** by the management	xxx
Less:	
Government grant received specific to the asset (Ind AS 20)	xxx
Trade discounts and rebates (If included in above costs)	xxx
Cost of PPE to be capitalised	**xxxx**

5.1.1 Exclusions from Cost of PPE

(a) Costs of conducting business in a new location or with a new class of customer (including costs of staff training)

(b) Costs incurred in introducing a new product or service.

(c) Cost of opening a new facility

(d) Administrative and other general overhead costs

> The income and related expenses of incidental operations are recognised in profit or loss

4.2 Self – Constructed PPE

The cost of a self-constructed asset is determined using the same principles as for an acquired asset.

Inclusions:

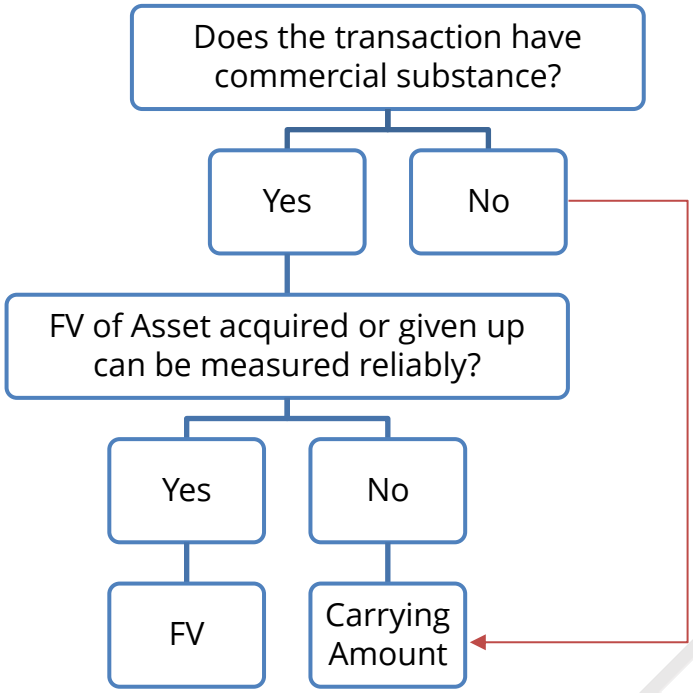
- Costs of construction that directly relate to the specific assets
- Costs that can be attributable or allocated to the construction activity.
- Borrowing costs if PPE is a qualifying asset as per Ind AS 23

Exclusions:

- Internal profits (Always take cost of construction and not sale price)
- The cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset.

4.3 PPE is acquired by exchange of non-monetary assets

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If both the above conditions are satisfied, PPE is measured at

(a) Fair value of asset given up (1st Preference)

(b) Fair value of asset received

If both are available, consider whichever is more clearly evident.

If above conditions are not satisfied, PPE is measured carrying amount of the asset given up.

Commercial Substance:

An exchange transaction has commercial substance if:

(a) The risk, timing, and amount of the cash flows of the asset received are significantly different from the cash flows of the asset transferred.

(b) There is a significant effect on the present value of the after tax cash flows that an entity expects to arise from the continuing use and disposal of the asset due to exchange transaction.

Fair Value of the Asset:

The fair value of an asset is reliably measurable if:

a) The variability in the range of reasonable fair value measurements is not significant for that asset

b) The probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value.

If the PPE is acquired by issuing shares of the entity, it will be dealt separately by Ind AS 102 – Share based payments

4.4 Cost of Bearer Plants

All the cost of activities necessary to cultivate the bearer plants before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Costs incurred in using or redeploying an item are not included in the carrying amount of that item

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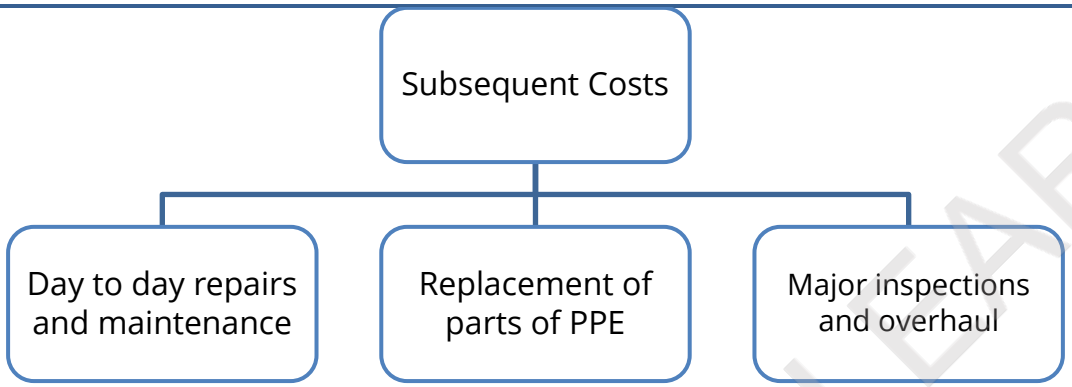
5. Cessation of Capitalisation

Recognition of costs to carrying amount of PPE ceases when the item is in the

- location and
- condition
- necessary for it to be capable of operating in the manner
- intended by management.

For Example, Initial operating losses, cost of relocating or reorganising entity's operations are not included in the cost of PPE.

6. Subsequent Costs



6.1 Repair and maintenance

Recognised in profit or loss as incurred.

6.2 Replacement of parts of PPE

Parts of some items of PPE may require replacement at regular intervals.

> Entity should capitalise the cost of replacement as a component of PPE and depreciate such cost over its useful life.

The carrying amount of those parts that are replaced should be derecognised.

6.3 Major Inspections or overhauls

A condition of continuing to operate an item of property, plant, and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced.

> When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant, and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection is derecognised.

The inspection costs are recognised irrespective of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed.

If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

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7. Deferred credit period

The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. The difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with Ind AS 23.

8. Depreciation

The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

Historical cost/ Revalued Amount	xxx
Less: Estimated residual value	xx
Depreciable Amount	xxx

The depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.

Commencement of Depreciation	**When the asset is available to use.** i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.
Cessation of Depreciation	Ceases at the earliest of (a) The asset is classified as held for sale or included in disposal group that is classified as held for sale (As per Ind AS 105) (b) Date on which the asset is derecognised.

> Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

8.1 Component Accounting for depreciation

An asset may consist of different and significant physical components. If an item of PPE comprises two or more significant components, with substantially different useful lives, usage, or flow of economic benefits, then each component should be recognised and depreciated separately over its individual useful life.

When significant component is replaced or restored, the old component is derecognised, and the cost of new component is capitalised.

> Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

If the cost of land includes the costs of site dismantlement, removal, and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs.

A combination of more than one depreciation method is sometimes used depending upon type, nature of circumstances for significant parts one PPE.

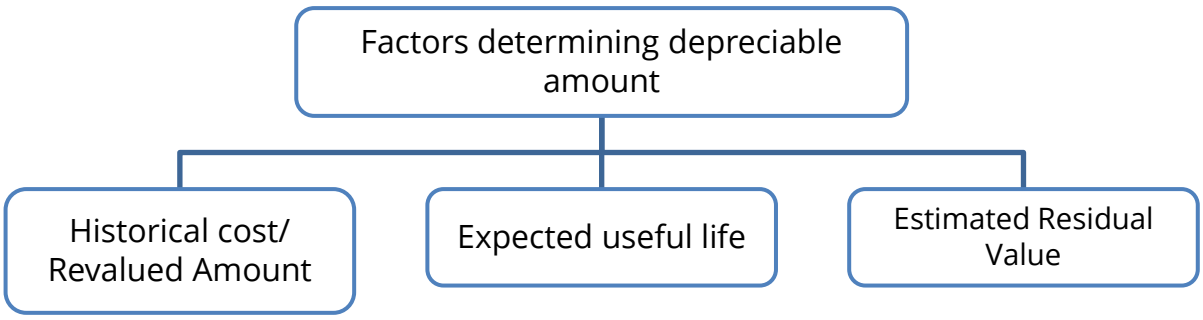
For Example:

Entity can follow WDV method for aircraft engine whereas SLM for aircraft body.

> In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

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8.2 Factors Determining Depreciable Amount



Depreciable amount is determined based on the following three factors

(a) Historical cost/ Revalued Amount

(b) Expected useful life of the depreciable asset.

(c) Estimated residual value of the depreciable asset.

8.2.1 Useful life of an asset -

Useful life is

(a) the period over which an asset is expected to be available for use by an entity

(b) the number of production or similar units expected to be obtained from the asset by an entity.

The following factors are considered in determining the useful life of an asset

- Expected usage of the asset.
- Expected physical wear and tear (Depends on operational factors)
- Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
- Legal or similar limits on the use of the asset.

The useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets

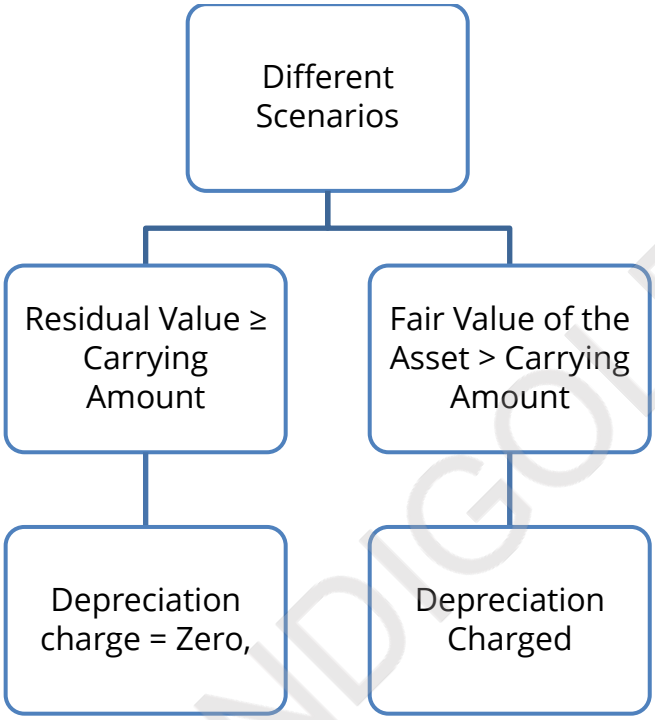
8.2.2 Residual Value

It is an estimated amount, which can be recovered from the asset at the end of its useful life. Residual value is a current estimat based on similar assets which would have reached the end of their useful life. The estimation is made by the management at the time of acquisition. If the estimated residual value is insignificant, value is considered as NIL.

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The residual value and the useful life should be reviewed at least at the end of financial year. Any change from expectations should be accounted for as a change in an accounting estimate (Ind AS 8)

Remaining depreciable amount should be depreciated over the remaining revised useful life.



8.3 Depreciation Method

The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

For Example:

Straight line depreciation	Constant charge over the useful life
Diminishing Balance Method	Decreasing charge over the useful life
Units of Production method	Charged based on expected use or output

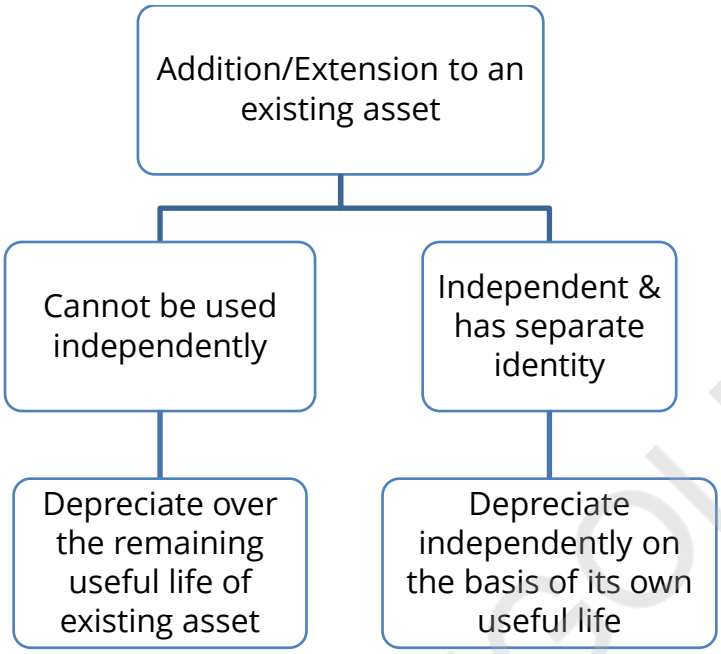
The management should consider **true & fair** view, **prudence**, **substance over form** and **materiality** while selecting depreciation method.

Depreciation charge **can be zero** if the entity follows number of units production basis for depreciation and **if no production happens** in a particular year. (But needs to **test for impairment** as per Ind AS 36)

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Depreciation method should **not be based on** ratio of revenue as **revenue** generated depends upon demand, supply, inflation, sales volume, and prices.

8.4 Depreciation of an addition/ extension to an existing PPE

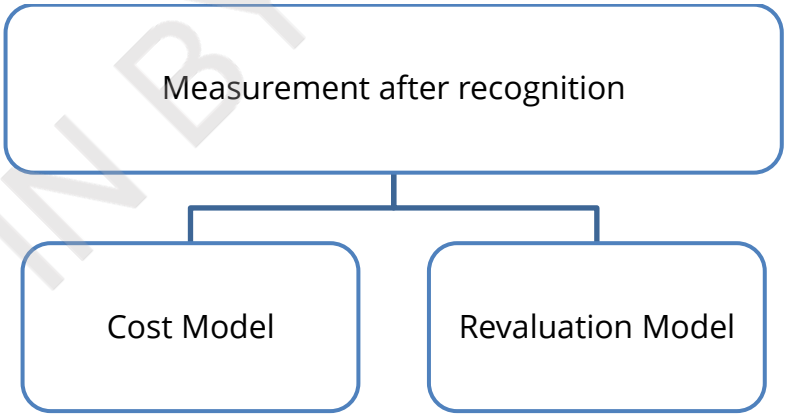


9. Impairment

Entity must calculate the recoverable amount in accordance with Ind AS 36.

Compensation from third parties for items of PPE that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

10. Measurement After recognition



10.1 Cost Model

Initial Cost	xxx
(-) Accumulated Depreciation	xxx
(-) Accumulated Impairment Loss	xxx
Carrying Amount	**xxx**

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10.2 Revaluation Model

Fair Value at the date of revaluation	xxx
(-) Subsequent Accumulated Depreciation	xxx
(-) Subsequent Accumulated Impairment Loss	xxx
Carrying Amount	**xxx**

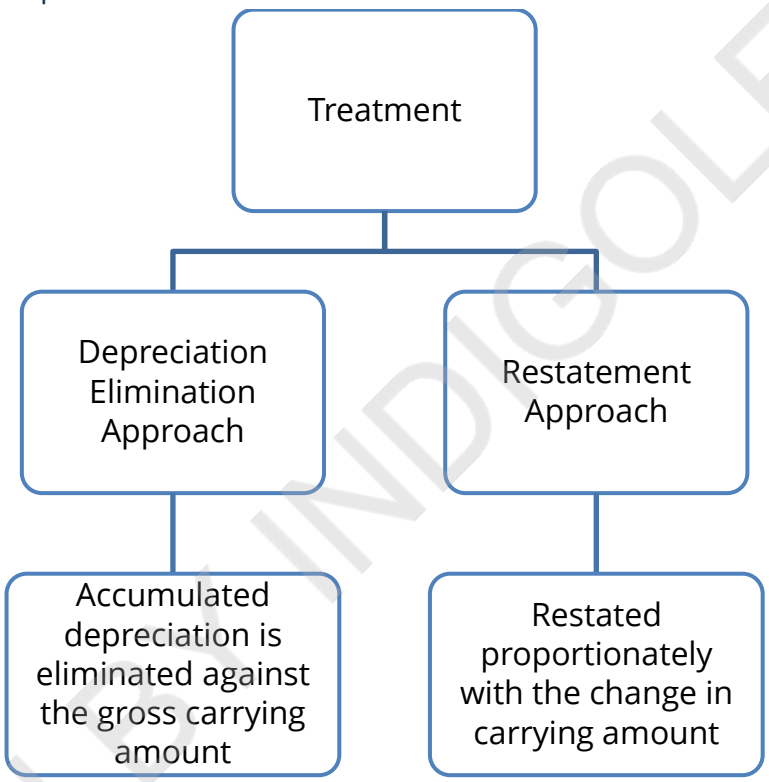
Revaluations are required to be carried out with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

8.2.1 Frequency of revaluations

The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued.

If PPE experience significant and volatile changes in fair value, there must be annual revaluation. Otherwise, it may be necessary to revalue the item only every three or five years.

8.2.2 Accumulated Depreciation at the date of revaluation



Restatement approach is used when an asset is revalued by means of applying an index to determine depreciated replacement cost

8.2.3 Limit on Revalued Amount -

The revalued amount should not be more than the recoverable amount (As per Ind AS 36)

8.2.4 Revaluation to be made for entire class of assets -

Revaluation should be performed for an **entire class of PPE**.

For Example: If the entity takes a decision to revalue its buildings, it should revalue all the buildings of the entity. i.e., revaluation of selective assets within a class is not permitted.

The entity can divide the PPE into classes based on the nature of items such as land, land and buildings, machinery, ships, aircraft, motor vehicles, furniture and fixtures, office equipment, bearer plants.

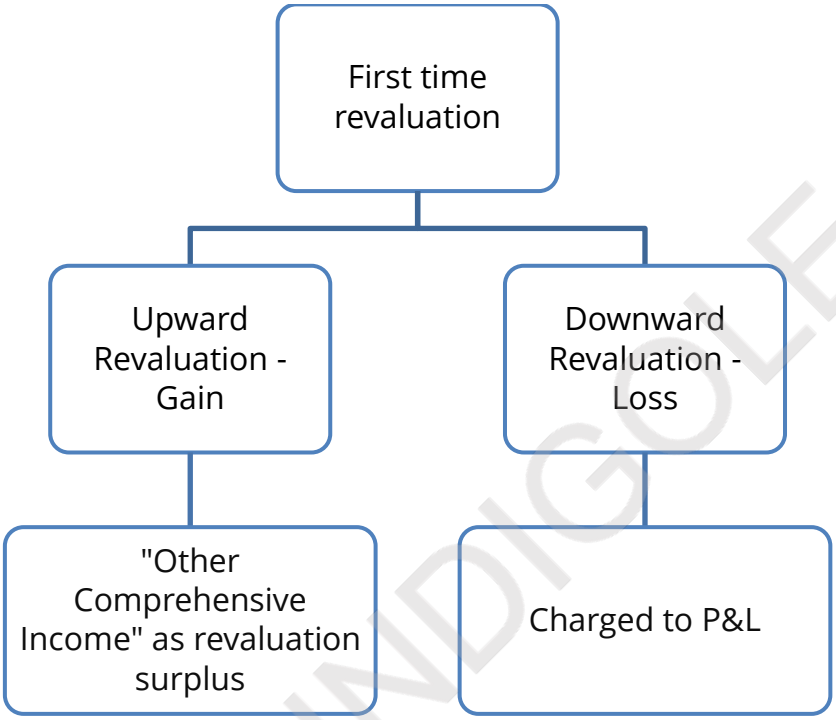
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The items within a class of PPE are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates.

8.2.5 Revaluation Accounting

The entity can do revaluation any number of times and it can be upward or downward revaluation.

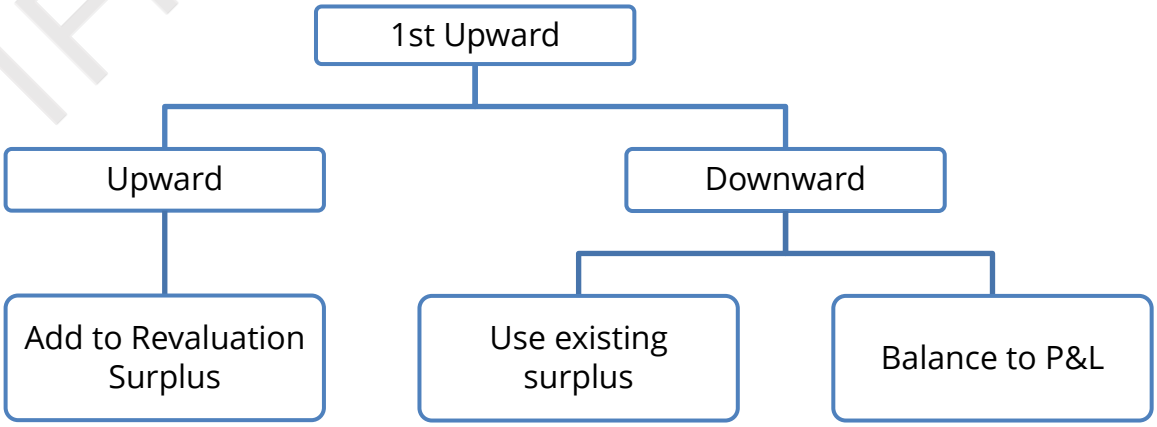
First Time Revaluation:



Upward Revaluation	PPE A/c To Revaluation Surplus A/c (OCI)	**Dr**
Downward Revaluation	Profit & Loss A/c To PPE A/c	**Dr**

Subsequent Revaluation:

(a) If first time is upward revaluation



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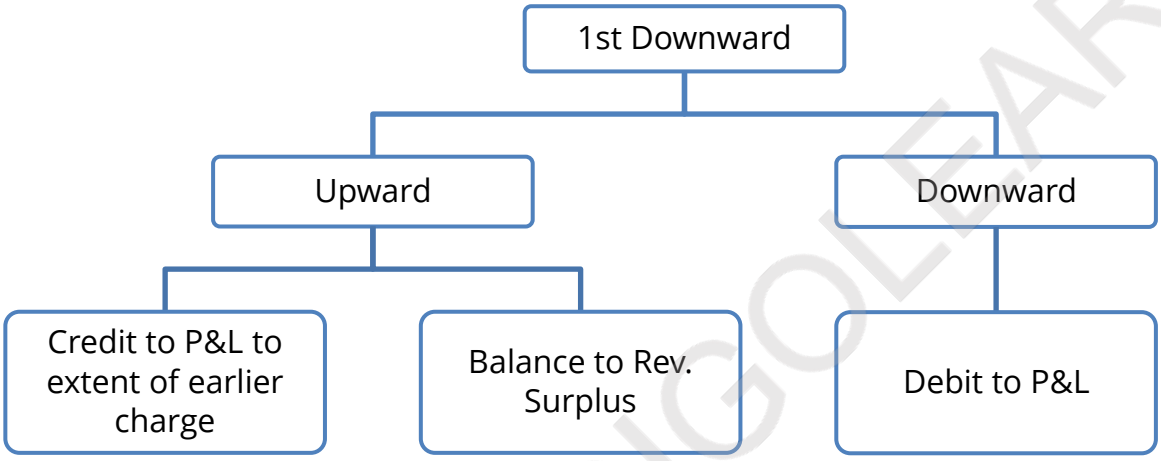
Subsequent upward revaluation – Further increase should be recognised in "Other Comprehensive Income" (OCI) and accumulated in equity under revaluation surplus.

PPE A/c **Dr**
To Revaluation Surplus A/c (OCI)

Subsequent downward revaluation – Utilise the available revaluation surplus and remaining balance should be charged to statement of profit and loss.

Revaluation Surplus A/c **Dr** (OCI)
Statement of Profit & Loss A/c **Dr** (Balancing Figure)
To PPE A/c

(b) If first time is downward revaluation



Subsequent downward revaluation – Further decrease should be transferred to statement of profit and loss.

Profit and Loss A/c **Dr**
To PPE A/c

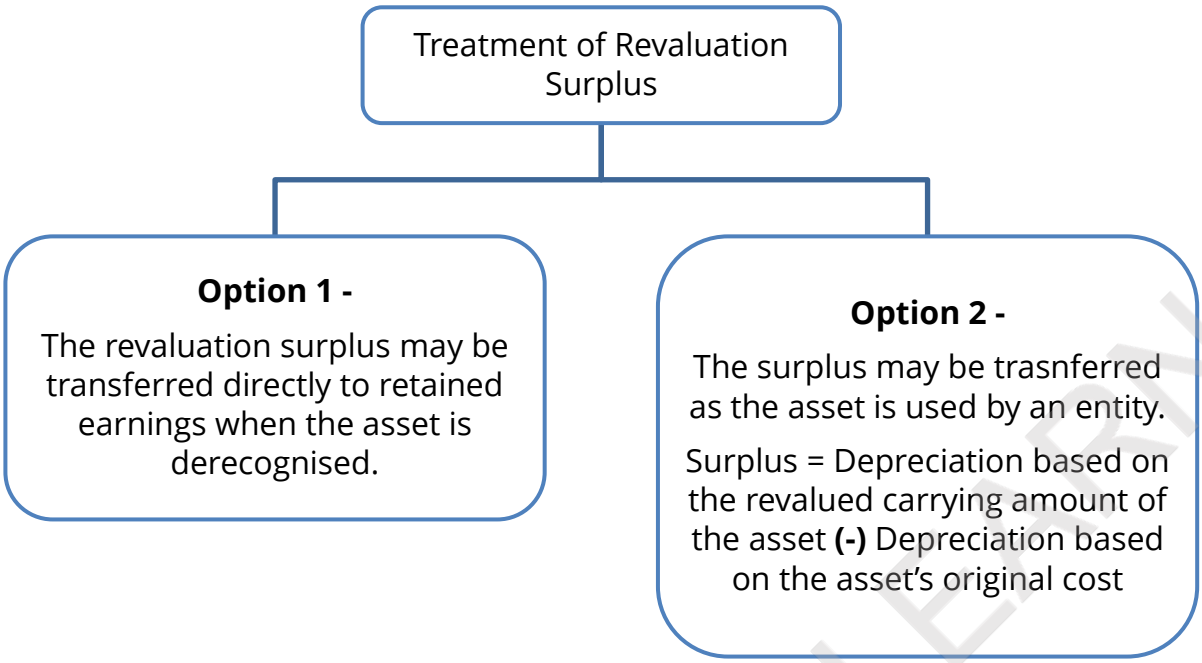
Subsequent upward revaluation – Credit the statement of profit and loss to the extent it was charged in earlier revaluation and remaining balance should be credited to "Other Comprehensive Income" and accumulated in equity under revaluation surplus.

PPE A/c **Dr**
To Profit & Loss A/c (To the extent charged earlier)
To Revaluation surplus (balancing Figure) (OCI)

The effects of taxes on revaluation are recognised and disclosed as per Ind AS 12 – Income taxes

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Treatment of Revaluation Surplus:



Transfers from revaluation surplus to retained earnings are not made through profit or loss.

11. Derecognition

The carrying amount of an item of property, plant and equipment should be derecognised

(a) on disposal

(b) When no future economic benefits are expected from its use or disposal.

The gain or loss arising from the derecognition of an item of property, plant and equipment is included in profit or loss when the item is derecognised.

Gain/Loss from derecognition of PPE = Net disposal proceeds – Carrying Amount.

Gains shall not be classified as revenue.

In determining the date of disposal of an item of PPE, an entity applies the criteria in Ind AS 115 (date recipient obtains control over PPE) for recognising revenue. Ind AS 116 applies to disposal by a sale and leaseback.

Transfers from revaluation surplus to general reserve should not be made through statement of profit and loss.

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12. Disclosure

(i) The financial statements should disclose, **for each class** of property, plant, and equipment:

a. The measurement bases used for determining the gross carrying amount
b. The depreciation methods used
c. The useful lives or the depreciation rates used
d. The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

(ii) Entity is also required to provide a reconciliation of the carrying amount at the beginning and end of the period showing:

a. additions
b. Assets classified as held for sale or included in a disposal group classified as held for sale in accordance with Ind AS 105 and other disposals
c. Acquisitions through business combinations
d. Increases or decreases resulting from revaluations and from impairment losses recognised or reversed in other comprehensive income;
e. Impairment losses recognised in profit or loss in accordance with Ind AS 36;
f. Impairment losses reversed in profit or loss in accordance with Ind AS 36;
g. Depreciation;
h. The net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and
i. Other changes

(iii) The financial statements should also disclose

a. The existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities
b. The amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
c. The amount of contractual commitments for the acquisition of property, plant and equipment; and
d. If it is not disclosed separately in the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

(iv) If items of property, plant and equipment are **stated at revalued amounts**, the following should be disclosed

a. the effective date of the revaluation;
b. Whether an independent valuer was involved;
c. For each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and
d. The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

(v) **Entities are encouraged but not required**, to disclose the following amounts:

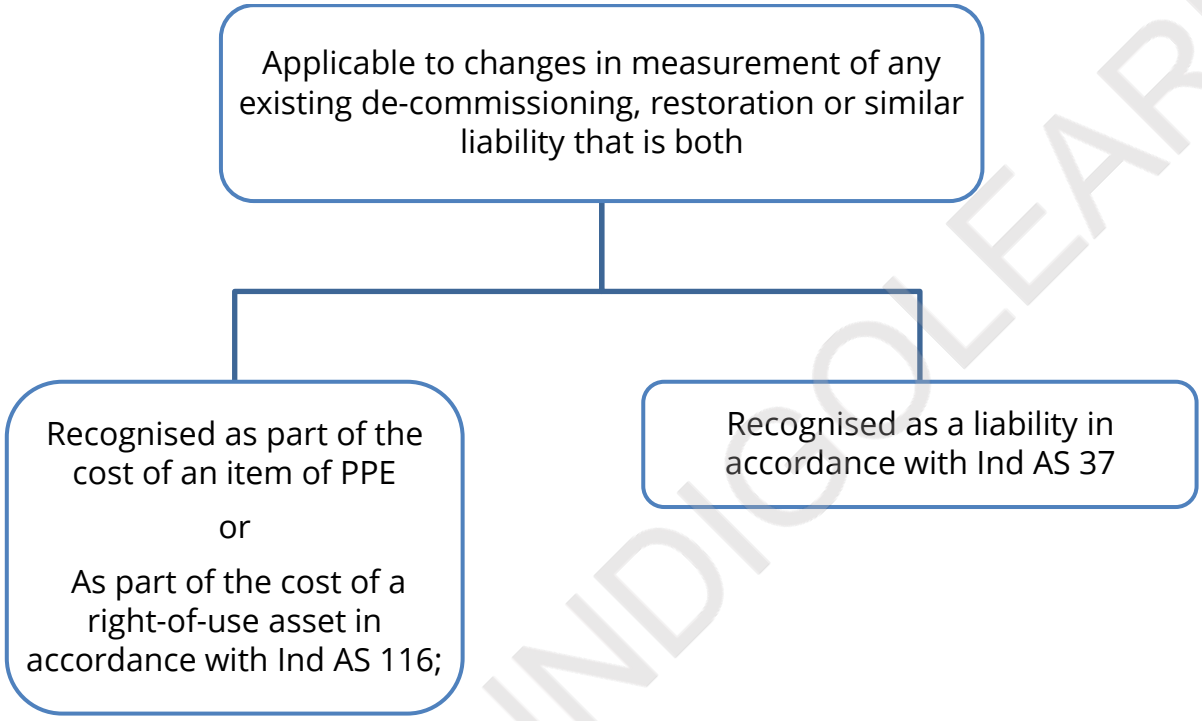
a. The carrying amount of temporarily idle property, plant and equipment

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b. The gross carrying amount of any fully depreciated property, plant and equipment that is still in use
c. The carrying amount of property, plant and equipment retired from active use and not classified as held for sale in accordance with Ind AS 105; and
d. When the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

13. Changes in Existing Decommissioning Restoration & Similar Liabilities (Appendix A)

13.1 Applicability of Appendix A to Ind AS 16?



This Appendix addresses how the effect of the following events that change the measurement of an existing decommissioning, restoration or similar liability should be accounted for:

a. A change in the estimated outflow of resources embodying economic benefits required to settle the obligation
b. A change in the current market-based discount rate
c. An increase that reflects the passage of time (unwinding of the discount)

13.2 Accounting Guidance in Appendix A

If related asset is measured using cost model:

i. Changes in liability shall be added to or deducted from the cost of the asset in the current period and related provision is adjusted accordingly.
ii. Decrease in liability cannot exceed the carrying amount of the asset.

If Decrease in Liability > Carrying Amount, excess is recognised as income

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iii. If changes in liability results in addition to the cost of PPE, consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, test for impairment as per Ind AS 36 and account for impairment loss.

If related asset is measured using Revaluation model:

i. Any increase in liability is adjusted against revaluation surplus (to the extent of balance available). Any excess is recognised in the statement of profit and loss

ii. Any decrease in liability is recognised in revaluation reserve. If any revaluation deficit is charged to profit and loss in the prior periods, to that extent, it is recognised as income in the statement of profit and loss.

> If Decrease in Liability > Carrying Amount, excess is recognised as income in the statement of profit and loss

iii. Any change in liability would require the asset to be tested for impairment to ascertain if there is any change in fair value.

iv. Change in the revaluation surplus arising from a change in liability shall be presented as a separate line item in the Statement of Other Comprehensive Income

Common points for both cost and revaluation model:

The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability shall be recognised in profit or loss as they occur.

The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost, as it occurs. Capitalisation under Ind AS 23 is not permitted.

14. Ind AS 16 vs AS 10

Ind AS 16	AS 10
Does not deal with Assets held for sale as they are governed by Ind AS 105	Deals with accounting for items retired from active use & held for sale
Provides guidance on measuring 'Stripping cost' of a production phase of a surface mine.	Does not have this guidance

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1. Illustration

On 1st April of year 1, XYZ Ltd. acquired a machine under the following terms:

	Amount (in ₹)
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 of year 1. At what cost the asset will be recognised?

2. Illustration

Moon Ltd incurs the following costs in relation to the construction of a new factory and the introduction of its products to the local market.

You are required to calculate the amount which can be capitalised as per Ind AS 16

Particulars	**₹ in 000** **Cost Incurred**
Site preparation costs	150
Direct Material	2,000
Direct labour cost, including Rs. 10,000 incurred during an industrial strike	1160
Testing of various processes in factory	200
Consultancy fees for installation of equipment	300
Relocation of staff to new factory	450
General overheads	550
Estimated costs to dismantle (at present value)	200

3. Illustration

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

4. Illustration

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

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

Other relevant information:

Material costing Rs. 1,00,000 had been spoiled and therefore wasted and a further Rs. 1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November, 20X0 and it is estimated that Rs. 22,000 of the labour costs 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 Rs. 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.

5. Illustration

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

Cost of the plant (cost per supplier's invoice plus taxes)	25,00,000
Initial delivery and handling costs	2,00,000
Cost of site preparation	6,00,000
Consultants used for advice on the acquisition of the plant	7,00,000
Interest charges paid to supplier of plant for deferred credit	2,00,000
Net present value of estimating dismantling costs to be incurred after 7 years	3,00,000
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.

6. Illustration

Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of Rs. 10 million. The fair value of such asset is Rs. 15 million. It exchanges the land and building for a private jet, which has a fair value of Rs. 20 million and pays additional Rs. 3 million in cash.

Show the necessary treatment as per Ind AS 16 and pass journal entry for the transaction

7. Illustration

A shipping company is required by law to bring all ships into dry dock every five years for a major inspection and overhaul.

A ship which cost Rs. 20 million with a 20-year life must have major overhaul every five years. The estimated cost of the overhaul at the five-year point is Rs. 5 million

8. Illustration

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

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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.

9. Illustration

An asset which cost Rs. 10,000 was estimated to have a useful life of 10 years and residual value ₹ 2,000. After two years, useful life was revised to 4 remaining years.

Calculate the depreciation charge for the years 1,2,3.

10. Illustration

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

11. Illustration

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

- Preparation and levelling of the land – Rs. 3,00,000.
- Purchase of materials for the construction Rs. 6.08 million in total.
- Employment costs of the construction workers – Rs. 2,00,000 per month.
- Overhead costs incurred directly on the construction of the factory – Rs. 1,00,000 per month.
- Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – Rs. 50,000 per month.
- Income received during the temporary use of the factory premises as a car park during the construction period – Rs. 50,000.
- Costs of relocating employees to work at the new factory – Rs. 3,00,000
- Costs of the opening ceremony on 31st January, 20X2 – Rs. 1,50,000.

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 Rs. 20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of Rs. 1 payable in 40 years' time at an annual discount rate of 8% is Rs. 0.046.

The construction of the factory was partly financed by a loan of Rs. 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 Rs. 100,000 on the temporary investment of the proceeds.

Required:

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

12. Illustration

Original Cost	₹ 1,00,000
Useful Life	10 Years
Depreciation	Straight Line
Model	Cost

At the end of 4 years, entity applies revaluation model. After 4 years, the fair value of the machinery is ₹ 80,000. Show accounting treatment.

13. Illustration

Show accounting treatment under revaluation model

Case 1 -

Particulars	Year 1	Year 2
Carrying Amount	₹ 1,00,000	₹ 90,000
Fair Value	₹ 1,20,000	₹ 1,00,000

Case 2 –

Particulars	Year 1	Year 2
Carrying Amount	₹ 1,00,000	₹ 90,000
Fair Value	₹ 1,20,000	₹ 80,000

Case 3 –

Particulars	Year 1	Year 2
Carrying Amount	₹ 1,00,000	₹ 90,000
Fair Value	₹ 1,20,000	₹ 65,000

Case 4:

Particulars	Year 1	Year 2
Carrying Amount	₹ 1,00,000	₹ 80,000
Fair Value	₹ 90,000	₹ 85,000

14. Illustration

Treatment of Revaluation Surplus & Excess depreciation

Particulars	**Amount**
Original Cost	₹ 1,00,000
Useful Life	10 Years
Depreciation	Straight line
Model	Cost

At the end of 4 years, entity applies revaluation model. After 4 years, the fair value of the machinery is ₹ 80,000.

15. Illustration

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.

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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?

16. Illustration

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, 20X5.

17. Illustration

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

18. Illustration

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

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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?

19. Illustration

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?

20. Illustration

M Ltd. is setting up a new factory outside the Delhi city limits. 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 capitalize 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?

21. Illustration

Flywing Airways Ltd is a company which manufactures aircraft parts and engines and sells them to large multinational companies like Boeing and Airbus Industries.

On 1 April 20X1, the company began the construction of a new production line in its aircraft parts manufacturing shed.

Costs relating to the production line are as follows ('000):

Costs of materials (list price less a 20% trade discount)	10,000
Recoverable GST not included in the purchase cost	1,000
Employment costs of the construction staff for the three months to 30 June 20X1	1,200
Other overheads directly related to the construction	900
Payments to external advisors relating to the construction	500
Expected dismantling and restoration costs	2,000

The construction staff was engaged in the production line, which took two months to make ready for use and was brought into use on 31 May 20X1.

The other overheads were incurred in the two months period ended on 31 May 20X1. They included an abnormal cost of Rs.3,00,000 caused by a major electrical fault.

The production line is expected to have a useful economic life of eight years. At the end of that time Flywing Airways Ltd is legally required to dismantle the plant in a specified manner and restore its location

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to an acceptable standard. The amount of Rs.2 million mentioned above is the amount that is expected to be incurred at the end of the useful life of the production line. The appropriate rate to use in any discounting calculations is 5%. The present value of Re.1 payable in eight years at a discount rate of 5% is approximately Re.0·68.

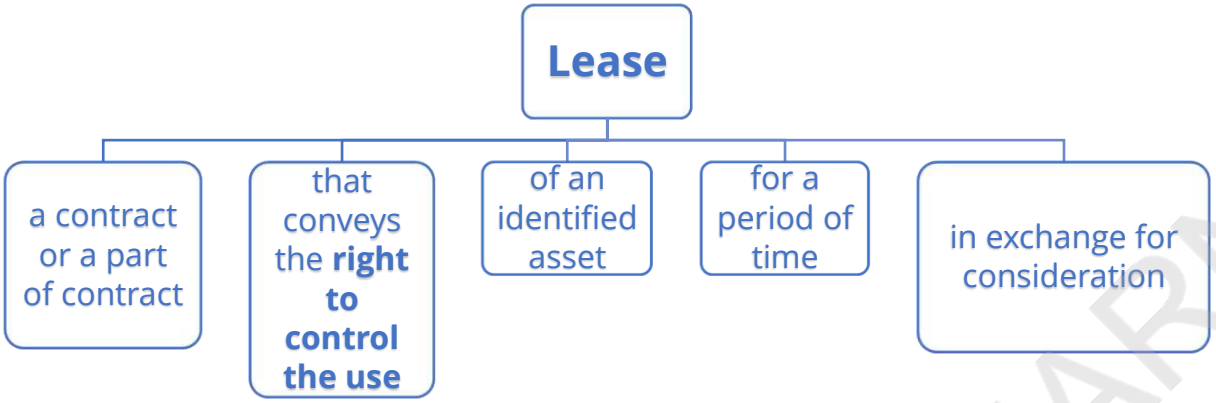
Four years after being brought into use, the production line will require a major overhaul to ensure that it generates economic benefits for the second half of its useful life. The estimated cost of the overhaul, at current prices, is Rs.3 million. The Company computes its depreciation charge on a monthly basis.

No impairment of the plant had occurred by 31 March 20X2.

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

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1 Identifying a Lease



An entity assess whether a contract is / contains a lease at inception of a contract. An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.

1.1 Identified Asset

A contract contains a lease only if it relates to an identified asset. An asset can be either

- explicitly specified in a contract or
- implicitly specified at the time it is made available for use by the customer.

1.1.1 Substantive Substitution Rights (SSR)

A customer does not have right to use an identified asset if the supplier has **substantive substitution right** to substitute the asset throughout the period of use. SSR should be checked at inception of contract and should not be based on future events.

Conditions for SSR

- The supplier has practical ability to substitute alternative assets throughout the period of use and
- The supplier would benefit economically from the exercise of its right to substitute the asset.

Cases when SSR does not exist

- Right arises **after a period of time or on occurrence of an event** (say an asset breakdown)
- If the customer cannot determine whether or not the supplier has substantive substitution right

Note – AS 19 does not have any requirement of SSR.

1.1.2 Assets not physically distinct

An identified asset is generally physically distinct.

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A portion or part of an asset or its capacity that is not physically distinct (e.g. in case of shared pipelines, tanks, optic fibres) is not an identified asset unless it represents significantly all (generally about 90%+) of the capacity of the asset.

1.2 Right to Control

A contract conveys the right to control the use of an asset to the customer if the customer has

- The **right to obtain substantially all of the economic benefits** from the use of an identified asset throughout the period of use **and**
- The **right to direct the use** of the identified asset.

Note – AS 19 does not provide guidance regarding right to direct and considers only right to use an identified asset.

An entity should consider all forms of service contracts, supply contracts and lease arrangements to evaluate right to control the use of an asset.

If customer has the right to control the use of an asset for only a portion of the term of the contract, then the contract contains lease for that portion of lease term.

1.2.1 Right to obtain substantially all of the economic benefits

A customer can obtain economic benefits either directly or indirectly by using, holding or subleasing the asset. An entity must consider economic benefits that arise from the defined scope of right to use the asset.

Economic benefits include

- asset's primary outputs (goods and service)
- by-products (including renewal credits generated)
- benefits from using the asset that is realised in a commercial transaction with a third party (e.g. sub-leasing)

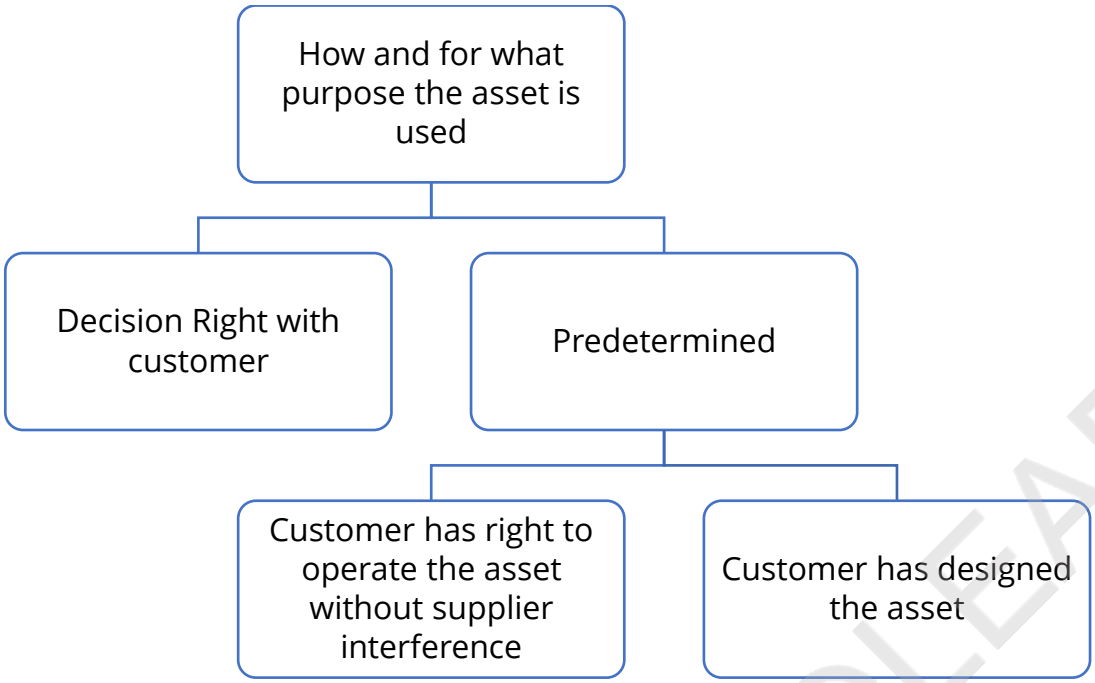
Customer can obtain substantially all of the economic benefits even in case of following –

Supplier's protective clauses – A contract that contains a clause that protects supplier's interest (e.g to prevent unauthorised use of the asset) in the asset.

Supplier/Third party payment – A contract requiring payment of a variable amount to supplier or to a third party based on cash flows generated from the use of an asset

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1.2.2 Right to direct the use of the identified asset is with customer if



- If the customer has the **right to direct how** and for **what purpose** the asset is used throughout the period of use; or
- if the relevant **decisions** about how and for what purpose the asset is used are **predetermined** and:
    - the **customer has the right to operate the asset** (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the lessor having the right to change those operating instructions; or
    - the **customer designed the asset in a way** that predetermines how and for what purpose the asset will be used throughout the period of use.

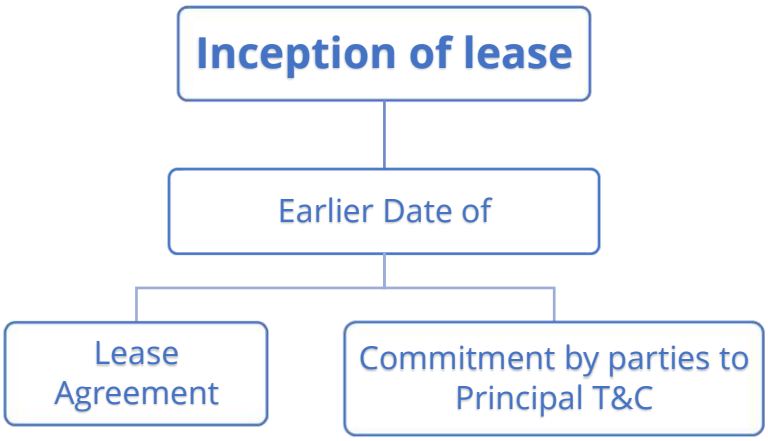
Right to direct is more important than the right to use.

Rights	Examples
To change the output that is produced by the asset	• Deciding whether to use containers for transportation or storage • Deciding the mix of products to be sold from a retail outlet
Change when the output is produced	Deciding when an item of machinery would be used
Change where the output is produced	• Deciding the destination for a vehicle • Deciding the location of usage of machinery
Decide whether to produce the output	Whether to operate a particular asset to produce output.
Decide the quantity of output	How much of quantity of output to be produced

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2 Inception and Commencement of Lease

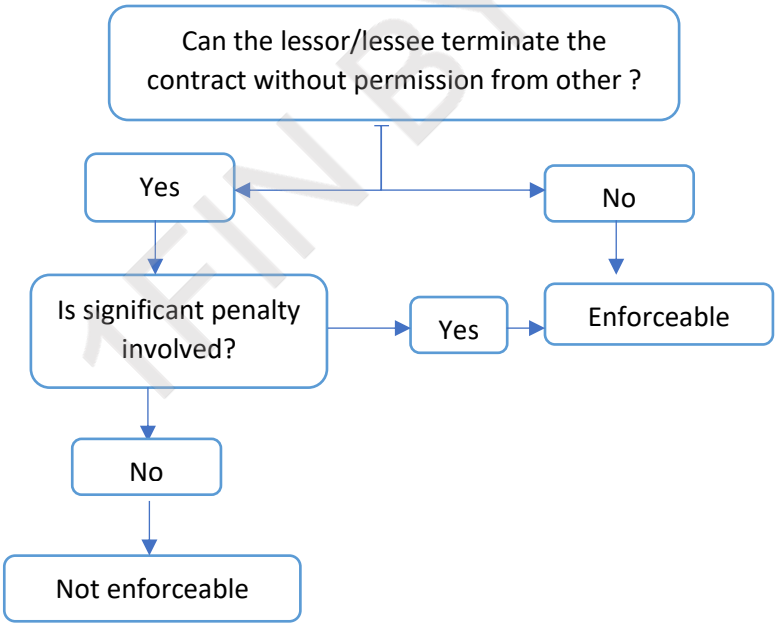
Customers and suppliers must determine whether a contract contains a lease at the **inception of lease**.



Commencement date is the date on which lessor makes an underlying asset available for use by the lessee (irrespective of whether the lessee has started operations or has started rental payments)

Inception date	Commencement Date
Entity assesses whether the contract contains lease	Entity recognises lease related transactions
	Lease period begins at this date

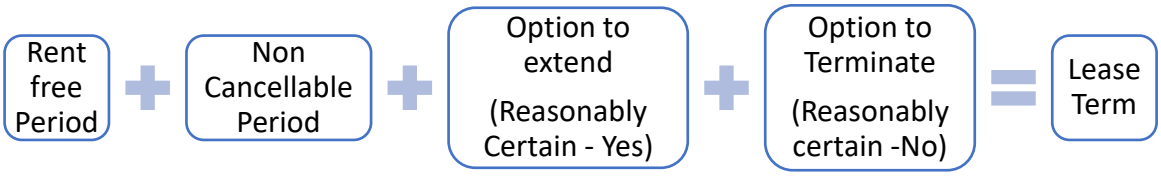
3 Lease term



3.1 Non-Cancellable Period

Non-Cancellable period is the period during which the contract is enforceable.

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3.2 Relevant Factors

- Lease term begins at **lease commencement date**
- If only the lessor has the right to terminate the lease, the period covered by the option is considered as non-cancellable.
- Lease term is aggregate of non-consecutive period if the lease is taken for non-continuous period.
- Option to extend/terminate to be assessed at lease commencement date. Assessment is
    - based on facts and circumstances.
    - Not based on just intentions or past practices

Considerations to assess options

Contractual Terms	**Asset Related Factors**
Lease rentals in optional period	Specialised Asset
Variable or contingent payment	Location of underlying asset
T&C after initial optional period	Leasehold improvements
Cost of replacement	Availability of alternatives

- Longer the lease term, more difficult it is to assess whether the option would be exercised or not.
- Significance of underlying asset to the lessee's operation impacts the lessee's decision to extend the lease
- Option to extend or terminate might be linked with other contractual terms like residual value guaranteed

3.3 Reassessment of reasonable certainty by lessee

If a significant event or change in circumstance occurs which

- is within the control of the lessee and
- affects whether the lessee is reasonably certain
    - to exercise (the option to extend) or
    - not to exercise (the option to terminate)

3.4 Revision of the lease term

The entity will revise the lease term if there is a change in the non-cancellable period of a lease.

Option to extend (Not included*)	**Option to Terminate (Included*)**
Lessee exercises at a later date	Does not exercise at a later date
An event occurs which obliges the lessee to exercise	An event occurs which prevents the lessee to exercise

*In determining the lease term

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4 Lessee Accounting

Lessee is an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

At the commencement of lease, the lessee recognises Right-of-use Asset (ROU Asset) and a Lease Liability.

There is no distinction in accounting treatment irrespective of whether it is an operating lease or finance lease (Under AS 19, the accounting differs on whether the lease is an operating lease or finance lease)

4.1 ROU Asset & Lease Liability

Right of Use Asset =	
Lease Liability	PV of Lease payments to be paid discounted at rate implicit in the lease or incremental borrowing cost (if implicit rate is not known)
+ Lease payment made at / before commencement	Advance lease payments
- Lease incentives received	
+ Initial Direct Cost	Incurred by lessee
+ PV of estimated dismantling, restoration cost	Similar to decommissioning costs under Ind AS 16. Liability accounted as per Ind AS 37

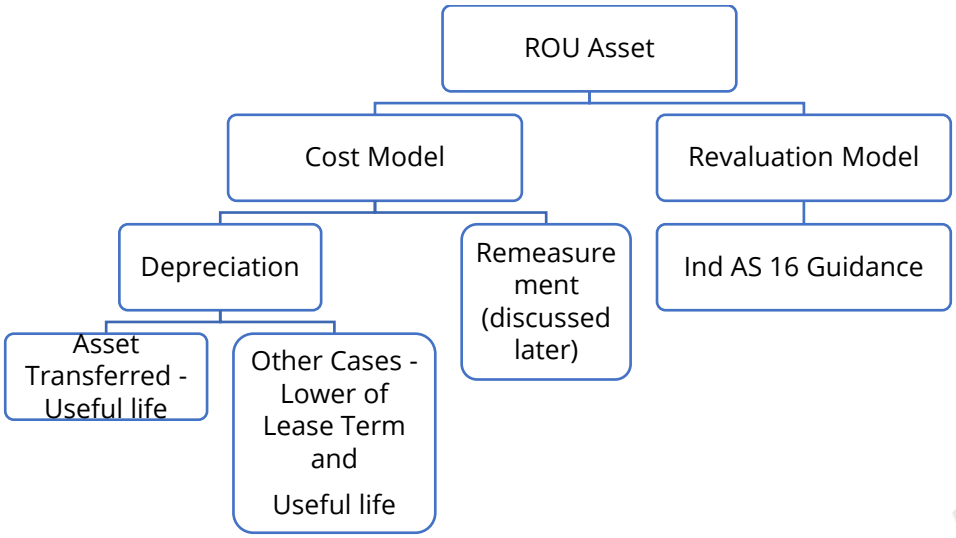
4.2 Lease Payments to be paid

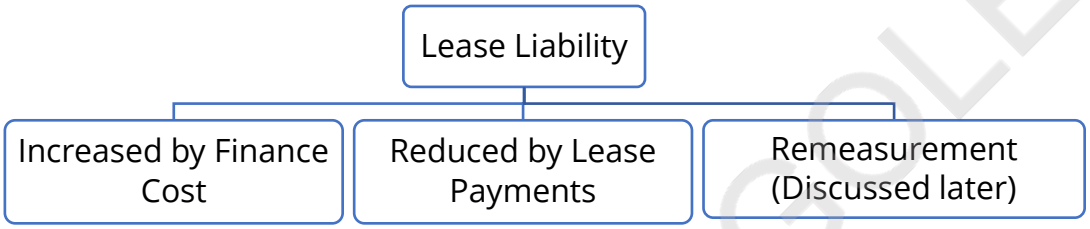
Lease Payments =	
Fixed Lease payments	Generally determined in the contract
+ In substance fixed lease payments	Though variable, considered as fixed (like minimum variable payment)
- Lease incentives received	
+ Variable payments dependent on index or rate	Variable based on rates like LIBOR, annual increment etc are considered. Performance based variable payments are excluded.
+ Residual value guaranteed by lessee	
+ Exercise price of purchase option	If the lessee is likely to exercise the purchase option

For determining the liability only unpaid lease payments are considered.

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4.3 Subsequent Measurement



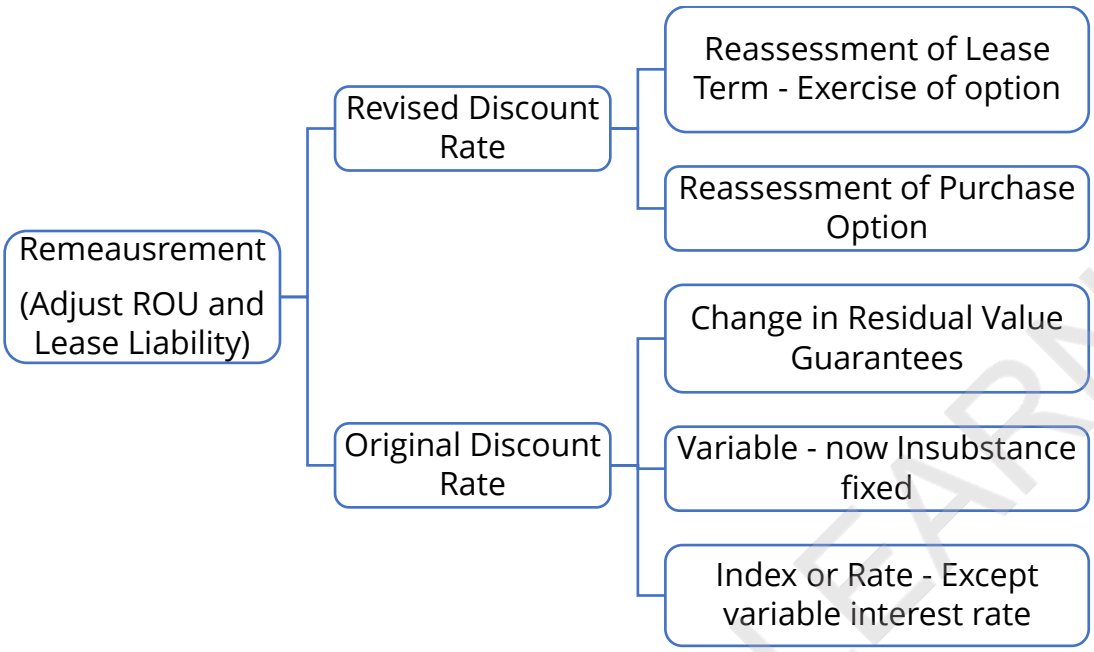


4.4 Important Points

- Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability (also referred to as interest rate implicit in the lease or IRR) – Refer example in class
- Amounts to be debited to Profit and Loss
    - Interest expense (unless it meets the capitalisation requirement)
    - Variable lease payment

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4.5 Remeasurement of Lease Liability



- The remeasurement of lease liability is adjusted to ROU Asset (increase or decrease). There is no impact on P&L.
- If ROU asset has 'Nil' carrying amount, reduction in lease liability is recognised in P&L.

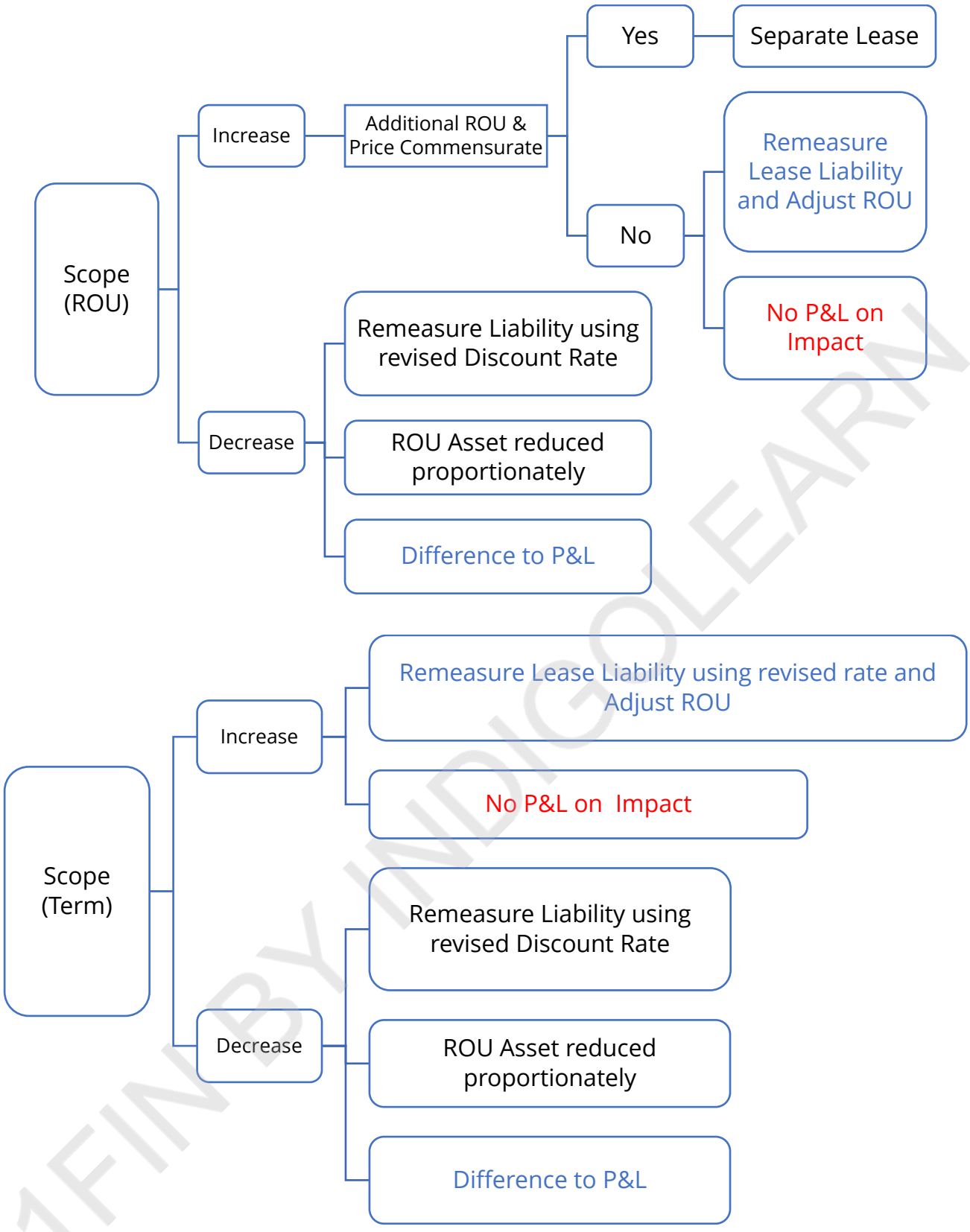
5 Lease Modifications

A Lease modification is a change in the **scope** of a lease or the **consideration** for a lease that was not a part of the original terms and conditions of the lease.

- Lease Extension
- Early termination of lease
- Change in timing of lease payment
- Additional space
- Surrendering part of asset

Accounting for lease modifications

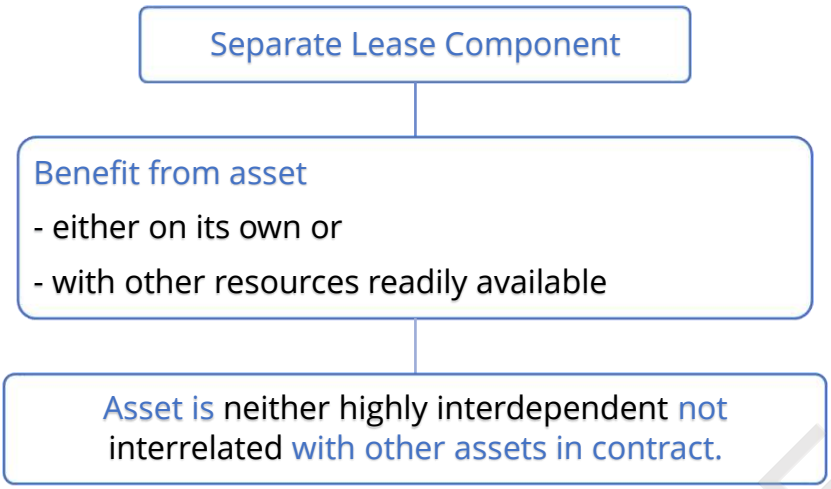
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For any other lease modifications (e.g change in considerations) there is no impact to P&L. All adjustments are made to ROU Asset & Lease Liability Account.

6.1 Separate Lease components (More than one ROU asset in a single contract)



If both of above conditions are not satisfied, then the right to use multiple assets is considered as a single component.

E.g. A contract to lease computer monitor and cpu would be considered as a single ROU. A contract to lease a truck and a car would be considered as having two ROUs – one for truck and other for car.

6.2 Separating lease components from non-lease components

A contract may contain lease component (ROU Asset) and an agreement to supply other (related) goods and services (non-lease component).

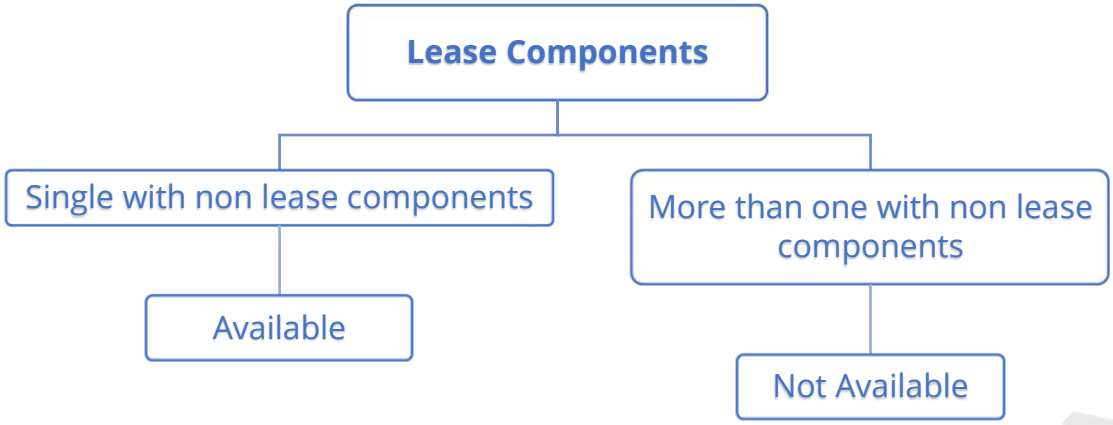
Lease Component	Non Lease Component
Right to use Property	Maintenance services like utility, security, cleaning etc.
Right to use coffee machine	Supply of consumables like coffee beans
Right to use a Truck	Service of drivers

The non-lease component are identified and accounted for separately from lease component. The non-lease component should involve transfer of goods or services from the lessor to lessee.

6.3 Optional exemption (using practical expedient) – only to lessee

A **lessee** can make an accounting policy election by class of underlying asset to account for each separate lease component of a contract and any associated non-lease components as a **Single Lease Component**.

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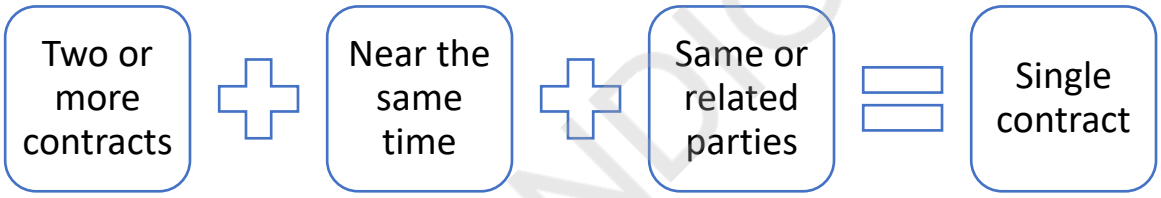
6.4 Determining and allocating the consideration in the contract - Lessee

Allocation of consideration in the contract are allocated to lease component(s) and non-lease component(s) on a relative stand-alone price basis.

Basis of Allocation :

- Observable/estimated lease consideration
- Observable/estimated fair value of components

6.5 Contract Combination



Two or more contracts entered into at or near the **same time** with the **same counterparty (or related parties of counterparty)** is considered as a single contract if any one of the following criteria is met.

Combination criteria

Negotiation	- Contracts are negotiated as a package - With overall commercial objective
Consideration	Consideration paid in one contract is dependent on consideration paid on another.
Lease Component	ROU assets under different contract are a single lease component

An entity may apply practical expedient to use portfolio approach for leases with similar characteristics if it is reasonably expected that the effects on financial statements would not differ materially.

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AS-19 does not provide guidance on separation of lease and non lease component. Entire contract including the non-lease component would be accounted as leased under AS-19

7 Presentation

Balance Sheet ROU Assets & Lease Liabilities	- Separately from other assets/liabilities - If presented together with owned assets/other liabilities, disclosure about the line items - **Investment Property** is disclosed as Investment property (not as ROU) - ROU assets and lease liabilities are not netted off.
Profit & Loss	Separately disclose interest on expense and lease liability
Cashflow	Repayment of Lease Liabilities and Interest – Financing Activity Short term/low value lease payments – Operating Activity Variable lease payment – Operating Activity

8 Disclosure Requirements – Lessee

8.1 Quantitative disclosures for the following –

Balance Sheet	**Profit & Loss**
Additions to ROUs	Interest Expenses
Carrying value of ROUs by class	Short term/Low value lease expense
Maturity Analysis of lease liabilities separately from other liabilities	Variable lease payments expensed
	Income from subleasing
	Gains or losses arising from sale and leaseback

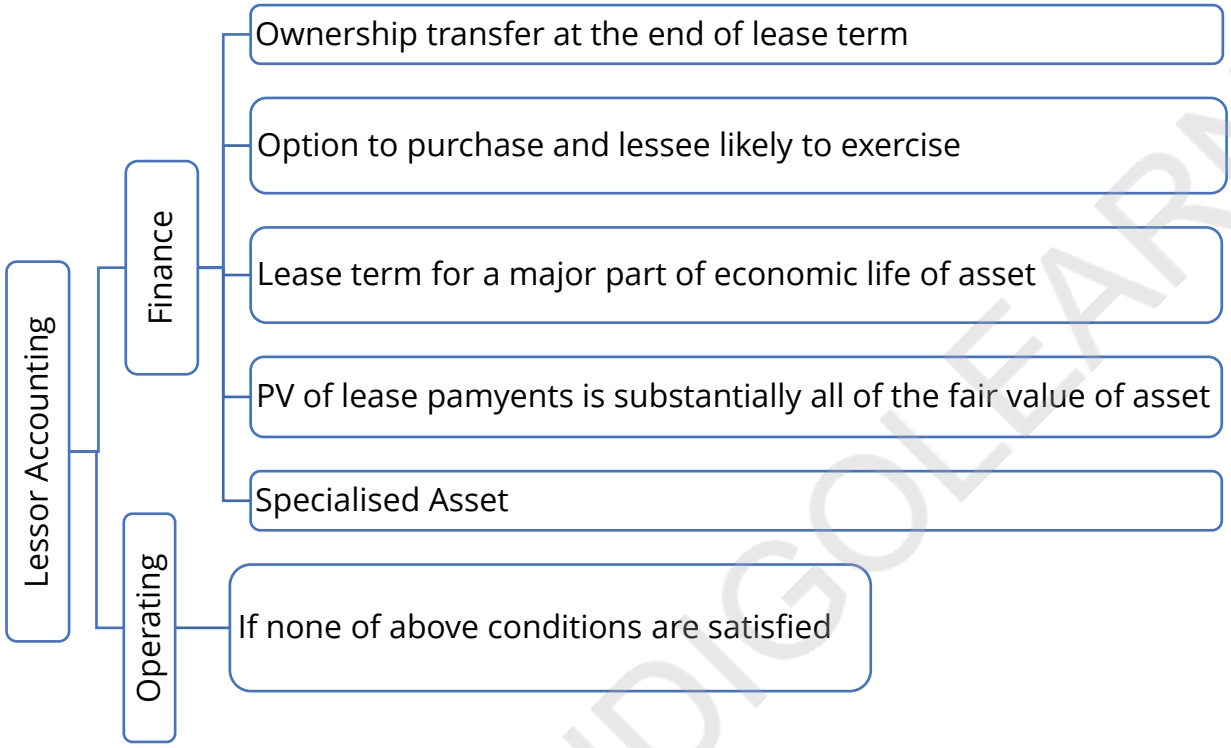
- If lessee has applied short term /low value lease exemption, the fact has to be disclosed.
- Lease commitments of short term lease if the portfolio of short term lease is different from the portfolio to which practical expedient is applied.
- If ROU asset meets the criteria of Ind AS 40, disclosures required by Ind AS 40
- If revaluation model is applied, disclosures required by Ind AS 16

8.2 Qualitative disclosures

- A summary of the nature of the entity's leasing activities;
- Potential cash outflows the entity is exposed to that are not included in the measured lease liability, including:
    - Variable lease payments;
    - Extension options and termination options;
    - Residual value guarantees; and
    - Leases not yet commenced to which the lessee is committed.
- Restrictions or covenants imposed by leases; and
- Sale and leaseback transaction information.

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Lease classification is done at inception and is not reassessed unless there is a lease modification.
A lease is classified as a **finance lease** if it ***transfers substantially all the risks and rewards*** incidental to ownership of an underlying asset.
A lease is classified as an **operating lease** if it ***does not transfer*** substantially all the risks and rewards incidental to ownership of an underlying asset.



9.1 Finance Lease Examples

- the lease **transfers ownership** of the underlying asset to the lessee by the end of the lease term;
- the lessee has the **option to purchase** the underlying asset at a **price** that is expected to be **sufficiently lower than the fair value** at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;
- the lease term is for the **major part of the economic life** of the underlying asset even if title is not transferred;
- at the inception date, the **present value of the lease payments** amounts to at least substantially all of the **fair value of the underlying asset**; and
- the underlying asset is of such a **specialised nature** that only the lessee can use it without major modifications.

If any one of the above criteria is met, the lease is classified as a finance lease.

Additional Conditions which can lead to a finance lease

- if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
- the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

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Basically, these conditions indicate that lessee takes, in substance, the ownership of the asset for the lease term.

9.2 Classification for land and buildings

- The classification for land and buildings is done separately as land normally has an indefinite useful life.
- The lessor allocates lease payments between the land and the buildings elements in proportion to the relative fair values of the elements at the inception date.

9.3 Key Concepts for lessor accounting

Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease.

Gross Investment in Lease = Lease Payments + UGRV

Lease Payments =
Fixed Lease payments
+ In substance fixed lease payments
- Lease incentives paid
+ Variable payments dependent on index or rate
+ Residual value guaranteed by lessee
+ Residual value guaranteed by third party unrelated to lessor (capable of fulfilling the obligation)
+ Exercise price of purchase option

UGRV (Unguaranteed residual value) is that portion of the residual value of the underlying asset, the realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

9.4 Other Considerations

- Lease rentals based on a market rate for use of asset – Operating Lease
- Lease rentals based on a financing rate for use of funds – financing lease
- Put (option to sell) and call (Option to buy) options
    - Predetermined rate – Finance Lease
    - Market rate – Operating lease
- Lease of land and building – To be assessed separately.
- Lease classification is reassessed only in case of lease modification.

10 Lessor Accounting – Recognition

10.1 Finance Lease

At lease commencement a lessor accounts for a finance lease as follows

Dr. Lease Receivable	*Recognises net investment in the lease*
Cr. Asset	*Derecognises the carrying amount of the underlying asset.*
Profit / Loss (Bal figure)	*Recognises selling profit or loss in P/L*

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10.1.1 Net investment in lease

Net Investment in Lease is the PV of Lease payments and UGRV discounted using the interest rate implicit in the lease (discount rate)

10.1.2 Interest Rate Implicit in the lease

The rate of interest which makes the following two equal

PV of	Sum of
• Lease payments • UGRV	• FV of asset • IDC* of lessor

*In case of manufacturer/dealer lessor, IDC is not considered to computed IRR. Since IDC is included in computation of IRR, the interest rate would be less and the finance income recognised would automatically be lesser.

Students are not required to compute IRR in exams and this would be provided.

10.1.3 Finance Lease – Subsequent Measurement

- Recognise finance income over the lease term (the pattern should reflect constant periodic return on the net investment in lease)
- Lease payment are applied to reduce the lease receivable and to recognise finance income.
- Derecognition and impairment requirements of Ind AS 109 are applied.
- If there is a reduction in estimated UGRV, the lessor shall revise the income allocation over the lease term.
- Variable lease payments that are not included in net investment in the lease are recognised in P&L.

10.2 Operating Lease – Initial & Subsequent

Recognise	***Explanation***
Cr. Income	*Lease payments on SLM basis or any other systematic basis*
	Variable lease payments
Dr. Depreciation	*On asset as per applicable Ind AS*
Dr. Asset	*Initial direct cost and recognise the cost as expense in same manner as lease income.*

11 Manufacturer – Dealer Lessor

Finance Lease

Recognise	***Explanation***
Revenue	*Lower of* *- Fair value of underlying asset and* *- PV of lease payments*

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Cost of sale	*Cost / carrying amount less PV of UGRV*
Selling Profit or loss	*Difference between Revenue and Cost of Sale*

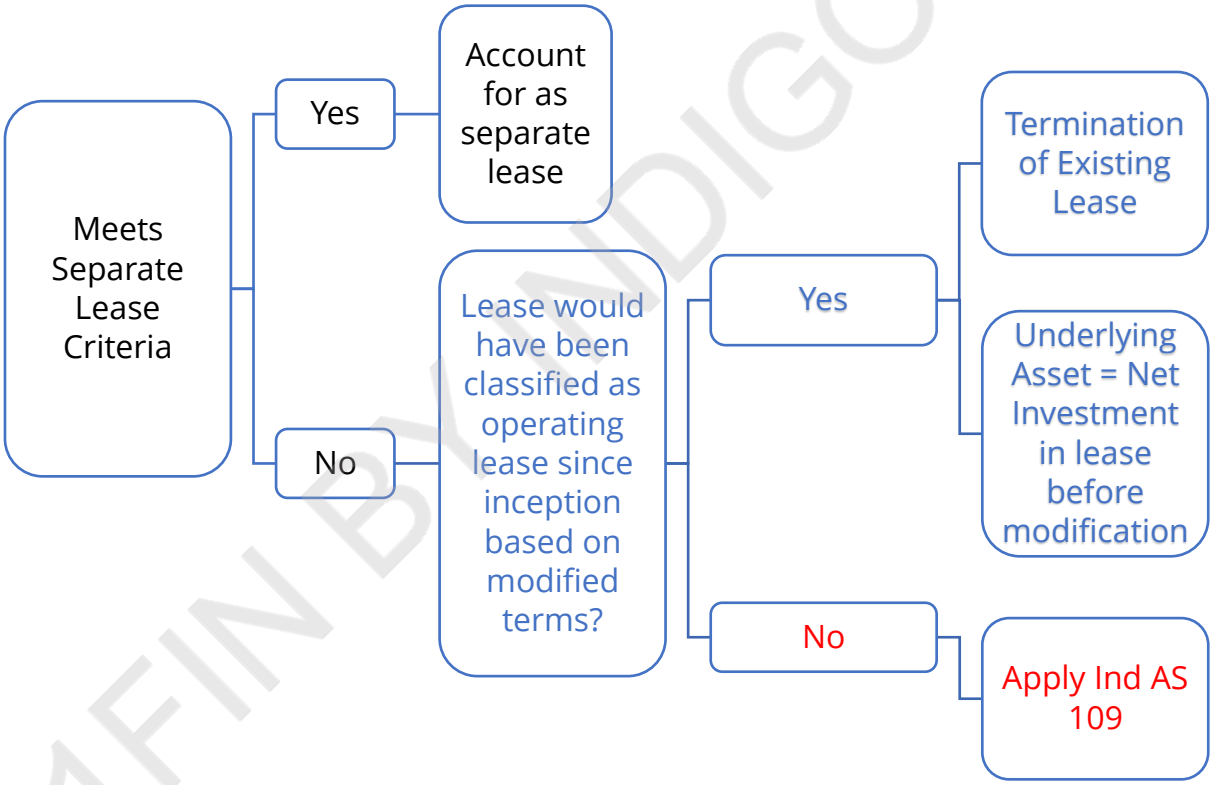
- Profit / Loss should represent profit/loss from an outright sale.
- If artificially low interest rates are quoted, Lessor recognises profit considering market rates of interest.
- Cost incurred by lessor are expensed at commencement and are not considered to be a part of Initial Direct Cost.

Operating Lease

No Profit / Loss is recognised in case of an operating lease.

12 Lease Modification

12.1 Finance Lease Modification



12.2 Operating Lease Modification

- Accounted as a new lease
- Any prepaid or accrual of lease payments – treated as payment for new lease

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13 Lessor – Presentation and Disclosure

13.1 Presentation

Finance Lease	Operating Lease
Receivable - Net Investment in Lease - Classification as current and non-current	Follow principles given under Ind AS 16/38

13.2 Disclosures

Finance Lease	Operating Lease
– Selling profit or loss; – Finance income on the net investment; – Income from variable lease payments; – Qualitative and quantitative explanation of changes in the net investment; and – Maturity analysis of lease payments receivable.	– Lease income, separately disclosing variable lease payments; – Disclosure requirements of Ind AS 16 for leased assets, separating leased assets from non-leased assets; – Other applicable disclosure requirements based on the nature of the underlying asset (eg. Ind AS 36, Ind AS 38, Ind AS 40 and Ind AS 41); and – Maturity analysis of lease payments.

14 Sub-Leases

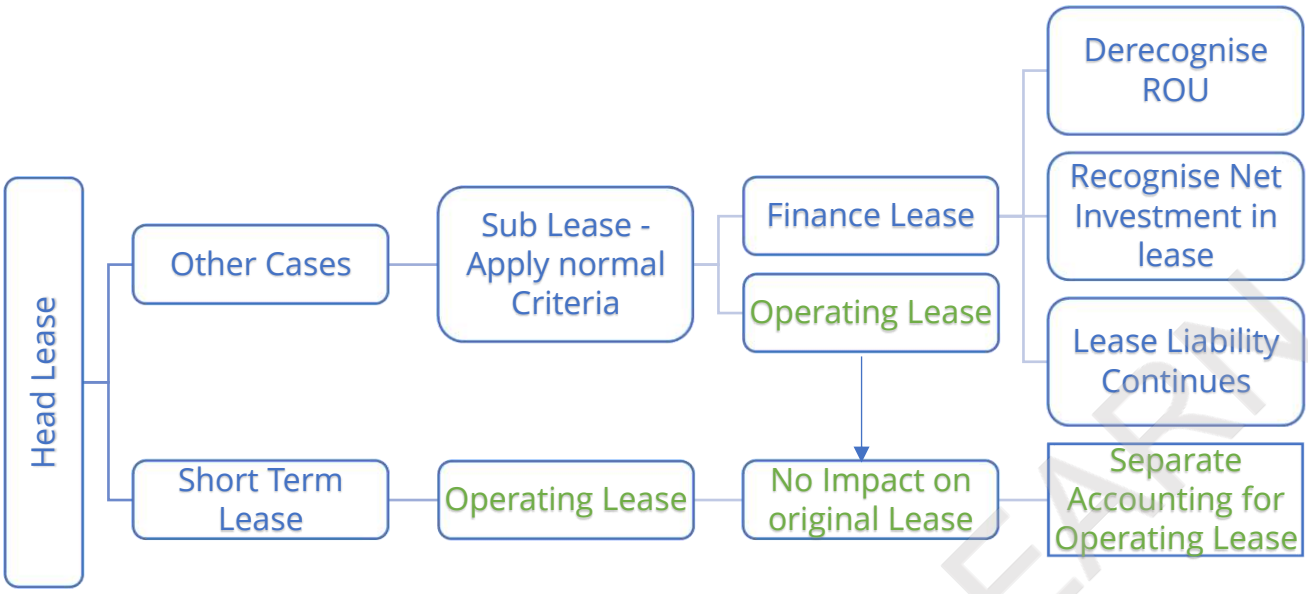


14.1 A 'Sub-lease' is defined as a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the original lease ('head lease') between the head lessor and lessee remains in effect.

14.2 Accounting for Sub-Lease

- Intermediate lessor uses interest rate implicit in lease. If the same cannot be determined, the interest rate in head lease can be used after adjusting for initial direct cost.
- Combination criteria to be checked.
- Exemption under low value lease cannot be applied.

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15 Sale and Leaseback transactions

A sale and leaseback transaction involves the transfer of an asset by an entity (the seller-lessee) to another entity (the buyer-lessor) and the leaseback of the same asset by the seller-lessee.

The seller-lessee and buyer-lessor should apply principles under IndAS 115 to determine whether the transaction qualifies as a sale transaction – Test of transfer of control.

15.1 Fair Value Adjustments

Sale proceeds are adjusted if the transaction is not at fair value i.e,

- The value of consideration for sale of an asset does not equal to the fair value of asset or
- The payment for lease are not at market rates.

How to adjust for fair value differences?

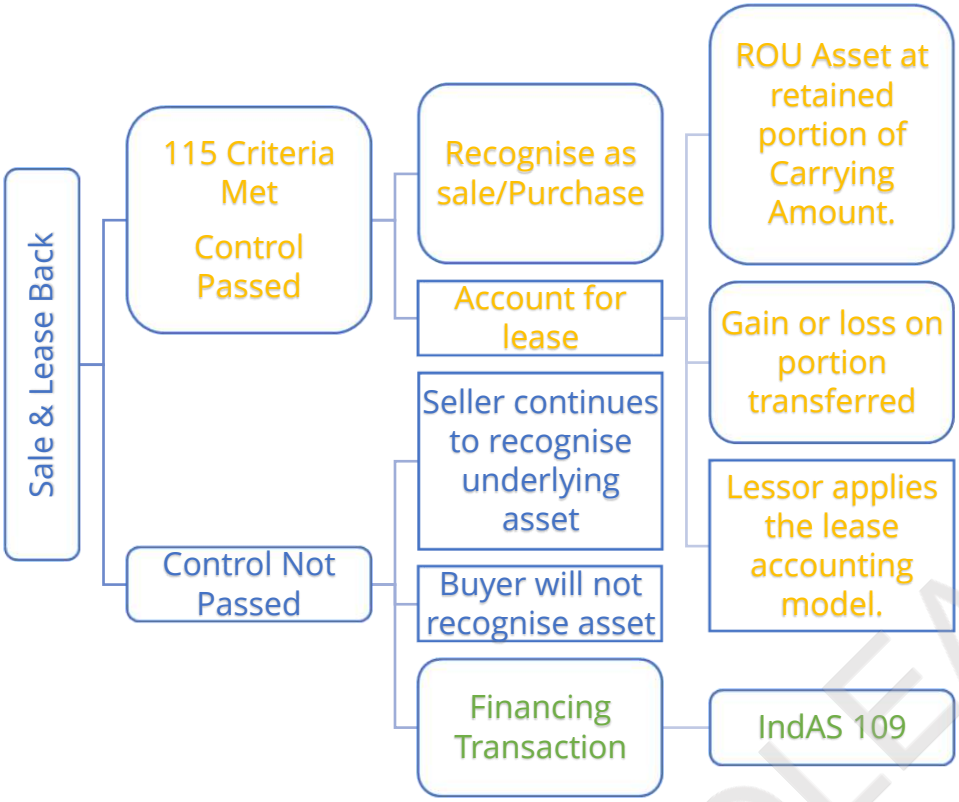
Step 1 – Check which is more determinable

- Difference between sale consideration and Fair value of Asset
- Difference between PV of lease rentals and PV of market lease rentals

Step 2 – Treatment of difference

- Sale price is less or PV of lease rentals is less
  - Difference added to sale consideration and
  - Considered as prepayment for measurement of ROU asset
- Sale price is greater or PV of lease rentals is greater
  - Difference reduced from sale consideration and
  - Considered as additional financing received.

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15.2 Disclosures

- Additional quantitative and qualitative disclosures.
- Gains and losses from sales and lease back separately
- Lessee's reason for sale and lease back transactions
- Key terms and conditions of sale and leaseback
- Payments not included in measurement of lease liability
- Cash flow effect of sale and lease back transactions.

16 Transition Approach

16.1 Definition

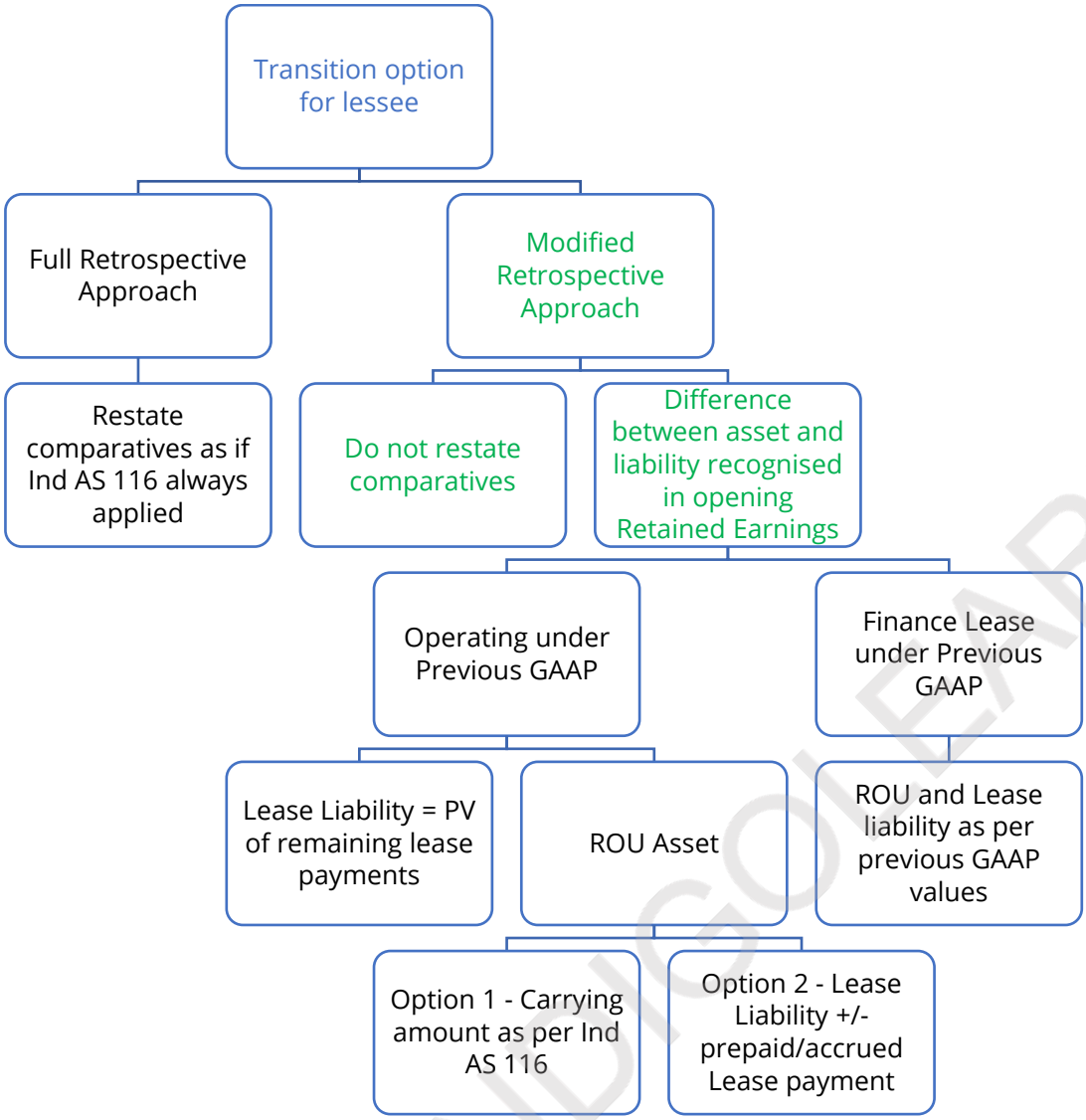
The Lessee can choose either of the following

- Apply the lease definition to all contracts (old and new)
- Apply the lease definition to only new contracts (Practical expedient)

A single choice has to be made for all contracts. Disclosures to be made as per Ind AS 8

16.2 Transition approach - Lessee

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16.3 Transition approach - Lessor

A lessor is not required to make any adjustments on transition for leases except in case of intermediate lessor for sub leases.

In case of subleases which were classified as operating leases applying Ind AS 17 but finance leases applying Ind AS 116, the sublease will be accounted as a new finance lease on the date of initial application.

Gain or loss arising is included in cumulative catch-up adjustment to retained earnings.

16.4 Other points

- An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements under Ind AS 115.

17 Scope and Exclusions

Ind As 116 applies to all leases including leases of ROU assets in a sublease except for

Exclusions	Covered by
Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources	Ind AS 106

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Leases of biological assets held by lessee	Ind AS 41
Service concession arrangements	Appendix D of Ind AS 115
Licences of Intellectual Property	Ind AS 115
Rights held by a lessee under licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights	Ind AS 38

18 Recognition Exemptions

A lessee can elect not to apply Ind AS 116's recognition requirements to:

1. Short-term leases (Option to be taken by class of asset)
   A lease that has a lease term of 12 months or less and does not include an option to purchase the underlying asset.

2. Leases for which the underlying asset is of low-value (entity's judgement) [E.g – Mobile phone]

   Conditions for low-value exemption
   - Lessee can benefit from the use of underlying asset on its own or together with resources that are readily available to lessee
   - Underlying asset is not highly dependent on or highly interrelated with other assets.

   Head lease do not qualify as low value assets.

18.1 Accounting Treatment

The lease payments shall be recognised as an expense on either a Straight-line basis over the lease term or another systematic basis, if that basis is more representative of the pattern of the lessee's benefit.
If a lessee accounts for "short-term leases" as per the approach mentioned above, it shall consider the lease to be a "new lease" for the purposes of Ind AS 116 if:
(a) there is a lease modification; OR
(b) there is any change in the lease term

Indian Accounting Standard 116 - LEASES ILLUSTRATIONS

1. Illustration

Customer XYZ enters a 10-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?

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2. Illustration

Customer XYZ enters 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?

3. Illustration

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?

4. Illustration

Assume the same facts as in earlier Scenario 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?

5. Illustration

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?

6. Illustration

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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?

7. Illustration

Entity X, a garment manufacturer enters into an arrangement with a warehouse facility Y for the right to store the ready garments in a specified storage warehouse.

The warehouse has twenty rooms serially numbered and the rooms one to eleven are contractually allocated to Entity X with exclusive right to use.

Y does not have substitution rights. The storage space which is allocated to Entity X represents the 55% of the total storage capacity of Y.

Whether the storage space (capacity portion) used by Entity X meets the criterion of an identified asset?

8. Illustration

Entity X (PNG provider) enters into an arrangement for 15 years with Entity Y for using 60 % of the capacity of a gas pipeline.

The quantity of gas which is to be sent in the pipeline is decided by Entity X. Entity Y makes all decisions regarding operation and maintenance of the pipeline.

Entity X pays a fixed capacity charge per month and a variable amount which depends on the quantity of gas transported.

Entity Y may allow third parties to use the remaining unused 40 % capacity only if Entity X refuses to utilise the same, i.e., Entity X has the right of first refusal.

Whether the pipeline meets the criterion of an identified asset?

9. Illustration

Entity Y owns a large shopping centre. Customer X enters into a contract to lease a specified retail space for five years.

Under the contract, Entity Y can require X to relocate to another retail space within the shopping centre.

Entity Y would need to pay for costs of relocation and provide X with another space of similar attributes.

Entity Y would only benefit economically from relocating X if a major new tenant were to move in, taking up a large amount of space at a sufficiently higher rate than the existing tenants.

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Although it is possible that those circumstances may arise, at inception of the contract, it is not likely that those circumstances will arise.

Whether Entity Y has substantive substitution rights?

10. Illustration

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?

11. Illustration

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?

12. Illustration

Entity X (customer) enters into a contract for six years with Entity Y (supplier). As per contract, Entity Y is required to install an air-conditioning plant in its office premises.

Air-conditioning plant is designed as per the specifications provided by Entity X.

To optimize the efficiency of the air conditioning plant, Entity Y provides operation and maintenance services on regular basis and as and when required throughout the contract period.

However, Entity X decides and directs the hours of operation and the floors of the building on which and at what time the cooling is required and the temperature to be maintained by the air conditioning plant.

Whether Entity X has right to direct the use of the air conditioning plant?

13. Illustration

Entity X, a utility company (customer) enters into a contract for twenty years with Entity Y, a power company (supplier) to install, operate and maintain a solar power station to fulfil the power requirements of Entity X. The team of professionals engaged by Entity X determined the location of the power station and the

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specifications of the power station. The power station is to be constructed as per the design and other specifications provided by Entity X.

Entity X has the exclusive right to receive and the obligation to take any energy produced.

Whether Entity X has right to direct the use of the solar power station?

14. Illustration

Entity X takes on lease a crossover which is explicitly specified in the contract, for a period of two years. As per the contract, Entity X can drive it only up to a maximum of 1,50,000 kilometres during the period of two years.

Considering the cap on the number of kilometres that the crossover can be driven by it, whether Entity X obtains substantially all of the economic benefits from use of the crossover?

15. Illustration

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?

16. Illustration

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?

17. Illustration

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?

18. Illustration

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.

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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?

19. Illustration

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?

20. Illustration

Given,

- Fair Value of the car, currently – Rs.40 lakhs
- Instalment payments at the end of each year for the first three years – Rs.10 lakhs
- Incentive for extension – Rs.1 lakh
- Instalment Payments for year 4 and 5 – Rs.5 lakhs
- Amount payable for usage – Rs.5 per km driven and minimum per year – Rs.1 lakh
- Option exercisable at end of 5th year – Purchase car at Rs.5 lakh
- Useful life of the car – 10 years

Compute the lease liability using implicit rate of return.

21. Illustration

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?

22. Illustration

Entity P enters into a five-year lease for office space with Entity Q.

The initial base rent is Rs.1 lakh per month.

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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?

23. Illustration

Company N leases a production line.

The lease payments depend on the number of operating hours of the production line – i.e., N has to pay Rs.1,000 per hour of use.

The annual minimum payment is Rs.10,00,000.

The expected usage per year is 1,500 hours

24. Illustration

An entity enters into a 10-year lease of property. The lease payment is to be done at the beginning of each year. The lease payment for the first year is Rs. 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.

You are required compute the lease liability at the commencement of the lease and at the lease payment is adjusted assuming a discount rate of 8%.

25. Illustration

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 Rs.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?

26. Illustration

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 Rs. 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

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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?

27. Illustration

An entity (a lessee) enters into a lease and guarantees that the lessor will realise Rs. 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 Rs.8,000 at the end of the lease.

Whether the lessee should include the said payment of Rs.8,000 as a lease payment?

28. Illustration

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 Rs. 10,000 upon execution of the lease.
- Entity Z will pay Entity Y Rs. 50,000 cash incentive to enter into the lease payable upon lease execution.

Entity Y incurred Rs. 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 Rs. 8,50,000.

How would Lessee Company measure and record this lease?

29. Illustration

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?

30. Illustration

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:

Rs. 20,000 in year one

Rs. 30,000 in year two

Rs. 50,000 in year three.

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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?

31. Illustration

Company EFG enters into a property lease with Entity H. The initial term of the lease is 10 years with a 5-year renewal option. The economic life of the property is 40 years and the fair value of the leased property is Rs. 50 Lacs.

Company EFG has an option to purchase the property at the end of the lease term for Rs. 30 lacs. The first advance annual payment is Rs. 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 Rs. 2 lacs (payable at the beginning of year 2), which is to be used for normal tenant improvement.

Company EFG is reasonably certain to exercise that purchase option. How would EFG measure the right-of-use asset and lease liability over the lease term?

32. Illustration

Given,

- Lease Term – 10.00 years
- Annual Lease Payment (beginning) Rs.2,00,000
- First lease payment before commencement of lease:
    - Initial direct cost (Lessee) Rs.20,000
    - Reimbursement of IDC by Lessor Rs.5,000
- Implicit rate of return in lease is not readily determinable
    - Incremental borrowing rate @ 6%

Show accounting in books of lessee at commencement of lease

33. Illustration

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 Rs. 100,000 and Rs. 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.

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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?

34. Illustration

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs. 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., Rs. 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?

35. Illustration

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs. 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 Rs. 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?

36. Illustration

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 Rs. 1,00,000 per year to Rs. 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?

37. Illustration

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Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are Rs. 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 sq. mtr 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 Rs. 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?

38. Illustration

Calculate of Lease liability and ROU Asset at commencement when,

- Lease Term is 2 years
- Date of commencement is 1st April 2019
- Lease payment at end of every quarter is Rs.1,00,000
- Discount factor per annum is 8%

39. Illustration

Computation for low value assets

- Lease Term – 3 years
- Lease payment each year
    - Year 1 – Rs.2,000
    - Year 2 – Rs.2,500
    - Year 3 – Rs.2,100

40. Illustration

Entity X (lessee) manufactures phone handsets. X enters into a 10-year lease contract with Entity Y (lessor) of a non-specialised machine to be used in manufacturing parts for phone A1. It expects this model of phone to remain popular with customers until it completes development and testing of an upgrade model – phone A2, which is expected to be launched in near future, i.e., within one year. The current machine can be easily replaced and the cost to install it in X's manufacturing facility is not significant. X and Y each have the right to terminate the lease without a penalty on each anniversary of the lease commencement date. The lease agreement does not provide any purchase option in respect of the leased asset to Entity X.

Whether the recognition exemption for 'short term leases' as per paragraph 5 of the Ind AS 116 is available to Entity X?

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Would the answer be different, if the development and testing of the upgraded model is expected to be completed in three years rather than one year?

41. Illustration

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?

42. Illustration

Scenario A:

A lessee enters into a five-year lease of equipment, with fixed annual payments of Rs. 10,000. The contract contains fixed annual payments as follows: Rs. 8,000 for rent, Rs. 1,500 for maintenance and Rs. 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?

43. Illustration

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	Rs. 80,000
Maintenance	Rs. 10,000
Total	**Rs. 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	Rs. 85,000
Maintenance	Rs. 15,000
Total	Rs. 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?

44. Illustration

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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 Rs. 10,000 (Rs. 1,000 relate to maintenance services and Rs. 500 to insurance costs).

The Lessee is able to determine that similar maintenance services and insurance costs are offered by third parties for Rs. 2,000 and Rs. 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?

45. Illustration

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 Rs. 70,000 is payable at year end.

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 Rs. 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 Rs. 1,20,000 per year and stand-alone price of the 'facilities agreement' is Rs. 80,000 per year. Entity X has not elected to apply the practical expedient to separate non-lease component(s) from lease component(s)

How will Entity X account for lease liability as at the commencement date?

46. Illustration

Entity X is an Indian entity whose functional currency is Indian Rupee. It has taken a plant on lease from Entity Y for 5 years to use in its manufacturing process for which it has to pay annual rentals in arrears of USD 10,000 every year. On the commencement date, exchange rate was USD = Rs. 68. The average rate for Year 1 was Rs. 69 and at the end of year 1, the exchange rate was Rs. 70. The incremental borrowing rate of Entity X on commencement of the lease for a USD borrowing was 5% p.a.

How will entity X measure the right of use (ROU) asset and lease liability initially and at the end of Year 1?

47. Illustration

A Dealer-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 Rs 15,000, payable at the end of the year. Lessor expects the residual value of the equipment to be Rs 50,000 at the end of the 10-year lease term.

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- Lessee provides a residual value guarantee that protects Lessor from the first Rs 30,000 of loss for a sale at a price below the estimated residual value at the end of the lease term (i.e., Rs 50,000).
- The equipment has an estimated remaining economic life of 15 years, a carrying amount of Rs.1,00,000 and a fair value of Rs 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?

48. Illustration

Following details regarding a lease are given

- Commencement: Year 1
- Lease Term: 5 years
- Lease payments: Fixed Rs.2,00,000
- Residual value: Rs.2,50,000
- Guaranteed by lessee: Rs.2,00,000
- Unguaranteed RV Rs.50,000
- Fair value of the asset: Rs.10,00,000
- Useful life of the car: 6 years

It is unlikely that the Rs.50,000 of unguaranteed RV will be available at the end of year 2. Compute the loss due to the revised residual value.

49. Illustration

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.

How this will be accounted for by lessor?

50. Illustration

Entity X (lessee) entered into a contract with Entity Y (lessor) to lease an office equipment for a period of 5 years.

The following is the information about the lease and the leased assets at lease inception.

Lease term	5 years (no renewal option held by either party)
Purchase option	None
Annual lease payments	INR 1,95,000
Payment date	Annually on April 1
Fair value of the leased equipment	INR 12,00,000
Entity Y's carrying amount of the leased equipment	INR 12,00,000

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Estimated RV	INR 4,00,000
GRV	INR 3,00,000
Implicit rate in the lease	5%
Economic life of the leased equipment	10 years

Other Title to the asset remains with Entity Y.

At the end of year 1 of the lease, Entity X and Entity Y agree to modify the lease to shorten the lease term by two years.

The relevant information at the modification is given below

Modification date	Beginning of year 2
Remaining modified lease term	2 years
Remaining economic life of the leased equipment	7 years
Purchase option	None
Annual lease payments	INR 1,90,000
Payment date	Annually on April 1
Fair value of the leased equipment	INR 10,00,000
Estimated residual value at the end of next 2 years	INR 7,00,000
Residual value guarantee at the end of next 2 years	INR 3,50,000
Interest Rate implicit lease	5.43%

51. Illustration

Lessor L leases retail space to Lessee Z and classifies the lease as an operating lease. The lease includes fixed lease payments of Rs. 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?

52. Illustration

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?

53. Illustration

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Entity X (lessee) enters into an arrangement with Entity Y to lease 10,000 square feet of office space for a period of 10 years. The annual lease payments are INR 1,00,000 in the first year, increased by 5 percent each year thereafter, payable in arrears. The economic life of office space if 40 years.

The present value of office space is not substantially all of the fair value of the office space. Furthermore, the title does not transfer to Entity X as a consequence of the lease and the lease does not contain an option for Entity X to purchase the office space.

At the beginning of Year 6, Entity X and Entity Y agree to amend the original lease for the remaining 5 years to include an additional 10,000 square feet of office space in the same building for an additional annual fixed payment of INR 1,50,000.

How would Entity Y account for the modification in the lease contract?

54. Illustration

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of Rs. 30,00,000. Immediately before the transaction, the building is carried at a cost of Rs. 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 Rs. 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 Rs. 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?

55. Illustration

A retailer (lessee) entered into 3-year lease of retail space beginning at 1 April 2017 with three annual lease payments of Rs. 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:

a. Full Retrospective Approach
b. Modified Retrospective Approach

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Indian Accounting Standard 21
THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES

1 Introduction

Ind AS 21 deals with accounting for change in foreign currency of transactions or foreign operations.

Ind AS 21 corresponding to AS 11, but there is Fundamental difference. There is a concept of Functional Currency under in Ind AS 21.

2 Presentation vs Functional vs Foreign currency

2.1 Preparation Currency

Presentation Currency is the currency in which financial statements are presented

For Eg: Amazon in USA is Holding company of Amazon in India, So Amazon in India is required to prepare F.S in $. Here $ is the Presentation Currency.

2.2 Functional Currency

Functional Currency is the currency of primary economic environment in which entity operates

For Eg: Amazon in India has 95% of business in UK based. Here £ is the functional currency.

Note: Generally, Presentation/ reporting currency = Functional Currency. But It can differ. In above example Presentation currency is ₹, but Functional currency is £.

2.3 Foreign Currency

Foreign Currency is a Currency other than functional currency of the entity

3 Scope of Ind As 21

3.1 Applicability of Ind AS 21

- Accounting for transactions and balances in foreign currencies, except for derivatives transactions and balances covered by Ind AS 109
- Translating the results and financial position of foreign operations that are included in the financial statement of the entity.
- Translating an entity's results and financial position into a presentation currency

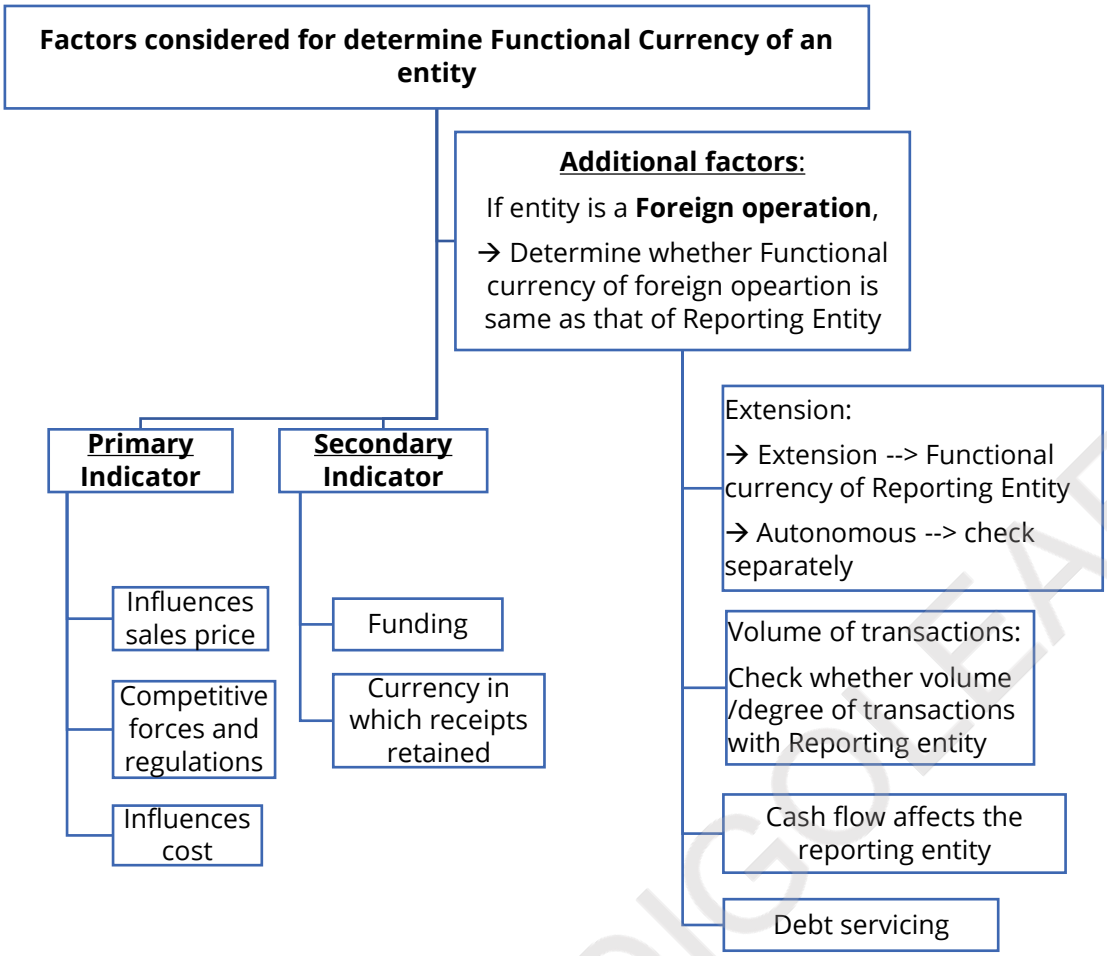
3.2 Non-Applicability of Ind AS 21

- Hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. Applicable Ind AS 109
- Presentation of cash flows from transactions in a foreign currency or a to translations of cash flows of a foreign operation. Applicable Ind AS 7
- Long term foreign currency items for which an entity has opted for the exemption as per Ind AS 101

4 Functional Currency

Ind As 21 requires each entity to determine its functional currency. All the transactions must be recorded in Functional currency

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Note:

- Primary indicators/ factors are in one currency (For eg: USD), but the settlement can be in another currency (Eg: local currency – INR). We have to consider the primary factors indicating currency for deciding functional currency.
- As there may be a chance of conflicting between one factor to another, those factors are not conclusive rules to decide the functional currency.
- Deciding Functional currency based on Judgement considering all the above factors.

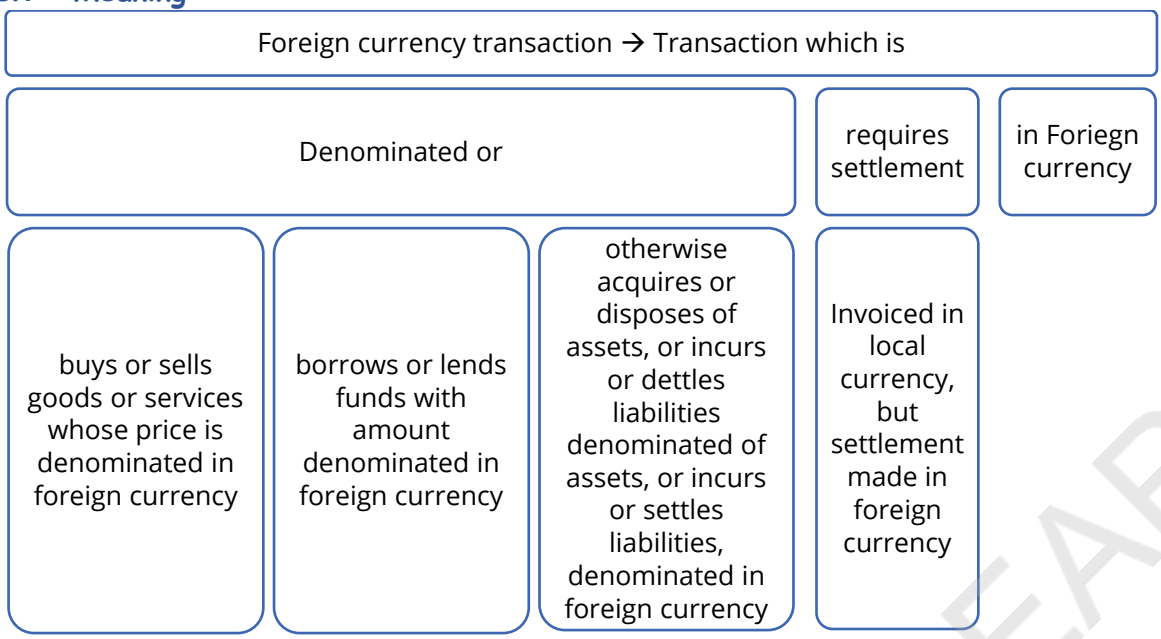
Important Points

1. A currency used for pricing purpose may not always represent functional currency.
2. To check whether functional currency is local currency or other → check Primary & Secondary factors
3. Importing products from foreign and payment for the same in foreign currency does not imply foreign currency is functional currency
4. When functional currency is not obvious, management uses its judgement to determine functional currency that most faithfully represents economic effects of underlying transactions, events and conditions.

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5 Foreign Currency transaction

5.1 Meaning



5.2 Initial measurement

A Foreign currency transaction shall be recorded

- On initial recognition
- In the functional currency
- By applying to the foreign currency amount
- The spot exchange rate between the functional currency and the foreign currency
- At the date of the transaction

Foreign currency transaction is initially recorded by translating in entity's functional currency at exchange rate on transaction date.

- Determine Functional currency

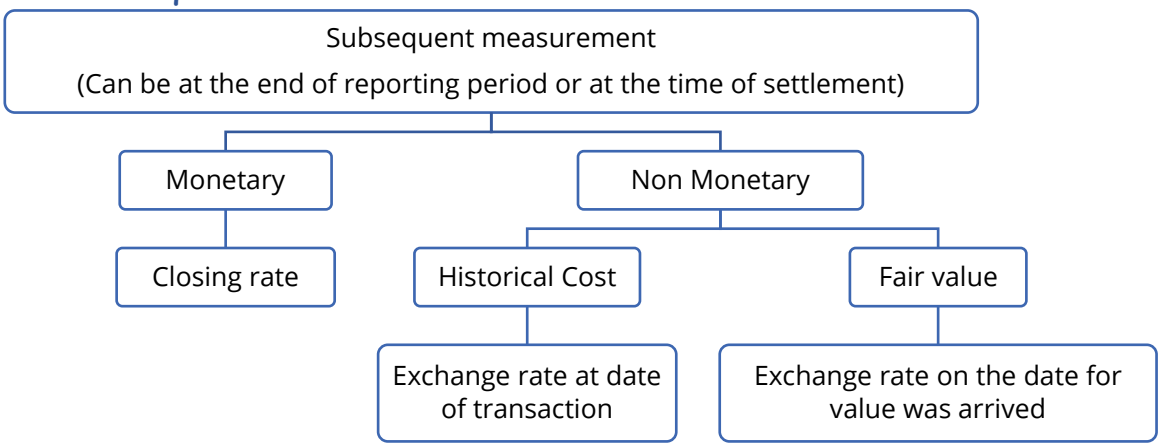
  For eg:

  If Reporting currency – INR
  Functional currency – USD
  Transaction currency – GBP/INR
  Then initial recognition will be done at Functional currency – USD (Even though the presentation currency is INR)
  Later convert into Presentation currency (INR) for Reporting/ presentation purpose.

- Identify Exchange rate on transaction date
  - Average rate for day, week or month might be used for all transactions in each foreign currency occurring during that period (Only if exchange rate fluctuation is insignificantly)
  - If exchange rate fluctuates significantly, the use of average rate for the a period is inappropriate.
  - Mostly Company uses reference rate (published by an association) or some pre-defined rates (Closing or Average exchange rates) as per their policies.

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5.3 Subsequent measurement



For Eg:
Foreign branch purchased PPE $ 10,000 & Fair value on Reporting date is $ 11,000
Exchange rate: On Purchase date is 1 USD = INR 85 & Reporting date is 1 USD = INR 83

PPE measured at	Cost Model	Fair value model
Value (A) [As per IND AS 16]	Historical cost = $ 10,000	Fair/Revalued value = $ 11,000
Exchange rate (B) [As per IND AS 21]	On date of purchase = Rs.85	On date of revaluation = Rs.83
Value of PPE (A×B)	Rs.8,50,000 ($ 10,000 * Rs.85)	Rs.9,13,000 ($ 11,000 * Rs.83)

Foreign branch purchased Inventory $ 20,000 & Fair value on Reporting date is $ 20,500
Exchange rate: On Purchase date is 1 USD = INR 85 & Reporting date is 1 USD = INR 82

Inventory measured at	Lower of Cost or NRV	
Value (A) [As per IND AS 2]	Cost = $ 20,000	NRV = $20,500
Exchange rate (B) [As per IND AS 21]	On date of purchase = Rs.85	On date of revaluation = Rs.82
(A×B)	Rs.17,00,000 ($ 20,000 * Rs.85)	Rs.16,81,000 ($ 20,500 * Rs.82)
Value of Inventory	Rs. 16,81,000	

Note:
Ind As 21 explains only in which currency Foreign currency transaction to be recognised, not how to measure.

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Monetary items vs Non-Monetary items

Monetary Items

Units of currency held and assets & liabilities to be received paid are in fixed or determinable number of units of currency

Non-Monetary items

There is no fixed or determinable number of units of currency

Examples of monetary items:

> Pension and other employee benefits to be paid in cash

> Provision that are to be settled in cash

> lease liabilities

> Cash dividends that are recognised as a liability

> Debt security

> Contract to receive/deliver variable no.of entity's own equity instruments/ assets in which fair value equals fixed or determinable no.of units of currency

> Sundry Debtors & Accounts receivables, Cash & cash Equavalent, Fixed Deposits, Creditors & Loans

Examples of Non-monetary items:

> Inventory

> Fixed Assets

> Equity

> Investments in shares

> Goodwill, Intangible assets, Inventory, property, plant & equipment, right-of-use assets, provisions to be settled by delivery of non- monetart asset, amounts prepaid for goods & services and income received in advance

Example:

Infosys exports a Service for $ 10,000 on 01-01-X1
Functional Currency – INR
Foreign Currency – USD

Initial Measurement:

Date	Particulars	Debit	Credit	Currency	Exchange rate
01-01-X1	Receivables/customers A/c Dr To Revenue/Sales A/c	9,00,000	9,00,000	Functional Currency - INR	1 USD = INR 90

Subsequent Measurement: (As it is monetary item – Closing rate)

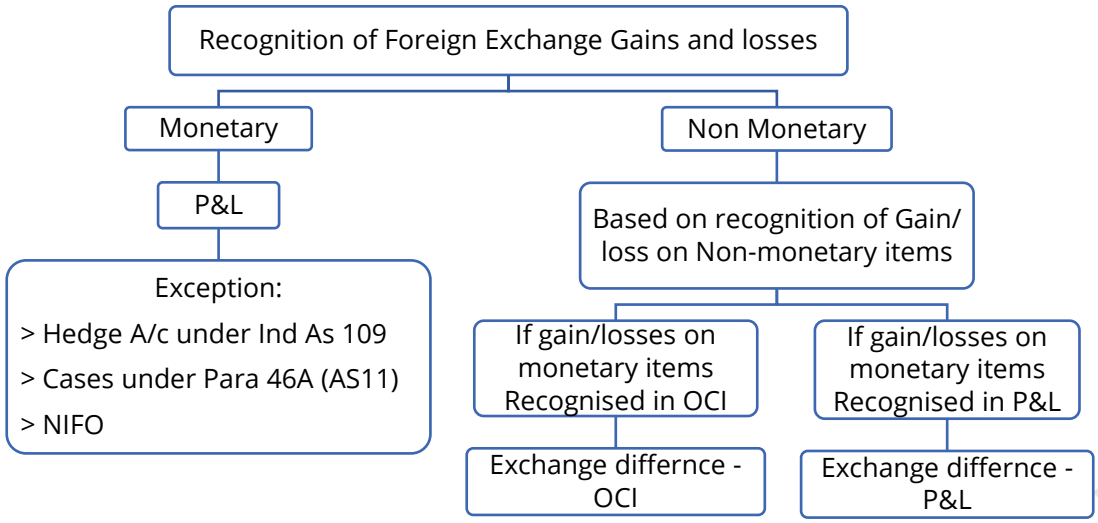
Date	Particulars	Debit	Credit	Currency	Exchange rate
31-03-X1	Foreign Exchange loss A/c Dr To Receivables/customers A/c	20,000	20,000	Functional Currency - INR	1 USD = INR 88

If It is settled on 31-03-X1:
(Loss or Gain are recognised based on the exchange rate on date of settlement)

Date	Particulars	Debit	Credit	Currency	Exchange rate
31-03-X1	Bank A/c Dr Foreign Exchange loss A/c Dr To Receivables/customers A/c	8,80,000 20,000	9,00,000	Functional Currency - INR	1 USD = INR 88

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5.4 Recognition of Foreign Exchange Gains and losses



Exception:

- If Exchange differences arises out of an item, which qualifies for Hedge accounting under IND AS 109, then IND AS 109 will apply for recognition instead of IND AS 21.
- IND AS 101 allows an entity to apply Para 46A under AS 11, (Optional)
  Exchange difference on Foreign currency of Long term monetary Item
  - If it is Depreciable asset → Add/Less from carrying amount
  - If it is Non-depreciable asset → Transferred to Foreign Currency Monetary Item Translation Difference Account (FCMITDA - Component of equity) → Amortise over the remaining life

  Example: Long term loan in foreign currency - $ 100,000 to acquire PPE. Exchange rate on that day 1 USD = INR 80. Closing Exchange rate → 1USD = INR 85

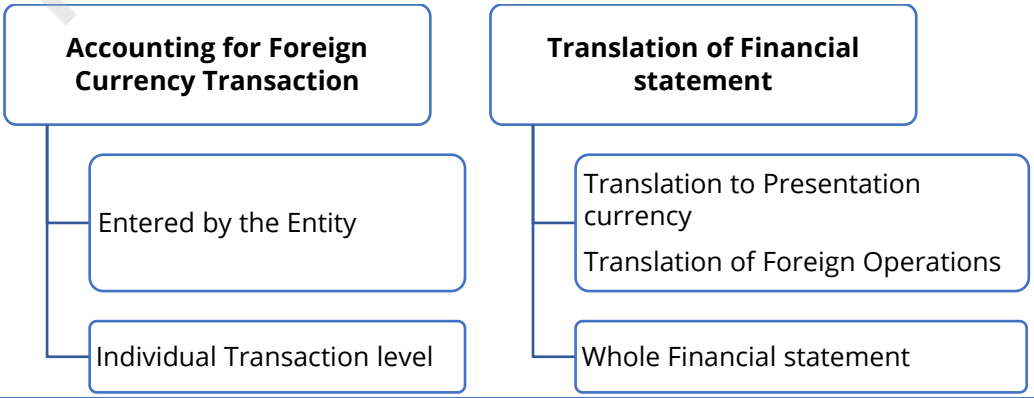
Particulars	PPE	Long-term Loan
Cost	Rs.80,00,000 ($ 100,000 × Rs.80)	Rs.80,00,000 ($ 100,000 × Rs.80)
Item	Non-Monetary Item	Monetary Item
Closing balance	Rs.80,00,000	Rs.85,00,000 ($ 100,000 × Rs.85)

Difference between loan balance (Rs.85,00,000 – Rs.80,00,000 = Rs.5,00,000) will be Transferred to Foreign Currency Monetary Item Translation Difference Account (FCMITDA - Component of equity) → Amortise over the remaining life

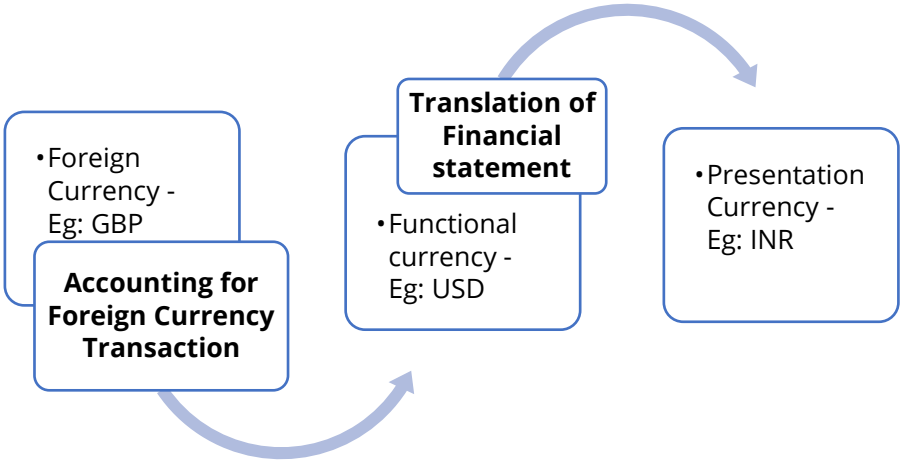
6 Translation of Financial statement

Translation of Financial Statement from one currency to another currency

6.1 Distinguish between Accounting for Foreign Currency Transaction vs. Translation of Financial statement



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6.2 Foreign Operation

Foreign Operation

Subsidiary | Associate | Joint venture | Branch

of reporting entity,
activity of which are based/conducted in a country/currency other that those of reporting entity

Note:

- Branch/ Subsidiary/ Associate/ Joint venture having different functional currency from the functional currency of reporting entity will be considered as Foreign Operation. Even though Both reporting entity & its associate company is in same country.

Translation of Foreign Operations:

Functional currency Foreign Operations → To → Functional Curreny of Parent Company → To → Presentation Currency

6.3 Translation to Presentation currency

Particulars	Exchange rate	Date
Assets & Liabilities	Closing Rate	Balance sheet
Profit & loss items	Individual rate or Average rate (If there exist Insignificant Fluctuation)	Transaction date
Equity	Historical Cost/ Historical Value	

Note:

- All resulting exchange difference recognised in Other Comprehensive Income (OCI) → FCTR (Foreign Currency Translation Reserve)
- In CFS, Goodwill raised from the acquiring shares of Subsidiary company will be treated as Asset i.e., Goodwill of the Foreign Operation and should follow the translation principle @ Closing rate.

7 Net Investment in a foreign operation

NIFO is

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- The amount of the reporting entity's interest
- in the net assets of that operation
- An item (Long term Monetary 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.

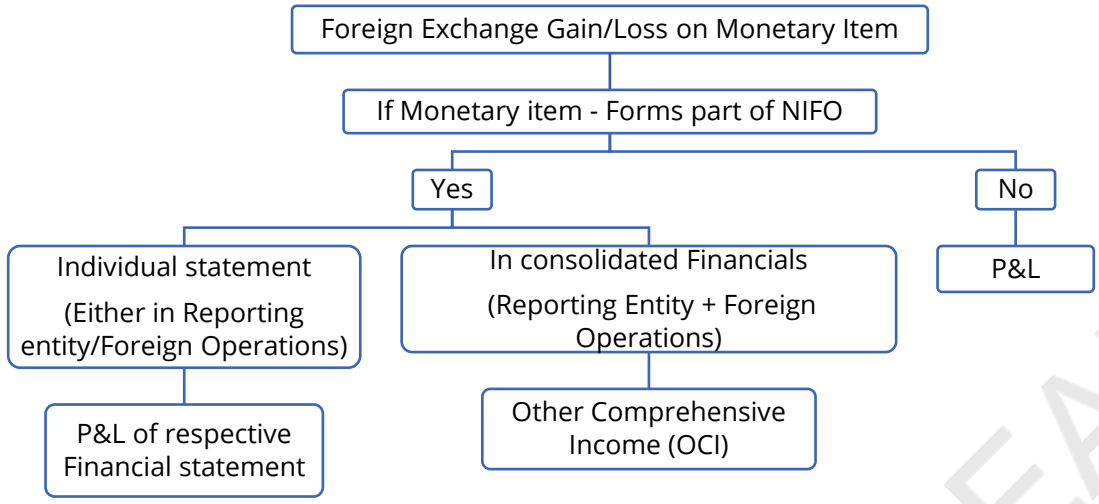


Illustration Summary:

- Gain or loss on monetary item is generally recognised in P&L. If monetary item forms part of NIFO, then in CFS it is recognised in OCI.
- Trade receivables & Trade payable will not be form part of NIFO, While Long term loans, receivables & payables will form part of NIFO.
- If Subsidiary company of reporting entity gives loan to another Subsidiary of reporting entity
  - If the given loan forms part of NIFO, then it should be recognised in OCI of Consolidated Financial statement of group companies.

8 Intra group transactions

Effect of Intra group transactions in Consolidated Financial Statement	• Intra group balances - Eliminate • Unrealised gain - Eliminate • Exchange gain/ loss recognised in standalone statements - Recognise in CFS

Exchange Gain/Loss on Monetary item

- Forming part of NIFO → OCI of CFS
- Not forming part of NIFO → Consolidated P&L

Example 1:

Exchange rate: Opening 1 USD = INR 50 & Closing 1 USD = INR 55

Year	Holding Company		Subsidiary Company	
	Asset	Amount (INR)	Liability	Amount (USD)
Beginning	Loan given to Subsidiary	1,00,000.00	Received Loan	2,000.00
End	Loan given to Subsidiary	1,00,000.00	Received Loan	1,818.18
			Exchange Gain	181.82

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- In Consolidated Financial statement, Loan given & received will set off &
- Exchange Gain = Rs.10,000 (181.82 × 55) recognised

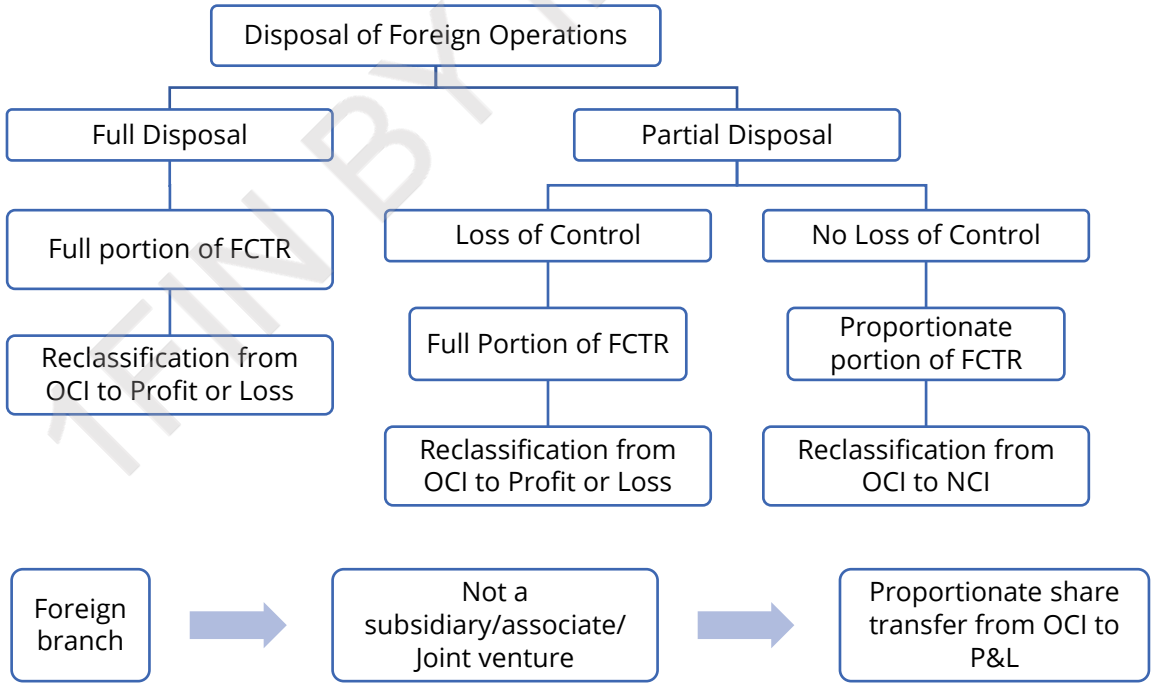
Example 2:

Holding company sold goods to Subsidiary worth $ 1,000. Profit element in sale = Rs.10,000
Inventory not sold & transaction not settled by Subsidiary.
Exchange rate: Opening 1 USD = INR 80 & Closing 1 USD = INR 85.

Holding Company:			
Date	**Particulars**	**Debit**	**Credit**
01-01-X1	Account Receivable - Subsidiary A/c Dr To Sales A/c	80,000	 80,000
31-03-X1	Account Receivable - Subsidiary A/c Dr To Exchange Gain A/c	5,000	 5,000
Subsidiary Company:			
Date	**Particulars**	**Debit**	**Credit**
01-01-X1	Inventory A/c Dr To Account Payable – Holding Company A/c	80,000	 80,000

- Exchange Gain on Account receivable = Rs.5,000 (Rs.85,000 - Rs.80,000) (This gain is recognised in Separate Financial Statement when restatement of Monetary items at closing rate). This will be offset by Account payable in Subsidiary.
- Inventory is a non-monetary item and it would not be restated in subsidiary financial statements. However, in CFS, inventory will be recognised at cost to holding company by eliminating unrealised gain.
- Subsidiary will recognise loss on account payable due to change in exchange rate.

9 Disposal of Foreign Operations.



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10 Change in Functional Currency

Change in Functional Currency

↓

Can be changed unless there is a change in the relevant underlying transactions, events and conditions

↓

The change is accounted for prospectively from the date of the change

↓

All the items are translated into the new functional currency using the exchange rate of the date of the change

↓

Exchange difference arising previously recognised in the other comprehensive income are not reclassified from equity to profit or loss until the disposal

- Non-Monetary items measured @ historical cost → Exchange rate at the date of change of functional currency will be used for arriving historical value in new functional currency.

11 Currency of a Hyperinflationary Economy as a Functional Currency

When an entity's Functional currency is currency of a hyperinflationary economy, the entity shall restate its financial statement in accordance with Ind As 29 before applying the translation method as explained below:

- If both the Functional and Reporting currencies are Hyperinflationary, translate using the closing rate at the end of reporting period.
  Example:

Year	20X3	20X2
Exchange Rate	31-03-20X3	31-03-20X3

- If Functional currency is Hyperinflationary & Reporting currencies is Non-hyperinflationary, then translate using closing rate at the end of respective period of Financial statement.
  Example:

Year	20X3	20X2
Exchange Rate	31-03-20X3	31-03-20X2

12 Disclosure

Ind AS 21 requires following disclosures:

- amount of exchange differences recognised in profit or loss
  - except for those arising on financial instruments measured at fair value through profit or loss in accordance with Ind AS 109;
- net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity,
  - along with the reconciliation of the amount at the beginning and end of the period
- when the presentation currency is different from the functional currency –
  - that fact shall be stated, together with disclosure of the
    - functional currency and

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- the reason for using a different presentation currency;

- in case of change in functional currency of either the reporting entity or a significant foreign operation:
  - (i) fact of such change;
  - (ii) reason for the change and;
  - (iii) date of change in functional currency;
- if presentation currency is different from functional currency, the financial statements can be described as complying with Ind AS only if all Ind AS including the translation method of this Standard is complied with.

  However, if an entity presents its financial statements or supplementary financial information in a currency other than its functional or presentation currency:
  - the information should be clearly identified as supplementary information to distinguish it from the information that complies with Ind AS;
  - the currency in which the supplementary information is displayed should be disclosed; and
  - the entity's functional currency and the method of translation used to determine the supplementary information should be disclosed.

13 AS 11 vs Ind AS 21

S.No	Particulars	AS 11	Ind AS 21
1	Functional Currency	Not exist	Exist
2	Foreign currency	Currency other than Reporting currency	Currency other than Functional currency
3	Presentation currency	Silent	It can be different from local currency, functional currency
4	Approach for Translation – Foreign Operation	Based on →Integral foreign operation and → Non-integral foreign operation (NIFO)	Based on Functional currency approach → Determining an entity's functional currency similar to indicators to determine Non-Integral FO in AS 11 → Despite of difference in terms there is no substantive difference in respect of accounting of a foreign operation.
5	NIFO	Non-integral foreign operation	Net Investment in foreign operation
6	Long term monetary items	→ No exemption given under Ind AS 21 → Ind AS 101 gives an	AS 11 itself explains about accounting LTMI

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		exemption of Para 46A under Ind AS 11 - either recognise in P&L or adjust the carrying amount of asset	
7	Exclusion of Forward exchange contract and other similar financial instrument	No specific mention	Excludes from its scope

ILLUSTRATIONS

1. Illustration

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.? (SM) [Ans: Local Currency (L$)]

2. Illustration

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? (SM) [Ans: USD]

3. Illustration

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 presume its functional currency to be INR? (SM)
[Ans: No. USD should be considered as the functional currency of B]

4. Illustration

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.

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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 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? (SM)
[Ans: INR]

5. Illustration

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 $ = Rs. 60. The fair value of the machinery determined on 31st March, 20X1 is $ 5,500. The exchange rate on 31st March, 20X1 is 1$ = Rs. 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$ = Rs. 67. The fair value of the machinery remain unchanged for the year ended on 31st March 20X2. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. Tax rate is 30%. A Ltd. follows Revaluation method in respect of Plant & Machinery. (SM)

6. Illustration

On 1st January, 2018, P Ltd. purchased a machine for $ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was $1= Rs. 68. P Ltd. is not required to pay for this purchase until 30th June, 2018. Rupees strengthened against the $ in the three months following purchase and by 31st March, 2018 the exchange rate was $1 = Rs. 65. CFO of P Ltd. feels that these exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees. which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same.
Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2018 as per Ind AS. (SM}

7. Illustration

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

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rates on 1st January, 2018 and 31st March, 2018 are Rs. 72 per USD and Rs. 75 per USD respectively. (SM)

[Ans: Amount of revenue to be recognised on date of revenue (31st March 2018) – ₹ 3,690 million)

8. Illustration

On 1st 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. (SM)

[Ans: Initial measurement amount – ₹ 1,45,00,000; Finance cost for year – ₹ 16,84,320; Closing balance – ₹ 1,62,14,000; Exchange loss – ₹ 16,79,860]

9. Illustration

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 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**	

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 (SM)

10. Illustration

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

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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? (SM)
[Ans: Recognised in Profit or Loss as it is in nature of Trade Balance]
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 group, T, rather than from P directly. That is, on directions of P, T gives loan to S. T is also a subsidiary of P. Where should exchange difference, if any, be recognised? (SM)
[Ans: Profit or loss in P's separate financial statements and in OCI in its consolidated financial statements]

11. Illustration

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 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 Rs. 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 and payable 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 = Rs. 83
Exchange rate on 31st March, 20X1 1 Euro = Rs. 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. (SM)

12. Illustration

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. (SM)

[Ans: (i) Rs. 117.6 million; (ii) Rs. 149.40 million]

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13. Illustration

Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for Rs. 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is Rs. 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of Rs. 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of Rs. 180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is Rs. 20 lakhs

Calculate P's gain on disposal in its consolidated financial statements. (SM)[Ans – Rs. 780 lakhs]

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1 Introduction

Ind AS 23 deals with Borrowing Costs – costs associated with Borrowed funds. Normally, such costs are taken to Statement of Profit and Loss as they represent an expense for the entity. However, certain borrowing costs are added to the cost of an asset.

1.1 Core Principle of Ind AS 23

Borrowing Costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset i.e., it is capitalised.

Other borrowing costs are recognised as an expense in the period in which they are incurred.

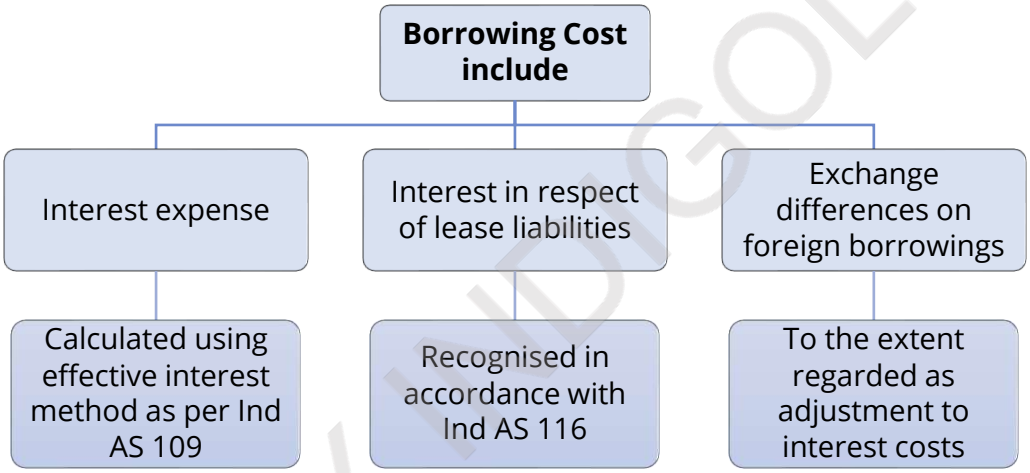
Ind AS 23 specifies about borrowing costs eligible for capitalisation and gives us guidelines for commencement, suspension, and cessation of capitalisation.

Capitalisation of borrowing costs helps reflect true cost of an asset and correct profit/loss for an entity.

2 Important Terms

2.1 Borrowing Costs

Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.



2.1.1 Effective Interest Method

This method is covered in detail in Ind AS 109 – Financial Instruments. In short, this method considers discount, premium, fees associated with borrowings and involves finding a rate that exactly discounts estimated future cash payments to the amortised cost of borrowings. It is basically, an IRR for the borrowed amount.

Example: Company issues 10% debentures of ₹1,00,000 at 5% discount with a tenure of 3 years. Here, effective interest rate will be 12.12% and interest expense for 3 years shall be as follows:

Year	Opening balance	Interest @12.12%	Payment	Closing balance
1	95,000	11,514	10,000	96,514
2	96,514	11,697	10,000	98,211
3	98,211	11,788	1,10,000	(0)

2.1.2 Exchange differences on foreign borrowings

- Company may borrow funds in a currency that is not its functional currency. E.g., an Indian company may take US $ loan
- This may have been done to take the benefit of lower interest costs of foreign currency borrowings
- But such foreign currency borrowings may involve exchange differences
- Regarding exchange difference required to be treated as borrowing costs:

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➔ **Adjustment amount should be equivalent to exchange loss not exceeding the difference between cost of borrowing in functional currency vis-à-vis the cost of borrowing in a foreign currency**

Example: Company borrows $ 20,000 @ 3% for 1 year on 1st Jan, 20x1 when $ 1 = ₹ 75. Interest and loan are repayable on 31st Dec, 20x1. On 31st Dec, 20x1, exchange rate is $ 1 = ₹ 78. Company could borrow ₹ funds @ 6%.

Date	$ borrowed	Exchange Rate	₹ equivalent
1 Jan 20x1	20,000	75	15,00,000
31st Dec 20x1	20,000	78	15,60,000
Exchange Loss	20,000	3	60,000

The exchange loss in this case is ₹ 60,000 [$ 20,000 x (₹ 78 - ₹ 75)]. Interest cost on this loan is ₹ 46,800 (3% x $ 20,000 x ₹ 78). Had the entity borrowed funds in ₹, the borrowing cost would have been ₹ 90,000 (₹ 15,00,000 x 6%).

₹ 43,200 is the savings in interest costs because of borrowing in $ vis-à-vis ₹. Company will treat exchange difference up to ₹ 43,200 (₹ 90,000 – ₹ 46,800) as a borrowing cost under this Standard. Thus, the total eligible borrowing cost is ₹ 90,000 (₹ 46,800 + ₹ 43,200).

➔ **The realised or unrealised gain to the extent of the unrealised exchange loss previously recognised as an adjustment should also be recognised as an adjustment to interest.**

Example: Company borrows $ 1,000 @ 4% on 1st Apr, 20x1 when $ 1 = ₹ 40. On 31st Mar, 20x2, exchange rate is $ 1 = ₹ 50. Company could borrow ₹ funds @ 12%.

At end of year 1, exchange loss (unrealised) is ₹ 10,000 [$ 1,000 x (₹ 50 - ₹ 40)]. Interest cost for year 1 is ₹ 2,000 (4% x $ 1,000 x ₹ 50). Had the entity borrowed funds in ₹, the borrowing cost would have been ₹ 4,800 (₹ 40,000 x 12%).

Company will treat exchange loss (unrealised) up to ₹ 2,800 (₹ 4,800 – ₹2,000) as a borrowing cost. So, total eligible borrowing cost for year 1 will be ₹ 4,800 (₹ 2,000 + ₹ 2,800).

At end of Year 2 – If Exchange rate $ 1 = ₹ 48
Interest cost for Year 2 is ₹ 1,920 ($ 1,000 x 4% x ₹ 48). Exchange gain (unrealised) is ₹ 2,000 ($ 1,000 x (₹ 50 – ₹48). Since in Year 1, unrealised exchange loss of ₹ 2,800 was adjusted in borrowing cost, exchange gain of ₹ 2,000 will be adjusted in the borrowing cost in this year. (Note: Exchange gain is less than exchange loss recognised in earlier year).
Net borrowing cost for year 2 will be (₹80) [₹ 1,920 - ₹ 2,000]

At end of Year 2 – If Exchange rate $ 1 = ₹ 44
Interest cost for Year 2 is ₹ 1,760 ($ 1,000 x 4% x ₹ 44). Exchange gain (unrealised) is ₹ 6,000 ($ 1,000 x (₹ 50 – ₹44). Since in Year 1, unrealised exchange loss of ₹ 2,800 was adjusted in borrowing cost, exchange gain upto ₹ 2,800 will be adjusted in the borrowing cost in Year 2 (Note: Exchange gain is more than exchange loss recognised in earlier year).
Net borrowing cost for year 2 will be (₹1,040) [₹ 1,760 - ₹ 2,800]

Part Payment [$ 600] – At end of Year 1 i.e., on 31st Mar, 20x2
Exchange rate on 31st Mar, 20x2 being $ 1 = ₹ 50, interest cost for year 1 is ₹ 2,000 (4% x $ 1,000 x ₹ 50). Had the entity borrowed funds in ₹, the interest cost would have been ₹ 4,800 (₹ 40,000 x 12%).
Realised exchange loss is ₹ 6,000 [$ 600 x (₹ 50 - ₹ 40)] and unrealised exchange loss is ₹ 4,000 [$ 400 x (₹ 50 - ₹ 40)]. Total exchange loss is ₹ 10,000.

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Company will treat total exchange difference up to ₹ 2,800 (₹ 4,800 – ₹2,000) as a borrowing cost. So, total eligible borrowing cost for year 1 will be ₹ 4,800 (₹ 2,000 + ₹ 2,800). Out of exchange difference of ₹ 2,800 regarded as borrowing costs, ₹ 1,680 $[\frac{2,800}{10,000} \text{ x } 6,000]$ relates to realised exchange loss and ₹ 1,120 $[\frac{2,800}{10,000} \text{ x } 4,000]$ pertain to unrealised exchange loss.

Thus, in future years, realised or unrealised exchange gain only to extent of ₹ 1,120 will be treated as adjustment to interest cost.

2.2 Qualifying Asset

Qualifying asset is an asset that necessarily takes a **substantial period of time** to get ready for its intended use or sale.

Depending on circumstances, any of the following may be qualifying assets:

(a) inventories
(b) manufacturing plants
(c) power generation facilities
(d) intangible assets
(e) investment properties
(f) bearer plants

2.2.1 Substantial period of time

- Ind AS 23 does not provide any guidance on what constitutes a **substantial period of time**
- Specific facts and circumstances should be considered in each case

Period of 12 months or more might be considered 'substantial'

2.2.2 Qualifying assets - Exclusions

- Financial assets, and inventories that are manufactured, or otherwise produced, over a short period of time
- Assets that are ready for their intended use or sale when acquired are not qualifying assets.

3 Scope of Ind AS 23

- An entity shall apply this standard in accounting for borrowing costs.
- This standard does not apply to

➔ **actual or imputed cost of equity, including preferred capital not classified as a liability**
Example: Dividend paid on equity shares, cost of issuance of equity shares, cost of preference share capital (not classified as liability as per Ind AS 32)

➔ **qualifying assets that are measured at fair value**
Example: Biological asset accounted for under Ind AS 41
If the assets are measured under fair value model, then capitalisation would not affect measurement of the asset and would involve only reallocation between finance cost and fair value movement in the Statement of profit and loss.

➔ **inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis even if they take a substantial period to get ready for sale**
It becomes difficult in such situations to allocate borrowing costs to such inventories and monitoring those borrowing costs until the inventories are sold.

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4 Recognition of Borrowing Costs

- Borrowing costs that are directly attributable to the acquisition, construction or production of a **qualifying asset** are capitalised as part of the cost of the qualifying asset
- Such borrowing cost are capitalised when below **two conditions are satisfied**:
  - ✓ it is probable that it will result in future economic benefits to the entity; and
  - ✓ costs can be measured reliably
- Other borrowing costs are recognised as an expense in the period in which they are incurred.
- When an entity applies Ind AS 29 Financial Reporting in Hyperinflationary Economies, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period.

4.1 Borrowing Costs eligible for Capitalisation

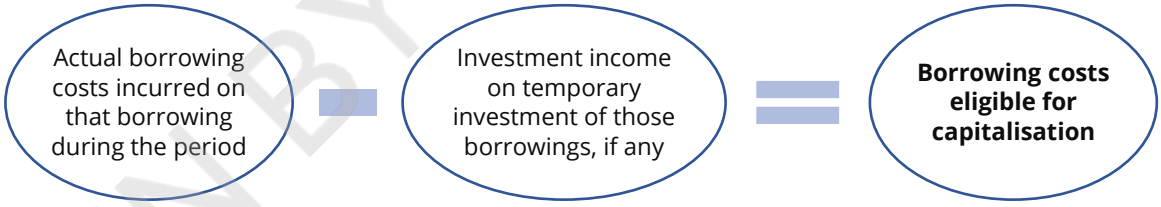
This includes those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.

A notional borrowing cost cannot be capitalised.

Example: If a company incurs an expenditure of ₹ 1 lakh on construction of qualifying asset by taking a 10% loan of ₹ 50,000 and using own funds of ₹ 50,000, then borrowing costs associated with loan shall only be capitalised, Opportunity cost of own funds are not capitalised.

4.1.1 Specific Borrowing Costs

- If an entity borrows funds specifically to obtain a qualifying asset, they are known as specific borrowings.
- Specific borrowings cost eligible for capitalisation would be **actual borrowing costs incurred** during the period ***less*** any investment income on temporary investment of those borrowings.
  - An entity may obtain borrowed funds and incur associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset.
  - In such circumstances, funds are often temporarily invested pending their expenditure on the qualifying asset.
  - In determining amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.



4.1.2 General Borrowing Costs

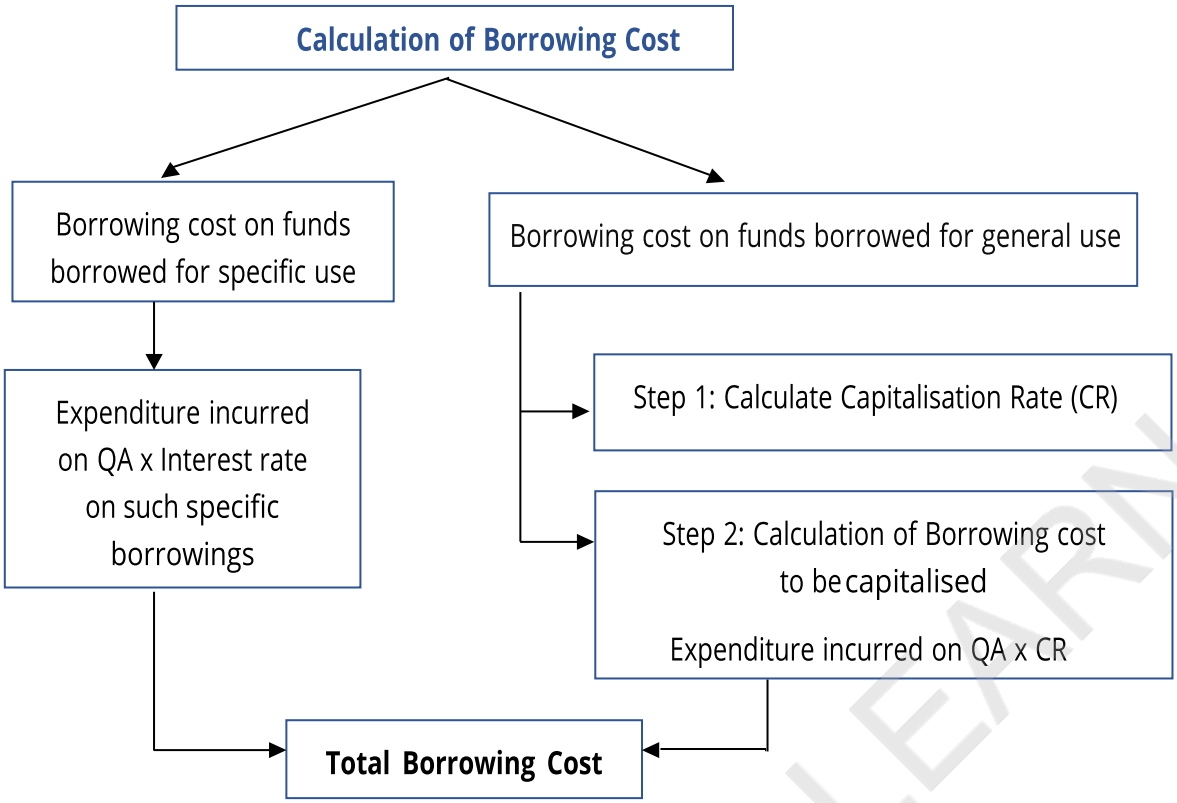
- All borrowings that are not specific represents general borrowings.
- If Specific borrowing remains outstanding after the related asset is ready for its intended use or sale, it becomes part of general borrowings.
- When general borrowings are used for qualifying assets, Ind AS 23 requires that, borrowing costs eligible for capitalisation is calculated by applying a **capitalisation rate** to the expenditures on qualifying assets.

4.2 Calculation of capitalisation rate

Capitalisation rate is the **weighted average of the borrowing costs** applicable to all the general borrowings of the entity that are outstanding during the period.

$$\textbf{Capitalisation Rate} = \frac{\text{Total borrowing costs on outstanding general borrowings}}{\text{Total outstanding general borrowings of entity during the period}}$$

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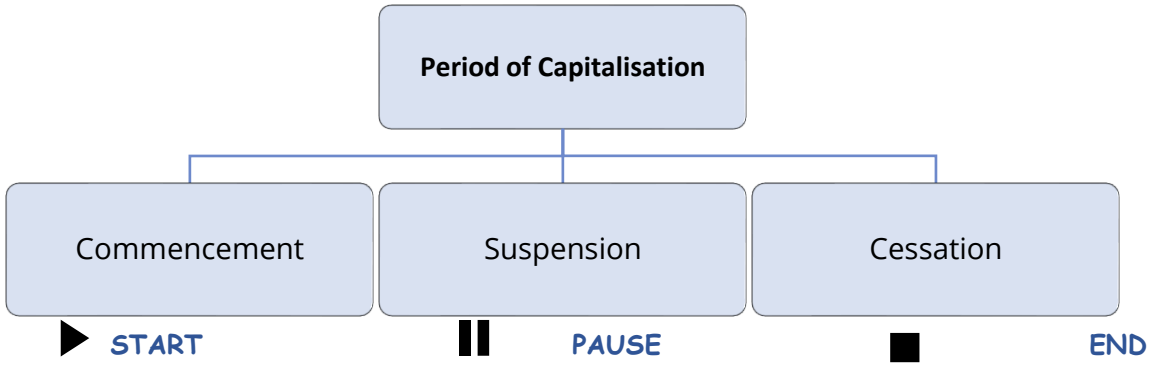
Things to Note:

- ✓ Amount of borrowing costs capitalised during a period shall not exceed amount of borrowing costs incurred during that period
- ✓ Capitalisation rate is calculated considering all general borrowings o/s during the financial year, not necessarily during construction period
- ✓ In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.

4.3 Expenditure to which capitalisation rate is applied

- Amount of expenditure on a qualifying asset include only those expenditures that have resulted in
  - payments of cash,
  - transfers of other assets or
  - the assumption of interest-bearing liabilities.
- Expenditures are reduced by any progress payments received and grants received in connection with the asset (Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance).

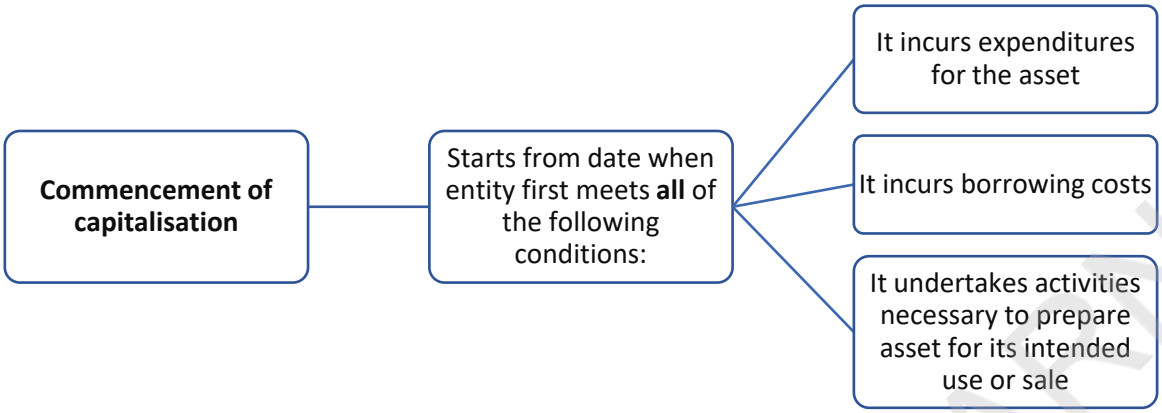
5 Period of Capitalisation



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5.1 Commencement of Capitalisation

An entity is required to begin the capitalisation of borrowing costs as part of the cost of a qualifying asset on the commencement date.



Activities necessary to prepare asset for its intended use or sale

- **Includes** technical and administrative work prior to commencement of physical construction, such as activities associated with obtaining permits
- **exclude** holding of an asset when no production or development that changes the asset's condition is taking place

5.2 Suspension of Capitalisation

- Capitalisation of borrowing costs shall be suspended during extended periods in which **active development of a qualifying asset is suspended**.
- Such costs are costs of holding partially completed assets and do not qualify for capitalisation.
- Capitalisation of borrowing cost is **not suspended when temporary delay is a necessary part** of the process of getting an asset ready for its intended use or sale
    - Example: Capitalisation continues during extended period when high water levels delay construction of a bridge, if such high-water levels are common during the construction period in the geographical region involved.

5.3 Cessation of Capitalisation

- Capitalisation of borrowing costs ceases when **substantially all activities necessary** to prepare qualifying asset for its intended use or sale are **complete**.
- An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might continue.
- If minor modifications, such as decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

5.3.1 When construction of qualifying asset is completed in parts

If each part is capable of being used while construction continues on other parts, entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.

Example: A business park comprising several buildings, each of which can be used individually, is a qualifying asset for which each part is capable of being usable while construction continues on other parts.

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Example: An industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill, is an example of qualifying asset that needs to be complete before any part can be used.

6 Disclosure Requirements

Entities are required to disclose:

(a) **amount of borrowing costs** capitalised during the period; and

(b) **capitalisation rate** used to determine the amount of borrowing costs eligible for capitalisation

7 Other Relevant Concepts

7.1 Dividends payable on shares classified as financial liabilities

- An entity might finance its operations in whole or in part by issue of preference shares and in some circumstances, these will be classified as financial liabilities (as per Ind AS 32).
- Dividends payable on these instruments would meet the definition of borrowing costs, subject to the fulfilment of certain conditions.

General rule: Dividends are not considered as Borrowing Costs.

7.2 Cessation of capitalisation for maturing inventories

- For maturing inventories, it is sometimes difficult to determine when 'period of production' ends, i.e., when inventories are being held for sale as opposed to being held to mature.
  - Example: Whisky is 'mature' after three years but goes on improving with age for many more years.
- Borrowing costs are added to the value of such maturing inventories for as long as it can be demonstrated that the particular item of inventory **continues to increase in value on account of** increasing age, rather than because of market fluctuations or inflation.
- If this cannot be demonstrated, then the inventories should be regarded as held for sale and no further borrowing costs should be capitalised.

7.3 Capitalising borrowing cost in group financial statements

Borrowings are taken by one company and qualifying asset is developed by another company within a group	• Entity carrying out development should not capitalise any interest in its own financial statements as it has no borrowings • Capitalise interest in the group financial statements
Intra-group borrowings	• Interest on such borrowings may be capitalised in entity's own financial statements, but not at the group level
Amount of interest to be capitalised	Interest capitalised should fairly reflect interest cost of the group on borrowings from third parties that could have been avoided if expenditure on qualifying asset were not made.

8 Significant Differences between Ind AS 23 and AS 16

Basis of differences	Ind AS 23	AS 16
Qualifying Asset measured at Fair Value	Does not require entity to apply standard to qualifying asset measured at fair value	Does not provide for such scope relaxation
Calculation of interest expense	Calculation of interest expense using effective interest rate method as described in Ind AS 109	Borrowing costs to include: interest and other expenses, amortisation of discounts or premiums, amortisation of ancillary costs

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Reporting in Hyperinflationary Economies	When Ind AS 29 is applied, part of the borrowing costs that compensates for inflation should be expensed	Does not contain similar clarification as no such standard on Hyperinflationary Economies
Substantial Period of Time	Explanation of 'Substantial Period of Time' is not included	Gives explanation for meaning of 'Substantial Period of Time'
Borrowings of the Parent and its Subsidiaries for Computing Weighted Average	Specifically provides that in some circumstances, it is appropriate to include all borrowings of parent and its subsidiaries when computing weighted average of borrowing costs while in other circumstances, it is appropriate for each subsidiary to use weighted average of the borrowing costs applicable to its own borrowings.	No specific provision
Applicability to Inventories	Excludes inventories that are manufactured/ produced in large quantities on a repetitive basis	Does not provide for such scope relaxation
Disclosure of Capitalisation rate	Requires disclosure of capitalisation rate	Does not have this disclosure requirement

9 Other Points to Note

Other things to note:

- Capitalisation rate is calculated considering all general borrowings o/s during the financial year, not necessarily during construction period
- In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.
- When an entity applies Ind AS 29 Financial Reporting in Hyperinflationary Economies, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period.
- Borrowing costs in case of maturing inventories can be capitalised if inventory continues to increase in value on account of increasing age
- Dividends payable on shares classified as financial liabilities as per Ind As 32 are considered as Borrowing Costs
- Things to refer in detailed notes - Capitalising borrowing cost in group financial statements, significant differences between Ind As 23 and AS 16

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ILLUSTRATIONS

1. Illustration

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?

2. Illustration

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?

3. Illustration

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	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 capitalised assuming that the factory building was completed on 31st March, 20X2.

4. Illustration

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

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.

5. Illustration

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	65,0000

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	15,00,000	1,65,000

Compute the borrowing costs that need to be capitalised.

6. Illustration

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 capitalisation rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'.

7. Illustration

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.

8. Illustration

H Limited, a real estate company, gives immovable property on rent. It has completed on 31st May, 20X1, a commercial complex consisting of various offices that could be rented out. It expects that the commercial complex will be completely rented out by 30th June, 20X1.

However, due to adverse market conditions, only 10% of the commercial complex could be rented out by its reporting date of 31st March, 20X2. H Limited wants to capitalise the eligible borrowing costs incurred up to 31st March, 20X2. Discuss.

9. Illustration

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.

10. Illustration

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

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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.

11. Illustration

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?

12. Illustration

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.

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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?

13. Illustration

How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹ 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

14. Illustration

Nikka Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of ₹ 510 lacs was incurred on installation of Plant and Machinery, ₹ 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of ₹ 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ₹ 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 20X2?

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Ind AS 36
IMPAIRMENT OF ASSETS

1. Introduction

1.1 Objective

- Prescribe the methodology that an entity applies to ensure that its assets are not carried at more than their recoverable amount.
- Recognise impairment loss if the asset is carried at more than its recoverable amount.
- Specifies when an entity shall reverse an impairment loss
- Disclosure requirements

1.2 Scope

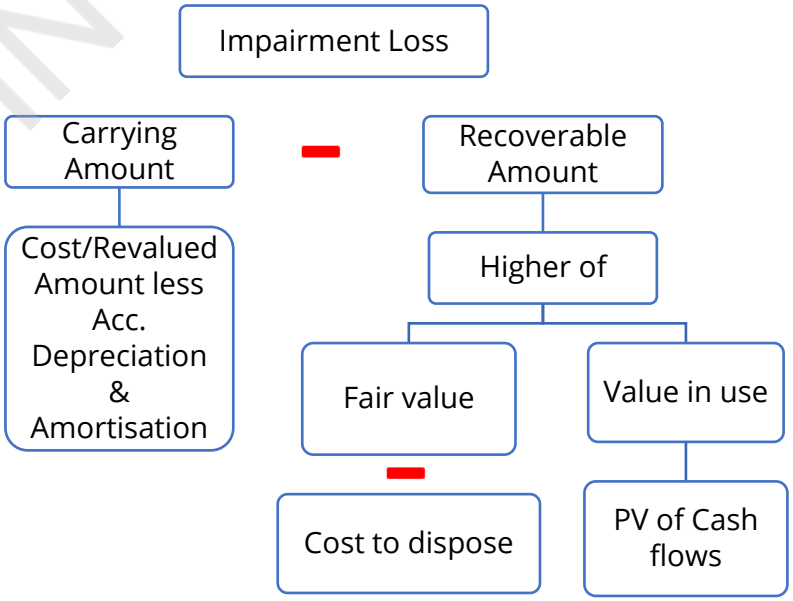
Applies to accounting for the impairment of all the assets **other than**

(a) Inventories	Ind AS 2
(b) Contract assets and assets arising from costs to obtain or fulfil a contract	Ind AS 115
(c) Deferred tax assets	Ind AS 12
(d) Assets arising from employee benefits	Ind AS 19
(e) Financial Assets	Ind AS 109
(f) Biological assets related to agricultural activity	Ind AS 41
(g) Deferred acquisition costs and intangible assets arising from insurance contracts	Ind AS 104
(h) Non-current assets (or disposal groups) classified as held for sale	Ind AS 105
(i) Financial Assets	Ind AS 109

This standard applies to financial assets classified as

(a) Subsidiaries (Ind AS 110)
(b) Associates (Ind AS 28)
(c) Joint Ventures (Ind AS 111)

2. Definitions



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2.1 Impairment Loss

It is the amount by which carrying amount exceeds the recoverable amount.

Impairment loss = Carrying Amount – Recoverable Amount

2.2 Recoverable Amount

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.

2.3 Value in Use

Present value of the future cash flows expected to be derived from an asset or cash-generating unit.

2.4 Fair Value

Price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between market participants at the measurement date.

2.5 Costs of Disposal

Incremental costs directly attributable to the disposal of an asset or cash-generating unit, **excluding** finance costs and income tax expense.

2.6 Carrying Amount

Amount at which an asset is recognised **after deducting** any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

2.7 Cash Generating Unit

A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For e.g. a Hotel division of ITC group

2.8 Corporate Assets

Corporate assets are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units. For e.g Corporate Head Office, Common shared service center.

3. Depreciation vs Impairment

Depreciation/ Amortisation	Impairment of Asset
(a) Reduction in the value of the asset	(a) Reduction in the value of the asset
(b) It is allocation of depreciable amount on a systematic basis.	(b) It is done only when there are indications that the asset was impaired.

4. Identifying an Asset that may be impaired

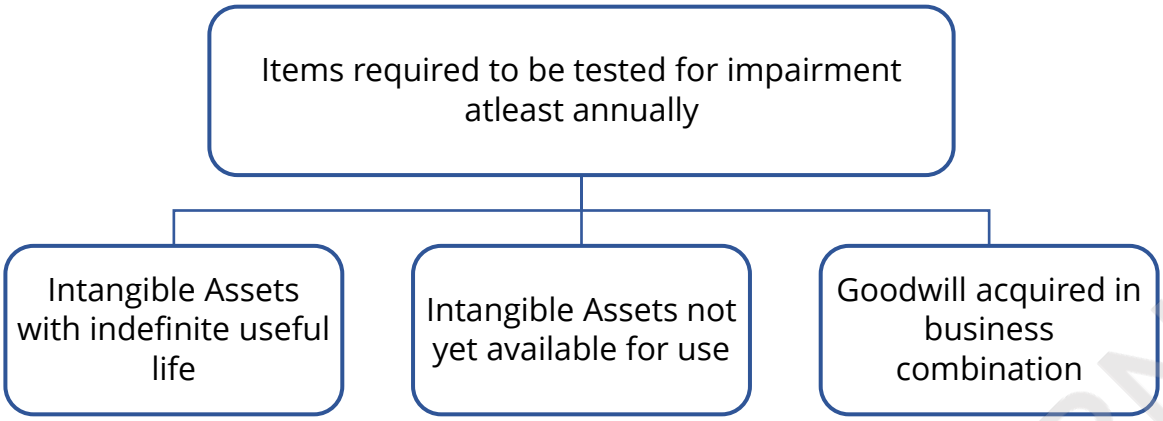
4.1 General Rule -

Assess at the **end of each reporting period** whether there is **any indication** that an asset may be impaired.

If any indication exists, estimate the recoverable amount of the asset.

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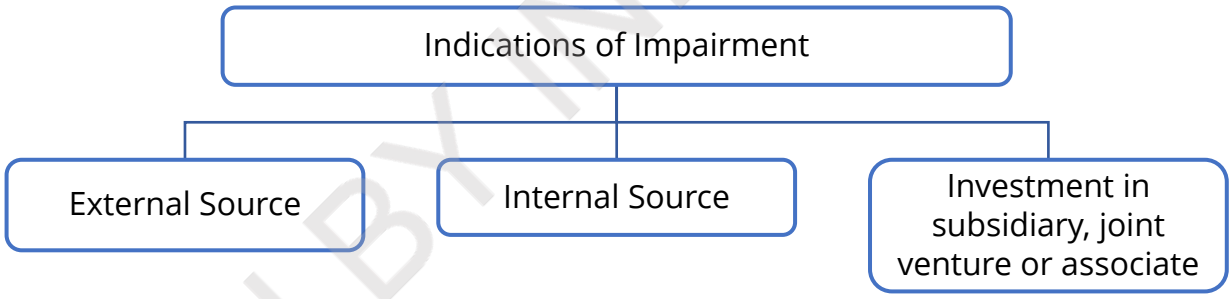
4.2 Exceptions to the general rule



4.2.1 Impairment in respect to Intangible Assets referred above –

- Impairment test may be performed at any time during an annual period, but it should be performed at the **same time every year.**
- Different intangible assets may be tested for impairment at different times.
- If the above intangible assets were initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.

5. Indications of Impairment



5.1 External source of Information

(a) Significant decline in the market value. Because of this, fair value less cost of disposal will be reduced.

(b) Significant changes in technology, market, economic or legal environment with **adverse effect** on entity.

(c) Increase in market interest rates or rate of returns. This affects discount rate used in calculating asset's value in use and decrease asset's recoverable amount

(d) Carrying amount of net assets > Market capitalisation of entity

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Sometimes the above indications **may not affect the specific company** and management may have their own strategies to overcome the challenges

For Example:

(i) Increase in short term interest rate may not have direct impact on the value in use in long run.

(ii) Increase in outflows may be compensated by increase in selling price

5.2 Internal sources of Information

(a) Obsolescence or physical damage of an asset.

(b) Significant changes in use or expected use of an asset with an **adverse effect** on the entity.

Once the asset meets the criteria to be classified as **held for sale** – it will be **out of scope of Ind AS 36** and governed by Ind AS 105

(c) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

For Example:

Cash outflows for operating and maintaining asset > Budgeted
Actual net cash flows or operating profits < Budgeted
Decline in budgeted net cash flows / Increase in budgeted loss
Operating losses or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

5.3 Investment in Subsidiary, Joint Venture and Associates - Indicators

If the investor recognises a dividend from the investment and evidence is available that

(a) Carrying amount of investment (in separate financial statements) > Carrying amount of investee's net assets (including associated goodwill) in the consolidated financial statements.

(b) Dividend > Total Comprehensive income of investee.

6. Measurement of Recoverable Amount

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.

6.1 Circumstances in which it is not necessary to calculate both an asset's fair value less costs of disposal and its value in use

(a) If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

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(b) If there is no basis for making a reliable estimate of fair value less costs of disposal, recoverable amount is measured by reference to value in use alone.

If earlier computations show that recoverable amount > carrying amount (**significantly**), it need not to perform the same immediately unless there are significant changes which affect it.

7. Cash Generating Unit (CGU)

If recoverable amount cannot be determined for an individual asset, it is determined for a CGU. An entity identifies the lowest aggregation of assets (CGU) that generate largely independent cash inflows, **monitored for internal management purpose**.

No impairment loss is recognised for the asset if the related cash-generating unit is not impaired.

CGUs shall be **identified consistently** from period to period for the same asset or types of assets **unless a change is justified**.

7.1 Existence of active market for the output produced by asset/CGU

If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a CGU, even if some or all the output is used **internally**. E.g Refinery producing oil sold by other divisions, Power plants generating electricity for internal use.

If cash flows are **affected by internal transfer pricing**, an entity shall use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:

a) the future cash **inflows** used to determine the **asset's or CGU value in use**
b) Future cash **outflows** used to determine the **value in use of any other assets** or cash-generating units that are affected by the internal transfer pricing.

8. Fair Value Less Cost of Disposal (FVLCD)

8.1 Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

8.2 Cost of Disposal

Costs of disposal are incremental costs **directly attributable to the disposal** of an asset or CGU, excluding finance costs and income tax expense.

For Example:

Stamp duty, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale.

Terminal benefits to employees and costs associated with reorganising a business following the disposal of an asset are not direct incremental costs to dispose the asset.

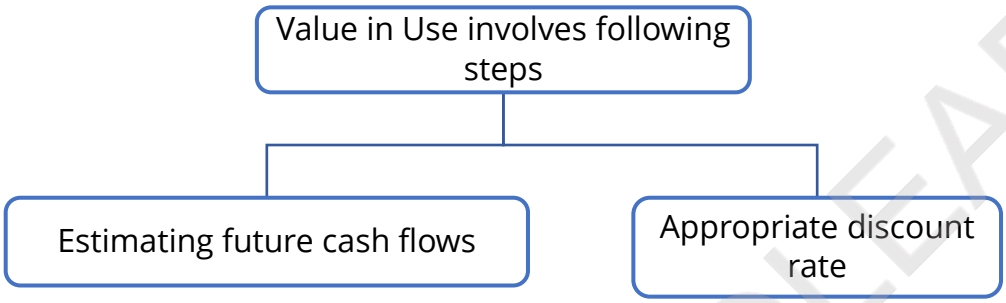
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If the **disposal** of an asset would require the **buyer** to **take over a liability** and **single fair value** less cost of disposal is available for both the asset and the liability, then

FVLCD = Price to sell asset and the liability **Less** cost of disposal

9. Value in Use

Value in use is the present value of the future cash flows expected to be derived from an asset or CGU



9.1 Estimation of Expected Future cash flows

(a) Cash flow projections should be based on reasonable and supportive evidence.

(b) The estimations must be based on economic conditions that will exist over the remaining useful life of the asset

More weightages must be given to external evidence

(c) Most recent financial budgets and forecasts that have been approved by the management to be considered.

- Forecasts should not be based on from future restructuring or enhancing the asset's performance.
- If entity is committed to future restructuring, include cashflows from such restructuring.

(d) Maximum period covered – 5 years (unless a longer period is justified)

(e) Cash flow projections beyond the budget period should be estimated by using a steady/declining/zero/negative growth rate.

Increasing growth rate can also be used only when it is **justified.**

(f) The growth rate used should not exceed the long term average growth rate of products, industry, country etc., unless a higher rate can be justified.

(g) Estimated Cash flows are based on following two approaches.

(i) Traditional approach – Best possible outcome

(ii) Expected value approach – Based on various possible outcomes.

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9.1.1 Inclusions and Exclusions from Future cash flows –

Inclusions	Exclusions
(i) Cash flows from the continuing use of the asset	(i) Cash inflows from assets that generate cashflows that are largely independent from the asset under review. **Example:** Receivables
(ii) Net cash flows to be received (or paid) for the disposal of the asset at the end of its useful life. **(Estimated on arm's length transaction)**	(ii) Cash outflows that relate to obligations that have been recognised as liabilities. **Example:** Payables
(iii) Day to day servicing of the asset, future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.	(iii) Cash flows from entity's restructuring plans which are not yet committed. If committed, its estimates of future cash outflows for the restructuring are included in a **restructuring provision** in accordance with **Ind AS 37**
(iv) Appropriate apportionment of corporate overheads **(care should be taken for internal charges, if any)**	(iv) Any internal charges incurred by the CGU for using corporate assets.
	(v) cash flows that are expected to arise from improving or enhancing the asset's performance.
	(vi) Cash flows from financing activities.
	(vii) Income tax receipts and payments.

Other Important Points:

(i) For estimating net cash flow at the time of disposal, entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used.

(ii) Future cash flows reflect assumptions that are consistent with the way discount rate is determined.

- Time value of money is considered by discounting the estimated future cash flows. Hence, cash flows from financing activities are excluded.

(iii) Estimates of future cash flows include future cash outflows which are necessary to maintain current standard of performance.

When individual asset/CGU consist of components with different estimated useful life, replacement cost of such components with shorter lives should be included in cash flows generated by the asset/CGU.

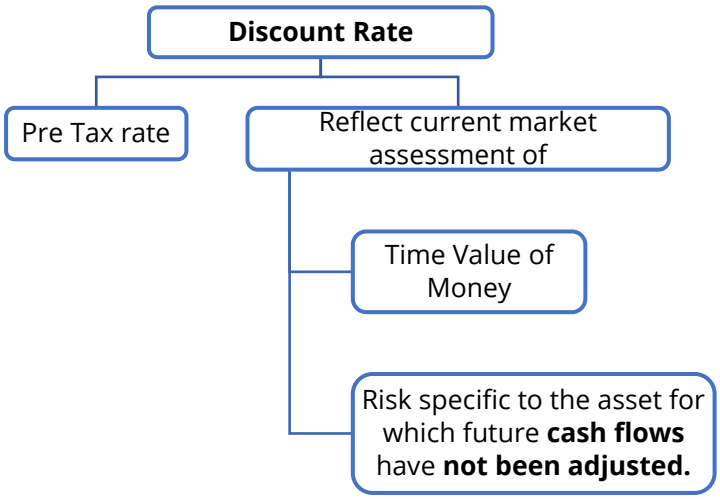
9.1.2 Foreign currency future cash flows

(i) Future cash flows are estimated in the currency in which they will be generated and then discounted using the discount rate appropriate for that currency.

(ii) Entity translates the present value using the spot exchange rate at the date if calculating value in use.

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9.2 Discount Rates



Risk Specific to the asset –

(i) It is the rate if return that an investor requires to earn from the asset. If the business with asset/CGU is risky, the entity's expectation of return is high and vice versa.

(ii) Entity should use different rates for different assets or CGUs considering risks associated.

(iii) This asset specific rate is estimated from the rate

- Implicit in current market transactions for similar assets **(or)**
- Weighted average cost of capital of a listed entity that has single asset (or a portfolio) similar in terms of service potential and risks to the asset under review.

When **asset specific rate is not directly available** from the market, an entity uses other bases such as

(a) Weighted average cost of capital (WACC) determined using CAPM technique
(b) Enterprise incremental borrowing rate
(c) Other market borrowing rates.

(iv) The above rates can be adjusted by

- Adding specific risks associated with projected cash flows
- Excluding risks that are not relevant to the projected cash flows.

Country risks, currency risks, price risks, cash flow risks also to be considered.

9.3 Adjustment to Inflation in cash flows and Discount rate

(i) Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation.

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(ii) If the discount rate includes the effect of general inflation, future cash flows are estimated in nominal terms.

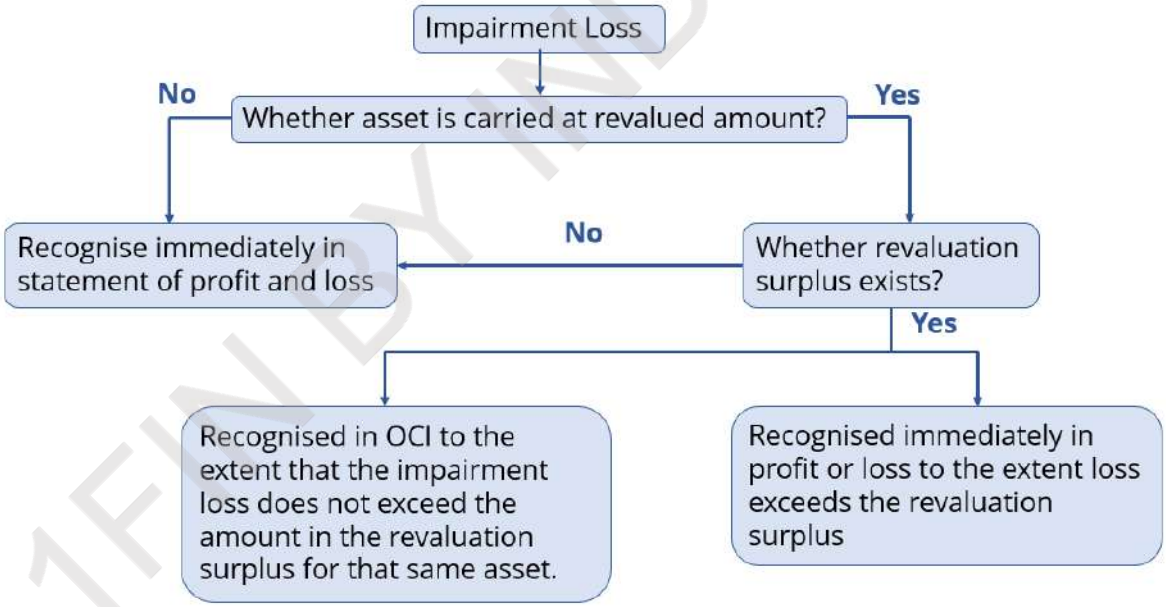
(iii) If the discount rate excludes the effect of general inflation, future cash flows are estimated in real terms **(but includes future specific price increase or decrease)**

The entity **adjusts** the **cash flows from the disposal** of an asset for the effect of both future price increases **due to general inflation** and specific future price increase or decrease.

If estimates of future **cash flows** from the asset's continuing use and the **discount rate exclude** the effect of general **inflation**, the entity also **exclude**s this effect from the estimate of net cash flows **on disposal**.

10. Recognition and Measurement of Impairment Loss

10.1 Individual Assets



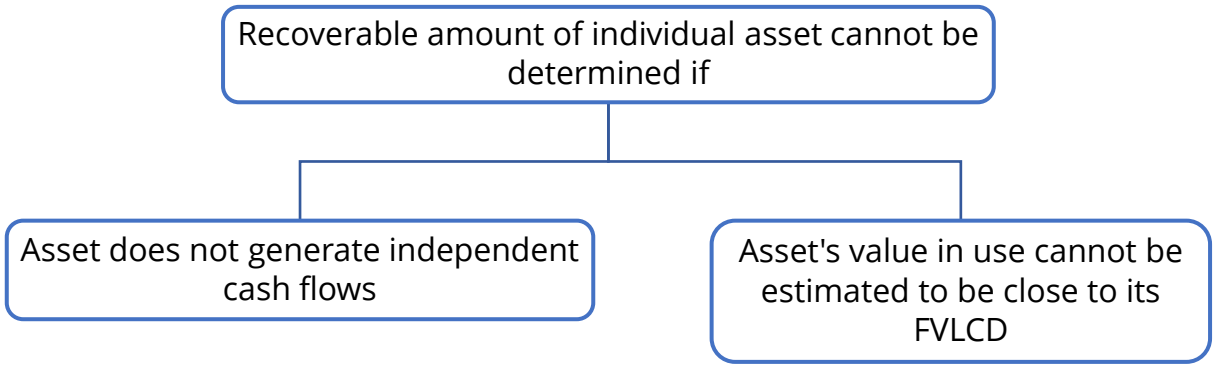
Other important points

(a) When Impairment loss > carrying amount of the asset, an entity shall recognise a liability.

(b) After recognition of impairment loss, depreciation/amortisation to be calculated on the revised carrying amount over its remaining useful life.

(c) After recognition, any related deferred tax assets and liabilities are determined in accordance with Ind AS 12 by comparing revised carrying amount with its tax base.

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10.2 Cash Generating Unit

10.1.1 Carrying amount of CGU

Inclusions	Exclusions
(i) Carrying amount of only those assets that can be attributed **directly**, or allocated on a **reasonable and consistent** basis, to the CGU and will generate future cash flows.	(i) Carrying amount of any recognised liability **unless** the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability.

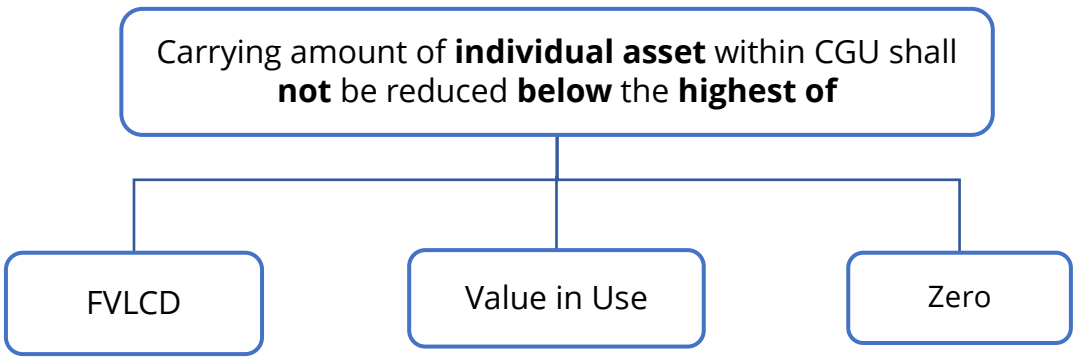
- If disposal of CGU would require the buyer to assume the liability,

FVLCD of CGU = Estimated selling price of assets & liability of CGU – cost of disposal.

- Carrying amount of liability is deducted in determining CGU's value in use and it's carrying amount to perform meaningful comparison.

10.1.2 Order of allocating impairment loss to assets of CGU

(a) First, reduce the carrying amount of any goodwill allocated to the CGU or group of units.
(b) Then, to other assets of the unit (group of units) pro rata on the basis of carrying amount of each asset in the unit (group of units)



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If any particular asset carrying amount becomes zero after impairment, the remaining impairment loss should be allocated to other assets on pro rata basis as if the asset does not exist.

11. Goodwill

For impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be **allocated** to each of the acquirer's CGU or groups of CGUs that are expected to **benefit from the synergies** of the combination on non-arbitrary basis, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units.

11.1 Size of CGU to which goodwill is allocated

CGU or Group of CGU to which goodwill is allocated shall

- Represent the **lowest level** within the entity at which the goodwill is monitored for **internal management purpose**
- **Not** be **larger** than an **operating segment** as per Ind AS 108

11.2 Timing of impairment test of Goodwill

(a) The annual impairment test for a CGU to which goodwill has been allocated may be performed at **any time during an annual period**, provided the test is performed **at the same time** every year.

(b) Different CGUs may be tested for impairment at different times.

If the **initial allocation** of goodwill acquired in a business combination **cannot be completed** before the end of the annual period in which the business combination is effected, that initial allocation **shall** be **completed before** the **end of the first annual period** beginning after the acquisition date.

If the initial accounting for a business combination can be **determined only provisionally** by the end of the period in which the combination is effected, the acquirer –

(a) Accounts for the combination using the **provisional values**.

(b) Recognises any **adjustments** to provisional values as a result of completing the initial accounting within measurement period, which **will not exceed 12 months** from the date of acquisition

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11.3 Disposal of operation with CGU to which goodwill has been allocated

Goodwill associated with the operation disposed shall be

(a) Included in the **carrying amount of the operation** when determining the gain or loss on disposal

(b) Measured on the basis of **relative values** of the operation disposed of and portion of CGU retained **unless** the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.

11.4 Change in composition of CGU to which goodwill has been allocated

In some cases, the entity reorganises the composition of CGUs (i.e., merging and demerging of CGUs) for corporate reporting purpose. In such case,

(a) Goodwill shall be reallocated to the units affected.

(b) Reallocation shall be performed using a relative value apprroach unless the entity can demonstrate some other better method.

11.5 Testing CGU with goodwill for impairment

Situation	When to Test?
When goodwill is related to the CGU but not allocated	Only when there is an indication that it may be impaired.
When goodwill is allocated to the CGU	(a) Annually **&** (b) whenever there is an indication that CGU is impaired.

If CGU **includes** in carrying amount an **intangible asset** that has indefinite useful life or not yet available for use, that asset can be tested for impairment only as a part of CGU and unit also to be tested for impairment **annually**.

11.6 Priority for testing impairment

If the assets in CGU to which goodwill has been allocated are tested for impairment at the same time as the unit	Individual assets shall be tested before the unit
If the CGUs constituting a group of CGUs to which goodwill has been allocated are tested for impairment at the same time as the unit	Individual units shall be tested before the group of units

11.7 Two Step approach for goodwill allocated to a group of CGUs

When goodwill is allocated to a group of CGUs for the purpose of impairment testing but cannot be allocated on a non-arbitrary basis to individual CGUs, the individual CGUs must be tested for impairment before the group of CGUs containing the associated goodwill.

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11.8 Rolling forward detailed calculations from a preceding period

Goodwill:

The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit to which goodwill has been allocated may be used in the impairment test of that unit in the current period provided **all the following criteria are met**:

a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation
b) In the most recent calculation, recoverable amount > carrying amount (**substantially**)
c) The likelihood that a current recoverable amount determination would be less than the asset's carrying amount **is remote**.

Intangible Assets:

The most recent **detailed calculation** of such an asset's recoverable amount made in a **preceding period** may be used in the impairment test for that asset in the current period, provided **all** of the following criteria are met:

(a) If the intangible asset does **not** generate cash inflows from continuing use that are largely **independent** of those from other assets or groups of assets and is therefore tested for impairment as part of the CGU to which it belongs, the **assets and liabilities** making up that **unit** have **not changed** significantly since the most recent recoverable amount calculation
(b) In the most recent calculation, recoverable amount > carrying amount (**substantially**)
(c) The likelihood that a current recoverable amount determination would be less than the asset's carrying amount **is remote**.

12. Corporate Assets

Corporate assets include group or divisional assets. They do **not generate** cash inflows **independently** of other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit under review.

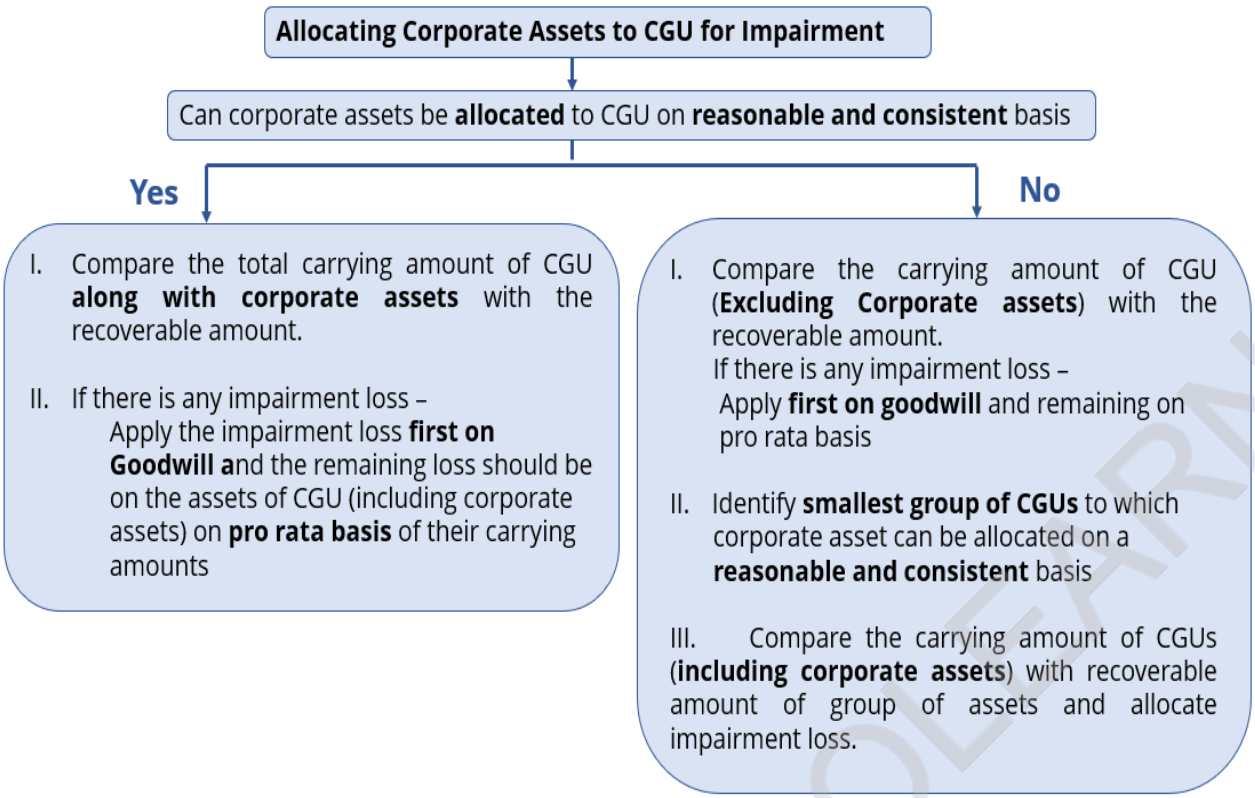
For Example:
Head office building, EDP equipment, research centre.

Recoverable amount of individual corporate asset cannot be determined unless it is disposed of.

Corporate assets are tested for impairment in the context of the CGU or group of CGUs to which asset belongs.

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12.1 Allocation of corporate assets to CGUs for impairment



13. Reversal of an Impairment Loss

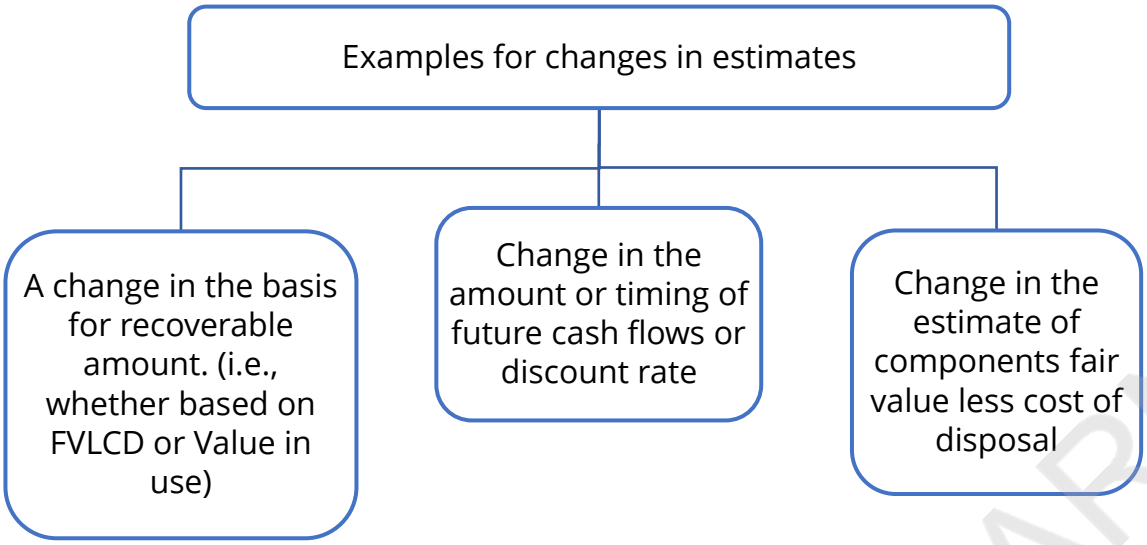
At every balance sheet date, entity should assess whether there is **any indication** that the impairment loss recognised in the previous years may be decreased or no longer exist.
Entity must estimate recoverable amount of that asset if any such indication exists.

Impairment loss recognised for goodwill shall not be reversed in a subsequent period.

13.1 Change in Estimates

Impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a **change in the estimates** used to determine the asset's recoverable amount since the last impairment loss was recognised

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13.2 Unwinding of Discount

- Asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer.
- However, the service potential of the asset has not increased.
- In such cases, an impairment loss is not reversed just because of the passage of time even if the recoverable amount is > carrying amount.

13.3 Indicators of reversal of Impairment Loss

External Indicators	Internal Indicators
(i) Significant increase in market value	(i) Significant change in the way the asset is used or expected to be used.
(ii) Significant changes in technological, economic, legal, market environment which have positive effect on the entity.	(ii) Evidence from internal reporting that indicates that the economic performance of the asset is /will be better than expected.
(iii) Decrease in market interest rates and those are likely to affect discount rates	(iii) Withdrawal of commitment for restructuring, discontinuing operations etc, which gives positive effect to entity.

13.4 Reversal of Impairment in case of Individual Asset

13.4.1 If NO Revaluation done in prior periods:

(a) Reverse the impairment loss by recording below journal entry

Dr.	Asset A/c
Cr.	Impairment Loss

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- The **increased carrying amount** of an asset shall **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.

- **Maximum** impairment loss reversal = Impairment loss previously recognised

13.4.2 If Revaluation done in prior periods:

Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase.

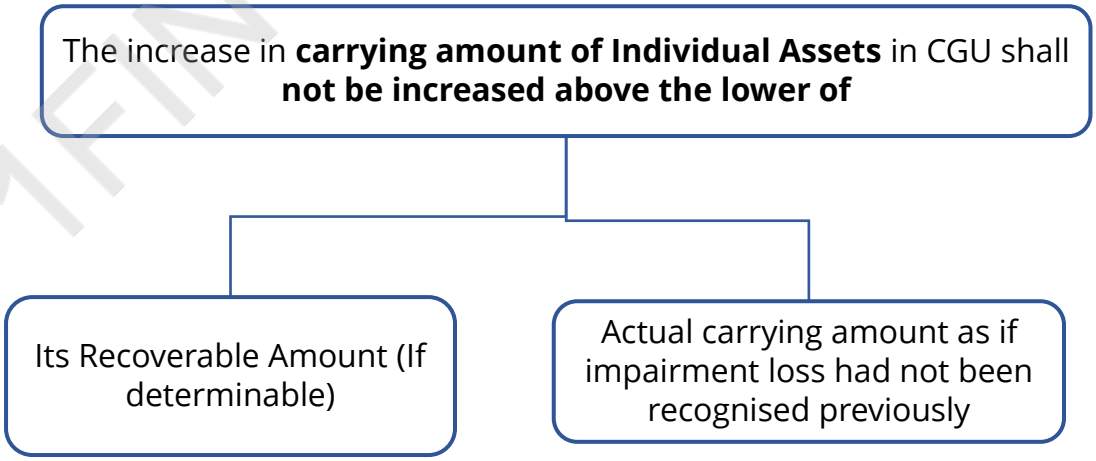
A reversal of an impairment loss is recognised in other comprehensive income and increases the revaluation surplus for that asset. However, to the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.

Dr.	Asset A/c
Cr.	Impairment Loss (P&L) (to the extent recognised in P&L)
Cr.	Revaluation Surplus (Balancing figure)

Depreciation (Amortisation) charge for the asset should be computed prospectively i.e., on the revised carrying amount after deducting residual value, over the remaining useful life of the asset.

13.5 Reversal of Impairment in case of CGU

A reversal if an impairment loss for a CGU should be allocated to **all** assets in CGU **except goodwill** on a pro rata basis of the carrying amount



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The amount of the reversal of the impairment loss should be allocated to each asset on a pro rata basis.

14. Non-Controlling Interests – The impact on goodwill impairment testing

Goodwill acquired in business combination is allocated to acquirer's CGU or group of CGUs which are expected to benefit from the synergies of the business combination.
The amount of goodwill recorded by an entity when it acquires a controlling stake in a subsidiary that is less than 100% of its equity depends on which of the two following methods have been used to calculate it.

Fair Value Method:
If non-controlling interest is measured at its acquisition-date fair value, it means that NCI share of goodwill is recognised in consolidated in financial statements.

Proportionate interest in Net Identifiable Assets:

(a) If an entity measures non-controlling interest as its proportionate interest in the net identifiable assets of the subsidiary at the acquisition date, goodwill attributable to the non-controlling interest is included in the recoverable amount of the CGU but is not recognised in the parent's consolidated financial statement.
(b) Acquirer shall gross up the carrying amount of goodwill to the CGU to include goodwill attributable to the non-controlling interest.
(c) The adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the CGU is impaired.

If a subsidiary is itself a CGU, the impairment loss is allocated between the parent and the non-controlling interest in the same proportion of profit and loss allocation.

15. Disclosures

15.1 General

- An entity is required to disclose the **amount of impairment losses** and **reversals of impairment losses** recognised in profit or loss and in OCI during the period **for each class of assets**.

15.2 Entities Reporting Segment Information

- An entity shall disclose the **amount of impairment losses** and **reversals of impairment losses** recognised in profit or loss and in OCI during the period **for each reportable segment**

15.3 Recognition / Reversal of material impairment losses

(a) An entity is required to disclose
  - the **events and circumstances** that led to the recognition or reversal
  - the **amount of the impairment loss** recognised or reversed
  - Some additional disclosures w.r.t individual asset and CGU are as follows

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For Individual asset	For CGU
• Nature **of the asset** • Reportable segment **to which the asset belongs** • Recoverable **amount**	• **Description** of CGU • Amount of impairment loss recognised or reversed by **class of assets** & by **reportable segment** • Description of the current and former way of **aggregating assets** and the **reasons** for changing • **Recoverable** amount

15.4 Other impairment losses/reversals material in aggregate to the financial statements

(a) An entity shall disclose

- **the main classes of assets** affected by impairment losses and reversals of impairment losses
- The **main events and circumstances** that led to the recognition of these impairment losses and reversals of impairment losses.

15.5 Unallocated Goodwill

An entity shall disclose the **amount of unallocated goodwill** along with **reasons**

15.6 Information to be disclosed for CGUs to which significant goodwill or indefinite – life intangible assets have been allocated

(a) An entity is required to disclose the following information

- **Carrying amount** of goodwill, intangible assets with indefinite useful life allocated to the unit (group of units)
- **Basis** on which the unit's (group of units') recoverable amount has been determined
- If the recoverable amount of unit is based on value in use / FVCD, disclose the following

Value in use	Fair value less cost of disposal
• Key assumptions **on cash flow projections**	• **Key assumptions** on determination of Fair value less cost of disposal
• **Description of** management's approach **to determining the values assigned to each key assumption**	• Description of **management's approach** to determining the values assigned to each key assumption
• Period **over which management has** projected cash flows **and explanations for why** longer period **(> 5 years) is** justified	• **Level** of the fair value hierarchy (Ind AS 113)
• Growth rates **used along with justifications if any**	• Any change in valuation techniques along with reasons
• Discount rates **applied**	• If FVCD is measured using discounted cash flow projections, disclose ✓ the period over which management has projected cash flows ✓ the growth rate used ✓ the discount rate(s) applied

(b) If a reasonably possible **change in a key assumption** would cause the unit's **carrying amount to exceed its recoverable amount**

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- the **amount** by which recoverable amount exceeds its carrying amount
- the **value assigned** to the key assumption
- the amount by which the value assigned to the key assumption must change, after incorporating any **consequential effects of that change on the other variables** used to measure recoverable amount, in order for the unit's recoverable amount to be equal to its carrying amount.

15.7 Information to be disclosed for CGUs to which insignificant goodwill or indefinite-life intangible assets have been allocated

(a) The amount so **allocated** to each unit (group of units) is **not significant** in **comparison with** the entity's **total carrying amount** of goodwill or intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to those units (groups of units).

(b) In addition, if the **recoverable amounts** of any of those units (groups of units) are based on the **same key assumptions** and the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to them is **significant** in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, an entity shall disclose that fact, together with:

- the **aggregate carrying amount** of goodwill, intangible assets with indefinite useful lives allocated to those units
- a description of the **key assumptions**
- Description of **management's approach** to determining the values assigned to each key assumption
- If a reasonably possible change in the key assumptions would cause the aggregate of the units carrying amounts to exceed the aggregate of their recoverable amounts
    - the amount by which the **aggregate** of the units **recoverable amounts exceeds** the aggregate of their **carrying amounts**
    - the **values assigned** to the key assumptions
    - the amount by which the values assigned to the key assumptions must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units recoverable amounts to be equal to the aggregate of their carrying amounts.

16. Significant Differences between Ind AS 36 with AS 28

Particulars	Ind AS 36	AS 28
Applicability	Applies to financial assets classified as subsidiaries, associates, joint ventures.	Does not apply to the above assets
Biological Asset	Excludes biological assets related to agricultural activity.	Does not specifically exclude

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Impairment testing for an intangible asset with an indefinite useful life	Annual impairment testing	No annual impairment testing
Reversal of Goodwill	Prohibits the recognition of reversal	Impairment loss recognised for goodwill should be reversed in a subsequent period when it was caused by a specific external event of an exceptional nature that is not expected to recur and subsequent external events that have occurred that reverse the effect of that event
Allocation of Goodwill	Goodwill is allocated to CGUs that are expected to benefit from the synergies of the business combination.	When goodwill cannot be allocated reasonably and consistently to the CGU, two levels of impairment tests are carried out, viz., bottom-up test and top-down test.
Additional Guidance	Gives additional guidance on following aspects: (a) Estimating Value in use (b) Reasonableness of the assumptions on which cash flows are based (c) Present value techniques	Does not provide such guidelines.

Illustrations

1. Illustration

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.

2. Illustration

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

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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

3. Illustration

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?

4. Illustration

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.

5. Illustration

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.

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6. Illustration

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

7. Illustration

On 1st 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 31st December Year 2 and the revaluation surplus arising on 1st January Year 3.

b) The carrying amount of the machine on 31st December Year 3 (immediately before the impairment).

c) The impairment loss recognised in the year to 31st December Year 4 and its treatment thereon

d) The depreciation charge in the year to 31st 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.

8. Illustration

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

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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?

9. Illustration

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?

10. Illustration

Entity A acquires Entity B for ₹ 50 million, of which ₹ 35 million is the fair value of the identifiable assets acquired and liabilities assumed. The acquisition of B Ltd. is to be integrated into two of Entity A's CGUs with the net assets being allocated as follows

			₹ in million
	CGU 1	CGU 2	Total
Fair value of acquired identifiable tangible and intangible assets	25	10	35

In addition to the net assets acquired that are assigned to CGU 2, the acquiring entity expects CGU 2 to benefit from certain synergies related to the acquisition (e.g. CGU 2 is expected to realise higher sales of its products because of access to the acquired entity's distribution channels). There is no synergistic goodwill attributable to other CGUs.
Entity A allocated the purchase consideration of the acquired business to CGU 1 and CGU 2 as ₹ 33 million and ₹ 17 million respectively.
Determine the allocation of goodwill to each CGU?

11. Example

An entity sells for ₹ 100 an operation that was part of a cash-generating unit to which goodwill has been allocated. The goodwill allocated to the unit cannot be identified or associated with an asset group at a level lower than that unit, except arbitrarily. The recoverable amount of the portion of the cash-generating unit retained is ₹ 300.
Since the goodwill allocated to the cash-generating unit cannot be non-arbitrarily identified or associated with an asset group at a level lower than that unit, the goodwill associated with the operation disposed of is measured on the basis of the relative values of the operation disposed of and the portion of the unit retained.

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Therefore, 25 per cent of the goodwill allocated to the cash-generating unit is included in the carrying amount of the operation that is sold.

12. Example

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.

Since the 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.

13. Example

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.

14. Example

Assets	Carrying Amount	Fair Value less cost of disposal	Impairment	Revised carrying amount
Plant & Machinery	1,00,000	50,000		
Building	80,000	85,000		
Electric Equipment	40,000	-		
Goodwill	50,000	NA		
Patents	20,000	NA		
Other Monetary assets	60,000	60,000		
Total	3,50,000			
Recoverable amount	2,00,000			

15. Illustration

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

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		(₹ in crore)
Corporate asset	**Carrying amount**	**Remarks**
X Y	600 200	The carrying amount of X can be allocated on a reasonable basis (i.e., pro rata basis) to the individual cash-generating units. The carrying amount of Y cannot be allocated on a reasonable basis to the individual cash- generating units.

Recoverable amount as on 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.

16. Illustration

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.

17. Illustration

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.

Scenario 1 - budgets/forecasts approved by management reflect no commitment of management to replace the machine.

Scenario 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?

18. Illustration

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.

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- 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 (subject 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?

19. Illustration

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.

20. Illustration

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.

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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.

21. Illustration

Elia limited is a manufacturing company which deals in to manufacturing of cold drinks and beverages. It is having various plants across India. There is a Machinery A in the Baroda plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machine A it cannot produce output as well. The Company considers this group of assets as a Cash Generating Unit and an Inventory amounting to ₹ 2 Lakh and Goodwill amounting to ₹ 1.50 Lakhs is included in such CGU.
Machinery A was purchased on 1st April 2013 for ₹ 10 Lakhs and residual value is ₹ 50 thousands. Machinery B was purchased on 1st April, 2015 for ₹ 5 Lakhs with no residual value. The useful life of both Machine A and B is 10 years. The Company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of the company is 10%.

Year	Cash Flows from Machinery A
1	1,50,000
2	1,00,000
3	1,00,000
4	1,50,000
5	1,00,000 (excluding Residual Value)
Total	6,00,000

On 31st March, 2018, the professional valuers have estimated that the current market value of Machinery A is ₹ 7 lakhs. The valuation fee was ₹ 1 lakh. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is ₹ 1.50 lakhs. Specialised packaging cost would be ₹ 25 thousand and legal fees would be ₹ 75 thousand.
The Inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is ₹ 10 Lakh as on 31st March, 2018. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is ₹ 11 Lakhs ie on 31st March, 2019. The Recoverable value of Machine A is ₹ 4,50,000 and combined Machine A and B is ₹ 7,60,000 as on 31st March, 2019

Required:

a) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2018 by providing all the relevant working notes to arrive at such calculation.
b) Compute the prospective depreciation for the year 2018-2019 on the above assets.
c) Compute the carrying value of CGU as at 31st March, 2019.

22. Illustration

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

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	₹ in '000
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.

23. Illustration

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.

Pluto Ltd comprises three cash generating units A, B and C. When Pluto Ltd was acquired the directors of Sun Ltd estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	Carrying value (before goodwill allocation)	Recoverable amount	
	₹ '000	₹ '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.

24. Illustration

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

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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.

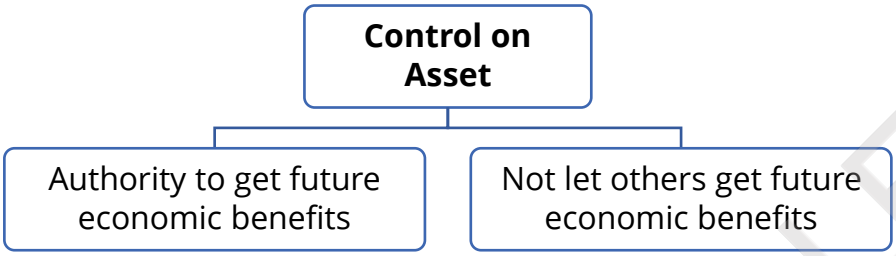
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1 Introduction

IND AS 38 prescribes the accounting treatment for intangible assets that are not dealt with specifically by another Standard.

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

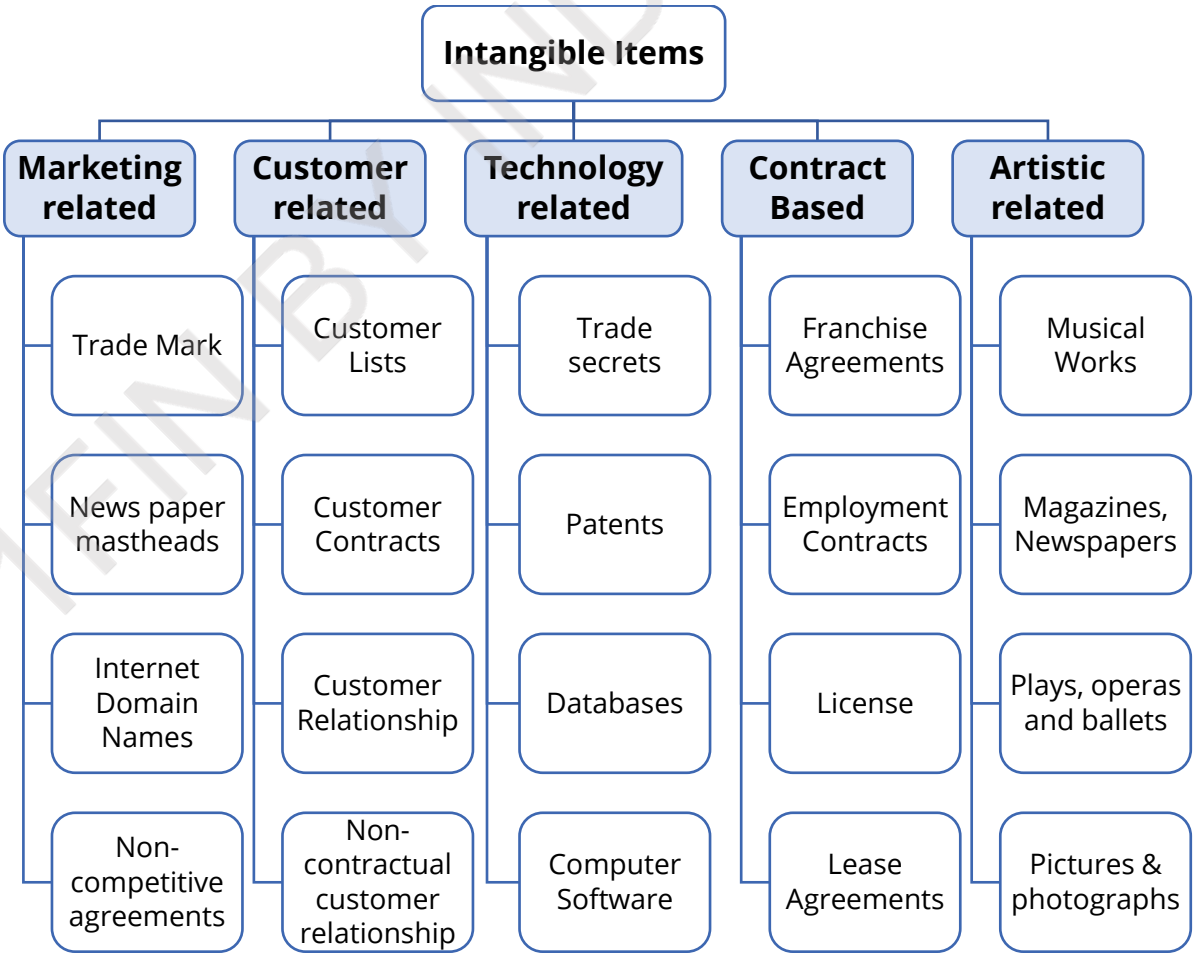
Intangible Asset An identifiable non-monetary asset without physical substance



The future economic benefits include:

- Revenue from the sale of products or services;
- Cost savings; or
- Other benefits resulting from the use of the asset by the entity.

1.1 Examples of Intangible Items



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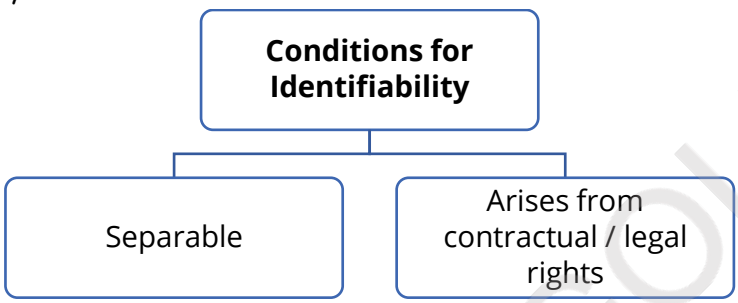
Intangible items like customer lists, market share, customer relationships can be considered as Intangible Assets only if the entity can exercise control over these to generate future economic benefits, which is very rare. They should be separable or contractual and able to be sold at a value independently.

2 Intangible Assets - Elements

2.1 Identifiability

An Intangible Asset should be identifiable to distinguish it from goodwill for it be considered under IND AS 38. An entity must be able to separate the intangible asset from other assets.
Ex: A copyright of a movie is separable from the identity of a entertainment company or other assets in the company and it can be sold independently.

Goodwill is the difference between the purchase price of a business and the fair value of its assets, net of liabilities [Refer IndAS 103]



An asset is identifiable if its either:

- **separable**, from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, not considering the company's intention; or
- **arises from contractual or other legal rights**, even if such rights are not transferable or separable from the entity.

Goodwill is not separately identifiable asset unless purchased.

2.2 Non-monetary

The classification of monetary assets and non-monetary assets is based on respective realizability of the assets in terms of money.

Monetary assets are assets whose economic benefits are determined in terms of currency units. Assets whose economic benefits will not be received in the form of fixed determinable units of currency are known as non-monetary assets.
Examples
Monetary – Account receivables
Non-Monetary - PPE

2.3 Non-physical substance

An Intangible Asset does not have physical substance - it should not be tangible i.e it should not perceptible by touch.

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But sometimes some Intangible Assets are associated with physical substance / tangible item for storage purpose. Ex: software stored on a CD or a patent signed on the paper. In such circumstances, since the physical substance is insignificant, the CD with software will be considered as Intangible Asset.

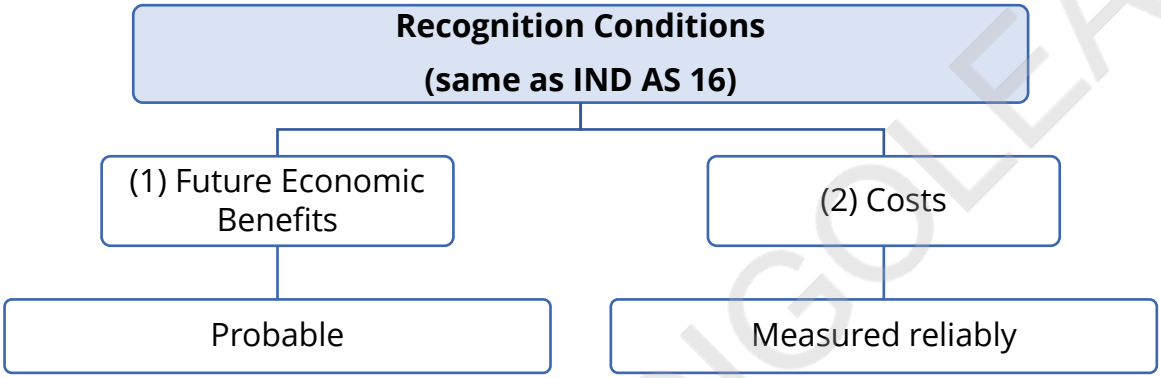




If the tangible part is significant, it will be considered under IND AS 16 as Property, Plant & Equipment. Ex: smart phone with operating system.

Monetary assets like Account Receivables, Deposits with Bank etc are not considered to be intangible assets.

3 Recognition of Intangible Asset



An item to be recognised as Intangible Asset, it should

- meet definition criteria
  - non-monetary,
  - non-physical,
  - identifiable
- meet recognition criteria
  - future economic benefits to flow into the entity and control on benefits established
  - costs measured reliably



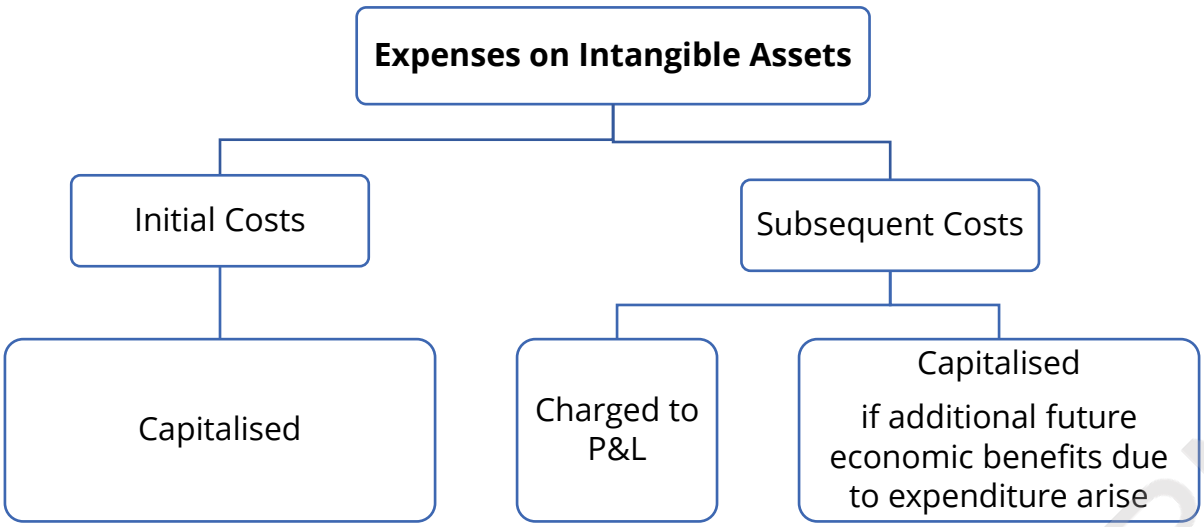
An intangible item should meet both definition and recognition criteria to be considered as IA.

This recognition criteria applies to:

- Initial costs incurred to
  - acquire an intangible asset or
  - internally generate an intangible asset; and
- subsequent costs incurred to add to / replace part of / or service intangible asset.

It is assumed that the subsequent costs on intangible assets are generally for maintaining existing future economic benefits and are expensed unless the recognition criteria is met.

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4 Measurement of Intangible Assets

Intangible Assets may be acquired or self-generated. In case of independent / separate acquisition of an intangible asset, it is assumed that future economic benefits will flow into the entity. There is no requirement for checking the viability of the economic benefits from such independent acquisition of intangible asset.

4.1 Costs for Acquired Intangible Assets

Purchase Price	xxx
Add:	
Non-refundable taxes and duties	xxx
Installation costs	xxx
Professional Fees	xxx
Borrowing costs (If permitted by Ind AS 23)	xxx
Any directly attributable cost to bring the asset to the location and condition, necessary to **operate for its purpose intended** by the management	xxx
Less:	
Government grant received specific to the asset (Ind AS 20)	xxx
Trade discounts and rebates (If included in above costs)	xxx
Cost of Intangible Asset	**xxxx**

Cessation of Capitalisation of Costs.

Capitalisation of intangible asset stops when the asset is ready for its intended use.

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4.2 Costs for Internally Generated Assets

4.2.1 Goodwill

Internally generated goodwill is not recognised as an asset because it does not meet the definition criterion nor the recognition criterion of an intangible asset i.e.

- it is not separable nor
- doesn't arise from contractual or other legal rights
- cannot be measured reliably at cost.

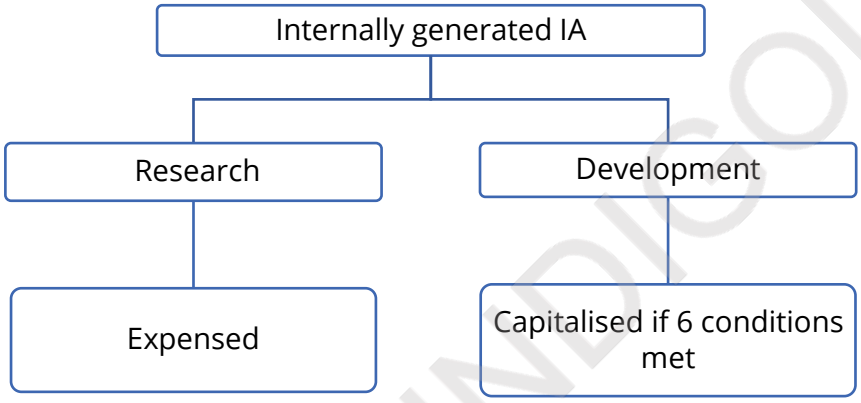
IND AS 38 prohibits the recognition of internally generated goodwill as an asset.

Internally generated goodwill cannot be measured reliably as there are many factors that affect the fair value.

Goodwill can also arise from business combination. Such a goodwill can be recognised in the books of accounts as the acquisition price for business over and above the fair value of the net assets acquired (IND AS 103)

Internally generated Brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets as per the standard.

4.3 Internally generated Intangible Assets other than Goodwill



Research Phase –

- It is a stage where new scientific or technical knowledge and understanding is obtained.
- Formulation, design evaluation and final selection of possible better alternatives is undertaken.
- In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits.
- Therefore, this expenditure is recognised as an expense when it is incurred.

Development Phase – It is the stage where research findings are applied and feasibility of production of new or substantially improved items is decided. Design, construction and testing of pre-production or pre-use prototypes and models is done. This stage is before the commercial production is undertaken.

If expense on Research and Development cannot be separated then it shall be expensed

Six Conditions for Capitalising Development Expenses:

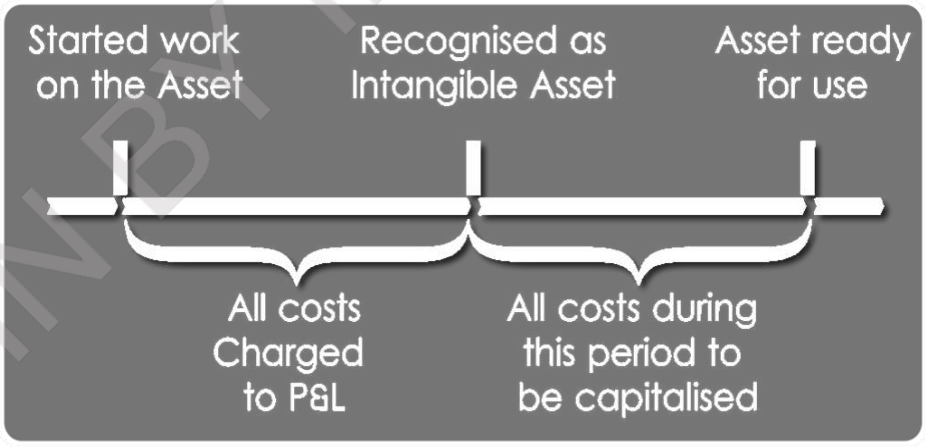
Expenses arising out of development will be capitalised if an entity can demonstrate all of the following

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- Technical feasibility for completion of Intangible asset to make it available for use or sale
- Intention of entity to complete the intangible asset and use or sell it
- Ability to use or sell the intangible asset.
- Demonstrate generation of probable future economic benefits
- Adequate resources (like technical, financial or others) are available to complete the development.
- Measure reliably the expenditure attributable to the intangible asset during its development.

5 Costs - Intangible Asset - internally generated

The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. All costs till the date of recognition of the intangible asset are expensed to the statement of profit and loss. All cost from the date of recognition till the date the asset is ready to be put to use are capitalised.



5.1 Inclusions

Directly attributable costs -

- Direct material
- Cost of services directly used
- Employee costs
- Legal expenses essential for the intangible asset (filing of patent application)
- Other intangible assets (patents & licenses) used for making the intangible asset ready for use

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- Borrowing costs as permissible under Ind AS 23

5.2 Exclusions

The following costs are excluded from the capitalisation for intangible asset:

- Selling Overheads
- Indirect Costs
- Initial operating losses
- Losses due to inefficiency
- Staff training costs

6 Intangible Assets in exchange of non-monetary asset

Intangible assets may be acquired in exchange for

- a non-monetary asset or assets, or
- a combination of monetary and non-monetary assets.

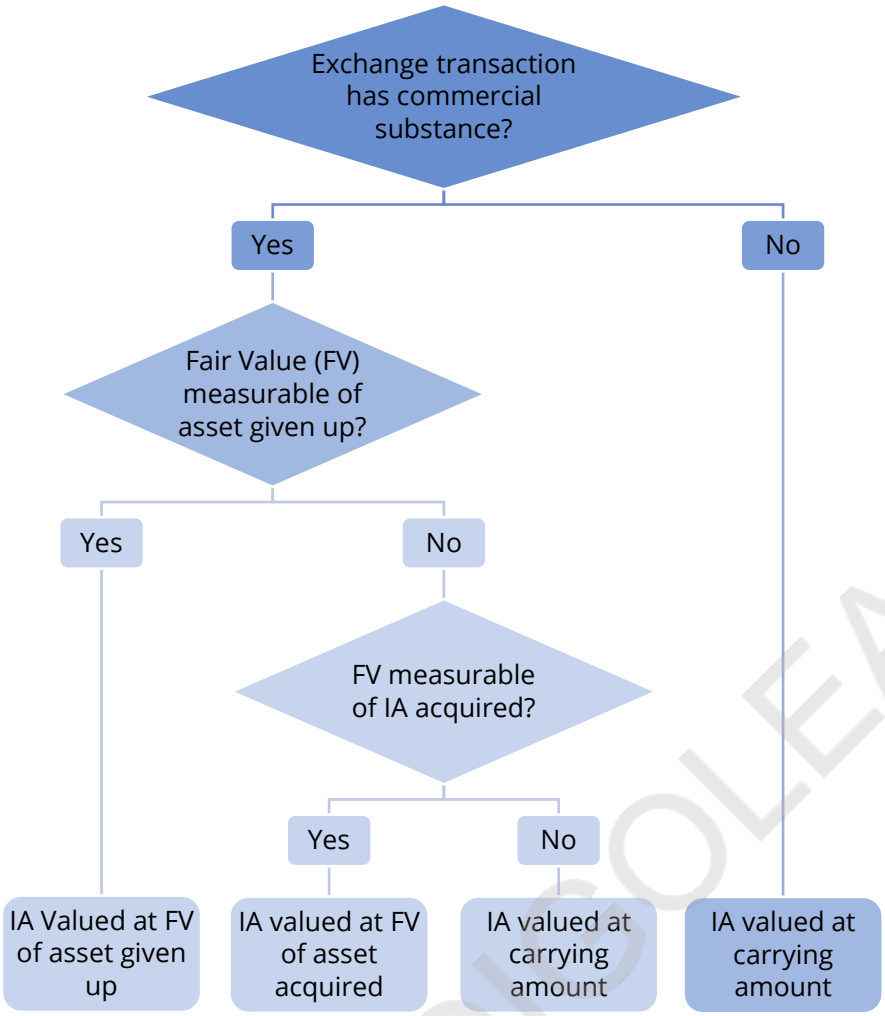
The capitalisation cost of an intangible asset exchanged for non-monetary asset depends on the commercial substance of the transaction.

An exchange transaction has commercial substance if:

(a) risk, timing and amount of the cash flows of the asset received is different from that of the cash flows of the asset transferred;

(b) entity's operations significantly affected by the transaction;

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7 Intangible Assets in the form of Govt. Grant

An intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant.

Such assets should be valued or capitalised in accordance with IND AS 20, i.e ***intangible assets received as grant at nominal consideration or free should be valued at nominal value or fair value.***

Any expenditure incurred in relation to such asset that is directly attributable to preparing the asset for its intended use can also be capitalised along with nominal or fair value.

8 Intangible Assets acquired as Business Combination

When an intangible asset is acquired in a business combination, the cost of that intangible asset is ***its fair value at the acquisition date***.

An acquirer recognises an identifiable intangible asset acquired at the acquisition date, separately from goodwill, even if the asset was not recognised by the acquiree before.

Even in-process research and development project of the acquiree can be valued by the acquirer if

- the project meets the definition of an intangible asset after acquisition; and
- asset is separately identifiable.

The acquirer may recognise a group of similar and related intangible assets as a single asset if the individual assets have similar useful lives.

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9 Expenditure on Intangible Asset should be expensed

Expenditure on Intangible Asset should be charged to statement of profit and loss i.e. expensed, unless it meets the recognition criterion.

Expenditure on an intangible item will be capitalised if:

- it meets the definition and recognition criteria and becomes part of cost; or
- the item is acquired in a business combination and cannot be recognised as an intangible asset. Goodwill be recognised

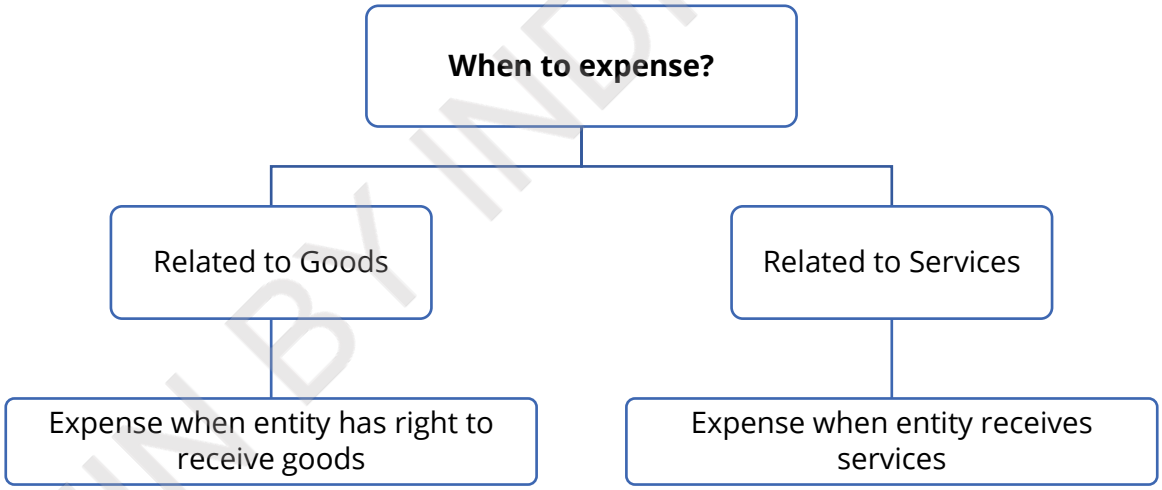
Once expensed or charged to P&L, an expenditure on Intangible Asset cannot be recapitalised.

9.1 Expenditure always expensed:

- Research expenditure (except when it is acquired as part of a business combination)
- Start up costs
  - Establishment (legal & secretarial) costs
  - Incorporation costs
  - Starting new operations or products
- Training costs
- Advertising and promotional expenses
- Reorganising or relocating expenses

9.2 Expenses which do not create intangible Asset.

Any expense which does not create intangible assets should be expensed as below.



An entity need not expense advance paid for goods or prepaid expenditure related to services in the year of payment.

Important Note – Once an expense is recognised, it cannot be capitalised back as intangible asset in future.

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Amortisation is

- Systematic allocation
- Of depreciable amount
- Over the useful life of the Intangible Asset

Depreciable Amount = Costs – Residual value

10.1 Residual Value

Residual value is usually the excess of current estimated realisable value over the estimated disposal costs assuming the asset is at its end of the useful life today.

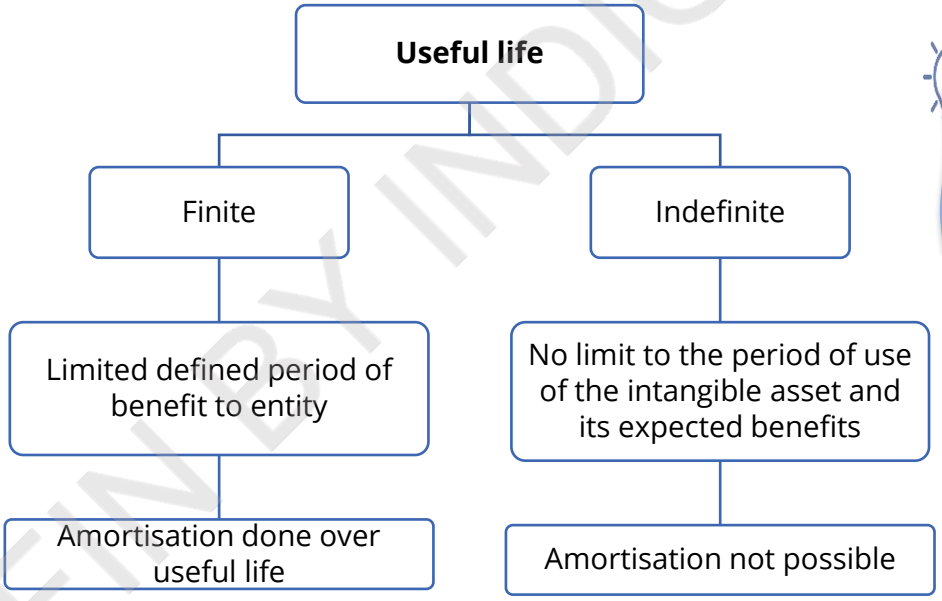
Generally, Residual Value (RV) of an intangible asset is assumed to be zero

Exception – Third party commitment to purchase or an active market exists

Reviewed	End of each period
Change in estimate of RV	Account as per Ind AS 8
If RV is higher than carrying Amount	Amortisation amount = 0
If RV again falls below Carrying amount	Restart amortisation

10.2 Useful life of an Intangible Asset

The accounting for an intangible asset is based on its useful life.



'Indefinite' does not mean 'infinite'

An intangible asset is considered to have indefinite useful life when there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity

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10.2.1 Factors to determine the useful life

Usage	• Expected usage of the asset by the entity and can it be managed by another team.
Procuct Life Cycle	• Product life cycles for the asset and public information on estimates of useful life of similar asset used in a similar way
Obsolescence	• Technical, technological , commercial or other type of obsolescence
Industrial and market changes	• Industrial stability in which the asset operate and changes in market demand for the products or services from the output
Competitors	• Expected actions by competitors or potential competitors
Maintenance Expenses	• Level of maintenance expenditure required to obtain the expected future benefits and management's intention to reach such level
Control over Asset	• Period of control over the asset and legal or similar limits on the use of assets, like expiry dates of related leases
Interdependence	• Whether the useful life is dependent on the useful lives of other assets of the entity

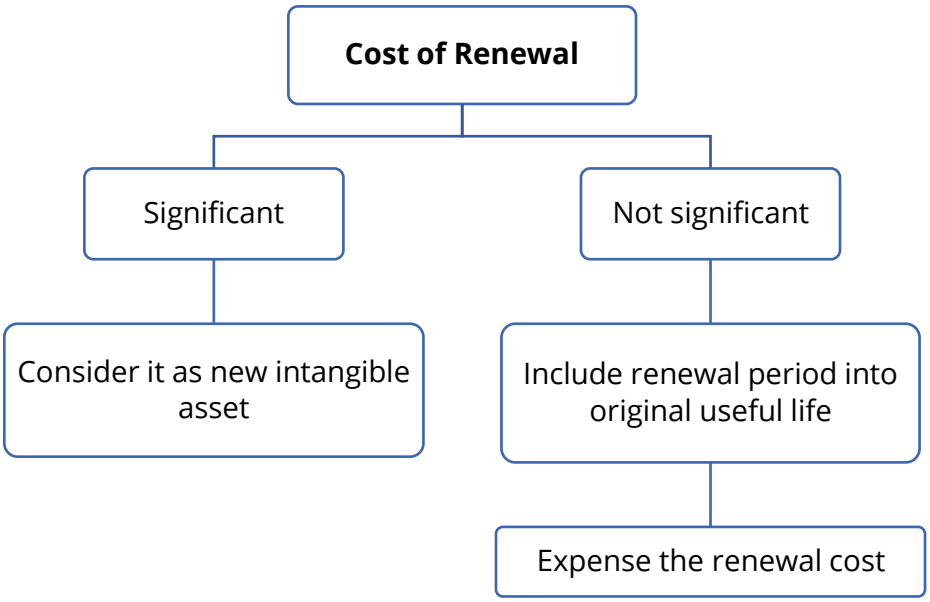
10.2.2 Useful life dependent on Contracts

The useful life of an intangible asset arising from contractual or other legal rights **shall not exceed the period of the contractual or other legal rights**, but may be shorter depending on the period over which the entity expects to use the asset.

Useful life ≤ Contractual period

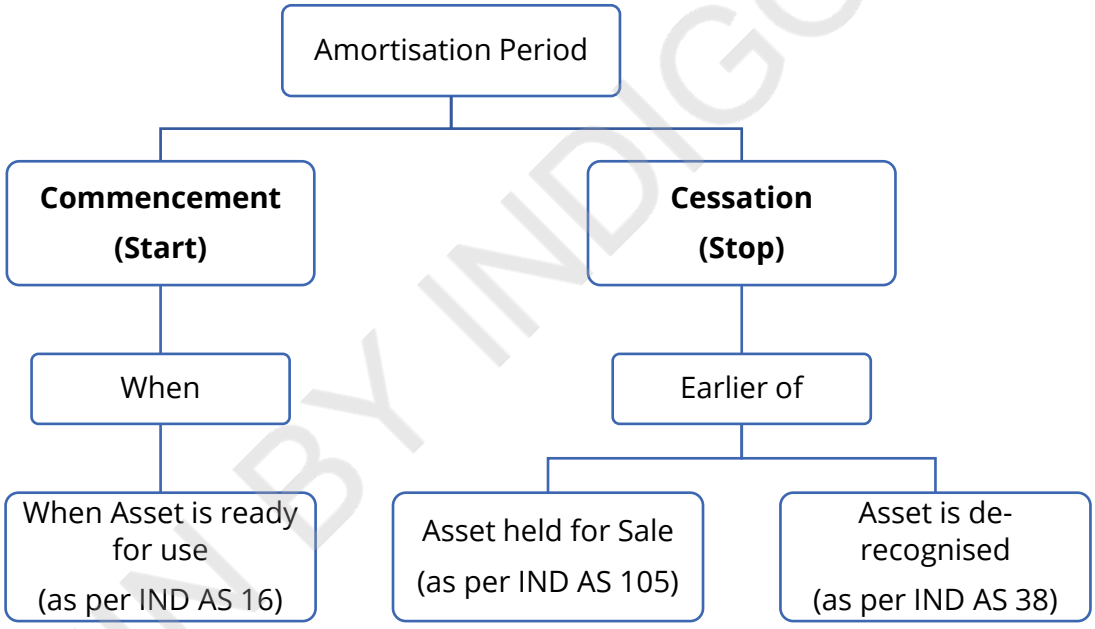
Renewal costs are considered significant or not-significant in comparison with the additional economic benefits received by the entity during the renewal period.

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10.3 Amortisation Period

Amortisation is done for an intangible asset only if the intangible asset has finite useful life.



Amortisation does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105.

The amortisation period for an intangible asset with a finite useful life should be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period should be changed accordingly. Such change is accounted for as a change in accounting estimates in accordance with Ind AS 8.

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10.4 Amortisation Methods

The amortisation method used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity i.e. the consumption of economic benefit's pattern should be matched with the amortisation amount pattern.

Entity determines the predominant limiting factor inherent in an intangible asset and based on such factor, chooses the amortisation method. These methods include the straight-line method, the diminishing balance method and the units of production method.

If that pattern cannot be determined reliably, the straight-line method should be used.

Revenue cannot generally determine the pattern of consumption, and thus revenue cannot be used as basis for amortisation.

Exception if

- the contract specifically states that the revenue as the limiting factor (For eg asset can be used upto a certain amount of revenue generated) or
- revenue has high correlation with the consumption pattern,

then amortisation can be based on revenue.

The amortisation method should be reviewed at least at each financial year-end. If there has been a change in the expected pattern of consumption of the future economic benefits, amortisation method can be changed and such change is considered as change in accounting estimates as per IND AS 8.

If that pattern cannot be determined reliably, the straight-line method should be used.

Amortisation is usually recognised in profit or loss. Sometimes they are absorbed in producing other assets like inventories.

Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used.

10.5 Intangible Assets with Indefinite Useful Lives

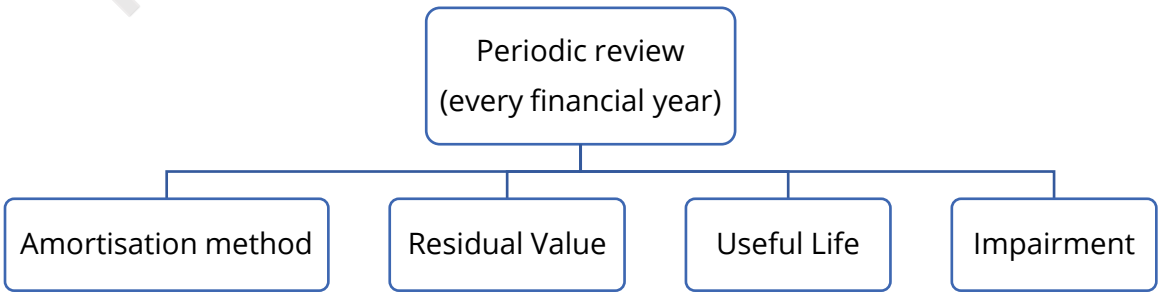
An entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount

(a) annually; and

(b) whenever there is an indication that the intangible asset may be impaired.

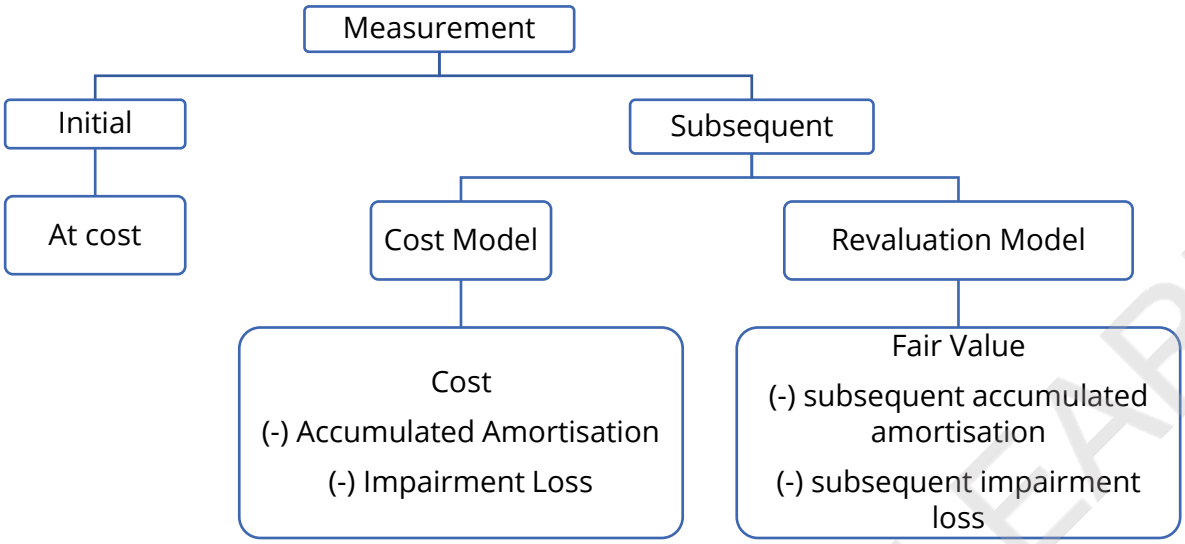
The change from indefinite to finite is considered as a change in an accounting estimate in accordance with Ind AS 8.

When the entity reassesses the useful life of an intangible asset as finite, it has to tests the asset for impairment and recognising any excess of the carrying amount over the recoverable amount as an impairment loss.



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Initial recognition is always at cost



11.1 Revaluation Model

The revaluation model does not allow:

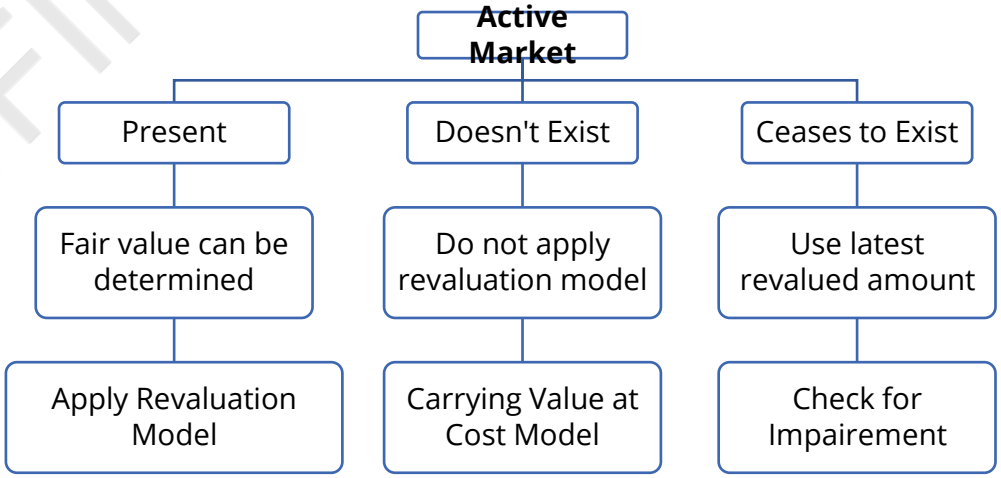
(a) the revaluation of intangible assets that have not previously been recognised as assets (i.e treated as expenses); or

(b) the initial recognition of intangible assets at amounts other than cost.

- Model must be followed by class of assets
- Carrying value should not differ significantly from the fair value
- Intangible assets received as government grants can be revalued.

11.2 Active Market

Fair value of the asset can be measured by reference to an active market at a subsequent measurement date. If there is no active market or the active market is unable to determine the fair value, then the IA will be revalued at earlier measured cost or earlier fair value.



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11.3 Accounting under Revaluation Model

The increase in carrying amount shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss.

First Time Revaluation	
Increase in value **(Fair Value > Carrying Amount)**	Intangible Asset A/c Dr. To Revaluation Surplus A/c
Decrease in value **(Carrying amount > Fair value)**	P&L A/c (loss) A/c Dr. To Intangible Asset A/c
Subsequent Revaluation	
Increase in value **(Fair Value > Carrying Amount)**	***If no downward revaluation earlier:*** Intangible Asset A/c Dr. To Revaluation Surplus A/c
	If downward revaluation earlier, to the extent of loss: Intangible Asset A/c Dr. To P&L A/c
Decrease in value **(Carrying amount > Fair value)**	***If no upward revaluation earlier:*** P&L A/c (loss) A/c Dr. To Intangible Asset A/c
	If upward revaluation earlier, to the extent of upward revaluation : Revaluation Surplus A/c Dr. To Intangible Asset A/c

11.4 Presentation of Revaluation Amount

Revaluation amount can be presented either on

- Net basis – accumulated amortisation is adjusted to the gross carrying amount and the adjusted net carrying amount will be restated with the revaluation amount added.
- Gross basis – increase the gross carrying amount and the amortisation value proportionately.

12 Derecognition of Intangible Asset

- Intangible Asset is recognised when entity ascertains that the future economic benefits would flow to the entity.
- Intangible Asset is derecognised when
  - no future economic benefits are expected to flow into the entity or
  - the asset is disposed by the entity
- The difference between carrying amount and disposal proceeds is recognised in P&L.
- Disposal proceeds is determined in line with principles given under Ind AS 115
- If intangible assets are sold as leaseback, gain / loss is recognised as per IND AS 116, otherwise gain or loss are recognised in statement of profit or loss.

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13 Disclosure

13.1 General Disclosures

An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) Useful life of IA - indefinite or finite (useful life, Amortisation rates)

(b) Amortisation methods – SLM, WDV, others;

(c) Gross carrying amount, accumulated amortisation, accumulated impairment losses

- beginning of the period
- end of the period;

(d) Line item(s) of P&L statement which includes amortisation

(e) Reconciliation (carrying amount) - beginning and end of the period showing:

(i) Additions

- Internal development additions,
- Acquired additions
  - separately
  - business combinations;

(ii) Disposals

- IA held for sale
- other disposals;

(iii) increases or decreases from

- revaluations
- impairment losses recognised or reversed in other comprehensive income

(iv) impairment losses recognised in P&L during the period

(v) impairment losses reversed in P&L during the period

(vi) any amortisation recognised during the period;

(vii) net exchange differences arising on translation (into presentation currency) of

- financial statements
- foreign operation;

(viii) other changes in the carrying amount during the period

Opening Balance	**Movements (+ / -)**						**Closing Balance**
	Additions	Disposal	Amortisation	Impairment	Revaluation	Exchange difference	

13.2 Specific Disclosures

(i) Intangible Assets with indefinite useful life

- carrying amount of that asset
- reasons supporting indefinite useful life.
  - factor(s) that played a significant role in determining so

(ii) Individual IA material to financial statements

- description,
- carrying amount and
- remaining amortisation period

(iii) IA acquired as Govt. Grant and initially recognised at fair value

- fair value initially recognised for these assets;

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- their carrying amount; and
- measured after recognition under the cost/revaluation model

(iv) Title Restrictions & Capital Commitments
- existence
- carrying amounts

(v) Pledged as Securities – Carrying amounts

(vi) Contractual commitments for the acquisition of IA

(vii) IA under Revaluation Model
- Every class of IA
  - Effective date of revaluation
  - Carrying amount of revaluation
  - Carrying amount of revalued asset as per Cost model
- Revaluation Surplus
  - Beginning and ending amount
  - Changes
  - Restriction on distribution to shareholders
- Methods & assumptions for estimating fair values

(viii) Research and Development Expenditure - An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

13.3 Voluntary Disclosure

An entity can disclose the following information:

a) a description of any fully amortised intangible asset that is still in use; and

b) a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before this standard was effective.

14 Exclusions from IND AS 38

Exclusions	Ind As
Inventory	2
Deferred Tax Assets	12
Leases of Intangible Assets	116
Financial Assets	32
Assets arising out of employee benefits	19
Goodwill on business combination	103
Deferred acquisition cost and Intangible Asset from insurance contract	104
Non-current assets held for sale	105
Assets arising from contracts with customers	115
Mineral oils and ores	106
Amortisation method for intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements before the beginning of the first Ind AS financial reporting period as per the previous GAAP	

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Rights under license agreement excluded under IND AS 116 will be dealt by IND AS 38

15 IND AS 38 vs AS 26

Basis of differences	AS 26	IND AS 38
Definition of IA	• Identifiable • non-monetary asset • without physical substance • held for ○ use in the production or supply of goods or services, ○ for rental to others, for administrative purposes	• identifiable • non-monetary asset • without physical substance Asset's purpose to hold for use is not a part of definition
Identifiability	Does not define 'identifiability'. Separability from goodwill not a necessary condition	Provides detailed guidance in respect of identifiability.
Recognition for Separately Acquired Intangible Assets	Criterion of probable inflow of expected future economic benefits is always considered satisfied	No such provision
Amortisation Method	No such guidelines	Revenue based amortisation not appropriate
Payment deferred beyond normal credit	No such consideration	Considered
IA under business combination	No such provision in AS 26 AS 14 deals with Amalgamation in nature of purchase	Dealt in detail
Subsequent expenditures on IA acquired under business combination	No such guidance	Guidance available for treatment
IA acquired under exchange	No mention of treatment	Specific mention of treatment
IA acquired free of cost or at nominal price	Use nominal value or cost of acquisition only. Fair value not considered.	Value IA at fair value or nominal value
Useful life of IA	Useful life always finite and presumption – use life cannot exceed 10 years	IA's useful life can be finite or indefinite.

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Expenses to be recognised	No detailed guidelines	Detailed guidelines available
Contractual & Legal Rights	Does not include such a provision	Useful life may be less than legal life
Residual value	Residual value increase not available	Provision for increase in residual value available
IA held for sale / retired from use	Covered	Not covered (they are covered by Ind AS 105)
Exclusions	Paragraph 5 of AS 26, does not apply to accounting issues of specialised nature that arise in respect of accounting for discount or premium relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, share issue expenses and discount allowed on the issue of shares	Discount or premium relating to borrowings and ancillary costs are not considered as they are dealt with by other Ind AS
Exclusions	No such exclusion	Toll road service concession agreement excluded
Valuation Model as Accounting policy	Revaluation model is not permitted.	Either the cost model or the revaluation model

16 Summary of IND AS 38

Intangible Assets - An identifiable non-monetary asset without physical substance

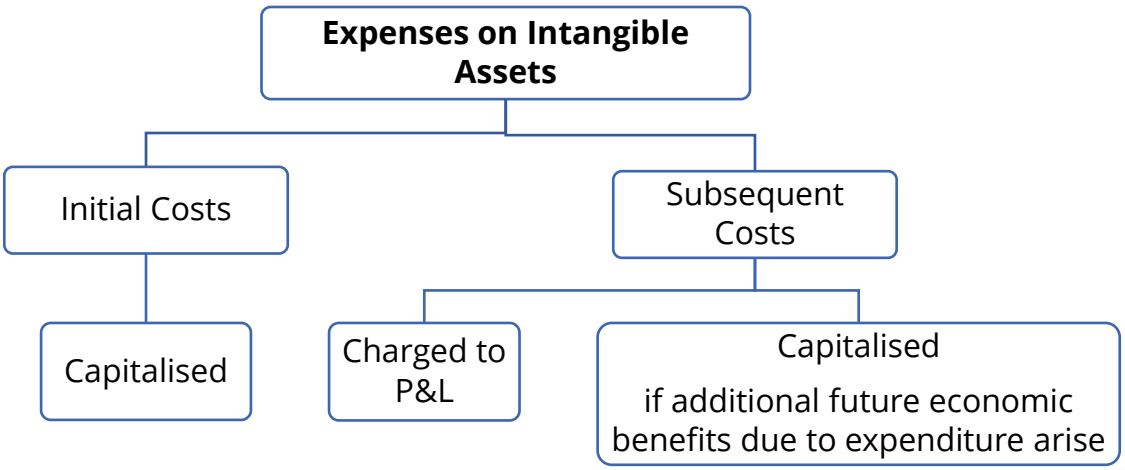
An item to be recognised as Intangible Asset, it should

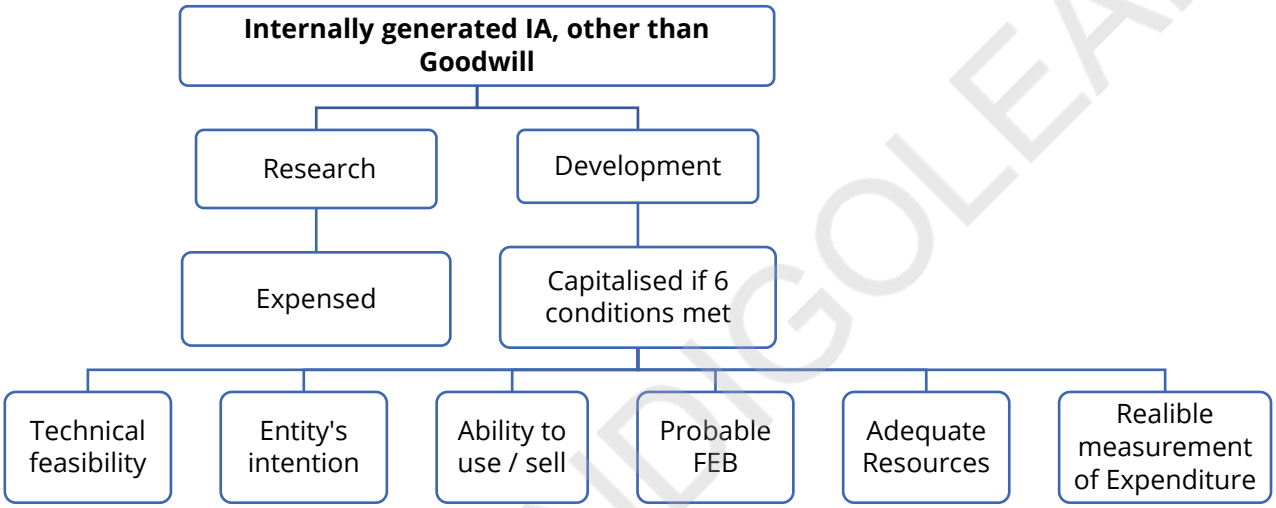
- meet definition criteria
  - non-monetary,
  - non-physical,
  - identifiable an
- meet recognition criteria
  - future economic benefits to flow into the entity and control on benefits established
  - costs measured reliably



An intangible item should meet both definition and recognition criteria to be considered as IA.

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Costs

All costs till the date of recognition of the intangible asset are expensed to the statement of profit and loss.

All cost from the date of recognition till the date the asset is ready to be put to use are capitalised.

Intangible Asset exchanged for non-monetary asset

Exchange has commercial substance –

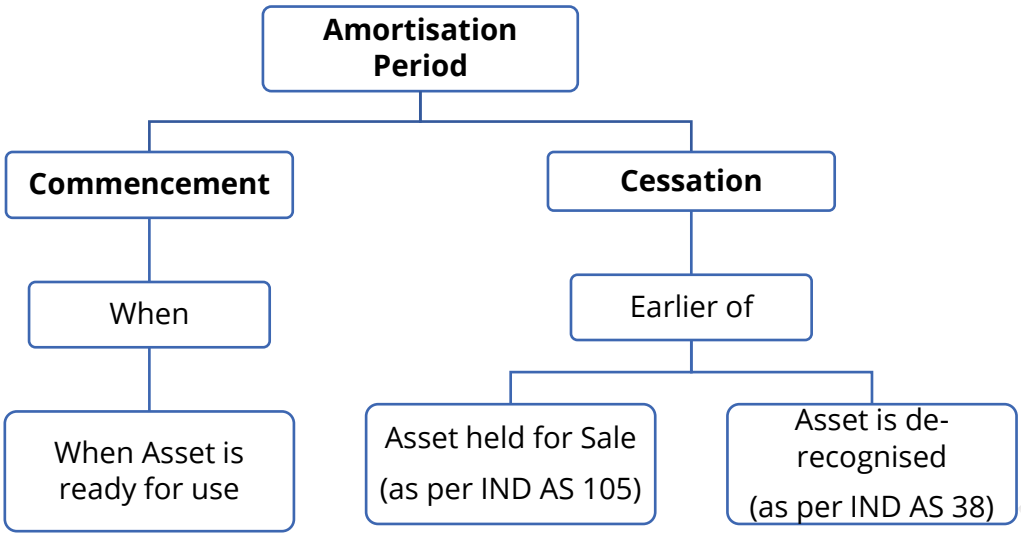
1st Priority - IA recognised at FV of asset given up

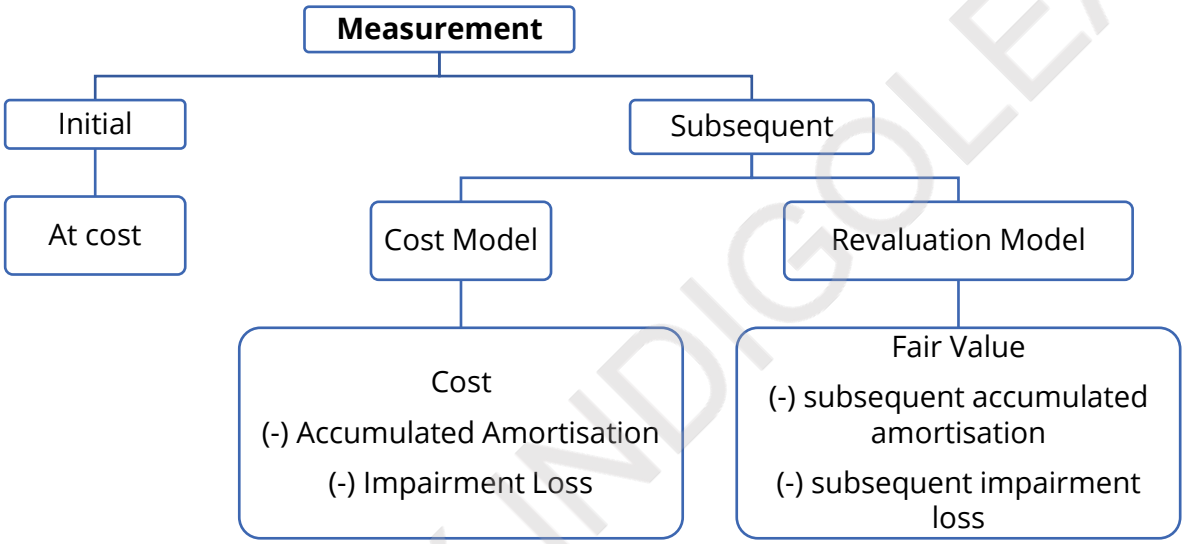
2nd Priority – FV of asset acquired if more evident

If FV not determinable or exchange lacks commercial substance – Carrying amount of asset given up.

Amortisation

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De-recognition

Intangible Asset is derecognised when

- no future economic benefits are expected to flow into the entity or
- the asset is disposed by the entity

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1. Illustration

Jupiter Ltd acquires new energy efficient technology that will significantly reduce its energy costs for manufacturing. Which costs can be considered for capitilisation?

	Costs incurred include (Rs.)
Cost of new solar technology	10,00,000
Trade discount provided	1,00,000
Training course for staff in new technology	50,000
Initial testing of new technology	35,000
Losses incurred while other parts of plant shut down during testing and training	25,000

2. Illustration

16.1.1 Venus India Private Ltd acquired a software for its internal use costing Rs.10,00,000. The amount payable for the software was Rs. 600,000 immediately and Rs. 400,000 in one year time.

16.1.2 The other expenditure incurred were:-

16.1.3 • Purchase tax: Rs. 1,00,000

16.1.4 • Entry Tax: 10% (recoverable later from tax department) Legal fees: Rs. 87,000

16.1.5 • Consultancy fees for implementation: Rs. 1,20,000 Cost of capital of the company is 10%.

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

3. Illustrations

A Company 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 Rs. 2,40,000. The finance director had authorised this campaign on the basis that it would create Rs. 5,00,000 of additional profits over the next three years.
2. A new product was developed during the year. The expenditure aggregated Rs. 1,50,000 of which Rs. 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 Rs. 70,000.
3. Staff participated in a training programme which cost the company Rs. 300,000. The training organisation had made a presentation to the directors of Baxter outlining that the incremental profits to the business over the next twelve months would be Rs. 500,000.

What amounts should appear as assets in Venus Ltd. Balance sheet as at 31st March, 20X2?

4. Illustrations

Sun Ltd acquired a software from Earth Ltd. in exchange for a telecommunication license.

•The telecommunication license is carried at Rs. 5,00,000 in the books of Sun Ltd.

•The Software is carried at Rs. 10,000 in the books of the Earth Ltd which is not the fair value.

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

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

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

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

5. Illustrations

16.1.7 X Ltd. acquired a patent right of manufacturing drug from Y Ltd. In exchange X Ltd. gives its intellectual property right to Y Ltd. Current market value of the patent and intellectual property rights are Rs. 20,00,000 and Rs. 18,00,000 respectively.

At what value patent right should be initially recognised in the books of X Ltd. in following two situations?

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

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

6. Illustrations

16.1.8 An entity is developing a new production process.

16.1.9 During 20X1-20X2, expenditure incurred was Rs. 1,000, of which

16.1.10 • Rs. 900 was incurred before 1st March, 20X2 and

16.1.11 • Rs. 100 was incurred between 1st March, 20X2 and 31st March, 20X2.

16.1.12 The entity is able to demonstrate that at 1st March, 20X2, the production process met the criteria for recognition as an intangible asset.

16.1.13 The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 500.

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

16.1.15 Explain the accounting treatment of expenditure incurred in 20X1-20X2 and 20X2-20X3 as per relevant Ind AS.

16.1.16

7. Illustrations

16.1.17 On 31st March, 20X1, Earth India Ltd. paid Rs. 50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd.'s net assets had a fair value of Rs. 30,00,000.

16.1.18 In addition, Sun Ltd. also held the following rights:

- Trade Mark named "GRAND" – valued at Rs. 180,000 using a discounted cash flow technique.
- Sole distribution rights to an electronic product; future cash flows from which are estimated to be Rs. 150,000 per annum for the next 6 years.

10% is considered an appropriate discount rate.

The 6-year, 10% annuity factor is 4.36.

Calculate goodwill and other Intangible assets arising on acquisition.

8. Illustrations

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 Rs. 10,00,00,000 for the use of know-how for a period of 5 years.

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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?

9. Illustrations

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

1. Acquired a 4 year license to manufacture a specialised drug at a cost of Rs. 1,00,00,000 at the start of the year. Production commenced immediately.
2. Also purchased another company at the start of year. As part of that acquisition, X Pharmacy Ltd. acquired a brand with a fair value of Rs. 3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.
3. Spent Rs. 1,00,00,000 on an advertising campaign during the first six months. Subsequent sales have shown a significant improvement and it is expected this will continue for 3 years.
4. It has commenced developing a new drug 'Drug-A'. The project cost would be Rs. 10,00,00,000. Clinical trial proved successful and such drug is expected to generate revenue over the next 5 years.
   - Cost incurred (accumulated) till 31st March, 20X1 is Rs. 5,00,00,000.
   - Balance cost incurred during the financial year 20X1-20X2 is Rs. 5,00,00,000.
5. It has also commenced developing another drug 'Drug B'. It has incurred Rs. 50,00,000 towards research expenses till 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?

10. Illustrations

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 Rs. 10,00,00,000 and fair value of net assets acquired is Rs. 8,50,00,000.

The purchase consideration includes payment for the following as well:

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

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

However, the above items (a) and (b) are not forming part of the net assets acquired of Rs. 8,50,00,000.

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

11. Illustrations

X Ltd. purchased a franchise from a restaurant chain at a cost of Rs.1,00,00,000 and the franchise has 10 years life.

In addition, the franchise agreement mentions that the franchisee would also pay the franchisor royalty as a percentage of sales made.

Can the franchise rights be treated as an intangible asset under Ind AS 38?

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12. Illustrations

16.1.19 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.

16.1.20 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?

13. Illustrations

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?

14. Illustrations

X Ltd. purchased a standardised finance software at a list price of Rs. 30,00,000 and paid Rs. 50,000 towards purchase tax which is non-refundable.

In addition to this, the entity was granted a trade discount of 5% on the initial list price. X Ltd. incurred cost of Rs. 7,00,000 towards customisation of the software for its intended use. X Ltd. also purchased a 5-year maintenance contract with the vendor company of Rs. 2,00,000.

At what cost the intangible asset will be recognised?

15. Illustrations

X Limited in a business combination, purchased the net assets of Y Limited for Rs. 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 Rs.)**
Property, Plant & Equipment	1,00,000
Intangible asset 1	20,000
Intangible asset 2	50,000
Cash & Bank	1,30,000
Liabilities	
Trade payable	50,000

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

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

16. Illustration

X Ltd. acquired Y Ltd. on 30th April, 20X1. The purchase consideration is Rs. 50,00,000. The fair value of the tangible assets is Rs. 45,00,000. The company estimates the fair value of "in-process research projects" at Rs. 10,00,000. No other Intangible asset is acquired by X Ltd. in the transaction.

Further, cost incurred by X Ltd. in relation to that research project is as follows:

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

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

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

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

17. Illustration

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

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

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

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

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

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

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

On 15th March, 20X1, the development phase was complete and a cash flow budget was prepared and based on which net profit for the year was estimated to be equal Rs. 40,00,000. How X Ltd. should account for the above mentioned cost?

18. Illustration

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

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

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

Expenditure incurred for development of the process in FY 20X2-20X3 is Rs. 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 Rs. 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?

19. Illustration

X Ltd. purchased a patent right on 1st April, 20X1, for Rs. 3,00,000; which has a legal life of 15 years. However, due to the competitive nature of the product, the management estimates a useful life of only 5 years. Straight-line amortisation is determined by the management to be the best method.

As at 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 Rs. 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 Rs. 3,00,000. Furthermore, the estimated useful life is now believed to be 4 more years.

Determine the value of intangible asset at the end of each financial year?

20. Illustration

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.

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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?

21. Illustration (Nov 2019 Question Paper)

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.

22. Illustration

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?

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Ind AS 102
Share Based Payments

1. Introduction

When an entity procures goods or services, the entity can settle the transaction by

- Paying cash/ Bank payment
- Transfer of other asset (Exchange of assets)
- Assuming a liability (trade payable)
- Issuing its equity instruments or assets equivalent value of equity instruments [Share based payments]

When an entity issues shares or agrees to pay / transfer cash/asset equivalent of shares, it is called share based payment and is covered under Ind AS 102.

1.1 Share based payment arrangement

It is an agreement between the entity or another group (parent, subsidiary etc) entity (including shareholder) and another party (including an employee) that entitles the other party to receive -

- **cash or other assets** of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity, **Or**
- **equity instruments** (including shares or share options) of the entity or another group entity, provided the specified **vesting conditions**, if any, are met.

1.2 Share based payment transaction

It is a transaction in which the entity –

- receives **goods or services** from the supplier of those goods or services (including an employee) in a share-based payment arrangement, or
- incurs an obligation to **settle the transaction** with the supplier in a share-based payment arrangement when **another group entity receives those goods or services**.[E.g Parent agrees to settle the transaction for goods purchased by subsidiary]

1.3 Important Points

- Share based payment should be formed with an agreement between an entity & a party (includes employees)
- Share based payments should be made for goods/ services and should be with an external person e.g. supplier including employee.
- A transaction with an employee (or other party) in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. E.g. employee subscribing to rights issue.
- For receiving goods / services, an entity needs to settle the transaction either
    - by issuing its own equity shares / or group entity's shares (**equity settled**) or
    - by paying cash amount equivalent against such shares (**cash settled**) or

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- a combination of these two where settlement option rests either with an entity or with the counterparty.

- Equity instruments, which means a residual interest in asset & liability of the company will include –
  - Ordinary shares
  - Redeemable preference shares
  - Written call option or warrants over such ordinary shares.
- Vesting conditions means the criteria which is to be fulfilled (if it is required as per the share based agreement) in order to get such Shared based payment

2. Scope

2.1 Applicability

An entity shall apply this Standard in accounting for all share-based payment transactions, whether or not the entity can identify specifically some or all of the goods or services received, including:

- equity-settled share-based payment transactions,
- cash-settled share-based payment transactions, and
- transactions where either party has choice of settling in equity or cash

2.2 Non Applicability

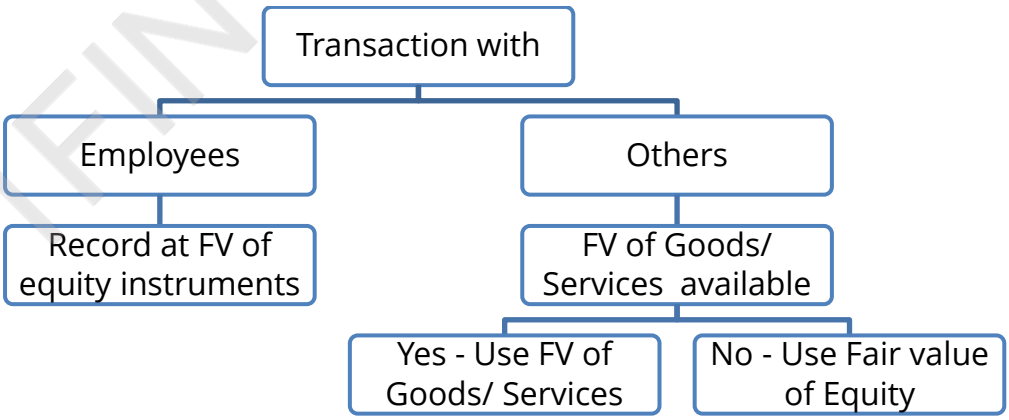
- Transaction with employee or suppliers in their capacity as shareholders
- Acquisition of goods as part of assets at the time of business combination.
- Transactions covered under Ind AS 32 - Financial Instruments

2.3 Equity Settled Share Based Payments

It is a share-based payment transaction in which the entity

- receives goods or services as consideration for its own equity instruments (including shares or share options), or
- receives goods or services but has no obligation to settle the transaction with the supplier. (This happens in cases where another group entity settles the transaction

Measurement



- In case of transactions with employees, it is difficult to estimate FV of employee servies received and hence FV of equity instruments granted is considered.
- In other cases, the first preference is the FV of Goods/Services received.

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Examples

An entity has agreed to issue 100 shares to each of its 500 employees if they remain in service for next 3 years. In this case 3 years is a service period for which shares will be issued the entity, however, since this is share based payment plan with employees of the entity, hence the fair value of equity instruments issued will be used for calculating transaction value of the share based payments.

An entity agreed to issue 100 shares to a supplier for providing some consultancy services for next 2 years. There is similar contract in the market which has a value of Rs. 20,000. The similar value of the contract will be used as fair value of this share based payment transaction unless there is no reliable fair value is available.

Counterparty	Measurement basis	Measurement date	Recognition date
Employee	Fair value of equity instruments awarded	Grant date	Date goods or services received
Non- employee	Fair value of goods or services received	Date goods or services received	Date goods or services received

2.4 Equity settled SBP

Vesting condition: A condition that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement.

Vesting period: The period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

Grant date : The date on which both the parties (entity and counterparty) agreed to the share based payment arrangement. If the agreement is subject to an approval process (e.g approval by shareholders), then the grant date is when the approval is obtained.

Example

A company grants Employee Stock Options to its employees. The employees have an option to subscribe to 1,000 shares of the company if they complete 3 years of service. In this case completion of 3 years of service is the service condition and the period of 3 years is the vesting period.

A company grants Employee Stock Options to its employees. The employees have an option to subscribe to 1,000 shares of the company if they achieve Rs. 50 lakhs of sales each year over a 3 year period. In this case achievement of sales target is the performance condition and the period of 3 years is the vesting period.

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Equity Instruments vest immediately

In this case there is on vesting condition and it is assumed that services have been received.

A company grants 1,000 share options to its employees which vest immediately. The employees can purchase shares of the company at an exercise price of Rs. 50 per share [face value of Rs.10]. The FV of options on grant date is Rs. 15 per share.

On Date of Grant

Employee Benefit Expense Dr. [FV = 15 x 1,000]	15,000	
To Share based payment reserve		15,000

On subscription by Employees

Share based payment Reserve Dr.	15,000	
Bank Dr. [Rs.50 x 1,000]	50,000	
To Share capital [10 x 1,000]		10,000
To Securities Premium		55,000

Employee received 1,000 shares by providing services worth 15,000 and paying cash of Rs. 50,000

Equity Instruments vest after completion of vesting period.

- **Determine the value of services to be received which is the FV of equity instruments granted**
- **Recognise employee benefit expense over the vesting period**
- **Consider the expected vesting at the end of each period considering the employees expecte to leave.**
- **When employees subscribe to shares, account for issue of shares. The consideration is cash paid and services received.**

A company grants 1,000 share options to its employees which carries a service condition of 2 years. The employees can purchase shares of the company at an exercise price of Rs. 50 per share [face value of Rs.10]. The FV of options on grant date is Rs. 20 per share. The estimated vesting at the end of each year is given below :

Year 1 – 96%

At the end of Year 2 – 95% of shares are vested and are subscribed by the employees.

The FV of options granted is Rs. 20,000.

On Date of Grant – No entry is passed

End of year 1	
Expected Vesting	96%
FV expected to Vest [96% x 20,000]	19,200
Vesting period	2 Years
Expense to be recognised in Year 1[19,200 x1/2]	9,600

Accounting Entry

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Employee Benefit Expense Dr.	9,600	
To Share based payment reserve		9,600

End of year 2	
Actual vesting	95%
FV Vested [95% x 20,000]	19,000
Vesting period	2 Years
Cumulative Expense to be recognised at end of Year2 [19,000 x 2/2]	19,000
Less: Expense already recognised	9,600
Expense to be recognised in Year 2	9,400

Accounting Entry

Employee Benefit Expense Dr.	9,400	
To Share based payment reserve		9,400

No of shares vested = 950 [95% of 1,000]

Total amount to be paid by employees = 950 x 50 = 47,500

Share based payment Reserve Dr.	19,000	
Bank Dr. [Rs.50 x 1,000]	47,500	
To Share capital [10 x 1,000]		10,000
To Securities Premium		56,500

Employee received 950 shares by providing services worth 19,000 and paying cash of Rs. 47,500

Summary –

- Recognise amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest
- Revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates.
- On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested.
- Fair value of grant date is considered and is not revised.

2.5 Cash settled – Share based payments

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.
- the entity shall remeasure the fair value of the liability at the end of each reporting period and at the date of settlement,
- any changes in fair value recognized in profit or loss for the period
- It can also take form of share appreciation rights.

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[In case of equity settled transactions, there is no remeasurement. This means that the amount recognised under equity is based on FV on the grant date]

Journal Entries – in case of immediate vesting

On Date of Grant

Expense	Xxx	
To Share based payment liability		Xxx

End of each year

In case of loss		
Expense Dr.	Xxx	
To Share based payment liability		Xxxx
In case of gain		
Share based payment liability	Xxx	
To expense		Xxxx

2.6 Share based payment with cash alternative

In this case either the entity or the other party has the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

Choice with counter-party
Treated as compound financial instrument [debt + equity] (Refer Ind AS 109)
FV of goods/services measured directly - Difference between FV of goods/services and FV value of debt component is considered as equity component. **If FV of Goods/Services not available or in case of employees** **FV of Compound Financial Instrument is used to measure the value of goods and services.** - Measure FV of debt - Measure FV of equity assuming cash alternative is surrendered FV of Compound Financial Instrument = FV of debt + FV of equity.
Liability component is fair valued
On Settlement Cash Paid – Dr. Liability & Cr. Cash. The equity component is not impacted. Equity issued – Dr. Liability & Cr. Equity

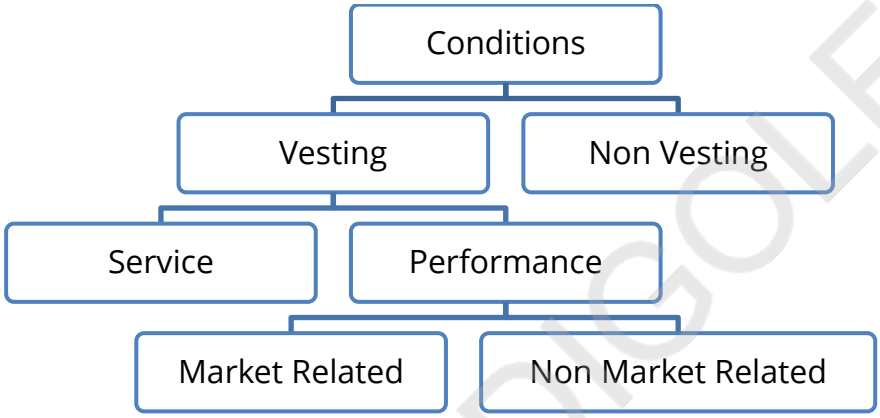
Choice is with the entity
Accounted as Cash settled or Equity Settled
Entity checks whether it has present obligation - Intention to settle - Past practice

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- Ability to settle in equity instruments [If restriction to issue equity, it is considered to be a cash settled]
Settlement - Accounted as equity and settled by issuing shares : Account for issue of shares - Accoutned as Equity settled but settled in cash : Treated as buy back of equity interest - Accounted as liability & Settled in cash – Dr. Liability & Cr. Cash - Accounted as liability but settled in equity : Transfer liability to equity - Settled at higher value – Differential portion is treated as additional expense.

3. Type of Conditions

Conditions in SBP can be vesting and non-vesting. A vesting condition is either a service condition or a performance condition.



Only Market based condition & Non vesting conditions will be considered to determine the fair value of SBP.
Remaining conditions are adjusted while estimating number of equity instruments which would vest. For e.g service condition is considered to estimate % of employees who would complete the number of years of service requirement.

Service condition: A vesting condition that requires the counterparty to complete a specified period of service during which services are provided to the entity. If the counterparty, regardless of the reason, ceases to provide service during the vesting period, it has failed to satisfy the condition. A service condition does not require a performance target to be met.

An entity has issued 100 shares each to its 1,000 employees under share based payment if they remain in the organization for next 3 years. This would be considered to be a service condition; 3 years being the period over which employee would be required to be in service as a condition.

Service condition does not impact the FV of SBP.

Performance condition: A vesting condition that requires:

- the counterparty to complete a specified period of service (ie a service condition); the service requirement can be explicit or implicit; and

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- specified performance target(s) to be met while the counterparty is rendering the service required above. Performance targets could be profit target, sales target, market price of shares etc.

Market related condition

When one of the conditions is to achieve target price/ value of the share by an entity, it is called as market-related performance condition. If the performance condition is a market condition, the estimate of the length of the expected vesting period shall be consistent with the assumptions used in estimating the fair value of the options granted, and shall not be subsequently revised.

An entity issues stock options to its employees who will serve the organization for next 2 years and till the time the share price reaches to Rs. 100. The target price to reach Rs. 100 is one of the market related condition.

If the options vest earlier than expected due to market condition, expenses will be recognised immediately. If options vest later than expected due to market condition, it is ignored.

Non-market related condition

When the condition is not market driven but linked with some internal performance/ operations or activities of the entity, it will be considered as non-market related conditions. If the performance condition is not a market condition, the entity shall revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates.

An entity issued some stock options to employees with a condition that they have to remain in the organisation for next 2 years and EBITA of the entity should rise to Rs. 10 lakhs. Here, the EBITA target is non-market related condition.

Non vesting Condition

In case of non-vesting condition, the condition does not impact vesting.

4. Reload Feature

Reload feature: A feature that provides for an automatic grant of additional share options whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price.

Reload option: A new share option granted when a share is used to satisfy the exercise price of a previous share option.

Treatment of a reload feature

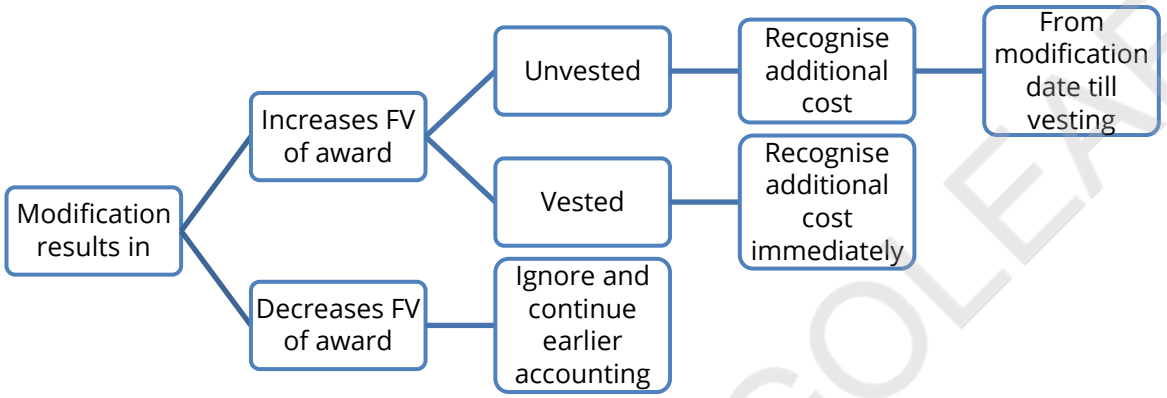
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For options with a reload feature, the reload feature shall not be taken into account when estimating the fair value of options granted at the measurement date. Instead, a reload option shall be accounted for as a new option grant, if and when a reload option is subsequently granted.

5. Modification, Cancellation & Settlements

An entity might modify the terms and conditions on which the equity instruments were granted. For example, it might reduce the exercise price of options granted to employees (i.e. reprice the options), which increases the fair value of those options.

5.1 Modification



- If the modification results in increase in number of shares, recognise additional cost from date of modification till date of vesting.

5.2 Cancellation

- recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period [acceleration of vesting]
- any payment made to the employee on the cancellation or settlement of the grant shall be accounted for as the repurchase of an equity interest. If amount paid is in excess of FV of equity instrument, the excess is treated as expense.

5.3 Grant of new equity instruments & cancellation of existing instruments

- Treated as replacement for cancelled instruments
- Consider as modification of the original grant and account as per above.

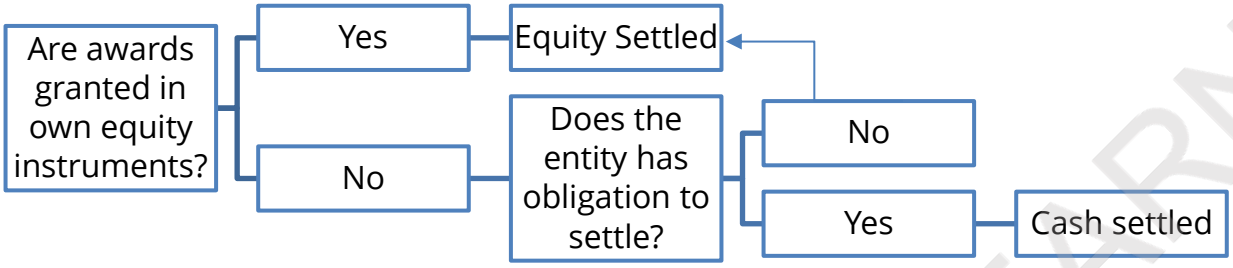
A	**FV of the replaced equity instruments**		XXXX
B	**(-)Net FV of cancelled instruments [C-D]**		
C	FV of cancelled instruments	xxxx	
D	(-) Amount paid to the employee on cancellation	xxxx	XXXX
A-B	**Incremental FV Granted**		**xxx**

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6. Group Share based payment plans

There are instances where goods or services are received by one group entity and another group entity has the obligation to settle the share based payment transaction. For e.g. Reliance Industries Limited grants stock options on its shares to the employees of Reliance Jio (Subsidiary).

Check the following for entity receiving goods and services to determine whether the plan is cash settled or equity settled.



Scenario	I	II
Who receives goods/ services?	Subsidiary	Parent
Who settles?	Parent	Subsidiary
Settlement by	Issuing shares of parent	Issuing shares of subsidiary
Type	Equity (Since subsidiary does not have obligation to settle)	Equity (Since parent does not have obligation to settle)
Accounting – Parent	Dr. Investment in subsidiary Cr. Equity	Dr. Expenses Cr. Dividend Income
Accounting Subsidiary	Dr. Expenses Cr. Equity	Dr. Retained Earnings Cr. Equity

7. Calculation of FV

The fair value of options can be determined using models like binomial model, Black Scholes Model etc. All option pricing models take into account the following factors:

- the exercise price of the option;
- the life of the option;
- the current price of the underlying shares;
- the expected volatility of the share price;
- the dividends expected on the shares (if appropriate); and
- the risk-free interest rate for the life of the option

If FV of options is not determinable, intrinsic value can be taken. Intrinsic value = Market Price – Exercise price.

8. Disclosures

Standard requires an entity to disclose the following-

- Type and scope of agreement existing during the reporting period.

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- Describing general terms & conditions of each type of share-based payment plans.
- The number of weighted average price of share option as outstanding with a movement of granted, vested, expired, exercised, cancelled and closing balance of share-based payment plans.
- The average share price of exercised options.
- The range of exercise prices and weighted average remaining contractual life of options outstanding at the end of reporting period.
- The valuation method used to estimate the fair value of the awards.
- The impact on Statement of Profit and Loss and Balance Sheet for such share-based payments.

ILLUSTRATIONS

1. Illustration

ABC Limited granted to its employees, share options with a fair value of Rs. 5,00,000 on 1st April, 20X0, if they remain in the organization up to 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? (SM)

2. Illustration

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 Rs. 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? (SM)

3. Illustration

Entity X grants 10 shares each to its 1000 employees on the conditions as mentioned below-

- To remain in service for 3 years & entity's profit after tax (PAT) shall reach to Rs. 100 million.
- It is expected that PAT should reach to Rs. 100 million by the end of 3 years.
- Fair value at grant date is Rs. 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. (SM)

4. Illustration

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 Rs. 95. SAR can be exercised any time up to 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:

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Fair value of SAR	Rs.
31st March, 20X1	112
31st March, 20X2	109
31st March, 20X3	114

Pass the Journal entries? (SM)

5. Illustration

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 (Rs.) 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.

6. Illustration

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**	**Rs.**
No of cash settled shares			74,000
Service condition		3 years	
Option II			
No of equity settled shares of face value of Rs. 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. (SM)

7. Illustration

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 Rs. 2,00,000 and face value of each share of Indian Inc was Rs. 100.

Pass the journal entries. (SM)

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8. Illustration

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 Rs. 1,00,000. Nominal value per share is Rs. 10.

Record the transactions. (SM)

9. Illustration

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 Rs. 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. (SM)

10. Illustration

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 Rs. 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? (SM)

11. Illustration

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%

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Year 3 25%

At the grant date, the fair value of the option was Rs. 120. How should we recognize the transaction? (SM)

12. Illustration

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	Rs. 25
Market condition	Share price to reach at Rs. 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. (SM)

13. Illustration

Entity X grants 10 shares each to its 1000 employees on the conditions as mentioned below-

- To remain in service for 3 years & entity's profit after tax (PAT) shall reach to Rs. 100 million.
- It is expected that PAT should reach to Rs. 100 million by the end of 3 years.
- Fair value at grant date is Rs. 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? (SM)

14. Illustration

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 Rs. 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 Rs. 50. After the re-pricing they are now worth Rs. 80, hence expense is expected to increase by Rs. 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? (SM)

15. Illustration

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.

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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 Rs. 1.20. The fair value increased to Rs. 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 Rs. 0.90, the Directors repriced the option and this caused the fair value to increase to Rs. 1.05. Trading conditions improved in the second half of the year and by 31st March, 20X3 the fair value of an option was Rs. 1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30th September, 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. (SM)

16. Illustration

Anara Fertilisers Limited issued 2000 share options to its 10 directors for an exercise price of Rs. 100.The directors are required to stay with the company for next 3 years.

Fair value of the option estimated	Rs. 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	Rs. 90
Market price of the share at the cancellation date was	Rs. 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 Rs. 95 per option to each of 9 directors.

How the cancellation would be recorded? (SM)

17. Illustration

P Ltd. granted 400 stock appreciation rights (SAR) each to 75 employees on 1st April 20X1 with a fair value Rs. 200. The terms of the award require the employee to provide service for four years in order to earn the award. The fair value of each SAR at each reporting date is as follows:

31st March 20X2	Rs. 210
31st March 20X3	Rs. 220
31st March 20X4	Rs. 215
31st March 20X5	Rs. 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? (SM)

18. Illustration

A parent grants 200 share options to each of 100 employees of its subsidiary, conditional upon the completion of two years' service with the subsidiary. The fair value of the share options on grant date is Rs. 30 each. At grant date, the subsidiary estimates that 80 percent of the employees will

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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. (SM)

19. Illustration

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 have left. The fair value of the shares on grant date is Rs. 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? (SM)

20. Illustration

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	Rs. 300
Number of years to vest after acquisition	1 year
Fair Value of award which replaces existing plan	Rs. 400

Calculate the share-based payment values as per Ind AS 102? (SM)

21. Illustration

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	Rs.
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. (SM)

22. Illustration

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 Rs. 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 Rs. 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 Rs. 12).

How much expense and liability is to be recognized at the end of each year? Pass Journal entries. (SM)

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Ind AS 108
OPERATING SEGMENTS

1 Core principle

An entity shall disclose information

- ✓ to users of financial statements to evaluate
  - a) The nature and
  - b) Financial effects of business activities in which
    - it engages
    - the economic environment in which its operates

2 Scope

Ind AS 108 applies to –

- ✓ Companies to which Ind AS is applicable
- ✓ If an entity is not required to apply with Ind AS 108 -
  - ✓ Chooses to disclose information about segments that does not comply with Ind AS 108
  - ✓ Shall not describe information as segment information.
- ✓ If Financial report contains -
  - ✓ both consolidated financial statement as well as parent's separate financial statements
  - ✓ segment information is required only in consolidated financial statements

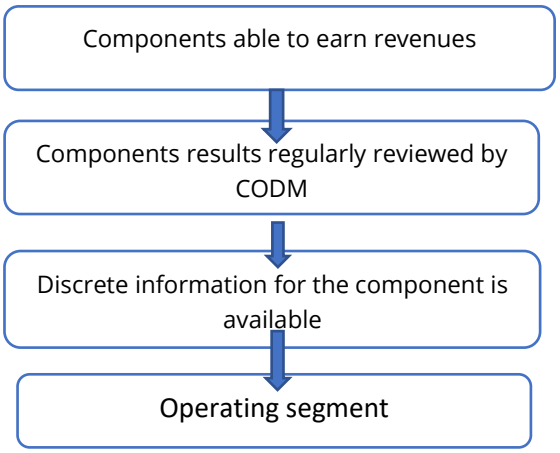
3 Operating segments

1. Not every part of an entity is necessarily an operating segment or
2. part of an operating segment.

3.1 Identification of operating segments

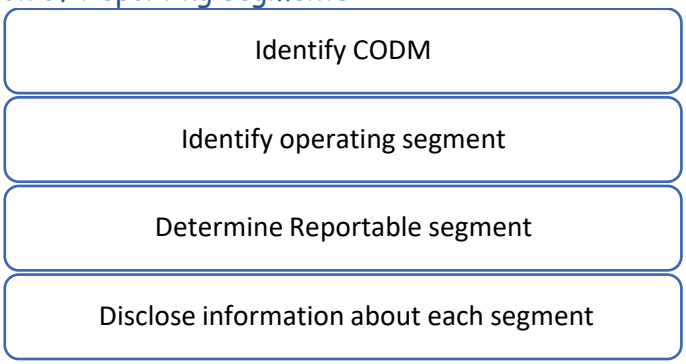
An operating segment is **component of entity**

- That engages in business activities
- from which it may earn revenues and incur expenses (including from transactions with other components of the entity)
- may engage in business activities for which it has yet to earn revenues
- Whose operating results are regularly reviewed by the entity's chief operating decision maker (CEO, COO, Group of Directors of operations/production/ geographical area)
- to make decisions about resources to be allocated to the segment and assess its performance
- For which **discrete** financial information is available



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3.2 Identification of Reporting segments



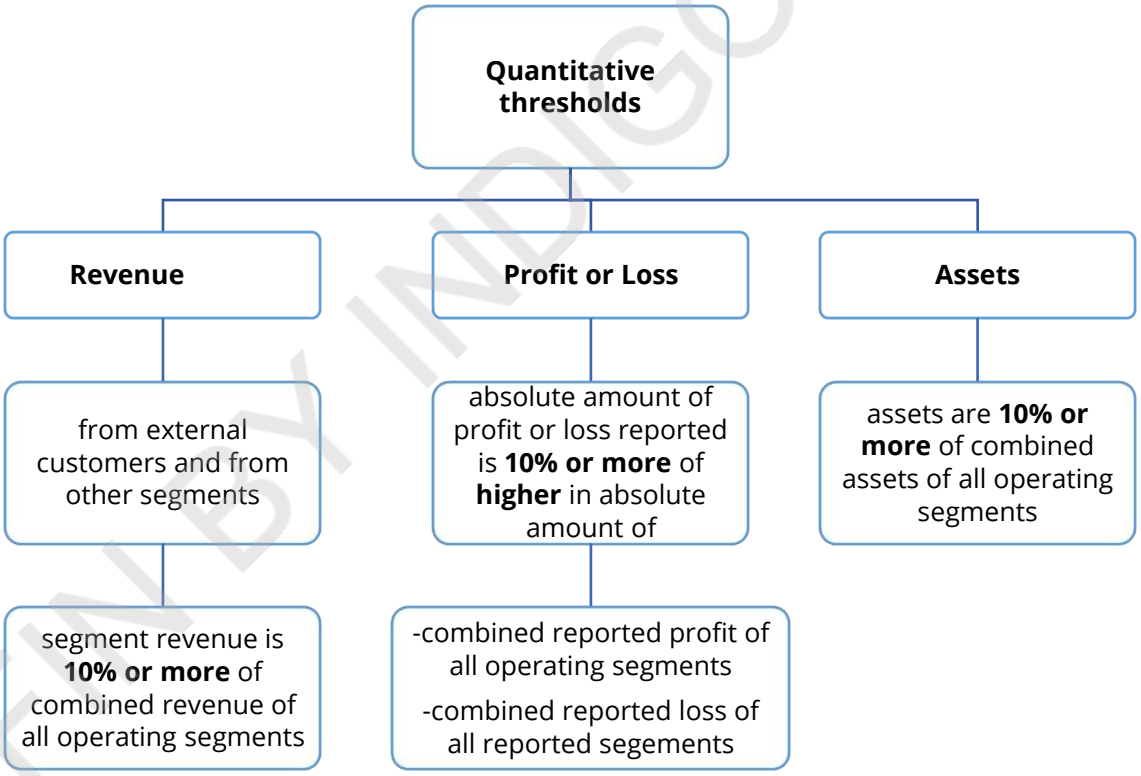
3.3 Aggregation Criteria

Two or more operating segments may be aggregated into single operating segment if aggregation is consistent with the **core principle** of Ind AS 108

Segments are similar in each of following respects-

a) Nature of product and services
b) Nature of production process
c) Type or class of customer for their product and services
d) Method use to distribute their products and services
e) If applicable, nature of regulatory requirement

3.4 Quantitative threshold

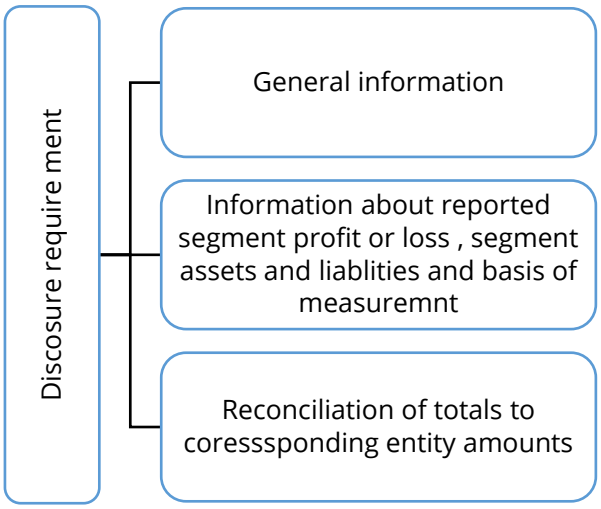


Points to Remember

✓ If above quantitative threshold criteria are satisfied, then such segment has to be reported separately.

Even if a segment does not satisfy the criteria but management believes that information about segment would be useful to users of financial statements, such segment should be reported separately.

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4.1 General information

- Factors used to identify the entity's reportable segments, including the basis of organisation

a) Product and services
b) Geographical areas
c) Regulatory requirement
d) A combination of factors and whether operating segments have been aggregated

- Judgments made by management in applying aggregation criteria

- Types of products and service from which each reportable segment derives its revenue

4.2 Information about profit or loss

- Revenues from external customer
- Revenues from transaction with operating segments of the same entity
- Interest revenue
- Interest expense
- Depreciation and amortisation
- Material items of income an d expenses disclose in accordance with Ins AS 1 presentation and disclosure
- The entity's interest in profit or loss of associate and joint venture accounted by equity method
- Income tax expense or income
- Material non-cash items other than depreciation and amortisation

4.3 Information about assets and liabilities

- The amount of investment in associates and joint venture accounted for by the equity method.
- The amounts of addition to on-current assets other than financial instrument, deferred tax assets, net defined benefit assets and rights arising under insurance contracts.

4.4 Measurement- Segment information

An entity should provide an explanation of the measurement of segment profit or loss, segment assets and liabilities for each reportable segment.

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At a minimum, an entity should disclose following

- ✓ **Basis of accounting** for any transactions between reportable segments
- ✓ Nature of any difference between the measurements of the reportable segments , **profit or losses** and the entity's profit or loss before income tax expense or income and discontinued operation
- ✓ Nature of any difference between measurement of reportable segments **assets and liabilities** and the entity's assets and liabilities
- ✓ Nature of any changes from **prior period** in the measurement methods used to determine reported segment profit or loss and effect, if any of those changes on the measurement of segment profit or loss
- ✓ Nature and effect of any **asymmetrical allocation** to reportable segment

ILLUSTRATIONS

1. Illustration

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? (SM)

2. Illustration

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. (SM)

3. Illustration

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'? (SM)

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4. Illustration

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? (SM)

5. Illustration

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? (SM)

6. Illustration

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? (SM)

7. Illustration

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:

(Rs. 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

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Additional information:

1. Unallocated income net of expenses is Rs. 30,00,00,000
2. Interest and bank charges is Rs. 20,00,00,000
3. Income tax expenses is Rs. 20,00,00,000 (current tax Rs. 19,50,00,000 and deferred tax Rs. 50,00,000)
4. Unallocated Investments are Rs. 1,00,00,00,000 and other assets are Rs. 1,00,00,00,000.
5. Unallocated liabilities, Reserves & surplus and share capital are Rs. 2,00,00,00,000, Rs. 3,00,00,00,000 & Rs. 1,00,00,00,000 respectively.
6. Depreciation amounts for coating & others are Rs. 10,00,00,000 and Rs. 3,00,00,000 respectively.
7. Capital expenditure for coating and others are Rs. 50,00,00,000 and Rs. 20,00,00,000 respectively.
8. Revenue from outside India is Rs. 6,20,00,00,000 and segment asset outside India Rs. 1,00,00,00,000.

Based on the above information, how X Ltd. would disclose information about reportable segment revenue, profit or loss, assets and liabilities for financial year 20X1-20X2? (SM)

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Ind AS 113

FAIR VALUE MEASURMENT

1 Scope

This standard will cover **requirements of all** other standards where fair value measurement and disclosure is needed.

1.1 Measurement exclusion

- Ind AS 102- Share based Payments
- Ind AS 116- Leases
- Ind AS 2- Inventories
- Ind AS 36- Impairment

1.2 Disclosure exclusion

- Ind AS 19- Employee benefits
- Ind AS 36- Impairment

2 What is fair value?

Fair value= market price

Fair value

- ✓ The price that would be received to sell an asset
- ✓ Paid to transfer a liability
- ✓ On an orderly transaction
- ✓ Between market participants
- ✓ At the measurement date

- Fair value is the value to **exit** the asset or liability
- But **not to buy** an asset or a liability

3 Assets or liability specific value

Fair value is **determined for asset / liability**

Fair vaue is **not entity specific**

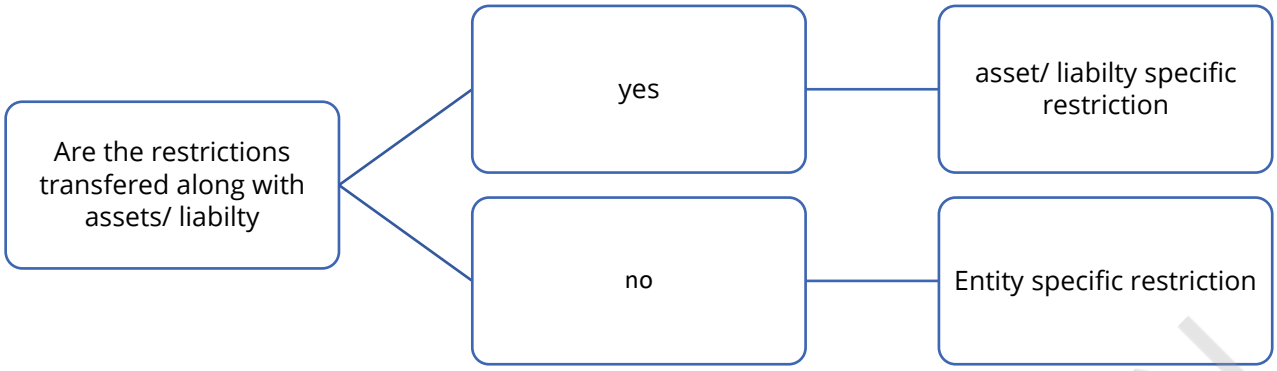
Restrictions/ conditions attached to the asset will be considered to determine the fair value

Points to remember

- Entity specific restriction are not considered to determine fair value
- Assets / liability specific restrictions shall be considered to determine fair value

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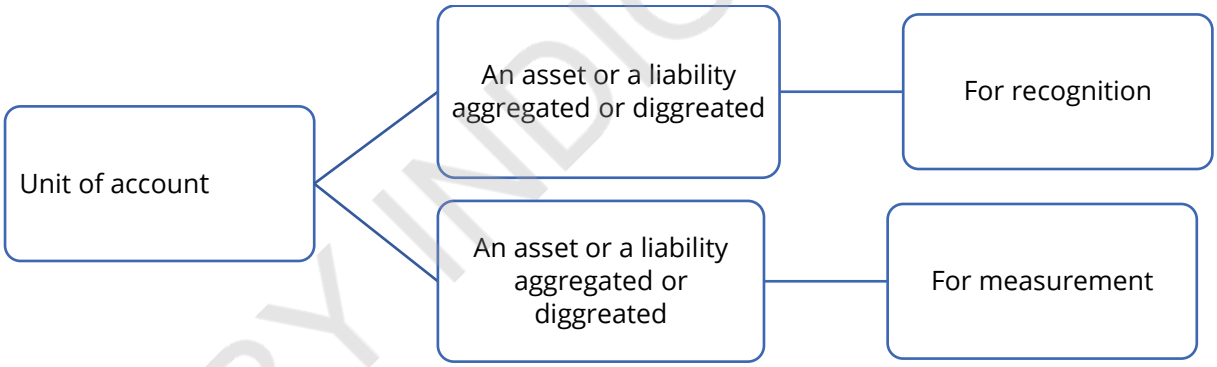
3.1 How to identify restrictions are entity specific or not?



4 Unit of Account

Means how to measure fair value-

a. Refer to respective Ind AS to measure such fair value
   Example-
   a) Securities – valued security by security at an individual level
   b) Cash generating unit-valued as per Ind AS 36 Impairment of assets after taking all the assets and liabilities
b. Aggregation or disaggregate the assets for valuation, observe and do as per other market participants.



5 Market

- ✓ Places where we buy and sell assets and liabilities
- ✓ Consider he **principal market** to determine the fair value
- ✓ In case of no principal market or multiple principle market, consider the **most advantageous market**
- ✓ Different entity can have different principal market for the same asset
- ✓ Entity may or may not sale in that market

5.1 Principal market

is a market having **highest volume** of trade with highest level of activities comparing with any other market available for similar transaction.

Example- Share of a company which is listed at BSE and NYSE has different closing prices at the year end. The price at BSE has greatest volume and activity whereas at NYSE it is less in terms of volume transacted in the period. Since BSE has got highest volume and significant level of activity comparing to other market although the closing price is higher at NYSE, the closing price at BSE would be taken.

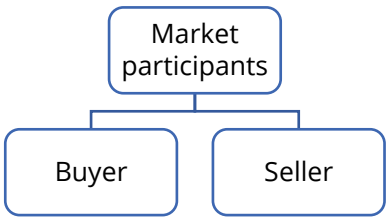
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5.2 Most advantageous market

Is a market where entity realises the **highest sales proceeds** after deducting transaction cost if any, or cost to reach that market (transportation cost)

These markets are used in valuation only if principle market can't be identified

6 Market participants



- ✓ An entity measure the fair value of asset / liability using assumption that market participant would use if it is in their **best economic interest**
- ✓ Market participants should **not be related**. If related then transaction should be at **arm's length price**
- ✓ They are **aware of the information**, restrictions, usage and other details of assets/ liabilities
- ✓ The parties are **not under any stress** or force to enter into these transactions

7 Price

Fair value is the price that is

- received when an entity sells the asset
- paid when an entity transfers the liability
- in an orderly transaction in principal market (or most advantageous) market at
- Measurement date under current market conditions.

Note- consider the price in most advantageous market

7.1 Transaction cost

- Are not characteristics of assets or liability but characteristics of transactions.
- Hence, it would not appropriate to consider any transaction cost further while assessing fair value

Note- transaction cost do not include transportation cost

7.2 Transport cost

- Cost that would be incurred to transport the asset from its current location to principle (or most advantageous) market.

	Principal market	**Most advantageous market**
Transaction cost	No	Yes
Transport cost	Yes	Yes

8 Application and determination of fair value

8.1 Non-financial assets

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8.1.1 Difference between financial and non-financial assets

FINACIAL ASSETS	NON FINANCIAL ASSETS
1)They have market and a structure to determine the fair value of the assets	1)Standard address the procedure to assess the fair value of Non- Financial asset
2)It does not change its characteristics	2)Assets can changes its characteristics and have multiple uses
3)Market is available readily	3)Absence of active market
4)Example-Investments, Receivables etc.	4)Example-Property, land and equipment, machinery etc.

8.1.2 Highest and best use

- Valuation concept used to value Non-Financial asset.
- The highest and best use of financial asset must be
    - Physically possible
    - Legally permissible
    - Financial feasible

8.1.3 Valuation premise

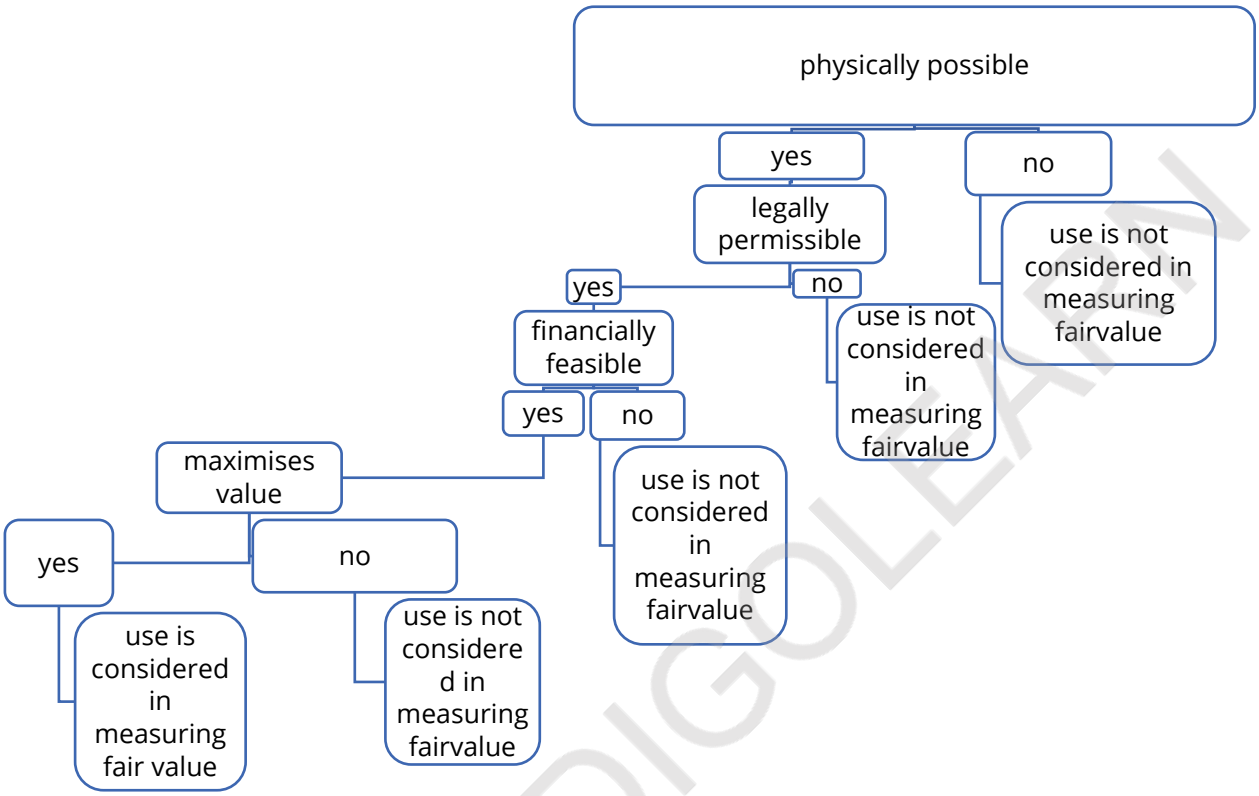
Fair value measurement of non-financial assets would be based on either

- In combination with other assets, or
- At stand-alone basis

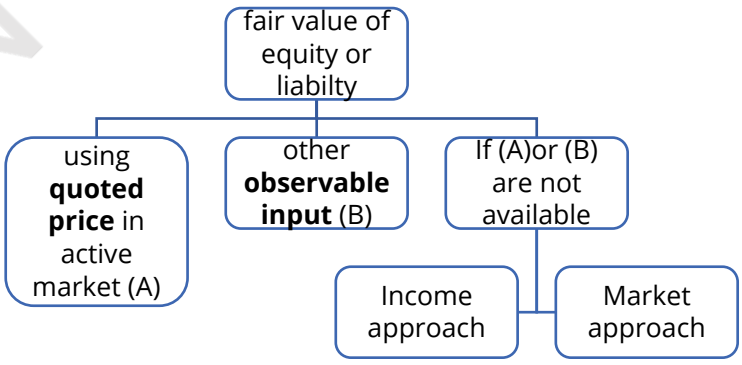
Points to remember

- In case of no alternate use / best use is determined
    - Assume that current use is best and highest use

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8.2 Applying fair value rules on liabilities and equity instruments



9 Valuation techniques for determining fair value

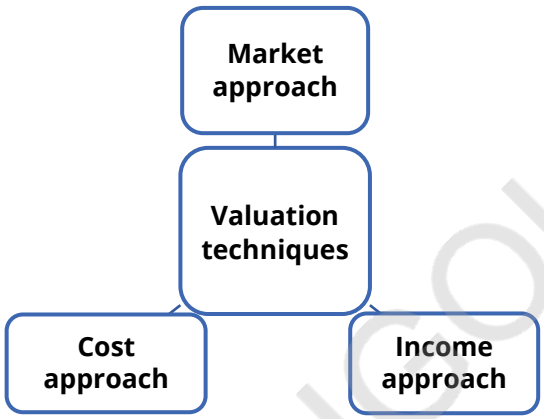
Observable input: inputs that are developed using market data such as publicly available information about actual events or transactions

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Unobservable input: inputs for which market data are not available and they are developed using best information available



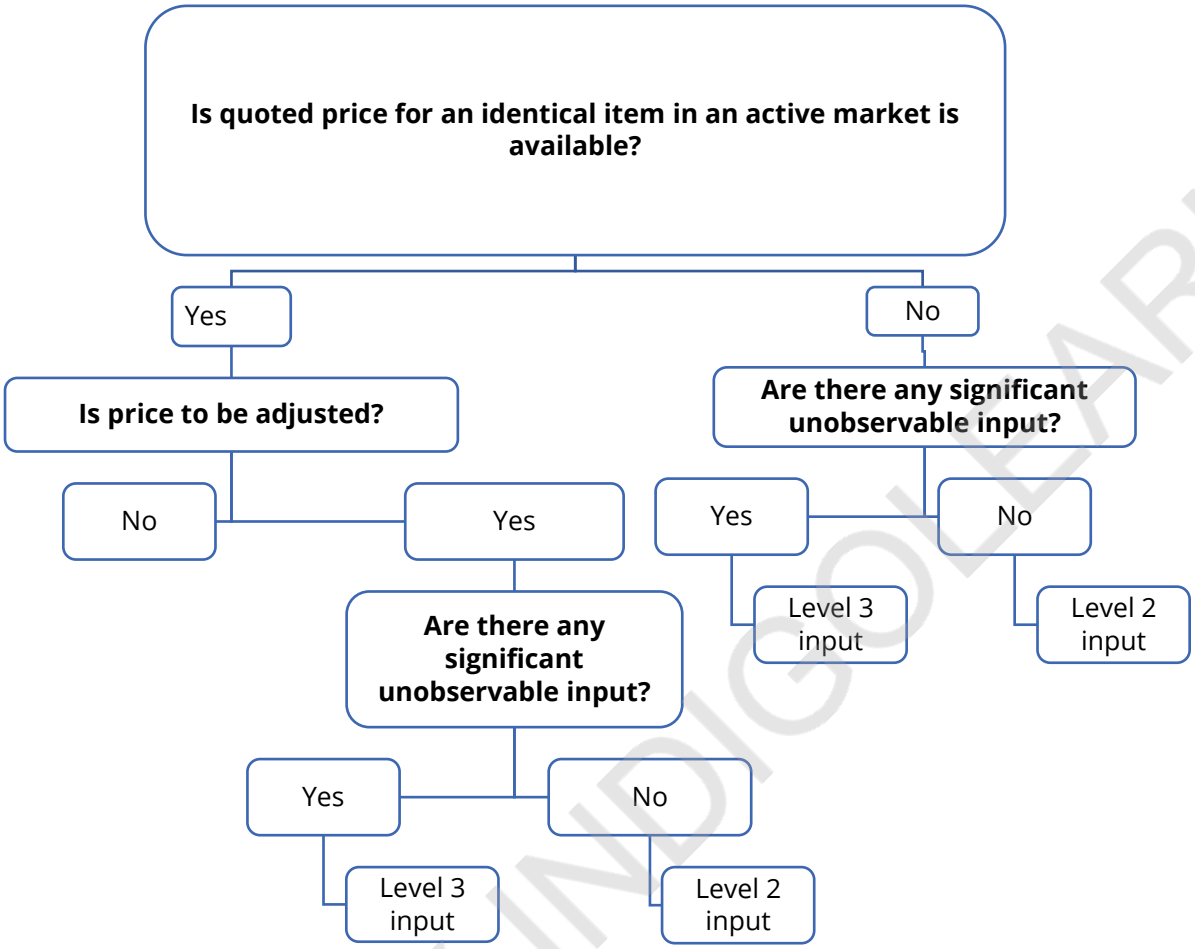
9.1 Approaches to measure fair value



Market approach	Income approach	Cost approach
Use prices and other information generated by market	Converts future amounts (cash flows or incomes and expenses) to a single current amount.	Describes how much cost is required to replace existing asset/ liability in order to make it in a working condition
Quoted prices are indicative values of business if it exchanges in active market	Future cash flows to be discounted at current date to get fair value of the asset/ liability	All related cost will be fair value
Valuation technique specified by standard- **Matrix pricing** normally used to value debt securities	Valuation technique specified by standard- ➢ **Present value** techniques ➢ Option pricing modals e.g. **Black-Scholes Merton modal or Binomial modal** ➢ The multi period excess earning method.	

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Inputs



11 Disclosure requirements

An entity shall disclose information that helps users of its financial statements assess both of the following

- for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the balance sheet after initial recognition, the valuation techniques and inputs used to develop those measurement
- for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

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	Fair Value Measurement						Disclosure		
	Recurring			Non-Recurring					
Level	1	2	3	1	2	3	1	2	3
Fair value at each reporting date	✓	✓	✓	✓	✓	✓			
Reasons for measurement				✓	✓	✓			
Level of hierarchy	✓	✓	✓	✓	✓	✓	✓	✓	✓
Transfers	✓	✓	✓						
Valuation techniques		✓	✓		✓	✓		✓	✓
If changes in valuation techniques		✓	✓		✓	✓		✓	✓
Quantitative information about significant unobservable inputs			✓			✓			
Reconciliation of opening and closing			✓						
Unrealized gains/losses from remeasurement			✓						
Valuation process and policies			✓			✓			
Sensitivity to changes in unobservable inputs			✓						
If highest and best use different from actual	✓	✓	✓	✓	✓	✓	✓	✓	✓

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1. Illustration

ABC Ltd. acquired 5% equity shares of XYZ Ltd. for Rs. 10 crore in the year 20X1-20X2. The company is in process of preparing the financial statements for the year 20X2-20X3 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 Rs. 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 Rs. 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?

Hint: Fair Value Rs.14.40 Crores

2. Illustration

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:

(Rs. 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 Rs. 1,465 crore and the surplus cash & cash equivalent is Rs. 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.

Hint: Value per share Rs.205

3. Illustration

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	Rs. 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

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Determine the Equity value of KK Ltd. as on the measurement date on the basis of above details.

Hint: Value per share Rs.375.72

4. Illustration

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.

Hint: (i) Highest best possibility of developing a commercial complex will be the basis. (ii) Level 3 (iii) If quoted price available then Level 2 inputs

5. Illustration

On 1st January, 20X1, A Ltd assumes a decommissioning liability in a business combination. The reporting 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. The following information is relevant:

If A Ltd was contractually allowed to transfer its decommissioning liability to a market participant, it concludes that a market participant would use all of the following inputs, probability weighted as appropriate, when estimating the price it would expect to receive:

a. Labour costs

Labour costs are developed based on current marketplace wages, adjusted for expectations of future wage increases, required to hire contractors to dismantle and remove offshore oil platforms. A Ltd. assigns probability to a range of cash flow estimates as follows:

Cash Flow Estimates:	100 Cr	125 Cr	175 Cr
Probability:	25%	50%	25%

b. Allocation of overhead costs: Assigned at 80% of labour cost

c. 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. Such compensation includes both of the following:

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i. Profit on labour and overhead costs:
A profit mark-up of 20% is consistent with the rate that a market participant would require as compensation for undertaking the activity
ii. The risk that the actual cash outflows might differ from those expected, excluding inflation:
A Ltd. estimates the amount of that premium to be 5% of the expected cash flows. The expected cash flows are 'real cash flows' / 'cash flows in terms of monetary value today'.

d. Effect of inflation on estimated costs and profits
A Ltd. assumes a rate of inflation of 4 percent over the 10-year period based on available market data.

e. Time value of money, represented by the risk-free rate: 5%

f. Non-performance risk relating to the risk that Entity A will not fulfil the obligation, including A Ltd.'s own credit risk: 3.5%

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.

You are required to calculate the fair value of the asset retirement obligation.

Hint: Fair value of decommissioning liability 194.88 Cr.

6. Illustration

(i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of Rs. 10. Entity XYZ's after-tax maintainable profits are estimated at Rs. 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.

(ii)Based on the facts given in the aforementioned part (i), assume that, Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is Rs. 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares.

Hint: (i) Value of Investment 42,000 (ii) Value of investment Rs.42,500

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Ind AS 115
Revenue from Contracts with Customers

1 Objective

- To establish the principles that an entity shall apply to report useful information about
  - Nature
  - Amount
  - Timing
  - Uncertainty

  of *revenue* and cashflows arising from *contract* with *customers* .
- Entity shall recognise revenue to depict
  - Transfer of goods and services to the customer
  - In an amount (consideration in exchange)

2 Five Step Model

An entity shall apply the five step model to recognise revenue.

Identify the contract with customer	•Approved contract •Identify each party rights •Identify the payment terms •Commercial Substance •Collection of consideration - Probable
Identify Performance obligations	•Performance Obligation - Promise •Each promise to transfer goods or services to the customer
Determine the transaction price	•amount of consideration which an entity expects to be entitled to receive in exchange of the goods or performance of services to a customer.
Allocate the transaction Price	•Allocate the transaction price to each performance obligation.
Recognise Revenue	•When the entity satisfies a performance obligation •by transferring promised goods or services •Customer obtains control of the asset

3 Step 1 – Identify the *contract* with the *customer*

Customer - A party that has contracted with an entity to *obtain goods or services* that are an *output of the entity's ordinary activities* in exchange for consideration.
Contract - An *agreement* between two or more parties that creates *enforceable rights and obligations.* Contract can be oral, written or as per customary business practices.
Recognising a contract

An entity shall account for a contract with customer only if all the following conditions are satisfied (Paragraph 9)

> An entity shall not reassess Step 1 once the criteria under Para 9 are met. This is the case even if the ability of customer to pay the consideration deteriorates subsequently. *If collectability is uncertain subsequently, the entity will test receivable for impairment as per Ind AS 109. Revenue is not reversed in such a case.*

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Contract is ***approved by parties*** (either orally, written or in accordance with customary business

Entity ***can identify each parties' rights*** regarding the goods or services to be transferred

Entity can ***identify the payment terms*** for the goods or services to be transferred

The transaction has ***commercial substance***, i.e., the risk, timing or amount of the future cash flows is expected to change

It is ***probable that the entity will collect the consideration*** to which it is entitled to

- *A contract does not exist if any of the party has a unilateral enforceable right to terminate a wholly unperformed contract without compensating the other parties. If both parties can mutually agree and terminate the contract (even without penalty), a contract exists for the purpose of Ind AS 115.*

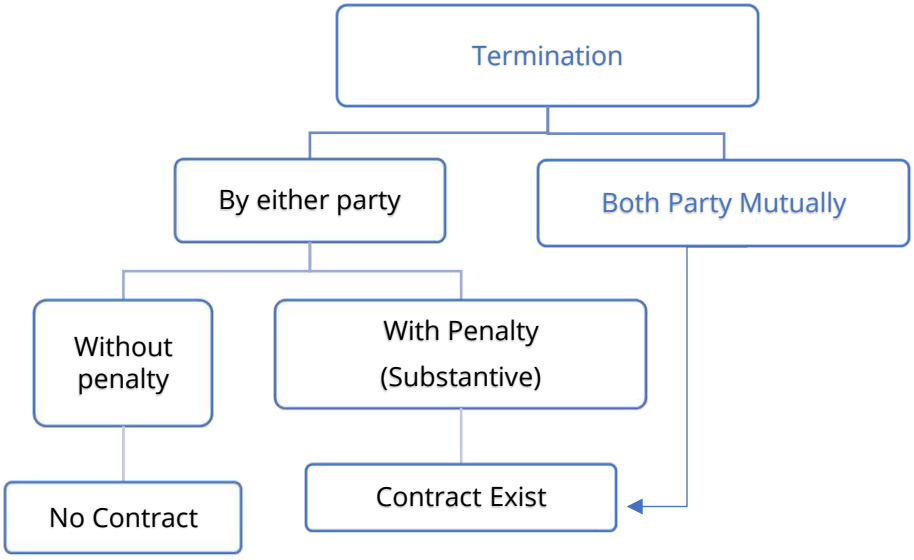
- A contract is wholly unperformed if
  - The entity has not yet transferred any promised goods or services and
  - The entity has not yet received or is entitled to receive any consideration in exchange for goods and services.

An entity shall apply Ind AS 115 to the duration of contract (contractual period) in which the parties have enforceable rights and obligations. Hence it is important to determine the duration of contract.

Examples – Whether a contract exists or not?

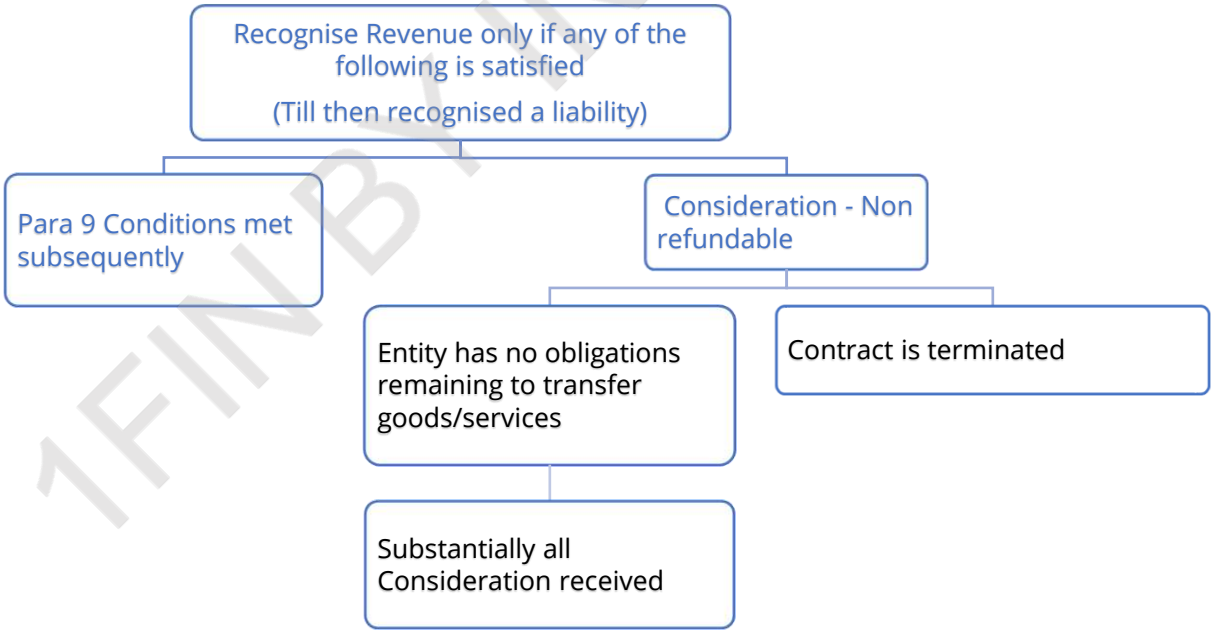
Case	Answer
Either party can terminate the contract without penalty	*Contract does not exist*
Both parties can mutually agree and terminate the contract	*Contract exists*
Two parties have entered into a four year contract. Neither party can terminate the contract in the first year. Either party can terminate the contract after first year without penalty.	*Contract exists and is enforceable for the first year.*
Contract is for 4 year and customer can terminate at each year end with substantive penalty	*Contract exists for 4 years*
Contract can be terminated at each month end at option of customer without penalty	*Contract exists and is considered as a month on month contract [e.g. Netflix subscription]*
Contract is for 1 year and customer can terminate the contract with penalty in the first year.	*Contract exists for 1 year*

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C – Contract ✔
R – Rights ✔
P – Payment terms ✔
C – Commercial Substance ✔
C – Collectability ✔

Consideration received from customer but Step 1 criteria not met



Reassessment of Step 1

If a contract with a customer meets the criteria in paragraph 9 at contract inception, an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances.

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Example - If a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which the entity will be entitled in exchange for the remaining goods or services that will be transferred to the customer.

Combination of contracts

Two or more contracts may need to be accounted for as a single contract if they are entered into at or near the same time with same customer if any of the following is satisfied:

- Contracts are negotiated as a package with a single commercial objective
- Amount of consideration in one contract depends on price or performance of another
- Goods and Services promised are single performance obligation

Contract Modifications

A contract modification exists if three conditions are satisfied:

- There is a change in the scope, price, or both in a contract
- That change is approved by both the entity and the customer
- The change is enforceable

Accounting for Contract Modification

Separate contract

Treated as a seperate contract if both the conditions are satisfied:

- Increases the scope by adding **new goods or services.**
- Increase in the contract price reflects the **stand-alone price** of the additional goods and services.

Not a Separate contract

If goods or services to be provided after modification are distinct from goods or services that were already provided.

Account for the modifiction **prospectively**

Other cases

Account for the modification on a **cumulative catch-up basis** (retrospectively)

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4 Step 2 – Identifying performance obligation

Criteria for identifying performance obligation

At contract inception, an entity shall assess:

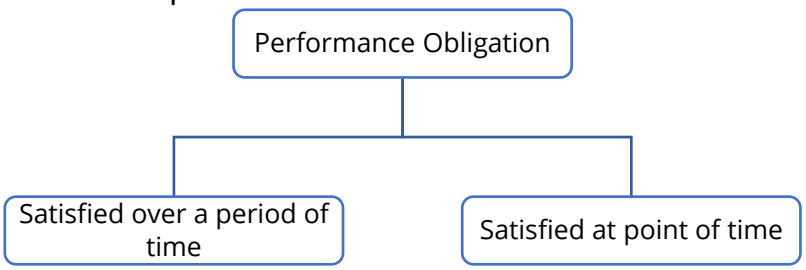
- The **goods and services promised** in a contract with a customer, and
- Shall **identify performance obligation** under each promise to be transferred to the customer.

- Promises under the contract can be
    - Explicit- which are promised to be provided in the future.
    - Implicit- which are implied by the customary business practice.

Performance obligation

It is a promise to transfer either :

- A good or service or a (bundle of goods or services) that is distinct; or
- A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer



Distinct performance obligation

A good or service that is promised to a customer is distinct if both of the following criteria are met:

Customer can benefit on its own or with other readily available resources

A customer can benefit from a good or service if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits.

Separately identifiable from other promises in the contract

Factors to consider:

- No significant integration service
- No significant modification or customisation
- Goods or services are not highly interdependent or highly interrelated.

Promise to transfer a series of distinct goods or services

There might be cases, where distinct goods or services are provided continuously over a period of time. For e.g. security services, or bookkeeping services.

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria to be a performance obligation satisfied over time; and
- the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

5. Step 3 – Determination of transaction price

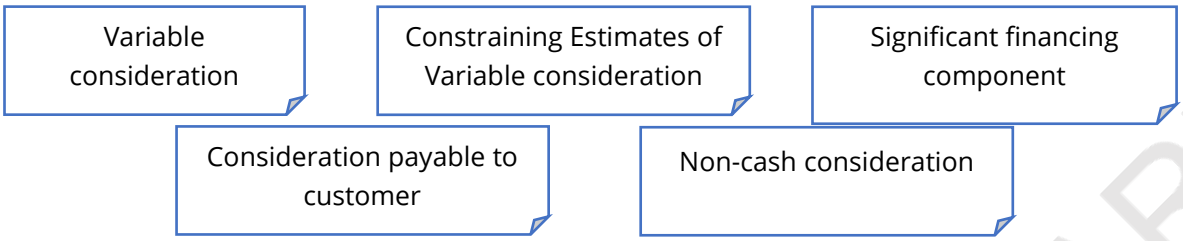
Transaction price-

- is the amount of consideration

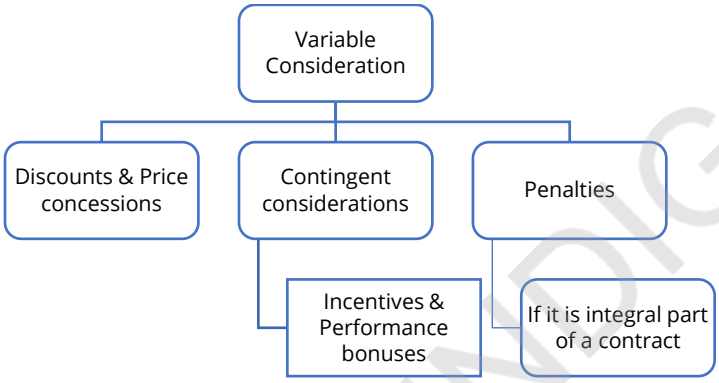
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- to which an entity expects
- to be entitled
- in exchange for transferring promised goods or services to a customer,
- excluding amounts collected on behalf of third parties (for example, sales taxes).

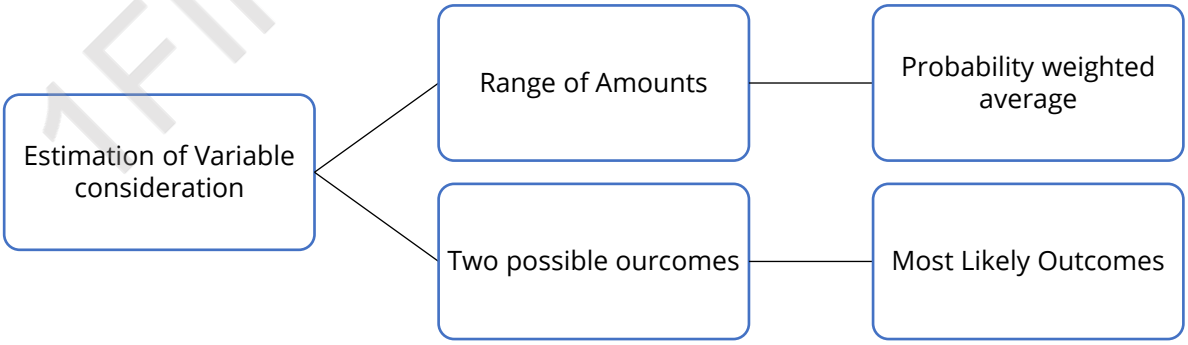
Consideration promised in a contract may be fixed or variable or both.
When determining the transaction price, an entity shall consider the effects of all of the following:



5.1 Variable consideration



- 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.
- An entity shall include in the transaction price some or all of an amount of variable consideration estimated only to the extent that it is **highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur** when the uncertainty associated with the variable consideration is subsequently resolved



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5.1.1 Penalties

Where the penalty is inherent in determination of transaction price, it **shall form part of variable consideration**.

5.1.2 Estimating the amount of variable consideration

An entity shall estimate an amount of variable consideration by using either of the following methods:

The Expected Value	*The most likely amount*
•The expected value is the **sum of probability-weighted amounts** in a range of possible consideration amounts. •This method is appropriate if an entity has large number of contracts with similar characteristics.	•It is the **single most likely amount** in a range of possible consideration amounts (ie the single most likely outcome of the contract) •This method is appropriate if the contract has only two possible outcomes .

An entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled.

5.1.3 Refund liabilities

An entity shall recognise a refund liability if

- the entity receives consideration from a customer and
- expects to refund some or all of that consideration to the customer.

A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (i.e. amounts not included in the transaction price).

5.1.4 Constraining estimates of variable consideration

An entity shall include variable consideration, in the transaction price only to the extent that it is highly probable that a significant reversal will not occur.

Factors that could increase the likelihood of a revenue reversal include –

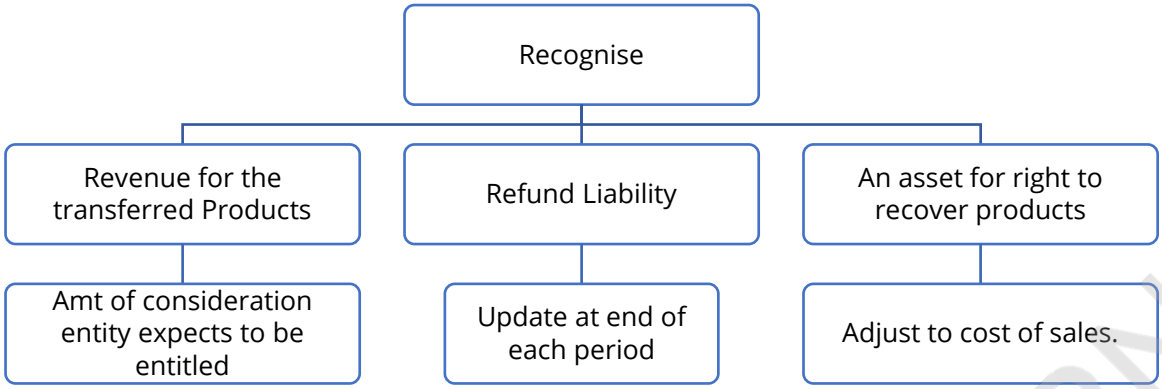
- the amount of consideration is highly susceptible to factors outside the entity's influence.
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time
- The entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value
- The entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances
- The contract has a large number and broad range of possible consideration amounts

5.1.5 Reassessment of variable consideration

At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period.

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5.2 Sale with a right of return



- For the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise :
    - **revenue for the transferred products** in the amount of consideration to which the entity expects to be entitled;
    - **a refund liability**; and
    - **an asset** (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.
- Exchanges by customers of one product for another of the same type, quality, condition, and price (for example, one colour or size for another) are not considered returns for the purposes of applying this Standard.

5.3 Significant financing component

- If there is a significant component financing, time value of money is adjusted from the agreed amount of consideration.
- Either party may benefit from financing:
    - customer may pay before the entity performs its obligation (a customer loans to the entity)
    - customer may pay after the entity performs its obligation (a loan by the entity to the customer
- Recognise revenue at the expected cash price.
- Financing component is recognised separately from revenue.
- Factors to determine whether financing component is significant
    - The difference, if any, between the amount of promised consideration and the cash selling price; and
    - The combined effect of both of the following:
        - the expected length of time between when the entity transfers the promised goods or services and when the customer pays; and
        - the prevailing interest rates in the relevant market.
- Entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.
- After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances.
- An entity need not adjust the the effects of a significant financing component if the entity expects, at contract inception, that the period between:
    - When the entity transfers a promised good or service to a customer and
    - When the customer pays for that good or service

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- will be one year or less.

A contract with a customer would not have a significant financing component if any of the following factors exist:

- customer paid for the goods or services in advance and the timing of the transfer ofthose goods or services is at the discretion of the customer.
- A substantial amount of consideration is variable based on future event that is not within the control of the customer or the entity.
- Difference between promised consideration and cash selling price arises for reasons other than the provision of finance.

Under AS-9, there is no specific requirement to identify and separate the significant financing component.

5.4 Non-cash consideration

- Sometimes a customer promises to pay for a good or service in a form other than cash, such as shares of common stock or other equity instruments, advertising, or equipment.
- To determine the transaction price, an entity shall:
  - In the first instance, measure the non-cash consideration at fair value
  - If it cannot estimate fair value , it shall measure at standalone selling price of goods or services given

5.4.1 Subsequent measurement of non-cash consideration

If the fair value of the non-cash consideration varies after contract inception because of its form	If the fair value of the non-cash consideration varies for reasons other than only the form of consideration
• Entity does not not adjust transaction price for any such change.	• Entity shall apply the guidance on variable consideration and the constraint when determining the transaction price.

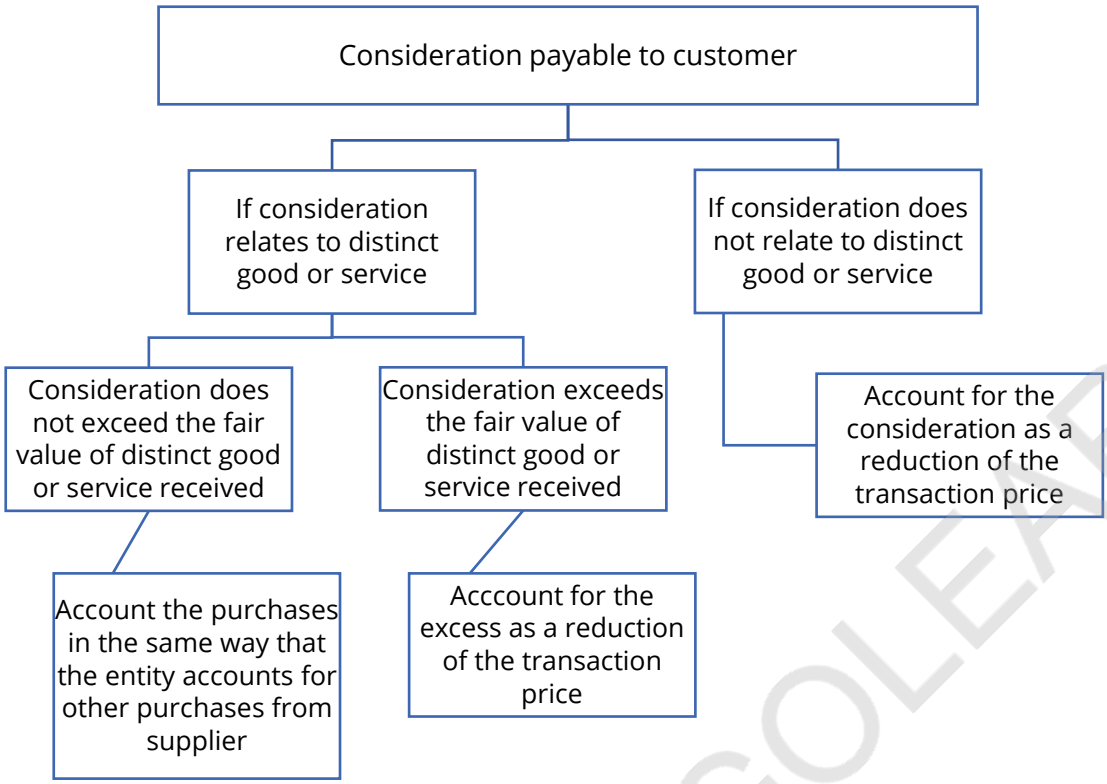
5.4.2 Customer-provided goods or services

- If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services.
- If entity obtains control fair value of goods or services supplied by customer will be added to transaction price.

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5. 5 Consideration payable to a customer

Consideration payable to a customer includes cash amounts, credit or other items that an entity pays, or expects to pay or that can be applied against amounts owed to the entity.



6. Step 4 – Allocating the transaction price to performance obligations

The entity shall allocate the transaction price to each performance obligation identified in the contract on a **relative stand-alone selling price** basis except-

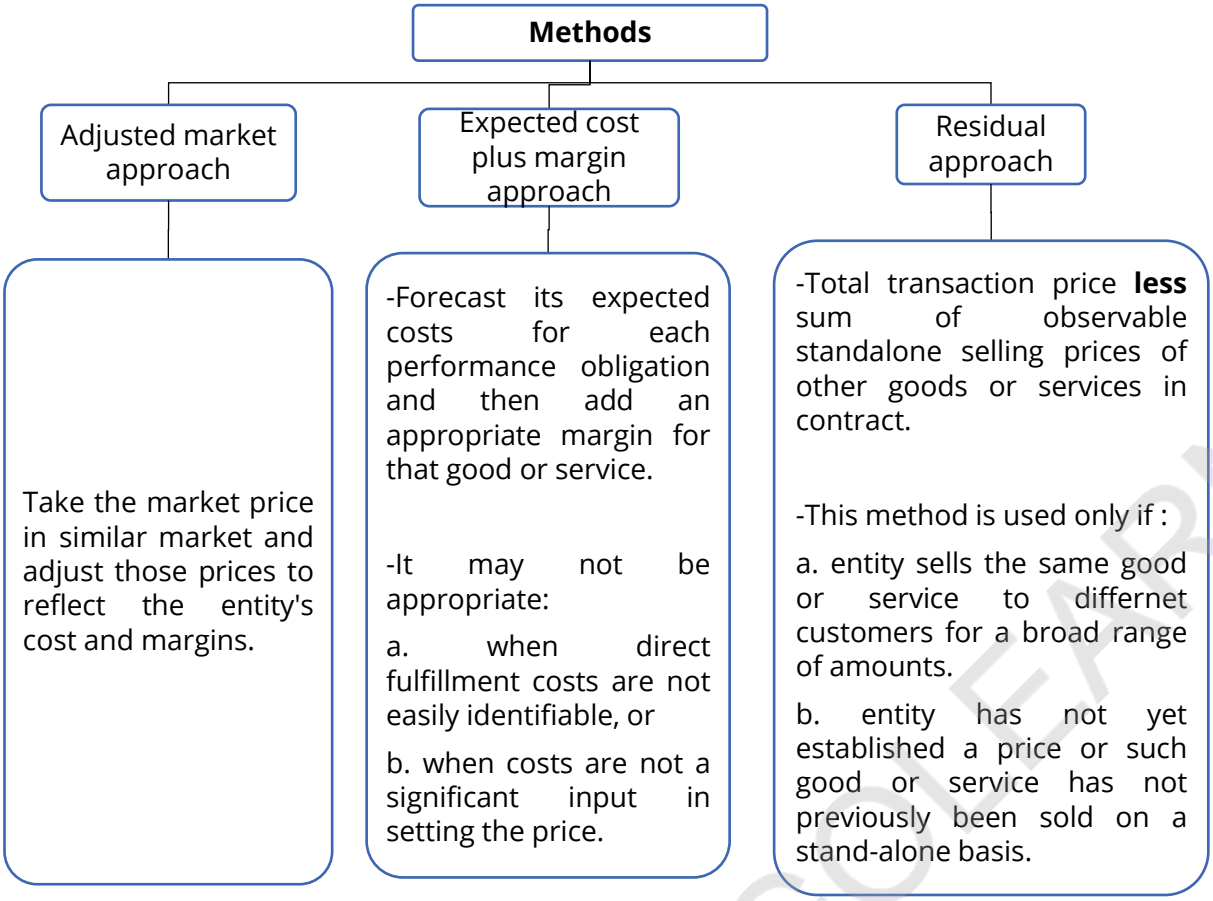
- For allocating discounts
- For allocating variable consideration

6.1 Determining stand-alone selling price

- **Stand-alone selling price** - the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.
- If **stand-alone selling price is not directly observable**, an entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity.
- An entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.

Methods for estimating the stand-alone selling price of a good or service include the following:

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- An entity shall allocate the discount before using the residual approach to estimate the stand-alone selling price of a good or service where the discount is allocated entirely to one or more performance obligations in the contract.

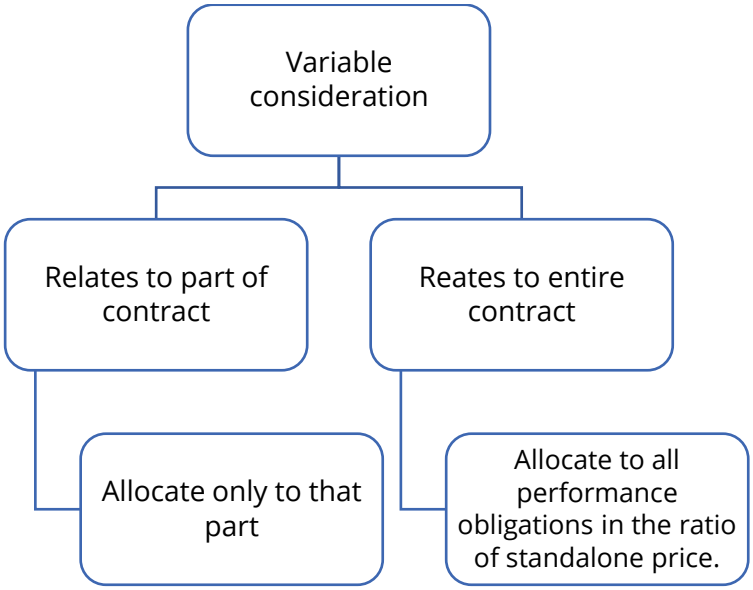
6.1.1 Allocation of a discount

- Discount relates to all performance obligations – Proportionately based on stand alone selling price
- Discount relates to one or more (but not all) performance obligation – Allocate to only specific performance obligation
- When to allocate discount to 'less than all' performance obligations?
    - The entity regularly sells each distinct or each bundle of those distinct goods or services;
    - Entity also regularly sells a bundle (or bundles) of some of those distinct goods or services at a discount; and
    - Discount attributable to each bundle of goods or services is substantially the same as the discount in the contract and an analysis provides evidence of performance obligations to which the entire discount belongs.

6.1.2 Allocation of variable consideration

- Variable consideration may be attributable to
    - the entire contract or
    - a specific part of the contract
- How to allocate variable consideration?

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- An entity shall allocate a variable amount entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation if both of the following criteria are met:
    - The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service.
    - allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective

6.2 Changes in transaction price

- An entity shall allocate to the performance obligations any subsequent changes in the transaction price on the same basis as at contract inception.
- An entity shall not reallocate the transaction price to reflect changes in standalone selling prices after contract inception.
- Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.
- If the change in transaction price is the result of a contract modification, the entity should follow the contract modification guidance.

7. Step 5 – Satisfying performance obligation

- An entity shall recognise revenue as and when the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when the customer obtains control of that asset.
- Questions that need to be answered at contract inception to determine if the seller has satisfied its performance obligation are:

Establish what does **transfer of control mean** in the context of the arrangement between the parties?

Does the customer acquire **control over a period of time or at a point in time**?

7.1 What does transfer of control mean?

Control of an asset refers to the ability to direct the use and obtain substantially all of the benefits from the asset or ability to prevent other entities from directing the use of, and obtaining the benefits from an asset.

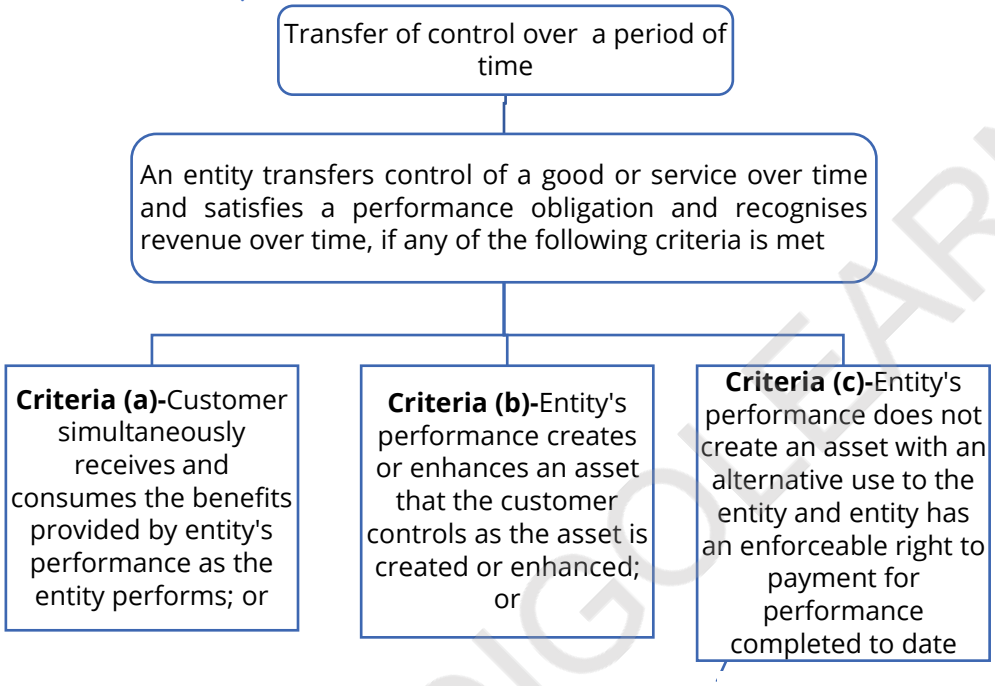
An entity shall consider indicators of the transfer of control which are as follows:

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- The entity has a present right to payment for the asset;
- The customer has legal title to the asset;
- The entity has transferred physical possession of the asset;
- The customer has the significant risks and rewards of ownership of the asset;
- The customer has accepted the asset.

7.2 Does the customer acquire control over a period of time or at a point in time?

7.2.1 Transfer of control over a period of time



- **Criteria (a)-** Applied in situations where benefit of seller's performance are immediately consumed by customer e.g security service.
- **Criteria (b)-** Applied in situations Where the customer ordinarily obtains control of the asset whose work is in progress – **construction done on customer's land**
- **Criteria (c)-** Applied in situations in which an asset is created at customer's discretion, which the seller is restricted from using for any other purpose and at the same time, the seller entity reserves a right to seek payment for work in process.

  Conditions for (c)
  - Asset does not have an alternative use to seller - This can arise due to contractual restrictions or practical limitations.
  - There is a Legally enforceable right to receive payment for performance completed to date. This payment should compensate the supplier for costs incurred plus a profit margin.

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- Methods of measuring progress of a performance obligation satisfied over time:

Output based method

- Recognise revenue on the basis of fair value of goods or services transferred to date relative to remaining goods or services.
- Example: Surveys of performance completed to date,appraisals of results achieved etc.

Input based method

- Recognise revenue based on the entity's efforts or inputs to the satisfaction of a performance obligation.
- Example: Resources consumed labour hours expended, cost incurred, time elapsed or machine hours used

7.2.2 Transfer of control at a point in time

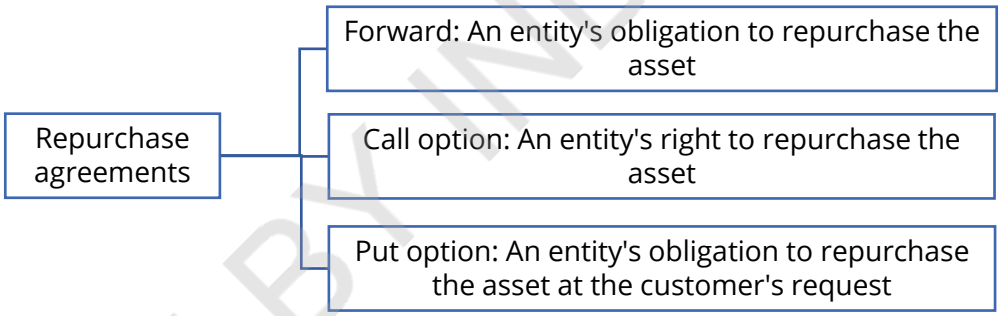
If none of the criteria of over a period of time is met, the performance obligation is considered to be discharged at a point in time.

Indicators to imply the point of time at which control of goods has been passed to the customer includes:

- A present obligation to pay
- Physical possession
- Legal title
- Risks and rewards of ownership
- Accepted the asset

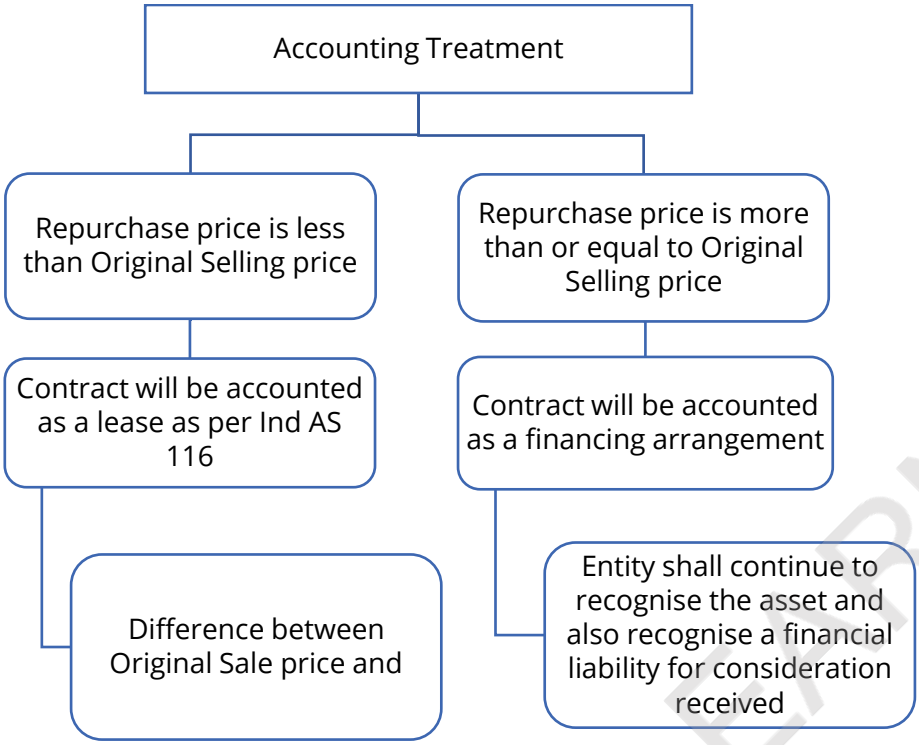
7.3 Repurchase agreements

A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option to repurchase the asset.



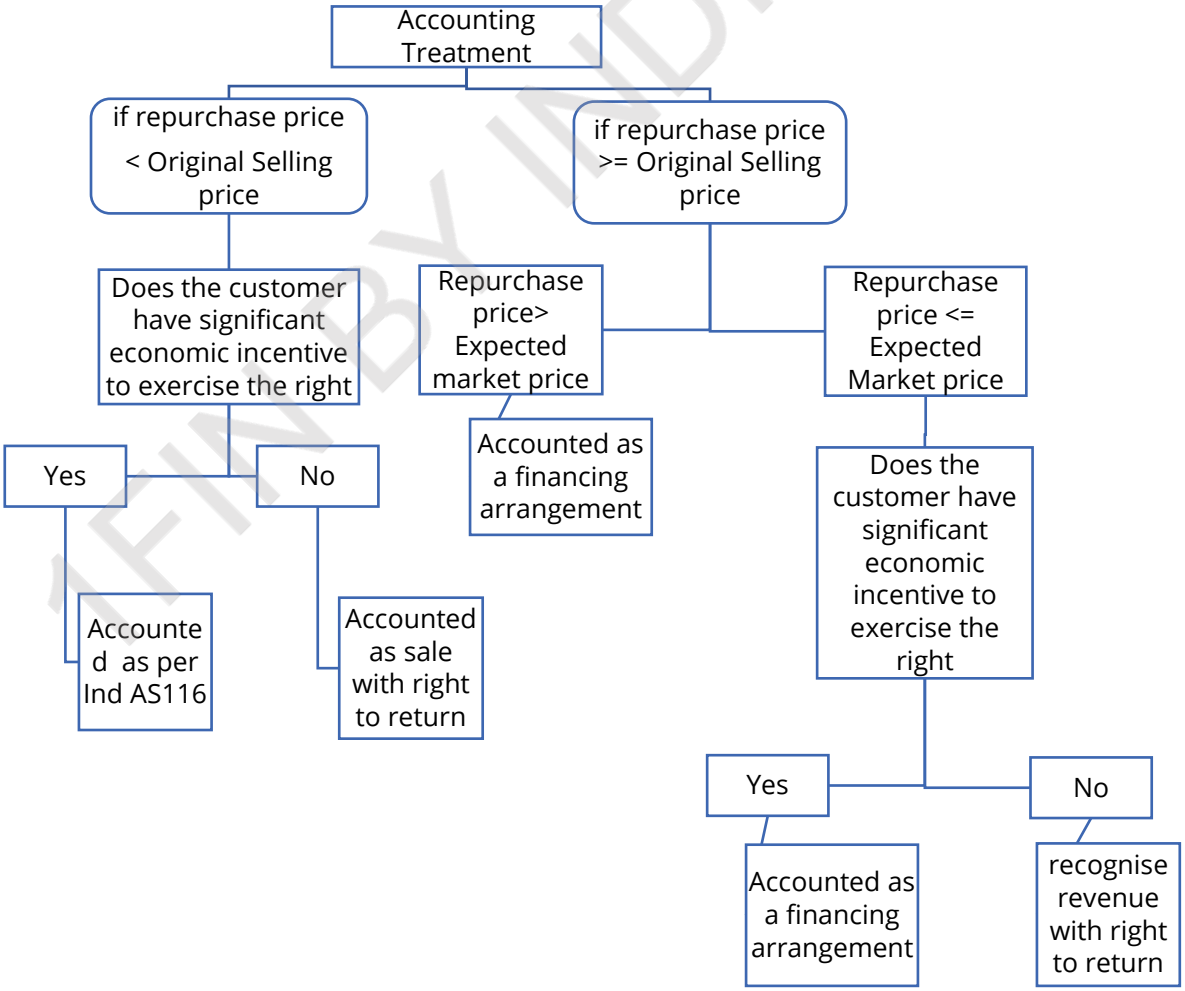
7.3.1 Forward or call option:

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- A customer does not obtain control of the asset
- If the option lapses unexercised, an entity shall derecognise the liability and recognise revenue.

7.3.2 Put option:



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7.4 Bill-and-hold

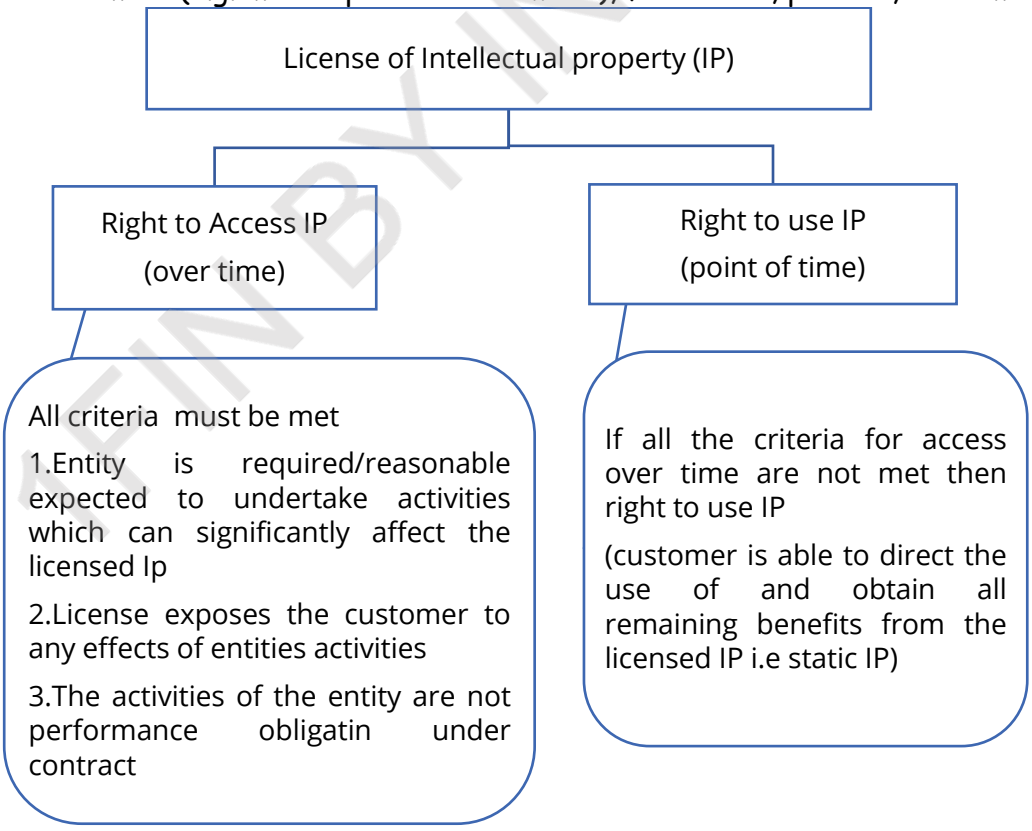
- A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future.
- In such arrangement, the entity shall recognise revenue at the point of time when control is transferred to the customer.
- For few cases, a customer may obtain control of a product even though that product remains in an entity's physical possession if all the following criteria is met:

The reason for the bill-and-hold arrangement must be substantive;
The product must be identified separately as belonging to the customer;
The product currently must be ready for physical transfer to the customer; and
the entity cannot have the ability to use the product or to direct it to another customer.

- Where an entity recognises revenue on bill-and-hold basis, the entity shall determine if it has any additional performance obligations and allocate a portion of transaction price to each performance obligation.

7.5 Licenses of intellectual property

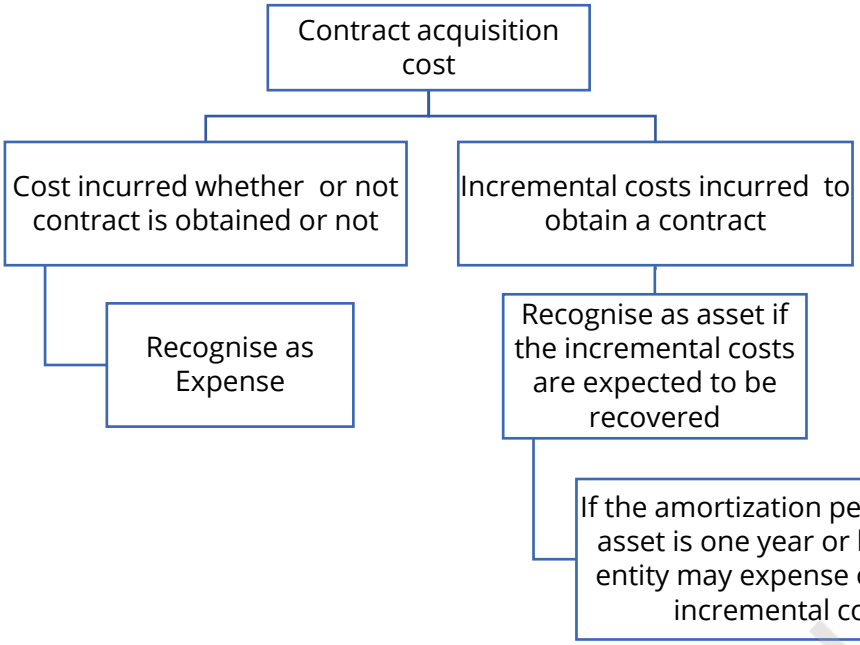
Licences of intellectual property establish a customer's rights to the intellectual property of an entity and may include licences for any of the following: software and technology, media and entertainment (e.g. motion pictures and music), franchises, patents, trademarks and copyrights.



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8. Contract Costs

8.1 Costs to obtain a contract (contract acquisition costs)

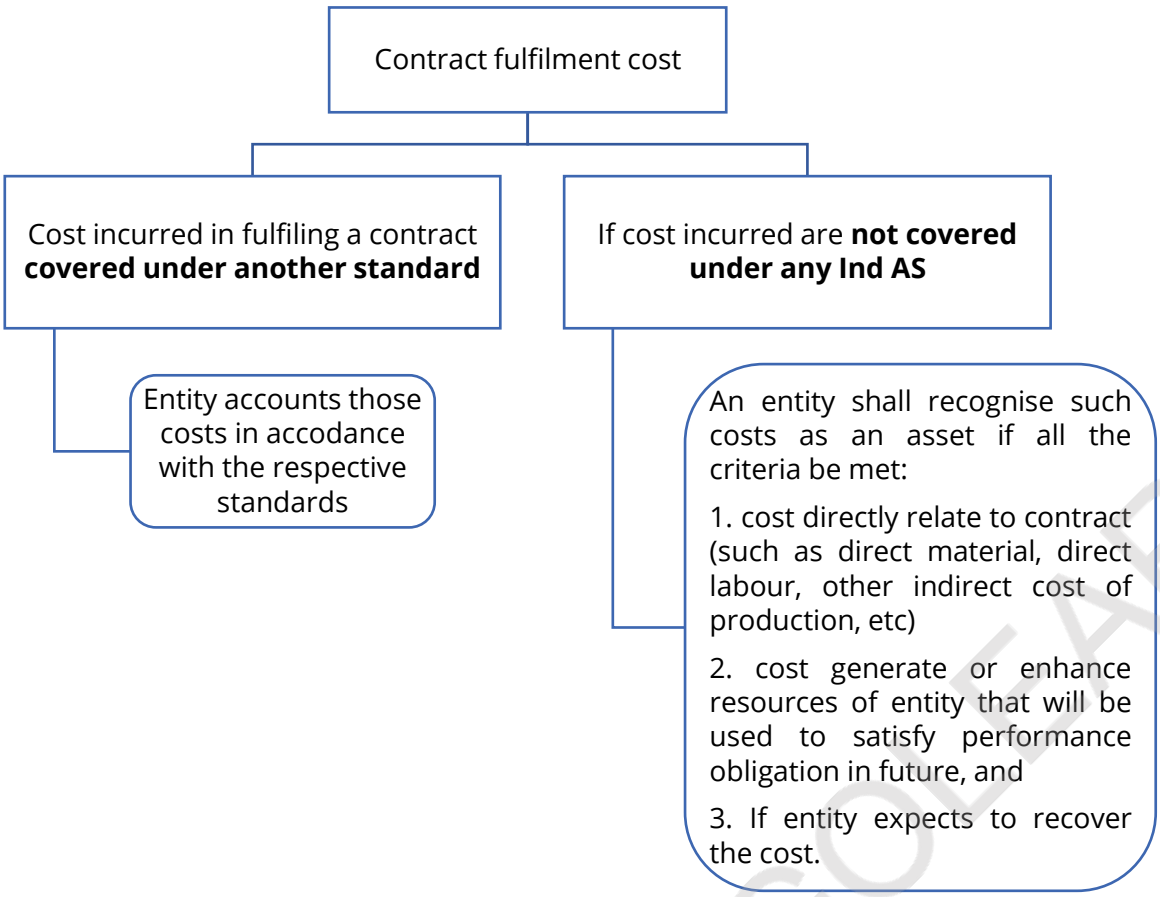


Examples of Contract Acquisition costs:

Cost	**Capitalize Or Expense**	**Reason**
Commission paid only upon successful signing of a contract	Capitalize	Assuming the entity expects to recover the cost, the commission is incremental since it would not have been paid if the parties decided not to enter into the arrangement just before signing.
Travel expenses for sales persons pitching a new client contract	Expense	Because the costs are incurred regardless of whether the new contract is won or lost, the entity expenses the costs, unless they are expressly reimbursable.
Legal fees for drafting terms of arrangement for parties to approve and sign	Expense	If the parties walk away during negotiations, the costs would still be incurred and therefore are not incremental costs of obtaining the contract.
Salaries for sales people working exclusively on obtaining new clients	Expense	The salaries are incurred regardless of whether contracts are won or lost and therefore are not incremental costs to obtain the contract.
Bonus based on quarterly sales target	Capitalize	Bonuses based solely on sales are incremental costs to obtain a contract.
Commission paid to sales manager based on contracts obtained by the sales manager's local employees	Capitalize	The commissions are incremental costs that would not have been incurred had the entity not obtained the contract. Ind AS 115 does not differentiate costs based on the function or title of the employee that receives the commission.

8.2 Costs to fulfil a contract (contract fulfilment costs)

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Following costs should be expensed as incurred :

- general and administrative costs that are not explicitly chargeable to the customer
- costs of wasted materials, labour, or other resources that were not reflected in the contract price
- costs that relate to satisfied performance obligations
- costs related to remaining performance obligations that cannot be distinguished from costs related to satisfied performance obligations.

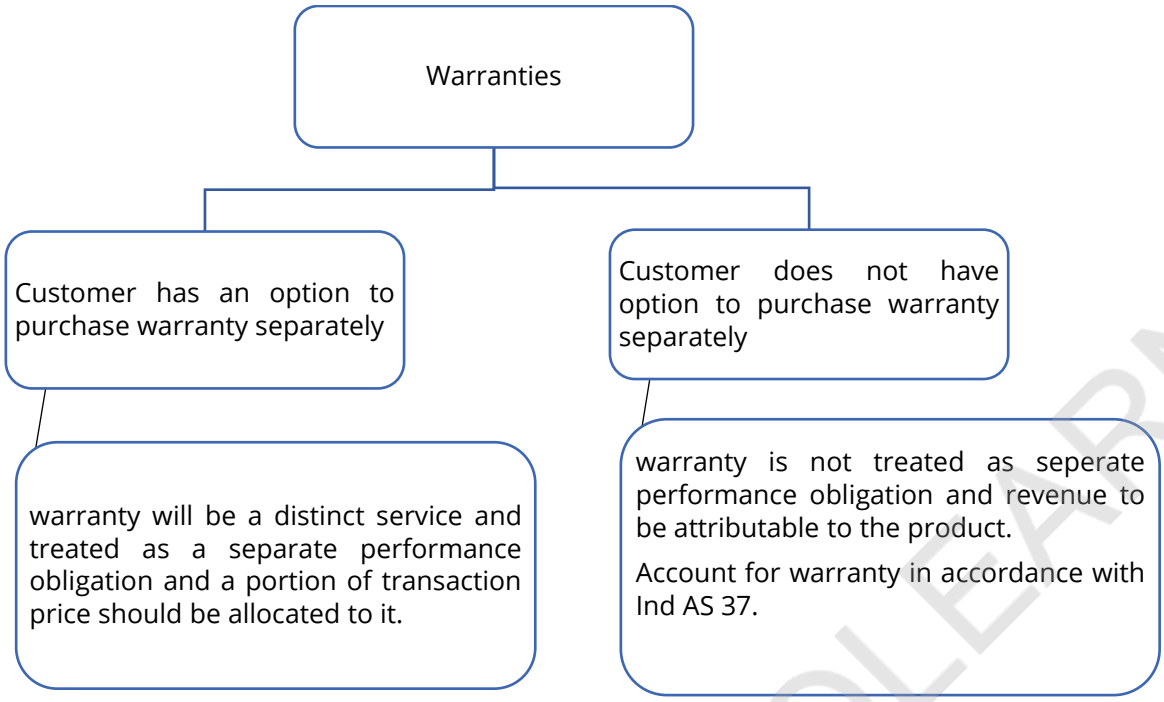
8.3 Amortisation and impairment

- Amortize capitalised contract costs on a systematic basis consistent with the pattern of transferring the goods or services. Any change in expected pattern, is accounted as a change in accounting estimate as per Ind AS 8.
- recognises an impairment loss in earnings if the carrying amount of an asset exceeds the remaining amount of consideration less any directly related contract costs yet to be recognised.
- Before recognising an impairment loss under the revenue recognition guidance, an entity recognises impairment losses associated with assets related to the contract that are accounted in accordance with another Standard (for example, Ind AS 2, Ind AS 16 and Ind AS 38)
- Reversal of impairment loss is allowed when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously.

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9. Misc Matters

9.1 Warranties



In assessing whether a warranty is a separate performance obligation or not, an entity shall consider factors such as:

Whether warranty is required by law	Length of warranty coverage period	Nature of task that entity promises to perform
•If required by law, it indicates that the promised warranty is not a performance obligation.	•The longer the coverage period, the more likely it is that the promised warranty is a performance obligation.	•Those tasks do not give rise to a performance obligation.

9.2 Customer options for additional goods or services

- An entity may grant a customer the option to acquire additional goods or services in form of coupons, gift cards and customer award credits etc;
- Such option is treated as a separate performance obligation if it provides a material right to the customer.
- The right is material if it results in a discount that the customer would not receive without entering into the contract.
- If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.
- Entity shall allocate the transaction price to performance obligations on a relative stand-alone selling price basis.
- If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it.

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- Estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:
  - any discount that the customer could receive without exercising the option; and
  - the likelihood that the option will be exercised.

9.3 Long term arrangements

Entities enter into arrangements to provide services on a long-term basis it shall be accounted for its rights and obligations s for each period in which the contract cannot be cancelled by either party. In long-term service agreements when the consideration is fixed, the accounting generally will not change regardless of whether a single performance obligation or multiple performance obligations are identified.

9.4 Consignment arrangements

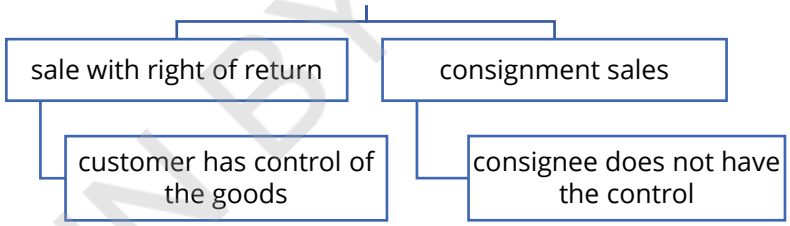
Consignment agreement – It is an agreement between a consignee and consignor for the storage, transfer, sale or resale and use of the goods.

Indicators for evaluating the arrangement as a consignment arrangement:

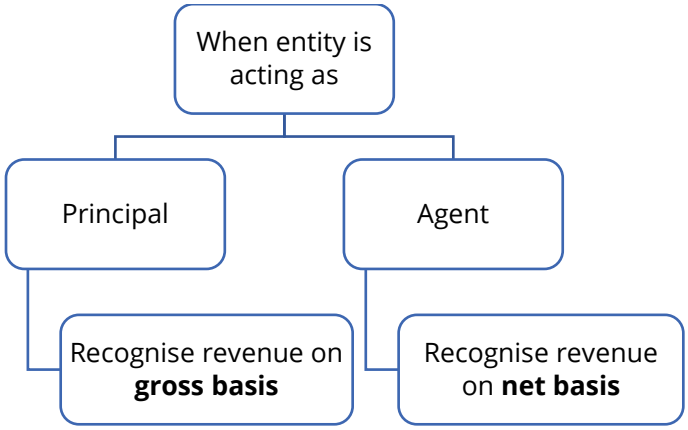
The product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;
The entity is able to require the return of the product or transfer the product to a third party; and
The dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit)

9.5 Revenue is recognized when the entity has transferred control of the goods to the consignor or the end consumer.

A consignment sale differs from a sale with a right of return



Principal vs agent consideration



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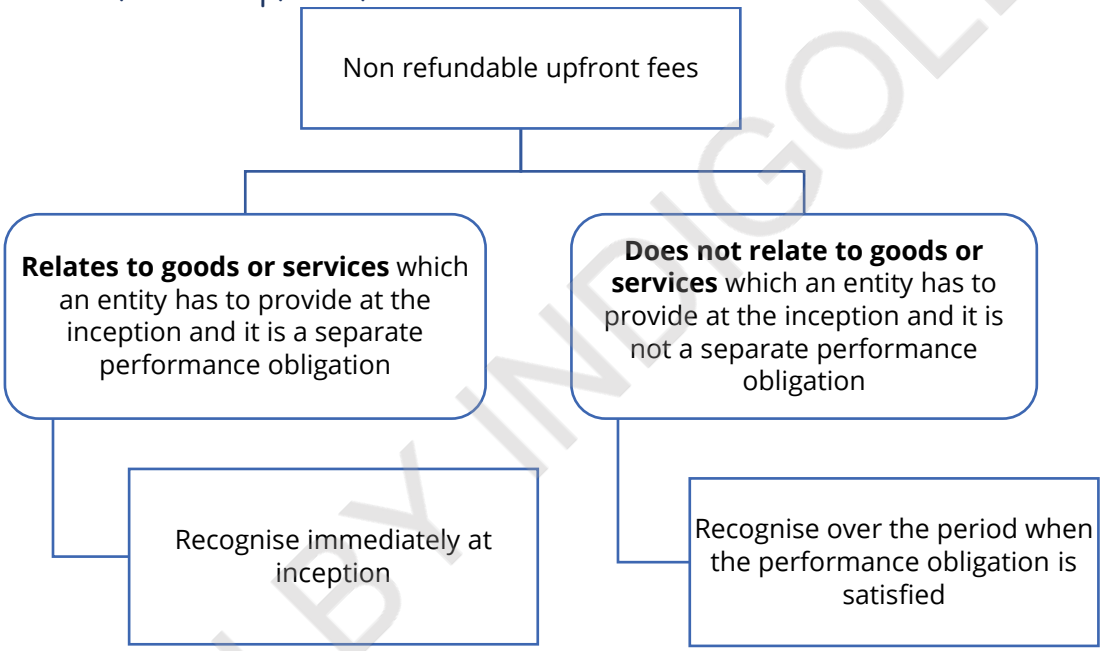
Indicators that an entity is a principal include the following:

the entity is primarily responsible for fulfilling the contract.
the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer.
the entity has discretion in establishing prices for the goods or services.

After an entity identifies its promise and determines whether it is the principal or the agent, the entity recognises revenue when it satisfies that performance obligation.

In some contracts in which the entity is the agent, control of the goods or services promised by the agent might transfer before the customer receives the goods or services from the principal.

9.6 Non refundable upfront fees



9.7 Sales-based or usage-based royalties

An entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

- The subsequent sale or usage occurs; and
- The performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

10. Presentation

Balance Sheet	As a contract liability, a contract asset or a receivable - contract liability: If the customer has paid consideration, or if payment is due on reporting date but the entity has not yet satisfied a performance obligation.

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	- contract asset or a receivable: If its right to consideration is conditioned on something other than the passage of time; otherwise, an entity recognises a receivable.
Profit & Loss	Recognise revenue

11. Disclosure

Disclosure area	Summary of requirements
General	• revenue recognised from contracts with customers, separately from its other sources of revenue. • impairment losses on receivables or contract assets.
Disaggregation of revenue	• categories that depict the nature, amount, timing, and uncertainty of revenue and cash flows. • sufficient information to enable users of financial statements to understand the relationship with revenue information disclosed for reportable segments under Ind AS 108.
Information about contract balances	• including opening and closing balances of contract assets, contract liabilities, and receivables (if not separately presented)
Information about performance obligations	• when the entity typically satisfies performance obligations • significant payment terms • nature of goods and services • obligations for returns, refunds and similar obligations • types of warranties and related obligations
Transaction price allocated to the remaining performance obligations	• that are unsatisfied and an explanation of when the entity expects to recognise such revenue.
Timing of satisfaction of performance	• performance obligations that an entity satisfies over time. • performance obligations satisfied at a point in time.
Information about significant judgements	• judgements impacting the expected timing of satisfying performance obligations transaction price and amounts allocated to performance obligations.
Transaction price and the amount allocated to performance obligations	• determining the transaction price, estimating variable consideration, adjusting the consideration. • estimate of variable consideration is constrained . • measuring obligations for returns, refunds, and other similar obligations. • allocating the transaction price, discounts, and variable consideration.

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Assets recognised from the costs to obtain or fulfil a contract	• judgments made in determining costs amount of the costs incurred to obtain or fulfil a contract with a customer. • amortisation method used for closing balances by main category and amortisation expense.
Practical expedients	• existence of a significant financing component. • incremental costs of obtaining a contract.

12. Service Concession Arrangements

12.1 About Service Concession Arrangement

- Service Concession Arrangement involves a private sector entity (an operator) constructing the infrastructure used to provide the public service. It also involves operating and maintaining infrastructure for a specified period of time.
- It is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

> **Operator**- An entity constructing and operating the infrastructure, the operator is responsible for the management of infrastructure and do not merely act as an agent. The operator is paid for its services over period of arrangement.
>
> **Grantor**- It is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved .

12.2 Accounting Principles

12.3 Treatment of the operator's rights over the infrastructure

Infrastructure shall not be recognised as property, plant and equipment of the operator because the operator has no right to control the use of the public service infrastructure to the operator, however operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

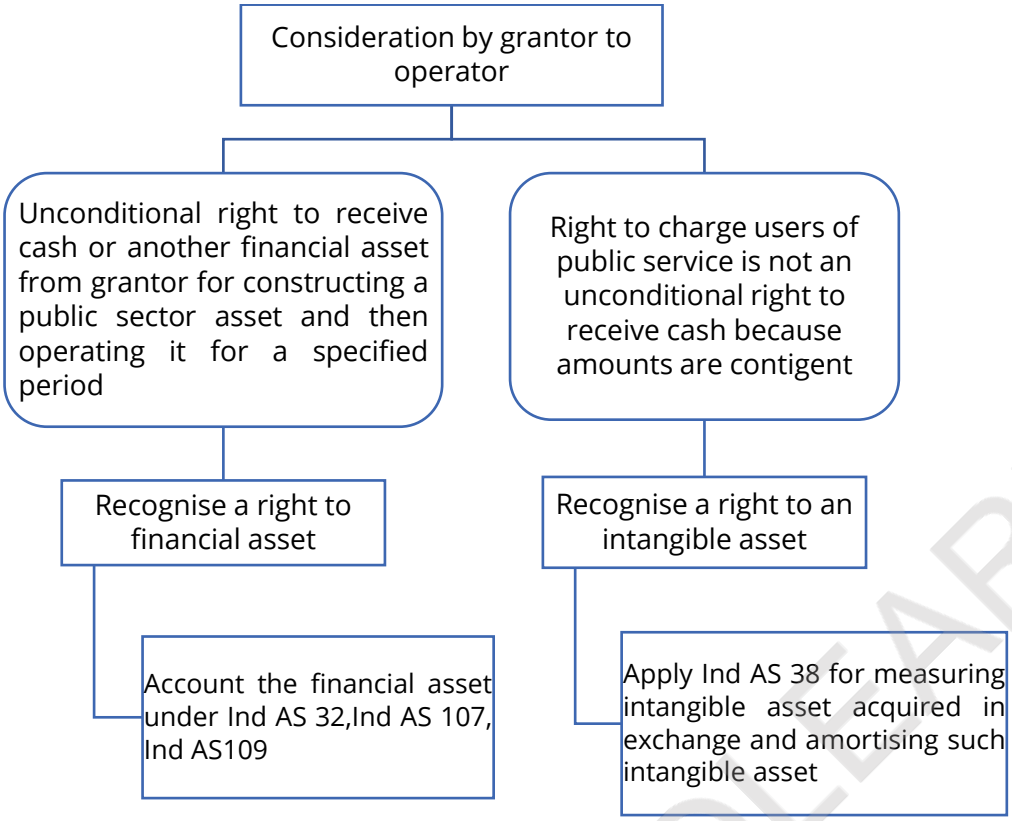
12.4 Recognition and measurement

- Operator acting as a service provider, shall recognise and measure revenue in accordance with Ind AS 115.
- If the operator performing more than one service (i.e, construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated on the fair values of the services rendered.

12.5 Consideration given by the grantor to the operator

- If the operator provides construction or upgrade services, the consideration received or receivable by the operator shall be recognized at its fair value.

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- If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of operator's consideration.

12.6 Contractual obligations to restore the infrastructure to a specified level of serviceability

The operator may have contractual obligations it must fulfil as a condition of its licence, like to maintain or restore infrastructure, except for any upgrade element, which shall be recognised and measured in accordance with Ind AS 37.

12.7 Borrowing costs incurred by the operator

- Operator has a contractual right to receive an intangible asset: recognise as an expense.
- Operator does not have a contractual right to receive an intangible asset: capitalise during the construction phase.

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Ind AS 115
Revenue from Contracts with Customers
ILLUSTRATIONS

1. Illustration (SM)

Company A has a customer P which is undergoing restructuring due to issues related to liquidity. Company A has decided not to do any further business with P. P has informed Company A that it will get Letter of Credit from a nationalised bank against which the Company A can despatch goods. Company A has manufactured the goods exclusively for P, but the Letter of Credit has not yet been arranged because it is in process. When should Company A recognise the revenue?

2. Illustration (SM)

An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for Rs.20,00,000. P Ltd. intends to use the said machinery to start a food processing unit. The food processing industry is highly competitive and P Ltd. has very little experience in the said industry.
P Ltd. pays a non-refundable deposit of Rs.1,00,000 at inception of the contract and enters into a long-term financing agreement with G Ltd. for the remaining 95 per cent of the agreed consideration which it intends to pay primarily from income derived from its food processing unit as it lacks any other major source of income. The financing arrangement is provided on a non-recourse basis, which means that if P Ltd. defaults then G Ltd. can repossess the machinery but cannot seek further compensation from P Ltd., even if the full value of the amount owed is not recovered from the machinery. The cost of the machinery for G Ltd. is Rs.12,00,000. P Ltd. obtains control of the machinery at contract inception.
When should G Ltd. recognise revenue from sale of machinery to P Ltd. in accordance with paragraph 9 of Ind AS 115?

3. Illustration (SM)

X Ltd. provides IT support services to its customers from a distant location. Customers call up the support team of X Ltd., who understand the client's requirement over the phone and provide necessary advice to the customer to resolve their issue. Before providing advice, the support team member will understand the client's problem and inform them about the price for the services to be provided. Once the problem is resolved, the customer will make the agreed payment to X Ltd. through online banking mode. X Ltd. considers that collection is probable and the oral contract is enforceable as per the laws applicable in the jurisdiction of X Ltd. In such a case, whether there is a valid contract in accordance with Ind AS 115?

4. Illustration (SM)

Company A, a manufacturer of specialised construction equipment enters into a contract with Customer B to manufacture and deliver a customised boom lift for Rs.95,000. The total cost to Company A of designing, manufacturing and delivering the boom lift is estimated to be Rs.70,000. Two days later, Company A enters into another contract with Customer B to deliver four boom lift tyres that Customer B will use on the customised boom lift in the future after the original tyres deteriorate. The contract price per tyre is Rs.800, however, the cost of each tyre is estimated at Rs.900. Whether these two contracts should be treated as a single contract?

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5. Illustration (SM)

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?

6. Illustration (SM)

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?

7. Illustration (SM)

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?

8. Illustration (SM)

An entity promises to sell 120 products to a customer for Rs. 120,000 (Rs. 1,000 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer at a price of Rs. 950 per product which is the standalone selling price for such additional products at the time of placing this additional order. The additional 30 products were not included in the initial contract.

It is assumed that additional products are contracted for a price that reflects the stand-alone selling price.
Determine the accounting for the modified contract?

9. Illustration (SM)

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?

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10. Illustration (SM)

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.

11. Illustration (SM)

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.

12. Illustration (SM)

A TV manufacturer sells TV sets to its dealers at the list price of Rs.10,000 per TV. If a dealer takes more than 8,000 sets during the contract period, then it is eligible for a discount of 5% on the list price retrospectively (i.e. for all sets purchased since the commencement of the agreement). The contract period starts in June and ends in May of each year. On the reporting date, i.e., March 31, 2018, a particular dealer has purchased 5,000 sets. Based on the past trends, it is expected that the total purchases to be made by dealer during the contract period up to May 2018 will be more than 8,000 sets. Should revenue be adjusted for the discount expected to be availed by such a dealer?

13. Illustration (SM)

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

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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.

14. Illustration (SM)

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.
Analyse the revenue to be recognised on 31st March, 20X2.

15. Illustration (SM)

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.

16. Illustration (SM)

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.

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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?

17. Illustration (SM)

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?

18. Illustration (SM)

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.

19. Illustration (SM)

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). Analyse the above transaction with respect to its financing component.

20. Illustration (SM)

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

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Case B—Contractual discount rate does not reflect the rate in a separate financing transaction ie 14%.

21. Illustration (SM)

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

22. Illustration (SM)

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

Analyse whether the contract contains any financing component

23. Illustration (SM)

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.

24. Illustration (SM)

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.

25. Illustration (SM)

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?

26. Illustration (SM)

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.

27. Illustration (SM)

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.

28. Illustration (SM)

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?

29. Illustration (SM)

A producer entity sells energy drinks to a retailer, a convenience store. Producer also pays Retailer a fee to ensure that its products receive prominent placement on store shelves, to attract the customer's eyeballs so that chances of sales of it's products are higher. The fee is negotiated as part of the contract for sale of the energy drinks. In this case, Producer should reduce the transaction price for the sale of the energy drinks by the amount of slotting fees paid to Retailer. Producer does not receive a good or service that is distinct in exchange for the payment to Retailer.

30. Illustration (SM)

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

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31. Illustration (SM)

An entity enters into a contract with a customer to sell Products A, B and C in exchange for Rs. 10,000.

The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable. 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.

The entity estimates the stand-alone selling prices as follows:

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

Allocate the transaction price.

[**Ans:** Product A – Rs. 3,300; Product B – Rs. 2,500; Product C – Rs. 7,500]

32. Illustration (SM)

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

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

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

Case A—Allocating a discount to one or more performance obligations

The entity enters into a contract with a customer to sell Products X, Y and Z in exchange for Rs. 100,000. The entity will satisfy the performance obligations for each of the products at different points in time; or Product Y and Z at same point of time. Determine the allocation of transaction price to Product Y and Z.

Case B—Residual approach is appropriate

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

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is Rs. 1,05,000 instead of Rs. 130,000.

[Ans:]

Case A	• If entity transfers control of Products Y and Z at same point in time: Entity can account for transfer as single performance obligation and can allocate Rs. 50,000 to it

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	• If entity transfers control of Products Y and Z at different point in time: Allocated Transaction Price for Product Y and Z will be Rs. 17,857 and Rs. 32,143 respectively
Case B	Product X – Rs. 50,000; Product Y and Z Rs. 50,000; Product Alpha – Rs. 30,000
Case C	Determine standalone selling price of Product Alpha using other method and then allocate transaction price for products based on relative stand-alone selling prices.

33. Illustration (SM)

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

Case A – Variable consideration allocated entirely to one performance obligation

The price stated in the contract for Licence A is a fixed amount of Rs. 1,600,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B. For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be Rs. 2,000,000. Allocate the transaction price.

Case B – Variable consideration allocated on the basis of stand-alone selling prices

The price stated in the contract for Licence A is a fixed amount of Rs. 600,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (i.e., the variable consideration) is Rs. 3,000,000. Here, Licence A is transferred 3 months later. The royalty due from the customer's first month of sale is Rs. 4,00,000.

Allocate the transaction price and determine the revenue to be recognised for each licence and the contract liability, if any.

[Ans:]

Case A	Licence A – Rs. 1,600,000; Licence B – Rs. 2,000,000
Case B	Allocation of fixed consideration: Licence A – Rs. 266,667; Licence B – Rs. 333,333. First month – Revenue of Rs. 222,222 allocated to Licence B; Contract Liability of Rs. 177,178 allocated to Licence A.

34. Illustration (SM)

On 1st April, 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for Rs. 2 crore. The consultant can earn Rs. 20 lakh bonus if it completes the software implementation by 30th September, 20X0 or Rs. 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 – Rs. 80 lakh
- Valuation – Rs. 20 lakh

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- Software implementation – Rs. 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 Rs. 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.

[**Ans:** On 1st July, 20X0, consultant shall consider total consideration for software implementation performance obligation as Rs. 1.2 crore and adjust the cumulative revenue to date to Rs. 72 lakh (60 percent of Rs. 1.2 crore).

35. Illustration (SM)

Telco G Ltd. grants a one-time credit of Rs. 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?

[**Ans:** Considered as contract modification and recognised over the remaining term of the contract]

36. Illustration (ICAI EM)

An entity, Moon Ltd. which manufactures auto components enters into a two year contract with a customer Venus Ltd., a car manufacturer. The total contract value is Rs.20,00,000. Additionally, Moon Ltd. agrees to pay Rs.4,00,000 to Venus Ltd. as compensation for storage facility which will require certain modifications to accommodate the components manufactured by Moon Ltd. The storage facility is controlled by Venus Ltd. and will be utilised exclusively to store goods received from Moon Ltd.

What will be the accounting treatment for the consideration payable to Venus Ltd.?

[**Ans**: Treated as reduction in revenue proportionately]

37. Illustration (ICAI EM)

Entity Y enters into an agreement to sell hardware, professional services and maintenance services for Rs. 2,00,000. Entity Y determines that each of the promised goods or services represents a separate performance obligation because the entity frequently sells professional services and maintenance services on a stand-alone basis. The stand-alone selling prices of professional services and maintenance services are Rs.25,000 and Rs.15,000 respectively. The Entity Y rarely sells the hardware on a stand- alone basis, so it estimates the stand-alone selling price at Rs.185,000 based on the hardware's underlying cost, the entity's targeted cost and the amount of margin the entity believes the market will bear (i.e., the expected cost plus a margin approach).

The contract price will include Rs.10,000 incentive, if professional services are provided within seven days of the delivery date of the hardware.

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(a) How will the transaction price be allocated to performance obligations?
(b) What will be the accounting treatment for the incentive amount?

[**Ans:** (a) Allocated transaction price for hardware, professional services and maintenance services will be Rs. 1,64,444.44; Rs. 22,222.22; Rs. 13,333.33 respectively; (b) Incentive amount will be allocated to professional services]

38. Illustration (SM)

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?

[**Ans:** Revenue shall be recognised over the period of time]

39. Illustration (SM)

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?

40. Illustration (SM)

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?

41. Illustration (SM)

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.

42. Illustration (SM)

ABC enters into a contract with a customer to build an item of equipment. The customer pays 10% advance and then 80% in instalments of 10% each over the period of construction with balance 10% payable at the end of construction period. The payments are non-refundable unless the company fails to perform as per the contract. Further, if the customer terminates the contract, then entity is entitled to retain payments made. The company will have no further right to compensation from the customer.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

43. Illustration (SM)

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

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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?

44. Illustration (SM)

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	50,00,000
Expected costs:	
(a) Elevators	15,00,000
(b) Other costs	25,00,000
Total	40,00,000

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?
[**Ans:** Total revenue to be recognised for year ended 31 March, 20X1 = ₹22,00,000]

45. Illustration (SM)

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.
[**Ans:** No. Holdback payment only to ensure successful completion of project]

46. Illustration (SM)

Company Z is a developer and manufacturer of defence systems that is primarily a Tier-II supplier of parts and integrated systems to original equipment manufacturers (OEMs) in the commercial markets. Company Z enters into a contract with Company X for the development and delivery of 5,000 highly technical, specialized missiles for use in one of Company X's platforms.
As a part of the contract, Company X has agreed to pay Company Z for their cost plus an award fee up to Rs. 100 crore. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such costs. However, the Rs. 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 Rs. 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.

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Assume Company Z has assessed the contract under Ind AS 115 and determined the award fee represents variable consideration. Based on their assessment, Company Z has estimated a total of Rs. 80 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.
[**Ans:** No. Intention is to provide incentive to Company Z to produce high functioning missiles]

47. Illustration (SM)

An entity has a fixed fee contract for Rs. 1 million to develop a product that meets specified performance criteria. Estimated cost to complete the contract is Rs. 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%	Rs. 100,000
700 or less	25%	Rs. 250,000

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

Year	Rs.
1	50,000
2	1,75,000
3	4,00,000
4	2,75,000
5	50,000

[**Ans:** Cumulative catchup adjustment – Rs. 98,684]

48. Illustration (SM)

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 Rs. 36,000. The entity determines that the stand-alone selling prices of the computer and the extended warranty are Rs. 32,000 and Rs. 4,000, respectively. The inventory value of the computer is Rs. 14,400.

Furthermore, the entity estimates that, based on its experience, it will incur Rs. 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty.

Pass required journal entries.

[Ans:]

Cash/Trade Receivable To Revenue To Contract Liability (Service-type warranty)	Dr.	Rs. 36,000	 Rs. 32,000 Rs. 4,000
Cost of Goods Sold To Inventory	Dr.	Rs. 14,000	 Rs. 14,000
Warranty Expense Dr. To Accrued Warranty Costs		Rs. 2,000	 Rs. 2,000

49. Illustration (SM)

Entity sells 100 ultra-life batteries for Rs. 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 Rs. 1,70,000 of the Rs. 2,00,000 transaction price should be allocated to the batteries and Rs. 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 Rs. 100 per battery.

Pass required journal entries.

Ans:

Cash/ Receivable To Revenue To Contract Liability (Service-type warranty)	Dr.	Rs. 2,00,000	 Rs. 1,70,000 Rs. 30,000
Warranty Expense Dr. To Accrued Warranty Costs		Rs. 10,000	 Rs. 10,000

50. Illustration (SM)

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.

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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.
[**Ans:** Entity is principal – has inventory risk and determines ticket price]

51. Illustration

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?
[**Ans:** Principal – It is primarily responsible for fulfilling promise to provide advertising services]

52. Illustration (SM)

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?

53. Illustration (SM)

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 fixed 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?

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54. Illustration (SM)

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

Ans: The software licence provides a right to use the IP that is satisfied at a point in time

55. Illustration (SM)

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

Ans: Licence provides a right to use its IP

56. Illustration (SM)

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?

57. Illustration (SM)

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?

58. Illustration (SM)

An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ₹10,00,000. The contract includes a put option that gives the customer the right to sell the asset for ₹ 9,00,000 on or before 31st December, 20X1. The market price for such goods is expected to be ₹ 7,50,000

How would the entity account for this transaction?

59. Illustration (SM)

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?

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60. Illustration (SM)

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.

61. Illustration (ICAI EM)

A Ltd. owns 20 resorts across India. Every customer who stays in any of the resorts owned by A Ltd. is entitled to get points on the basis of total amount paid by him. Under this scheme, 1 point is granted for every Rs.100 spent for stay in the resort. As per the past experience of A Ltd., the likelihood of exercise of the points is 100% and the stand alone price of each such point is Rs.5. Customer X spends Rs.10,000 in one of the resorts of A Ltd. and earns 100 points. What is the accounting treatment for the points granted by A Ltd.?

62. Illustration (ICAI EM)

A seller provides sales incentives to a customer when entering into a contract. Examples of such customer incentives include:

1. Cash incentives
2. Non-cash incentives in the three scenarios as described below:
    - Scenario 1: Loyalty points to purchase goods from the seller at a lower price;
    - Scenario 2: A coupon redeemable for free products from a third party; and
    - Scenario 3: Free goods or services that the seller normally sells or provides as part of its business (e.g., On purchase of two products, third product is free).

How should an entity account for cash and non-cash based sales incentives when entering into a contract for supply of goods or services?

63. Illustration

For every ₹ 100 of sale, entity awards 10. If total sales are ₹ 1,00,000. Each point is worth ₹ 1. Entity expects that only 9,500 points would be redeemed.
At the end of year 1, 4500 points were redeemed.
At the end of year 2, 4000 points were redeemed.
At the end of year 2, entity expects that 9,700 points would be redeemed.

Determine the revenue to be recognised in each year.

64. Illustration (SM)

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 out-sourcing contract:

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

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65. Illustration

Year	Cost	Fair Value	Type of cost
1	500	525	Construction
2	500	525	Construction
3 to 10	10	12	Operations
8	100	110	Obligation to resurface

Services being provided are Construction, operation and resurfacing.
Grantor pays consideration from year 3 to year 10. Determine how the revenue would be recognised.

66. Illustration

Year	Cost	Fair Value	Type of cost
1	500	525	Construction
2	500	525	Construction
3 to 10	10	12	Operations
8	100	110	Obligation to resurface

Services being provided are Construction, operation and resurfacing (as needed)
The entity expects that resurfacing should be done in 8th year.
Entity has a right to collect the user fee from the users based on usage from Year 3 to 10. Entity expects to collect ₹ 200 crores from user each year.

67. Illustration

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 to collect the toll from the users of the expressway. Under IGAAP, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Asset.

(i) What would be the classification of Bhilwara-Jabalpur Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

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(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.

68. Illustration

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?

69. Illustration

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?

70. Illustration

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?

71. Illustration

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.

72. Illustration (Nov 19 – 12 Marks)

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 from 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.

73. Illustration (Jan 21 – 12 Marks)

A Ltd. is a company which is in the business of manufacturing engineering machines and providing after sales services. The company entered into a contract with Mr. Anik to supply and install a machine, namely 'model pi' on 1st April 2018 and to service this machine on 30th September 2018 and 1st April 2019. The cost of manufacturing the machine to A Ltd. was Rs. 1,60,000.

It is possible for a customer to purchase both the machine 'model pi' and the maintenance services separately. Mr. Anik is contractually obliged to pay A Ltd Rs. 4,00,000 on 1st April, 2019.

The prevailing rate for one-year credit granted to trade customers in the industry is 5 percent per six-month period. As per the experience, the servicing of the machine 'model pi' sold to Mr. Anik is expected to cost A Ltd. Rs. 30,000 to perform the first service and Rs. 50,000 to perform the second service. Assume actual costs equal expected costs. When A Ltd. provides machine services to customers in a separate transaction it earns a margin of 50 % on cost. On 1st April, 2018, the cash selling price of the machine 'model pi' sold to Mr. Anik is Rs. 2,51,927.

The promised supply of machine 'model pi' and maintenance service obligations are satisfactorily carried out in time by the company.

You are required to:

(i) Segregate the components of the transaction that A Ltd. shall apply to the revenue recognition criteria separately as per Ind AS 115

(ii) Calculate the amount of revenue which A Ltd. must allocate to each component of the transaction

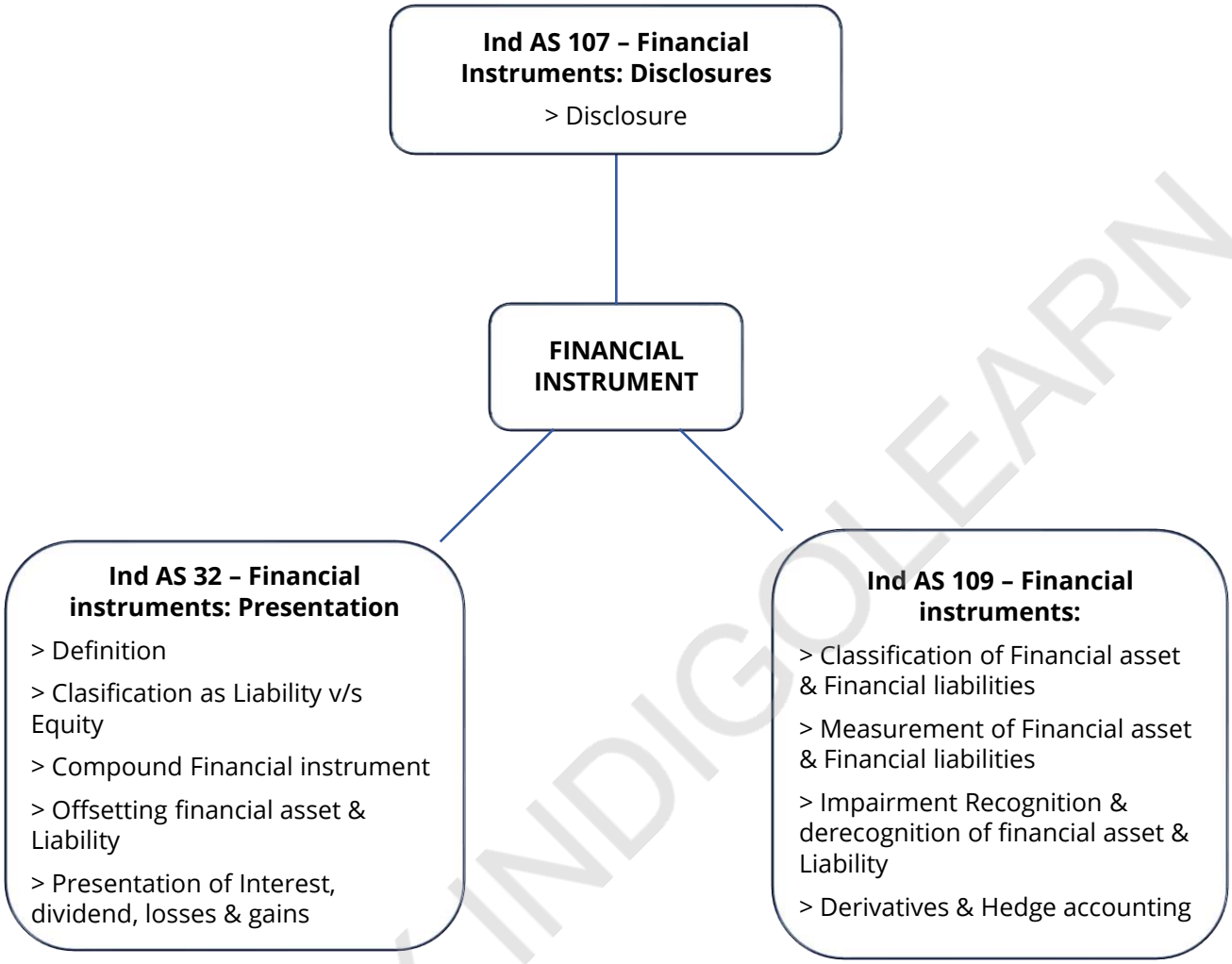
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(iii) Prepare journal entries to record the information set out above in the books of accounts of A Ltd. for the years ended 31st March·2019 and 31st March 2020; and

(iv) Draft an extract showing how revenue could be presented and disclosed in the financial statements of A Ltd. for the year ended 31st March 2019 and 31st March 2020.

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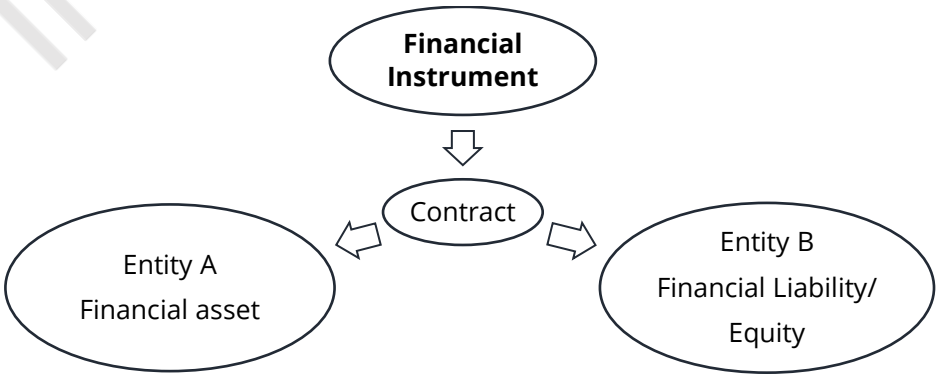
1 Introduction



2 Important Terms

2.1 Financial Instrument

A financial instrument is any **contract** that gives rise to a **financial asset** of one entity and a **financial liability or equity instrument** of another entity

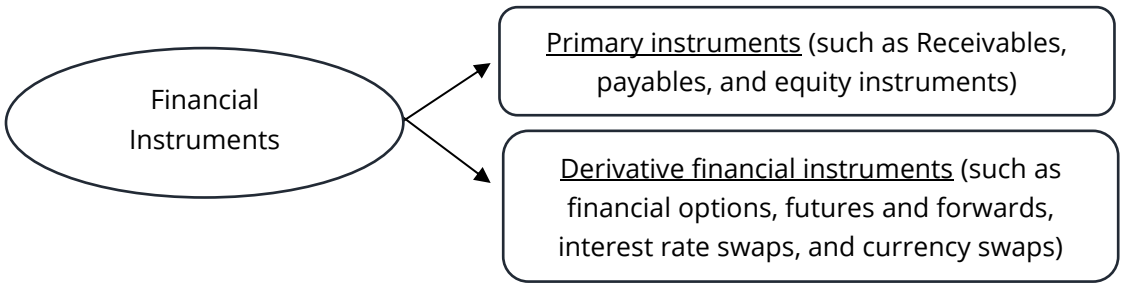


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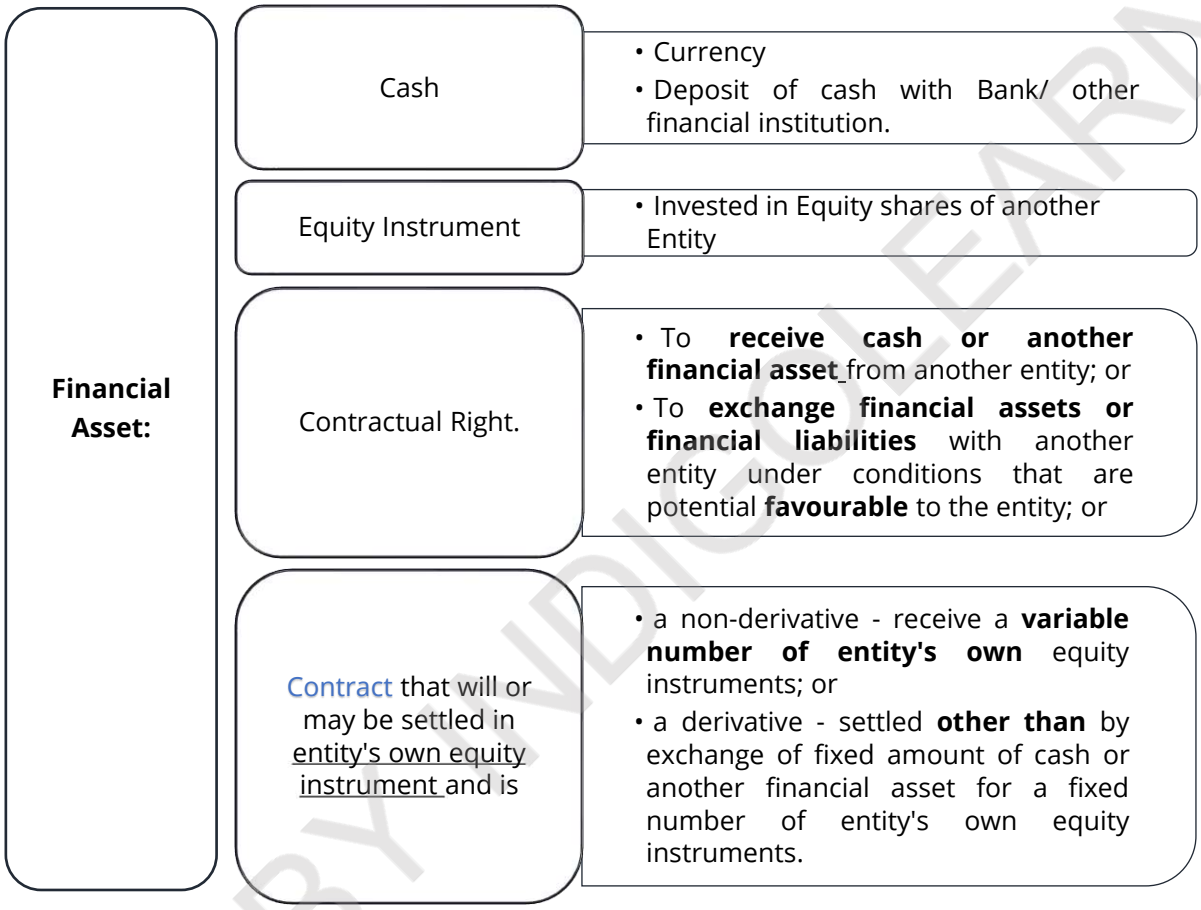
- Contract can be Oral/Written/Implied and may take a variety of forms.
- Not contractual Assets/Liabilities ⟹ Not financial liabilities or financial assets

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Eg: Income taxes (Statutory obligation), Deferred tax asset, Constructive Obligation as defined in Ind as 37.



2.2 Financial Asset



Note:

- Contract settled in Own equity, can either be
  - ➔ Non-derivative (receive variable no of entity's own equity instrument) or
  - ➔ Derivative – which is not a fixed to fixed contract.
  - ➔ If a contract involves exchange of fixed number of equity instruments against fixed consideration – it is classified as equity.
  - ➔ In case of a derivative asset, the entity gains in the contract.

- Examples for Contractual Right in definition are Trade receivable, Loans & notes receivable, Deposits made & Investment in bonds, Financial guarantees on behalf of borrower etc.
- In case of a derivative financial asset, an entity gains from the contract.

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Following are examples to evaluate Financial Asset:

S.No	Particulars	Whether FA or not	Remarks
1	Investment in bonds/ debentures	FA	Contractual right to receive cash.
2	Loans and receivables		
3	Deposits given		
4	Trade & other receivables		
5	Bank balance		
6	Security Deposit paid		
7	Cash and cash equivalents		Specifically covered in the definition.
8	Investments in equity shares		Equity instrument of another entity
9	Perpetual debt instruments Eg. perpetual bonds, debentures and capital notes.		contractual right • to receive interest for indefinite future or • to return of principal
10	Physical assets Eg. inventories, property, plant and equipment etc.	No	Control of such assets does not create a present right to receive cash or another financial asset.
11	Right to use assets Eg. Lease vehicle etc.		
12	Intangibles Eg. Patents, trademark etc.		
13	Gold		
14	Prepaid expenses Eg. Prepaid insurance, prepaid rent etc.		Future economic benefit in the form of goods or services, rather than the right to receive cash
15	Advance given for goods and services		

2.3 Financial liability

Financial Liability:

Any liability that is

- Contractual Obligation
  - To deliver cash or other financial asset to another entity; or
  - To exchange financial assets or financial liabilities with another entity under conditions that are potential unfavourable to the entity; or
- Contract that will or may be settled in entity's own equity instrument and is
  - a non-derivative - obliged to deliver a variable number of entity's own equity instruments; or
  - a derivative - settled **other than** by exchange of fixed amount of cash or another financial asset for a fixed number of entity's own equity instruments.

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Note:

- Contract settled in Own equity, either be
  - ➔ Non-derivative (variable no of entity's own equity instrument) or
  - ➔ Derivative – Not a fixed to fixed contract.
- In case of a derivative liability, the entity loses in the contract.

Following are examples to evaluate Financial Liability:

S.No	Particulars	Whether FL or not	Remarks
1	Loans payable or bank loan	FL	Contractual obligation to pay cash/bank.
2	Trade and other payables		
3	Bills payable /acceptance		
4	Deposits received		
5	Redeemable preferences shares		
6	Financial guarantee given		
7	Call option (Writer/seller)		Contractual obligation that are unfavorable to the entity
8	Future/Forward		

2.4 Equity Instrument

Equity instrument:

Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities and also both conditions to be met

No Contractual Obligation

- To deliver cash or other financial asset to another entity; or
- To exchange financial assets or financial liabilities with another entity under conditions that are potential unfavourable to the entity; or

Contract that will or may be settled in entity's own equity instrument and is

- a non-derivative - no contractual obligation for the issuer to deliver a variable number of entity's own equity instruments; or
- a derivative - settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of entity's own equity instruments.

Equity
• Equity instrument issued • Derivative: Warrants to issue fixed number of shares at fixed price against each warrant • Non-derivative: Other instrument convertible into fixed number of equity shares, etc • Derivative - Fixed for fixed settlement.

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Exception: FL treated as Equity

1. Puttable Financial Instrument with conditions	•For Eg: Mutual Funds, Units of trust, Puttable instrument of Venture capital Funds
2.Obligation to deliver pro-rata shares in Net asset at the time of liquidation subject to conditions (When Redemption/liquidation time is known)	•A business - Construction of Bridge (Liquidate in 2yrs) , Obligation to pay back the capital to the investor

Puttable Instrument is a Financial Instrument that gives the holder:

- the right to put the instrument back to the issuer for cash or another FA, or
- is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

Puttable Instrument classified as Equity instrument, If it satisfies following conditions:

In case of liquidation, Holder is entitled to a pro rata share of the entity's net assets

Subordinate to all other classes of instruments (last priority) on liquidation

All financial instruments in the most subordinate class have identical features

Only contractual obigation for the issuer to repurchase or redeem the instrument for cash or another FA.

No other contractual obligations: to deliver cash or another FA, or
to settle in variable number of entity's own equity instrument

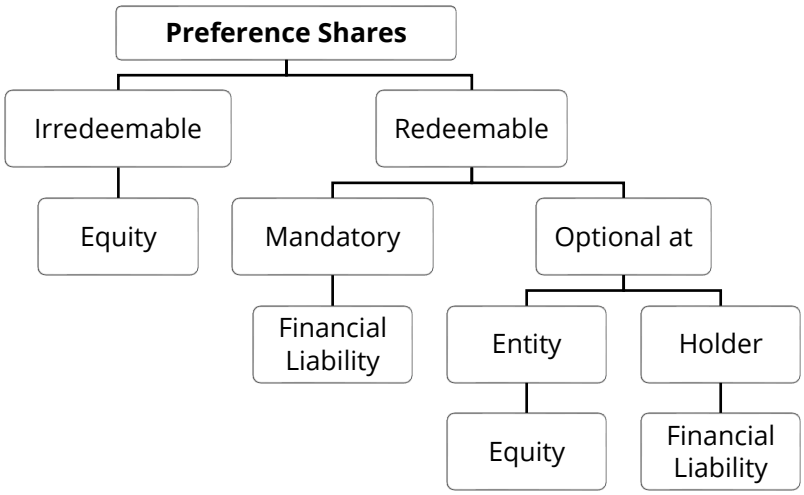
Total expected cash flows are based substantially on the:

a) Profit or loss; b) Change in recognised net assets or c) Change in fair value of recognised and unrecognised net assets of the entity

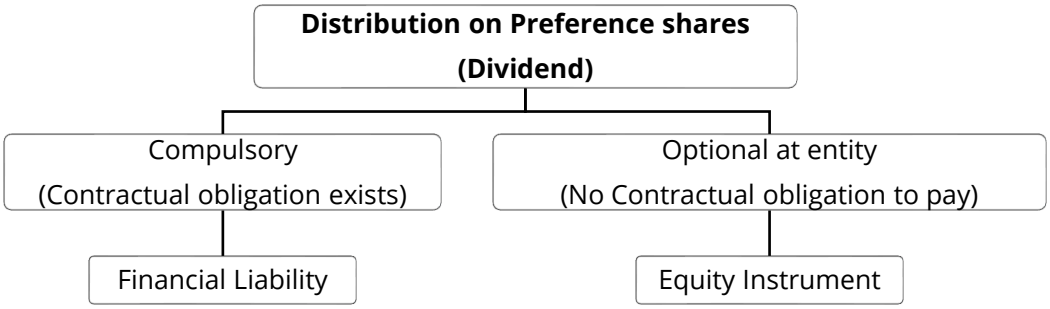
Issuer must have no other Financial instrument or contract that has:

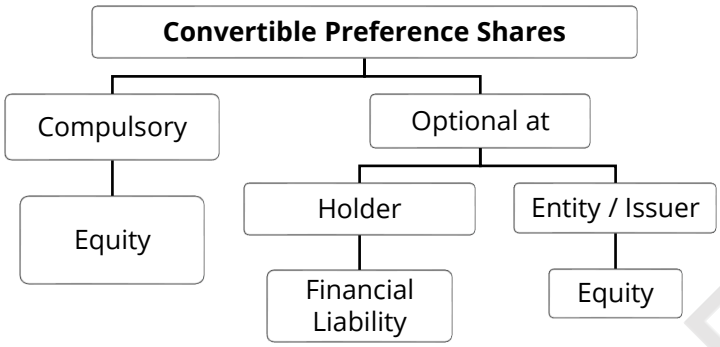
a) total cash flows on same terms as above, with

b) the effect of substantially restricting or fixing the residual return to the puttable instrument holders.



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3 Comparison of Financial Asset, Financial Liability and Equity

Item	Financial Asset	Financial Liability	Equity
Cash	Cash	-	Residual Int.
Equity Instrument of another entity	Yes	-	-
Contractual - Cash/FA - Exchange FA/FL	**Right** Receive Favorable Terms	**Obligation** Deliver Unfavorable Terms	 Not Equity Not Equity
Own Equity Instrument ND – Variable no of Equity ND – Fixed no of Equity	Receive -	Deliver -	- Delivers
Derivative - Cash/FA - Own Equity	 Variable Fixed	 Variable Fixed	 Fixed Fixed

Note:

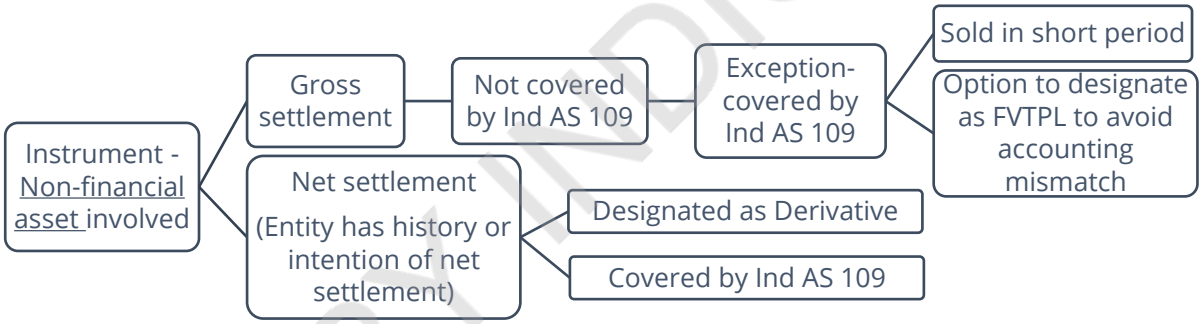
- Rights, Warrants, Options are issued -> Fixed Equity instrument to Fixed Consideration (can be any Currency) -> treated as Equity.
  Eg: Right Issue for Foreign Investor – Pay $20 per Share for subscription, Here Consideration ($20) is fixed – Currency doesn't matter
- Right issue must be made pro-rata based on existing share holding
- When No of Equity instrument varies (Conversion ratio changes):
  - Corresponding to underlying variable (Eg: based on Market value, Valuation), classified as Financial Liability.
  - in response to passage of time (which is a certain event), classified as Equity.
  - To protect right of convertible instrument holders (eg: bonus shares), classified as Equity
  - If issuer subsequently issues shares to others at a lower price, classified as Financial liability.
  - In a narrow range (eg: convertible at fair value not going below 15% & not going above 40%), classified as Financial Liability.

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4 Scope of Financial Instrument

S.No	Particulars	Covered under Ind As 109	Covered under Ind As 32	Applicable Ind As
1	Interest in Subsidiaries (At Cost)	No	No	Ind As 27 Ind As 28 Ind As 110
2	Interest in Associates (At Cost)	No	No	
3	Interest in Joint ventures (At Costs)	No	No	
4	Rights and obligations under leases	No	No	Ind As 116
5	Employers rights and obligations under employee benefit plans	No	No	Ind As 19
6	Rights and Obligations under an insurance contract	No	No	Ind As 104
7	Forward contract arising in case of business combination	No	No	Ind As 103
8	Loan commitment other than covered under Ind as 109 and Ind As 32	No	No	Ind As 37
9	Share-based payments	No	No	Ind As 102
10	Reimbursement right in respect of provision	No	No	Ind As 37
11	Rights and obligations under revenue for contracts with customers	No	No	Ind as 115

Own Use Exemption: Derivate - Contracts to buy or sell non-financial items for own use (Not for subsequent sale)



Example: Forward contract entered on 01-01-2022 to buy 1000 tons of oil on 30-06-2022 @$100/ton. On 30-06-2022, Oil price per ton increased to $110.

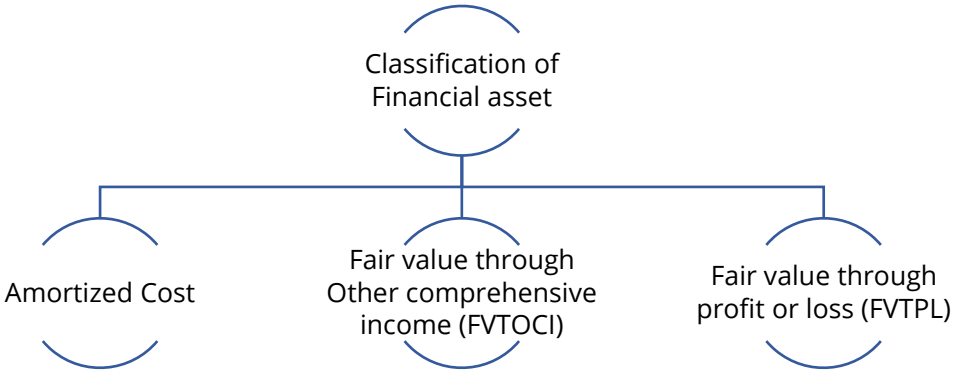
- On 30-06-2022, If Fully physically settlement (1000 tons of oil),
  - ➔ If it is sale in short time or designated as FVTPL to avoid accounting mismatch - covered under Financial Instrument (Exemption to Gross settlement)
  - ➔ Otherwise - not covered under Financial Instrument. [Gross settlement]
- On 30-06-2022, If (1000 tons* $(110-100) = $1000) net settlement either by cash/ exchanging Financial instrument - then Financial Instrument [Net settlement]

5 Classification and Measurement of Financial asset

5.1 Initial measurement and subsequent measurement

- Initial recognition at Fair value.
- Subsequent measurement depends on how we classify of Financial instrument.

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5.2 Test for classification of Financial Asset

Business Model: How Financial Assets are managed

Factors to determine Business model are:

- How the performance of business model & Financial assets evaluated & reported to Entity's KMP
- Risk that affects BM & FA and, way in which those risks are managed
- How Managers are compensated (compensation based on profit, Fair Value of asset managed)

Example for business model:

Business Model: Lend money and collect interest and loan at the end of tenure

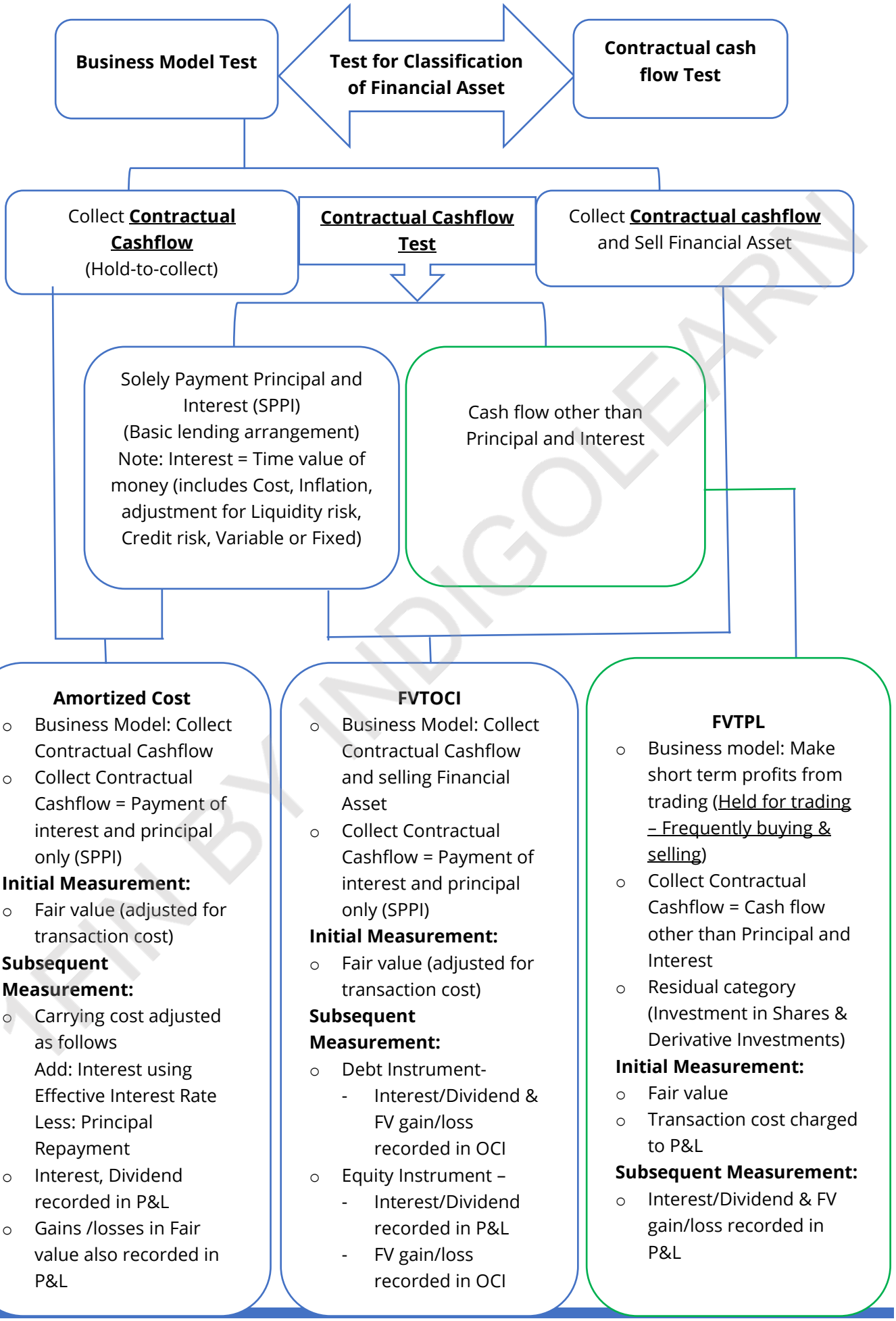
Cases of Loan default (Risk): Entity may try to sell these receivables to ARCs (Risk managed)

Business model Type: Hold the asset till its maturity.

Business Model: Buy loans from Bajaj Finserv like companies and Recovery/sell it subsequently

Business model Type: Sell by taking advantage of Market Volatility.

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Important points

- Fair value is determined by discounting future contractual cash flows by reference to market rate of interest.
- The following table must be prepared while solving questions

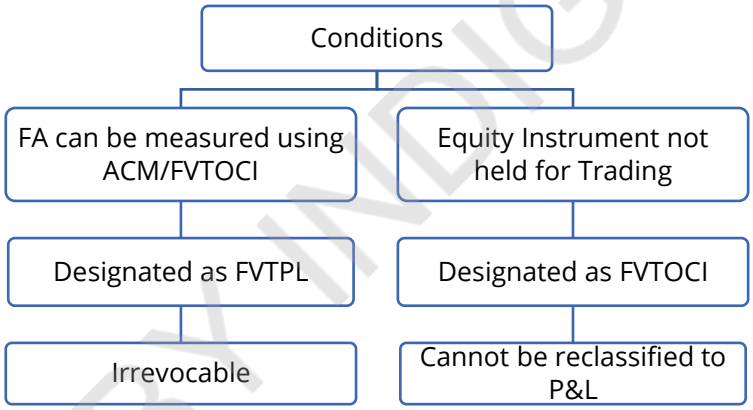
Year	Op bal	Int @ Mkt rate	Receipt @ coupon rate	Closing balance

- Interest income = op bal x effective interes rate (EIR) or the market rate.

Amortised Cost Method

Accounting entry on	Entry to be passed
Date of Acquistion	Dr. Financial Asset (FV + Transaction cost) Cr. Bank
Year End	Dr. Financial Asset Cr Interest income
Receipt of Interest	Dr. Bank Cr. Financial Asset
Redemption	Dr. Bank Cr. Financial Asset

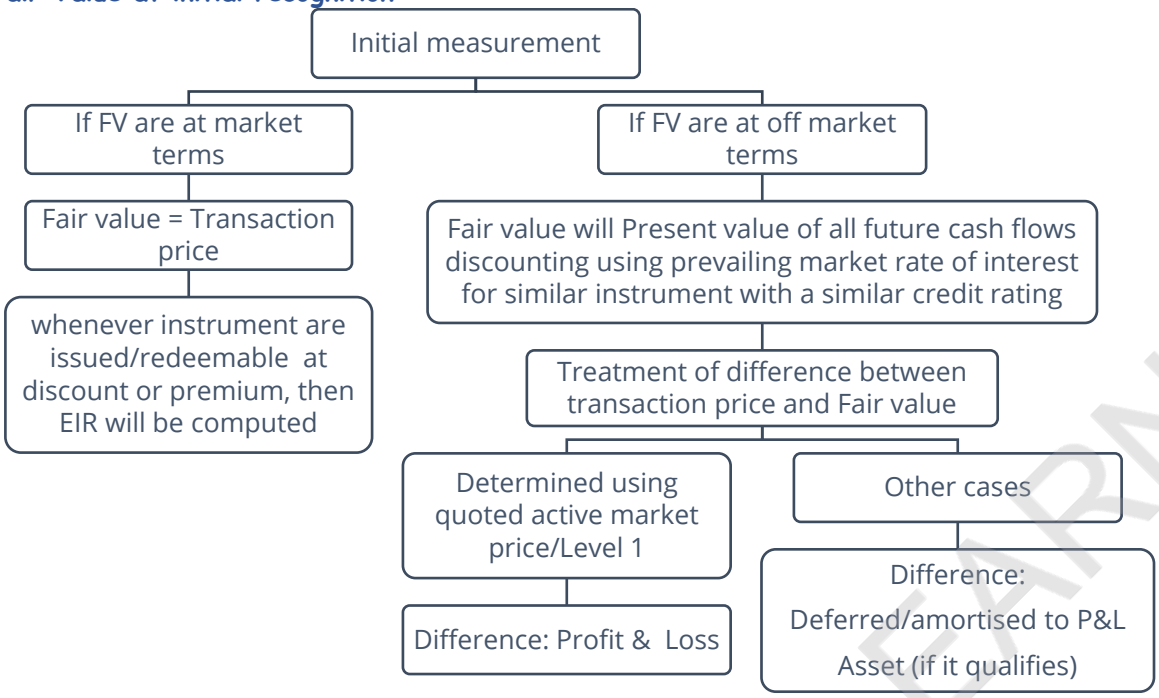
5.3 Exception to Classification of assets:



- If equity instruments are held for trading, they are classified as FVTPL.

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5.4 Fair Value at initial recognition:



Note: Look at substance over form, while difference is accounted.
If the parties of contract
→ Related (Parent & Subsidiary Co., Employer & Employee), then treated as Asset in lender books/Equity in borrower books
→ Not related, then treated under Profit & loss
EIR – Effective interest rates

5.5 Loan between group companies

- Interest free and Repayable on demand: Fair value should not be less than the amount payable on demand in books of lender and No interest will be accrued,
- No Fixed maturity: the entities need to estimate repayment date and determine its measurement accordingly.
- PV of cashflows is considered to be the Financial Liability/Financial Asset and the balance amount given is treated as equity/investment.

5.6 Equity instrument where FV not determinable

- Consider all the facts and try to establish Fair value
- If FV cannot be determined, Cost may be a representative of Fair value (Invested in Start-up Co.)
- Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments). It cannot be assumed Cost = Fair value.
- Instrument are at market terms: FV will be transaction price.
- Instrument at off-market terms: Exchanged at off market terms.
- FV measured as present value of all future cash flows discounting using prevailing market rate of interest for similar instrument with a similar credit rating.
- Then Fair value ≠ Transaction price.

Note:

- Selling assets due to unanticipated funding needs, worst case or stress case scenarios would not affect the entity's assessment of the business mode & classification of Financial asset, there is no retrospective reclassification.
- Principle = Fair value of Financial Asset at initial recognition PV of Cash flow discounted at appropriate rate.
- Accounts Receivables: Recognise as per Ind as 115 -> Initial measurement at Transaction price. IF any interest/loss allowance (Financial component) -> Refer Financial Instrument.
- If Value of Asset turns Negative

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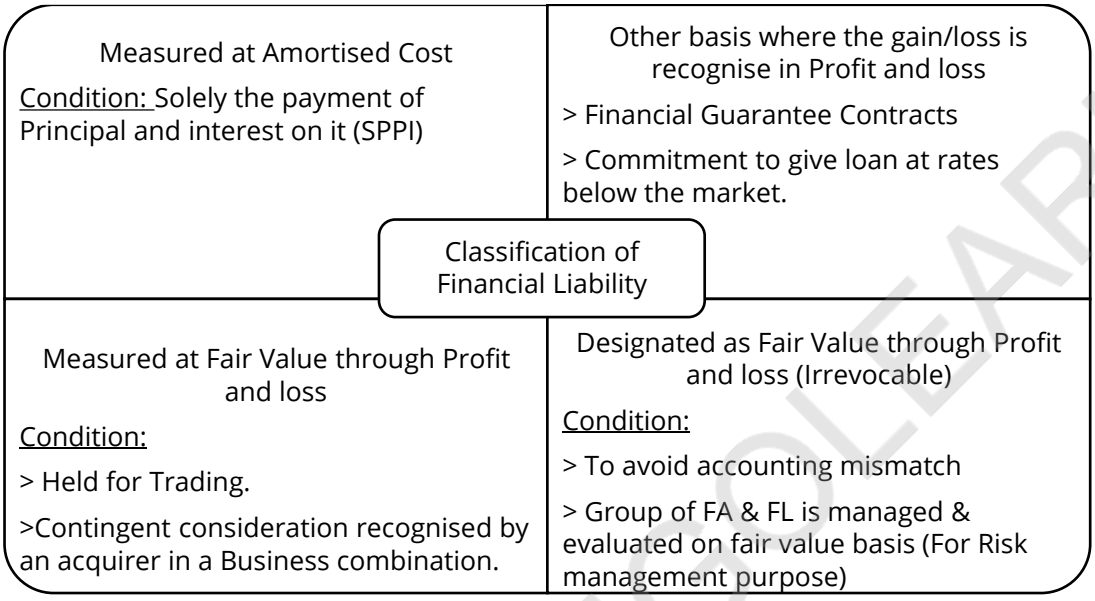
Eg: Derivative Contract: Future of Xltd

- Current Position: Financial Asset (Favorable). In Future, share price falls: Financial Liability (Pay the money)

6 Classification and Measurement of Financial Liability

6.1 Initial and Subsequent measurement

- Initially recognised at Fair value
- Subsequent measurement depends on classification



6.2 Measurement of Financial Liability

Amortised Cost method	FVTPL
• **Initial measurement:** Fair Value (adjusted for Transaction cost) • **Subsequent measurement -** Interest (Using EIR)-> Recognised in P&L • Changes in Rate of Interest in market will not have any Impact. • Change in cashflow due to Floating rate of interest -> Revise the EIR	• **Initial measurement:** Fair Value (Transaction cost charged to P&L) • **Subsequent measurement:** Changes in Interest will change Fair Value: >If due to own credit risk -> Recognised in OCI. >If due to other than own credit risk -> Recognised in P&L.

Note:

- Equity Instrument initially recorded at 'Cost' and carried at 'Cost'
- The following table must be prepared while solving questions involving financial liability

Year	Op bal	Int @ Mkt rate	Payment @ coupon rate	Closing balance

- Interest Expense = op bal x effective interes rate (EIR) or the market rate.

Amortised Cost Method

Accounting entry on	Entry to be passed
Date of issue	Dr. Bank Cr. Financial Liability (FV – Transaciton cost)
Year End	Dr. Interest cost Cr. Financial liablity
Payment of interest	Dr. Financial liability Cr. Bank
Redemption	Dr. Financial Liability

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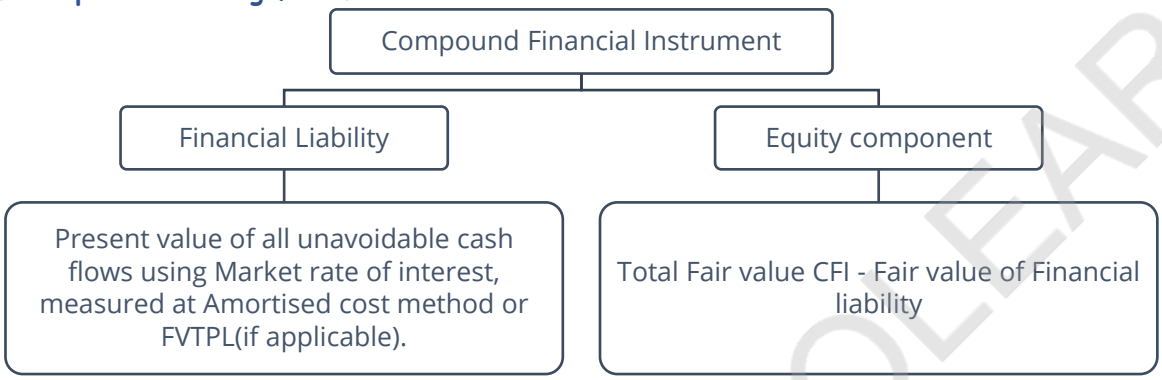
	Cr. Bank

7 Compound Financial Instrument

7.1 Definition

Those instruments which have features of both a financial liability and equity instrument are called "compound financial instruments"

7.2 Split Accounting for CFI

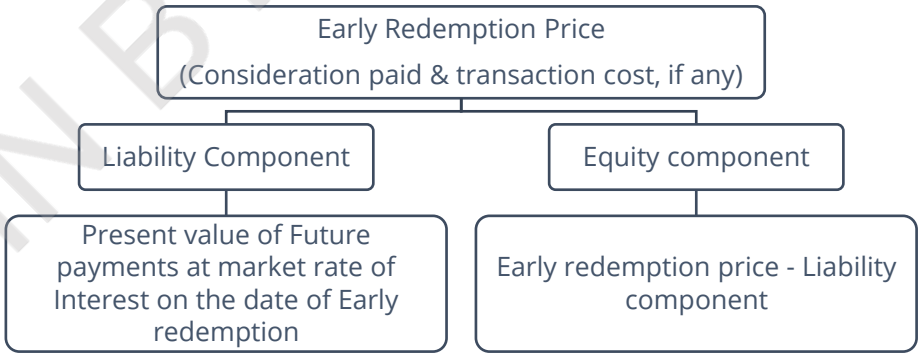


- Allocate the Transaction cost based on the ratio of gross carrying Value, after allocation of fair value.
- No gain/loss at time of initial recognition
- Fair value of FL is measured at Amortised cost method or FVTPL (if applicable).

Accounting entry
Dr. Bank
Cr. Financial Liability
Cr. Equity

7.3 Early Settlement/ Redemption:

Consideration paid is split between FL and Equity and recorded accordingly.

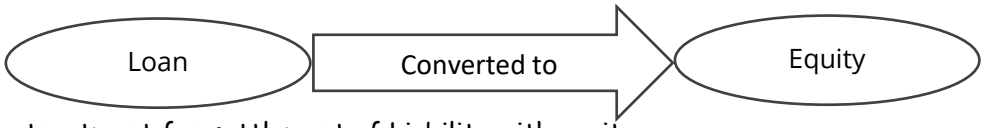


Note: Amount of gain or loss relating to the liability component is recognised in Profit and loss.

- Difference between original share and revised issue (as incentive to early conversion) is recognised in P&L account. (that incentive can be made in cash)
- Early Conversion: Transfer the liability part to Equity
- Early Repayment: consideration paid is split between FL and Equity and recorded accordingly.
- Any incentive paid in early conversion is recognised in P&L.
- If it is optionally convertible, principle value and Interest/dividend will be discounted. If it is compulsory convertible, only interest / dividend will be discounted.
- For calculating fair value of Liability component initially, market rate of interest will be considered instead of EIR considering transaction cost.

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7.4 Settlement of Liability with equity



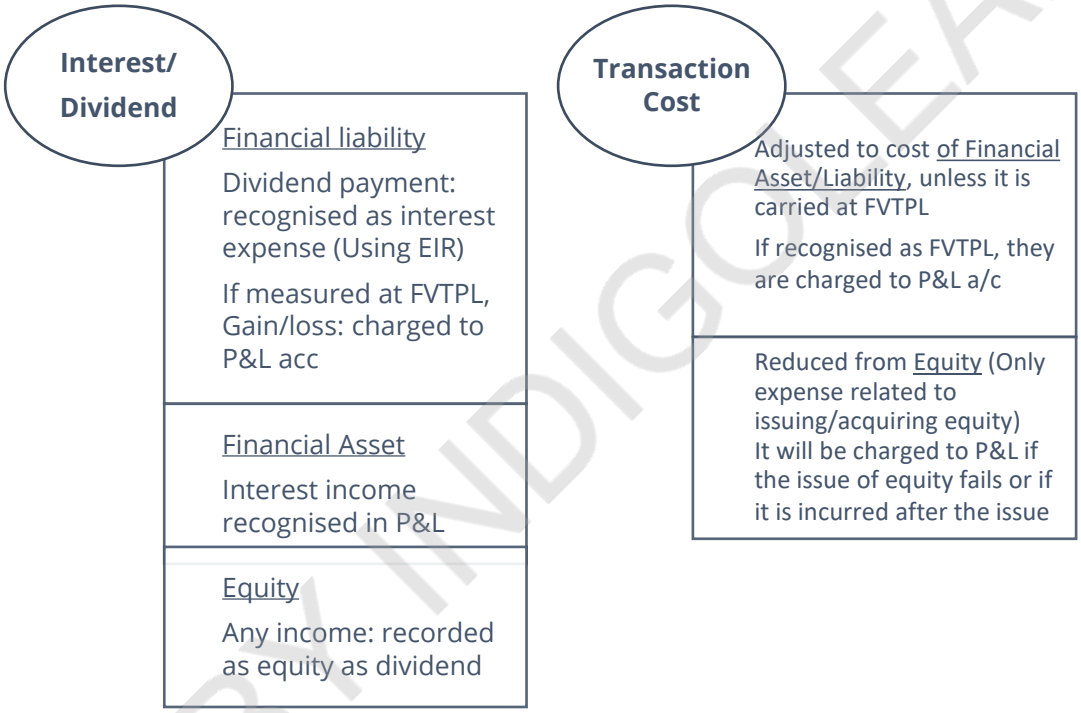
Accounting treatment for settlement of Liability with equity

1. Derecognize the Financial Liability and credit equity
2. Valuation = Fair value of consideration given
3. Any difference in consideration is recognised in Profit and loss
4. Carrying amount of Financial liability is considered as fair value of equity, when fair value of equity cannot be determined.

Exception to the above accounting treatment:

- Creditors directly/ indirectly is a shareholder and acting to be shareholder.
- Entity and creditor are controlled by the same party
- It is convertible instrument from the beginning

8 Accounting treatment of Interest, Dividend, Gain or loss and Transaction cost



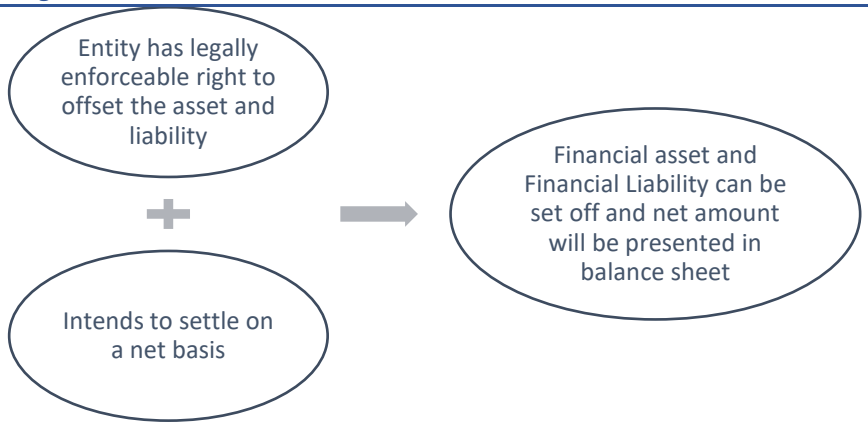
9 Treasury shares

- Company buys its own equity shares
- They are Equity instrument, but not Financial Asset.
- Accounting: Adjusted against equity and presented separately in line with Ind As 1
- No profit or loss is recognised on acquiring of treasury shares.

Note: In India under Companies act & SEBI regulations, a company cannot hold its own shares as investment. Hence It has to be extinguish within the stipulated time.

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10 Offsetting



Note:

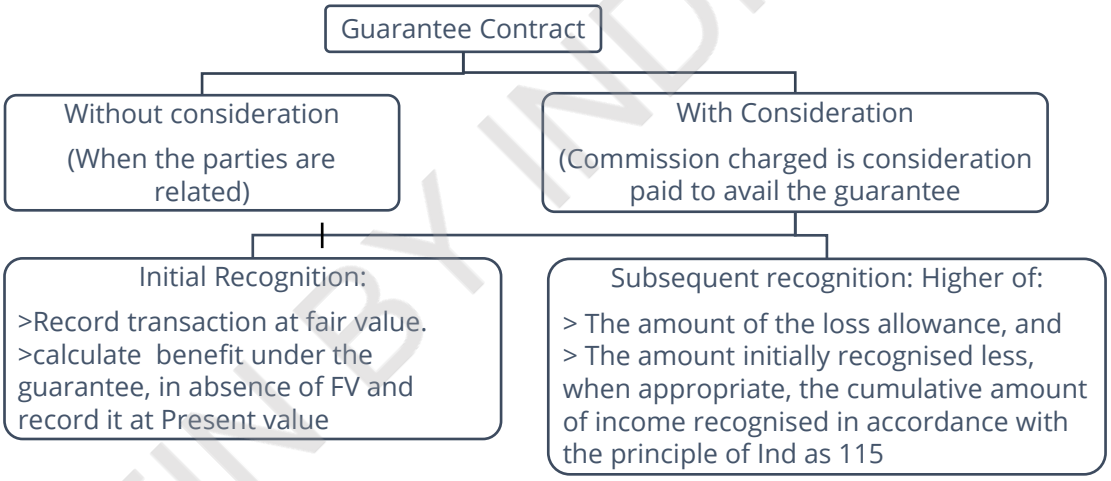
- Legally enforceable right should be current right, not contingent right
- Net presentation is not derecognition
- Example for legally enforceable right: If due dates for FA & FL is different, then no legally enforceable right.

11 Accounting for Financial guarantee Contract

Financial guarantee contracts and commitments to provide a loan at a below market interest rate are subsequently measured at higher of:

- The amount of the loss allowance, and
- The amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principle of Ind as 115

Apart from disclosure of guarantee given as Contingent liability, we have check whether there is any amount received for guarantee given or any liability need to pay should be accounted under Financial liability.



Note:

- For Eg: Interest on Unguaranteed loan = 10% and Interest on Guarantee loan = 9%
  Benefit under guarantee: (10% - 9%) 1%.
  FV of Guarantee: PV of benefit discounted at market rate of interest.
- If Financial contract meet the definition of Insurance contract, Ind AS 104 will be applicable instead of Ind AS 109.

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12 Derivative Financial Instrument

12.1 Derivative

A Financial instrument or other contract with all of the following three characteristics:

- Value changes due to underlying factor (Eg: specified interest rate, FI price, Commodity price, FE rate, index of prices or rates, credit rating or credit index, or other variable)
- No or Little initial net investment
- Future settlement

Contract with following two features are not Derivatives:

- Value of the contract changes with reference to one or more non-financial variable: and
- That non-financial variable (Temperature, earthquake or rainfall index) specific to one of the party to the contract
- All derivatives have to be accounted at FV through P&L. If it qualifies as hedging => Apply Hedge accounting principles.

12.2 Forward contract

@ Future Date, @Agreed price

Eg: Forward Contract – 1000 Dollars @ Rs.82 after 6 months

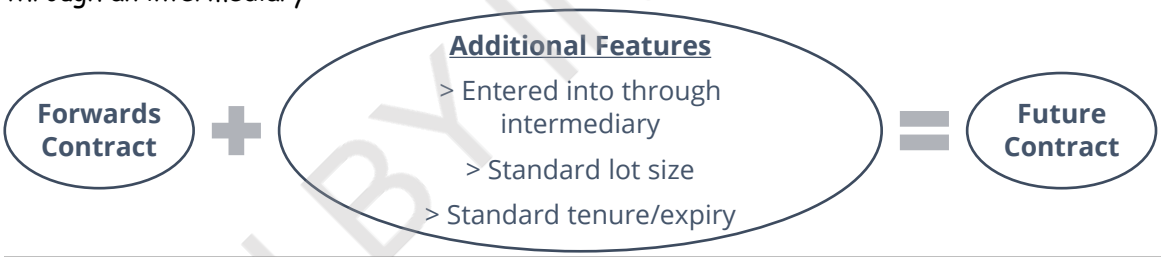
Dollar ($) rate	For the Seller	For the Buyer
Increase – Rs.85	Unfavourable	Favourable
Decrease – Rs.75	Favourable	Unfavourable

Favourable – Derivative Asset

Unfavourable – Derivative Liability

12.3 Future contract:

Contract to buy or sell an underlying asset/ instrument @ future date @ specified price for standard lot through an intermediary

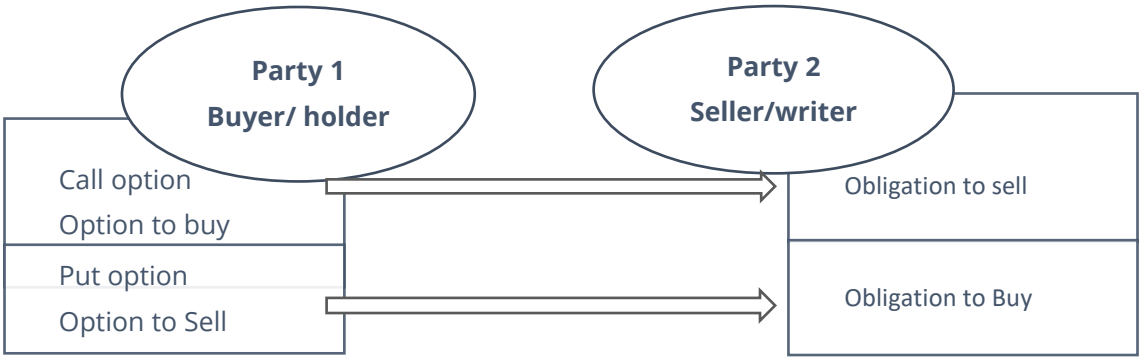


Forward Contract	Future Contract
Sell any Quantum (eg:732 dollars)	Sell Standard lot (eg:1000/2000 dollars)
No standard expiry	Expires on standard time
Contract directly between buyer & seller	There will be intermediate between buyer and seller
Flexible	Standard in terms of Tenure, expiry, quantity, Value

12.4 Options

- Strike price is predetermined
- Time is predetermined
- For taking Risk, Option premium for writer

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12.5 Swap

Payment on Exchange of Interest rate (Fixed & Floating rate) on notional principle

- Prepayment of Fixed interest rate, Variable Interest payment in Future → Derivative
- Prepayment of Variable Interest payment, Fixed interest rate in Future → Not derivative

Note: Share Warrant – Classified as Equity under Financial Instrument

12.6 Accounting for Derivatives

- All derivatives are measured at FV at initial recognition and at the end of each period.
- The FV gain or loss are recognised in P&L except in case of hedge accounting.

13 Embedded Derivatives

13.1 Embedded Derivative:

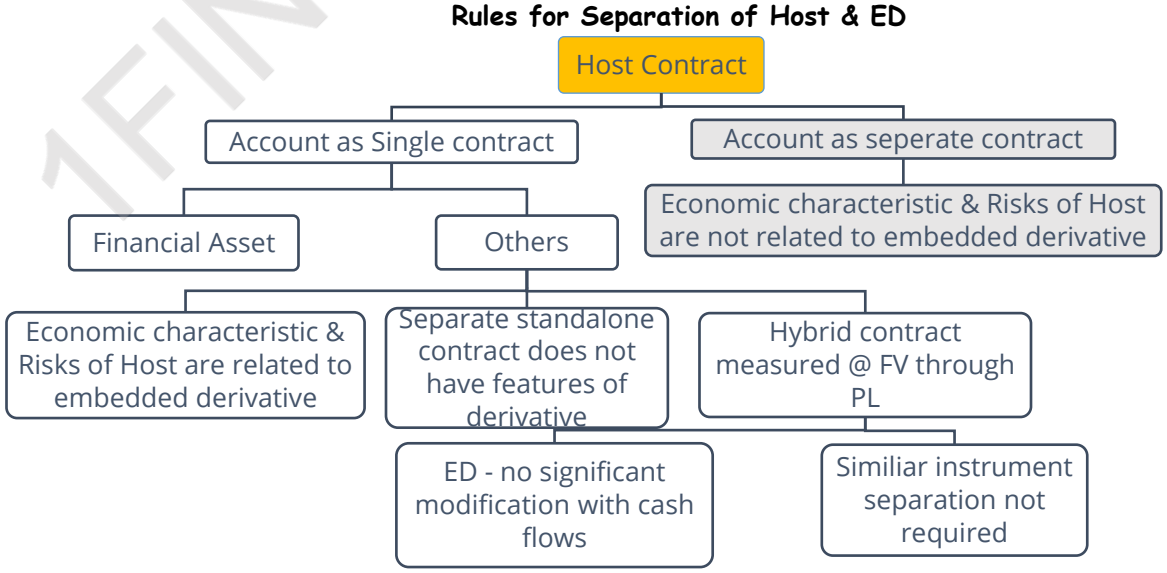
- A component of a hybrid contract
- That also includes a non-derivative host
- With the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

An embedded derivative causes some or all of the cashflows to be modified according to an underlying.



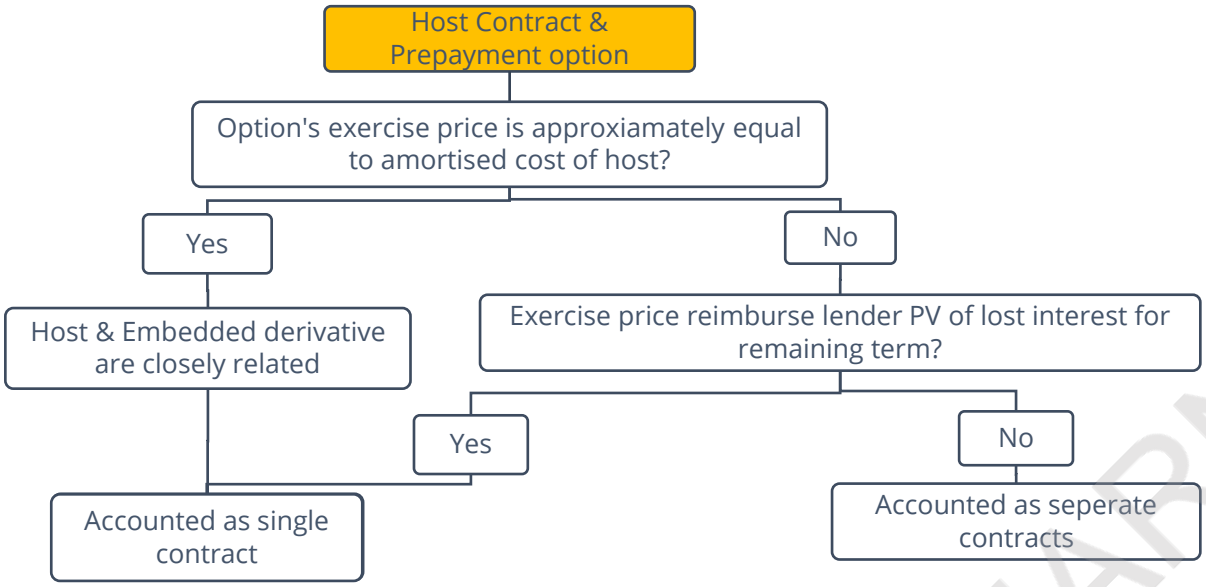
Example – Convertible Bond is a hybrid contract which has a host contract (non – derivative) in form of a bond and the conversion option in form of a derivative contract.

13.2 Accounting of Embedded Derivative:



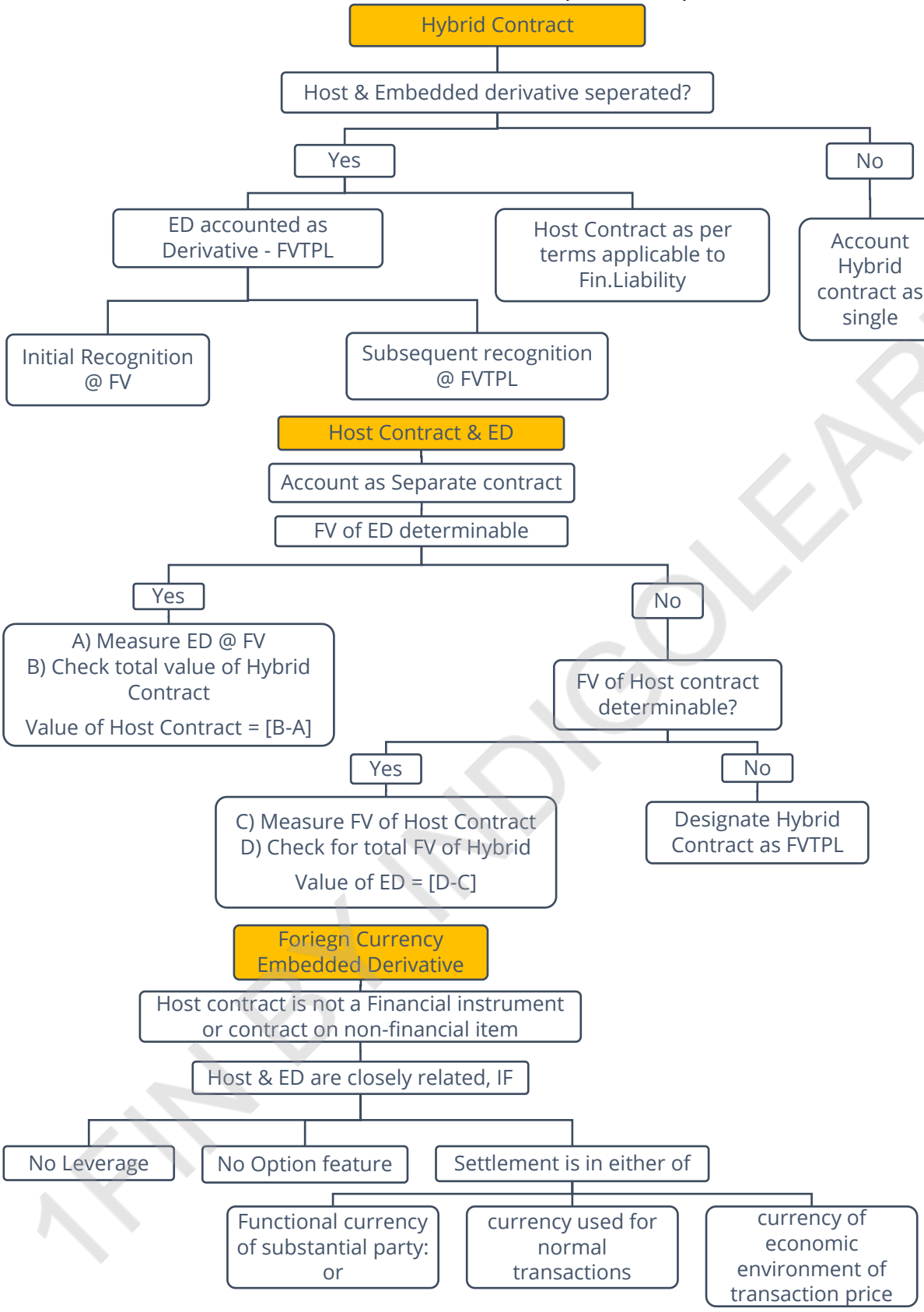
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Evaluation of whether option is closely related to host contract?



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Check Whether there is a need for Separation required of Host & ED?



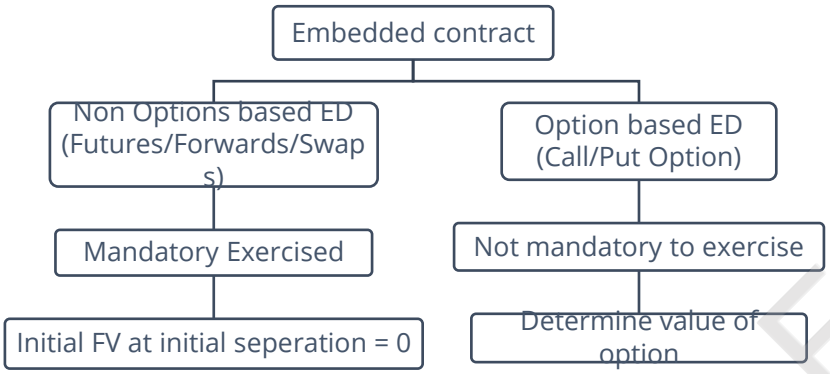
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Steps for solving illustrations:

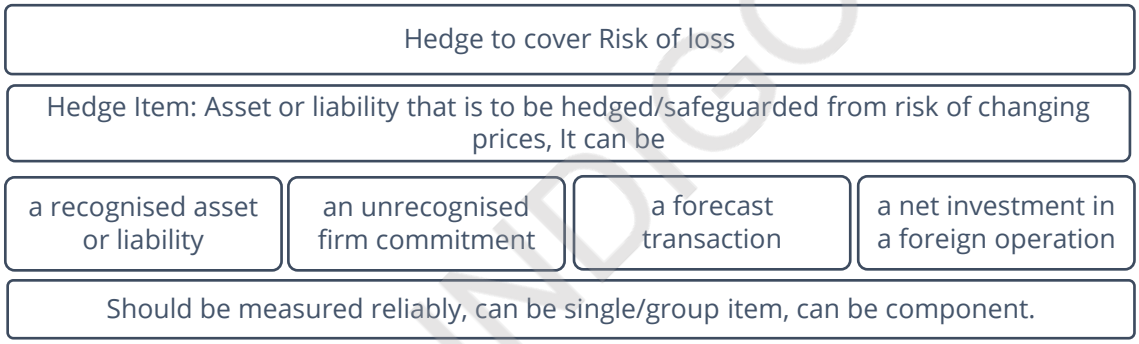
- Separate the host and ED if required
- At inception, if ED is a
  - Forward contract, then initial value = 0
  - Option contract, account derivative at the given value in the question
- At the end of each reporting period – recognise gain or loss on forward contract
  - If gain – increase the derivative asset

- IF loss – reduce the derivative asset/ create derivative liability

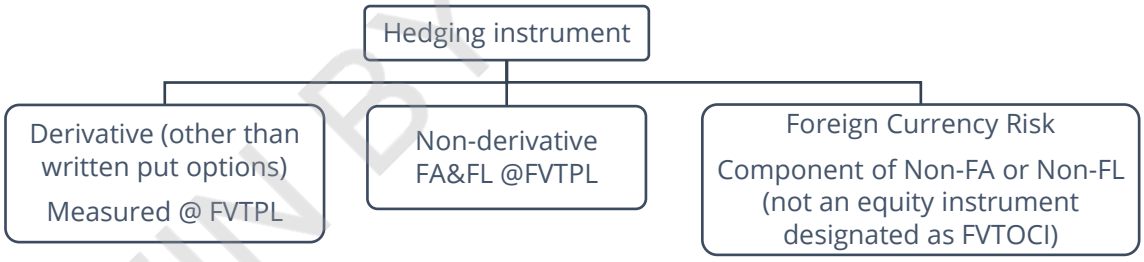
- At settlement date
  - Determine the FV
  - Arrive the gain or loss
  - Adjust the derivaive asset or liability
- On contract of purchase/sale of non-financial item
  - Account for amount received or paid through bank
  - Derivative asset or liability will be adjusted against the contract to sell/buy the non- financial item



14 Hedging



14.1 Hedging Instrument



Note:

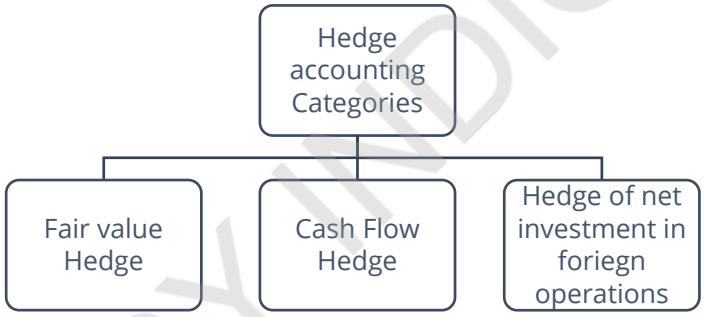
- If there is purchased option and also Written (sold) option and net impact is purchased option, then it can be considered as Hedging Instrument.
- Hedging instrument should be with the External party (Not with Group companies or related companies)
- Entire Instrument should designate as Hedge instrument, not in parts.
- Hedge accounting is not mandatory
- Once hedge accounting is started, till the time of qualification criteria is met, entity has to follow the hedge accounting.

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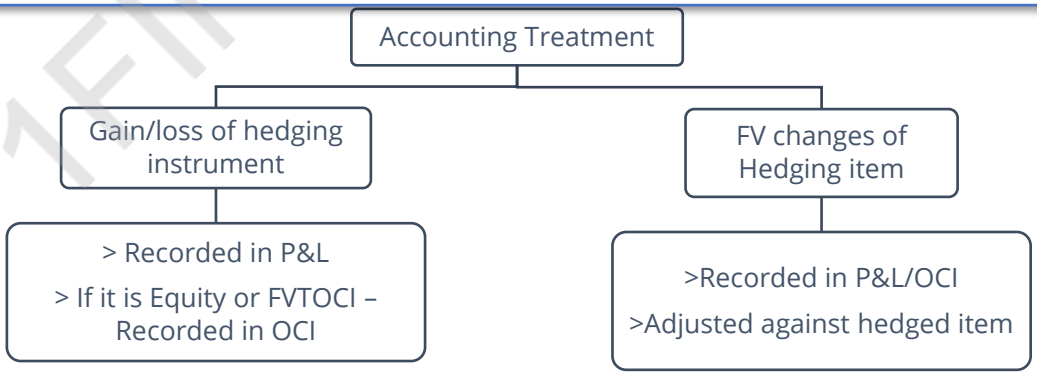
14.2 Conditions for Hedge Accounting

Hedged items & instrument	Eligible Hedged item & Hedging instrument should exist
Proper formal documentation at inception	Risk Management policy with purpose and details
	Hedge item?
	Hedging Instrument?
	Hedge effectiveness?
	Measurement of effectiveness & ineffectiveness
	Hedge ratio?
	Risk management?
Meet Hedge effectiveness requirement	Economic relationship between item & instrument
	Credit risk should not dominate the changes in value of relationship
	Hedge Ratio = Hedging Instrument / hedged Item

14.3 Hedging Accounting

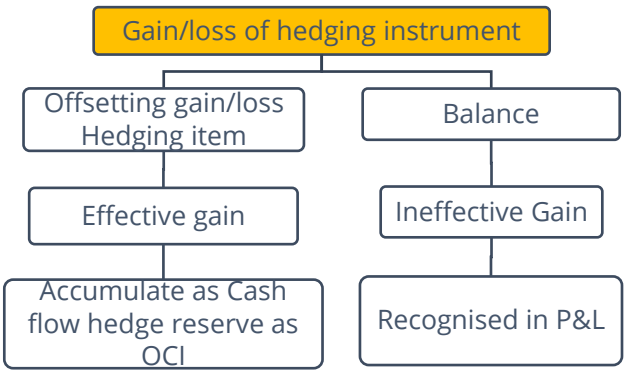


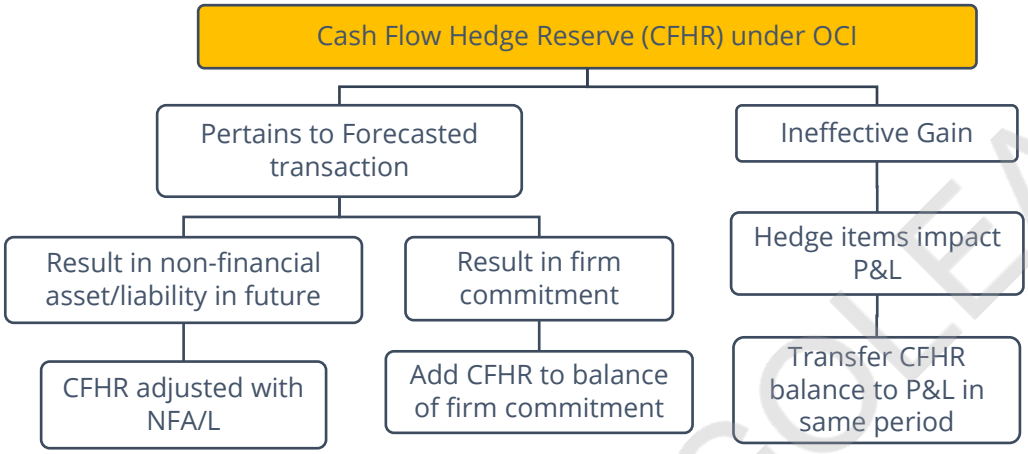
A Fair value Hedge is a hedge of the exposure changes in fair value of a recognized asset/liability or a unrecognized firm commitment or component of any such item that is attributable to a particular risk and could affect profit or loss



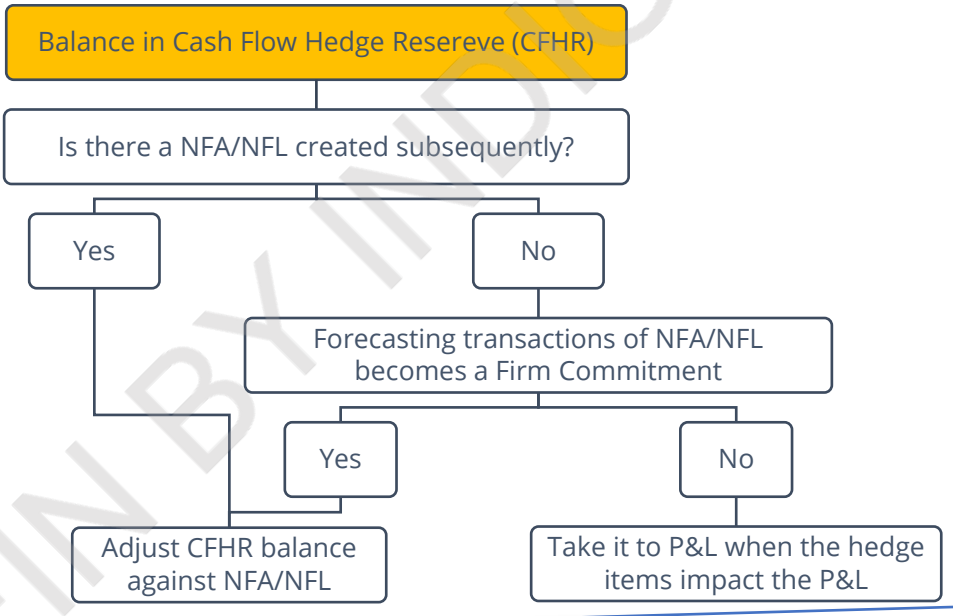
A Cash Flow Hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with on or a component of recognized asset/liability or a highly probable forecast transaction and could affect the PL.

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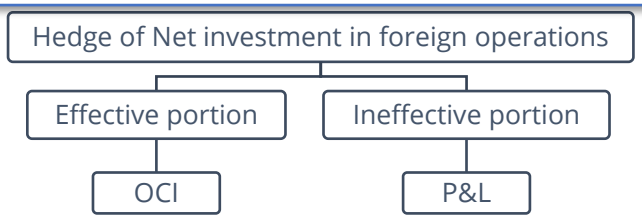




Note: Loss, which cannot be recovered should be reclassified to P&L



A Hedge of Net investment in foreign operations, including a hedge of a monetary item that is accounted for as part of the net investment, shall be accounted for similarly to cash flow hedges

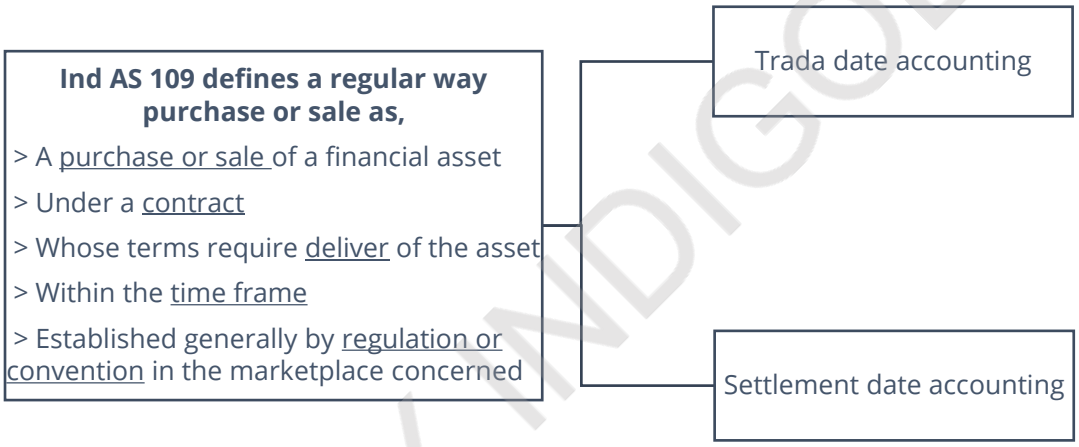


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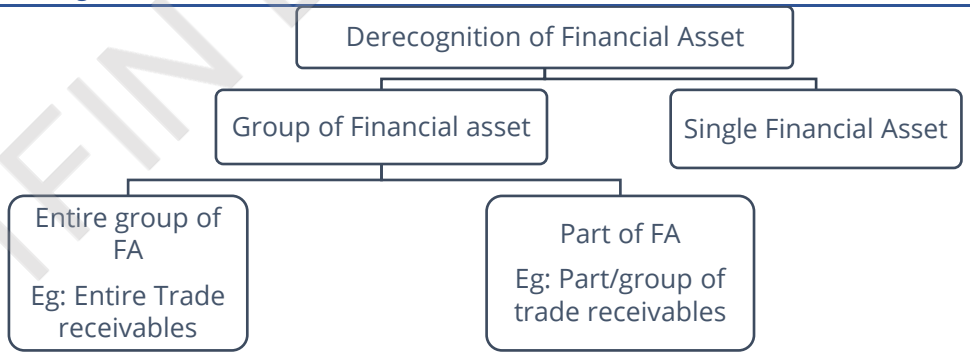
15 Recognition of Financial Instrument

Entity has to recognise a financial asset or a financial liability in its balance sheet when, and only when, the entity becomes party to the contractual provisions of the instrument.
Eg: Trade receivable recognised on sales happened (after delivery of goods), instead of sale agreement.
Examples for applying recognition principle

Nature of contract	Recognition Principle
Receivables and payables	When entity becomes party to contract & has legal right to receive /legal obligation to pay cash
Firm commitment to purchase/ sell goods or service	When at least one of the parties has performed under the agreement i.e., ordered goods or services have been shipped/delivered/rendered
Firm commitment to purchase/ sell goods or services designated as measured at fair value through P&L	Net fair value recognised as asset or liability @ commitment date
Forward & Future contracts	On commitment date, No recognition
Option contract	Holder/ Writer becomes party to contract. As premium/ amount will be paid upfront



16 De-recognition of Financial Asset



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16.1 Condition for partial De-recognition

The part comprises of specifically identified cash flows from a financial asset

1. Investment in Bonds

Interest payment	Principal payment

Both are specifically identified cash flows

2. Receivables of Rs.1 lakh from customer cannot specifically identify a part from the Financial asset

The part comprises of a fully proportionate (pro rata) share of the cash flows from a Financial asset

Trade receivables

Transfer 50% of cash flow

If Rs.10,000 Customer pays – Rs.5,000 to another

Another party

The part comprises pro rata share of specifically identified cash flows from a financial asset

Investment in Bonds

Interest payment	Principal payment

For eg: 50% of Interest or 50% of Principal transfer to another party

Any of the above 3 conditions are satisfied

- Yes → Apply the derecognition principles for a part of the financial asset or for a part of group of financial assets
- No → Need to apply the principles of derecognition to the Financial asset

Note:

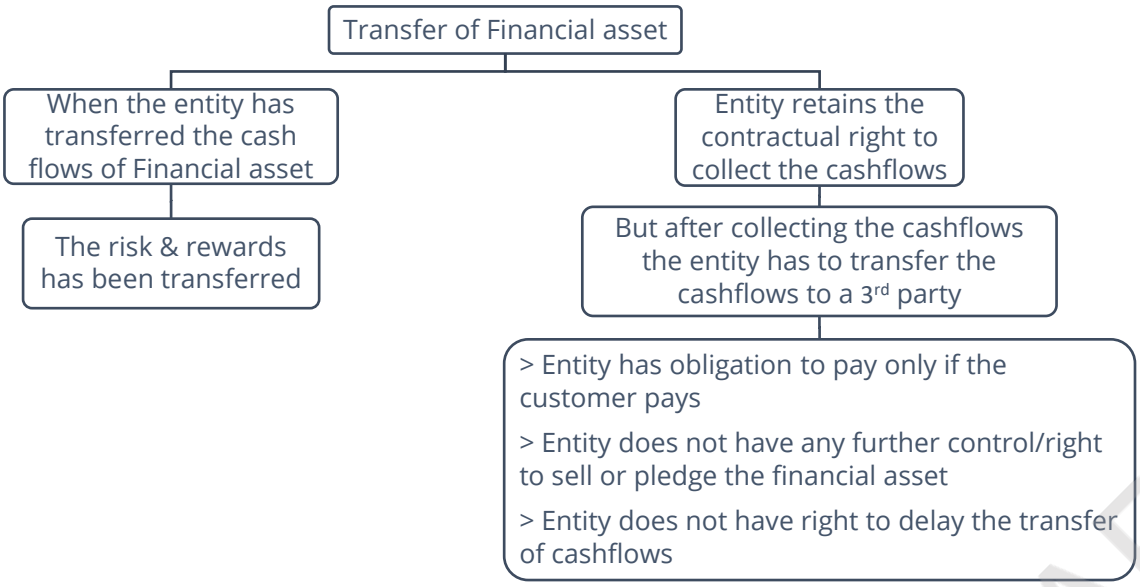
- If any Financial asset (For eg: Trade receivable) agreed to transfer first some percentage (eg:60%) of the cashflows to another party, then it is not a pro rata share of cash flow. So, need to apply principles of derecognition to the Financial asset.
- Financial asset can be transferred to multiple parties, but pro rata share should be transferred & pro rata share should be received
  (For eg: Trade receivable - agreed to transfer 20% to one party, 30% to another party & 50% retained on every cashflow received)

16.2 Specific derecognition principles

2 Conditions

- When cashflow from financial asset expire
  - > Debtors pays the money
  - > Debtors goes bankrupt and will not receive the money
  - > Investment in bond - Tenure is over the got back the money
- Transfer the financial asset/part of the financial asset and transfer meets the derecognition criteria
  - > Sold the debtor
  - > Sold the investment in bond
  - > Sold the Equity shares
  - > And specific conditions have met

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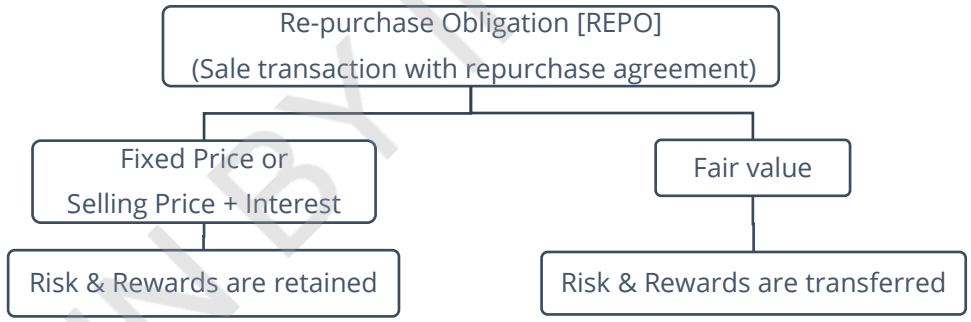
Additional conditions to be checked for transfer of financial asset

Whether substantially risk & rewards(If there is unconditional sale of financial asset) has been transferred

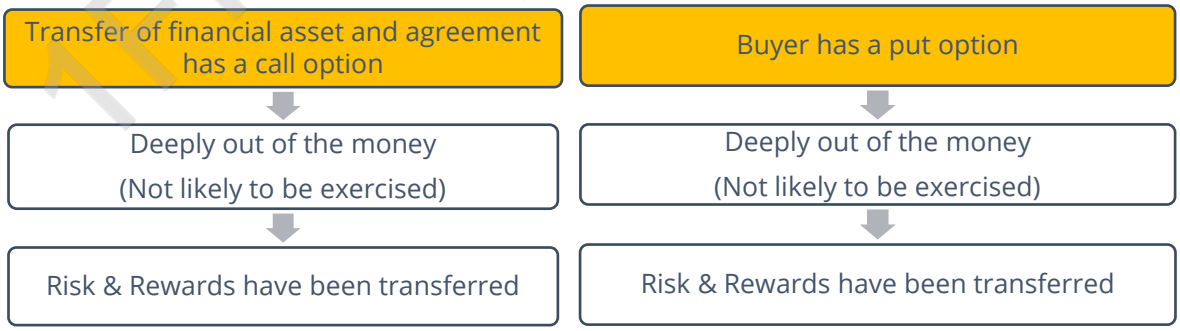
- Eg: Entity sold the cashflows from customer to 3rd party factor,
- If the customer does not pay -> Entity has to pay. Financial asset has not been transferred.



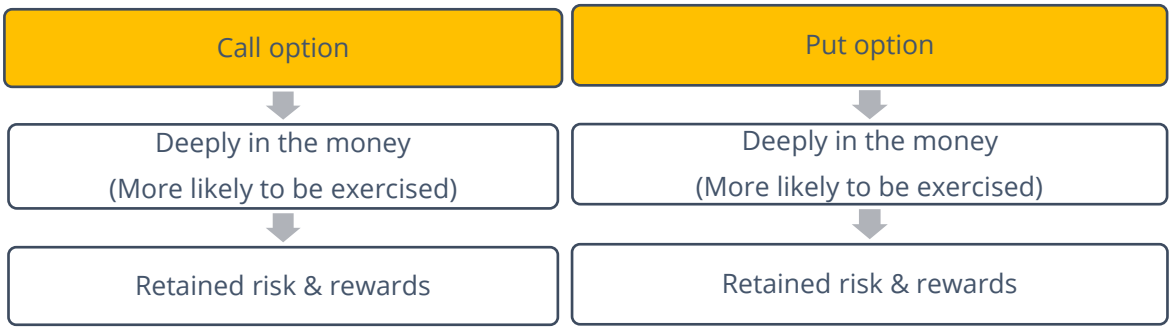
16.3 Sale transaction with repurchase agreement



16.4 Transfer with Options, SLB arrangements & Bills receivable

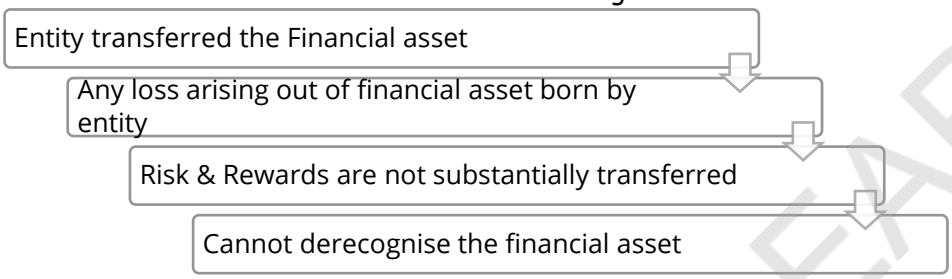


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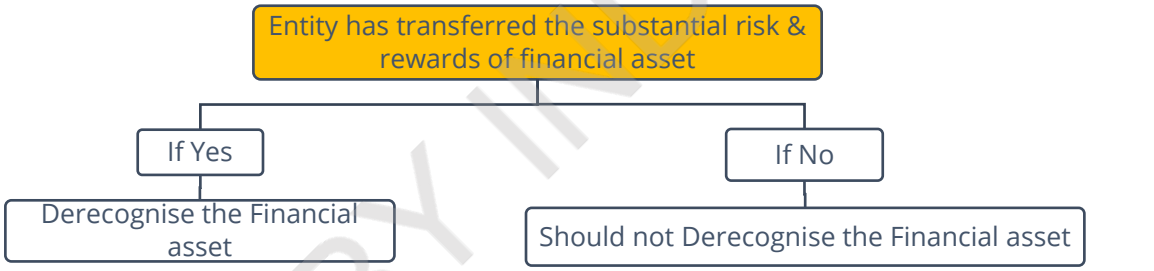


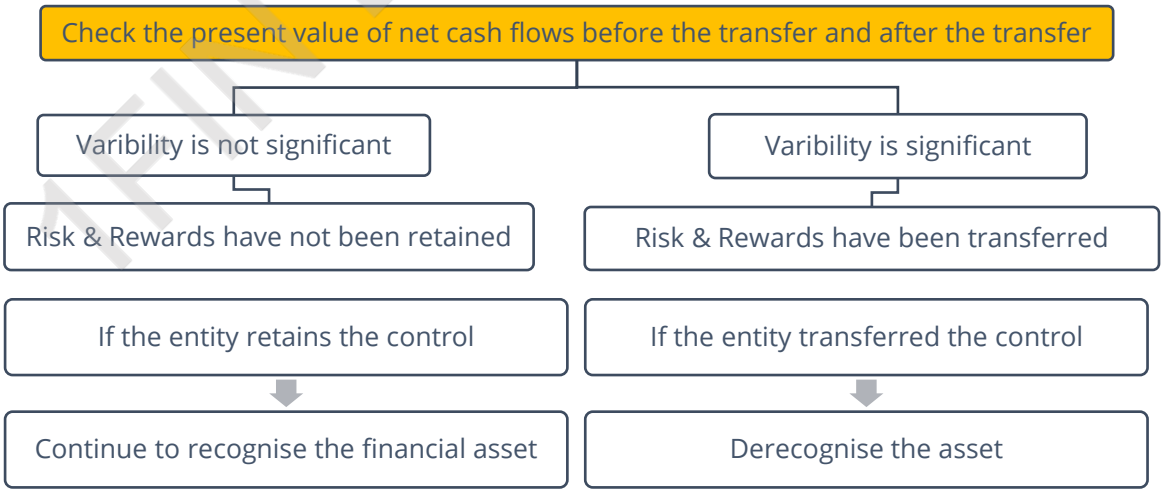
Note:

- ➔ Securities lending and borrowing arrangement: Not transferred the risk & rewards
- ➔ Bills receivable discounted with the bank – cannot derecognize the bills receivable



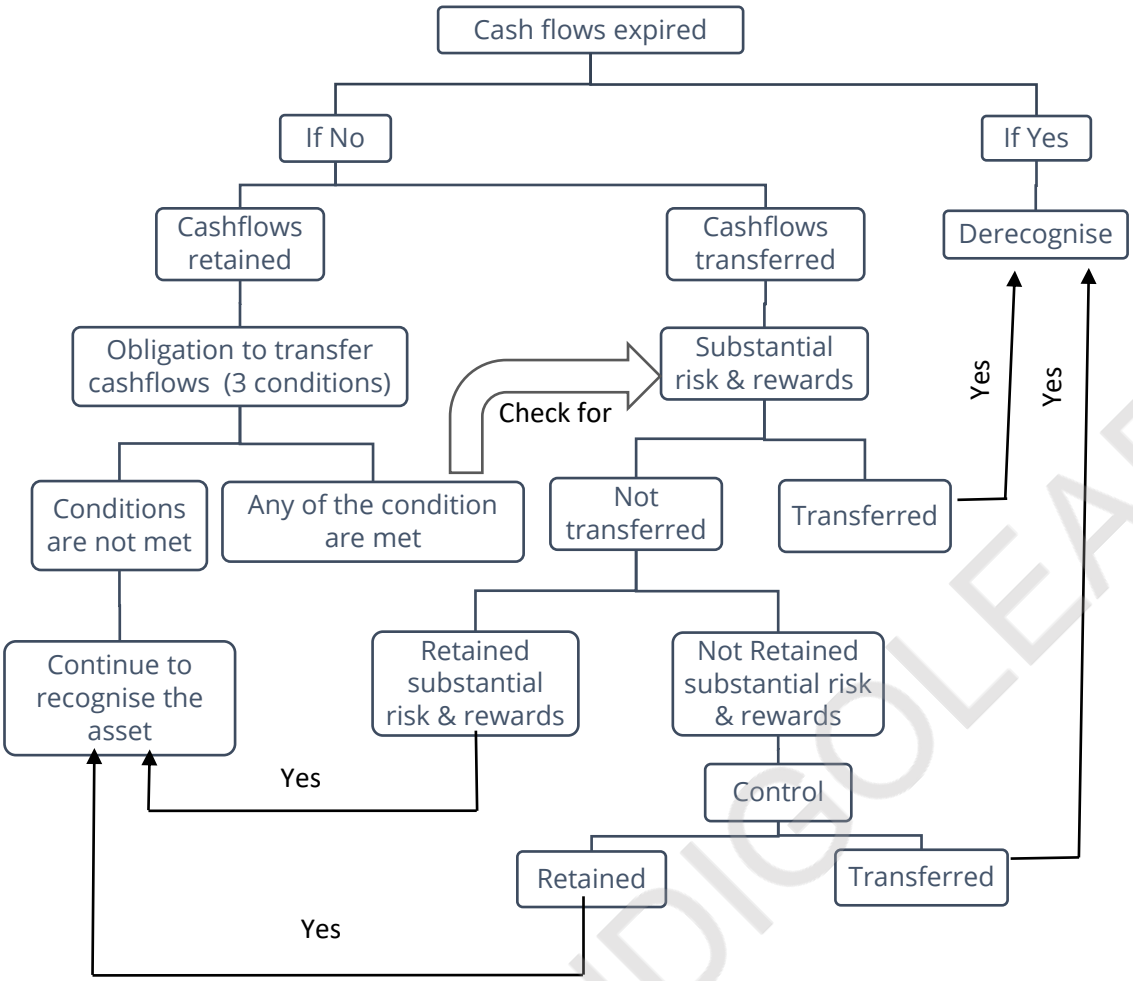
Bills receivable discounted with the bank
Amount received from the bank at the time of discoutng -> Create a Liability
Continue to recognise the bills receivable
On the due date if drawee pays to the bank -> Derecognise the Bills receivable

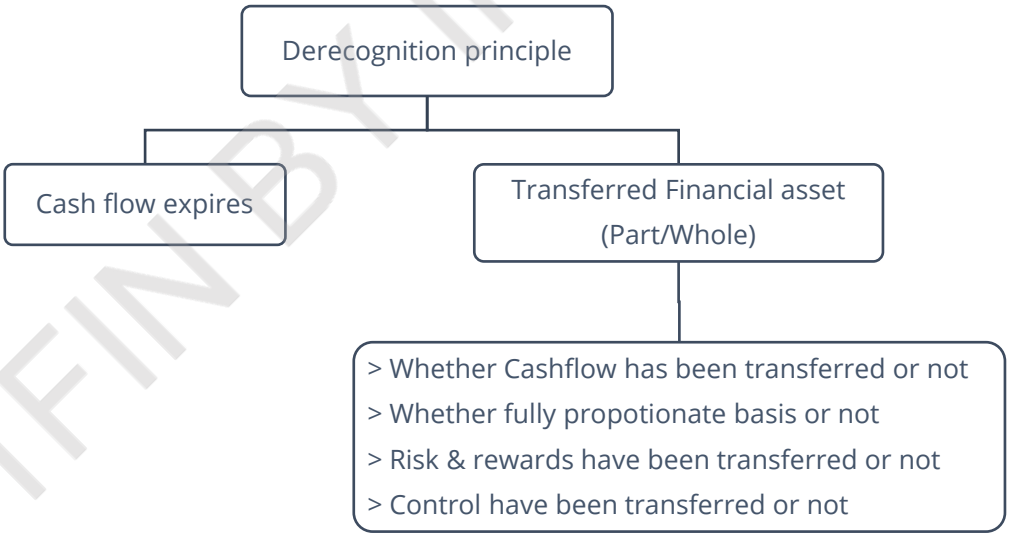




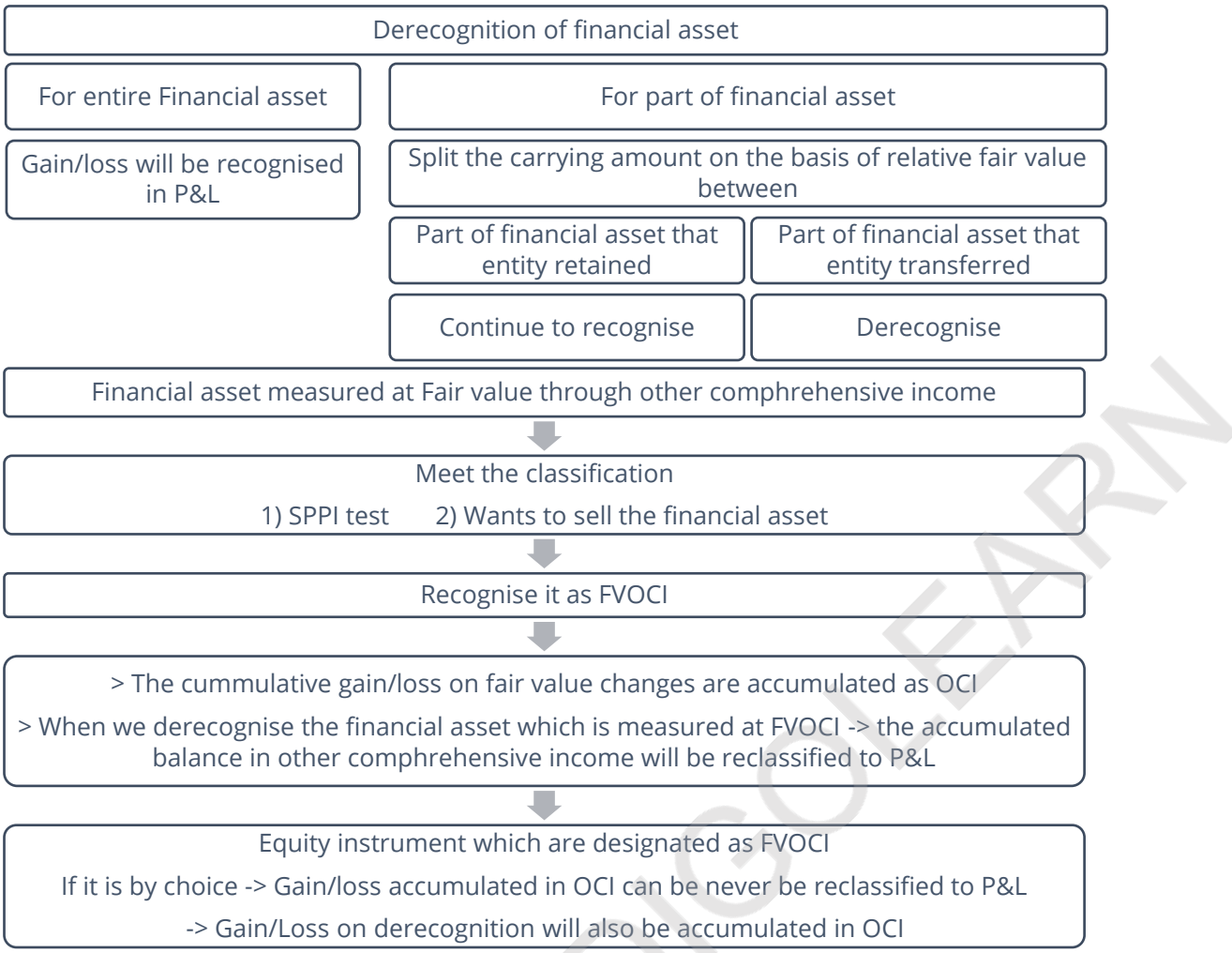
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16.5 Summary





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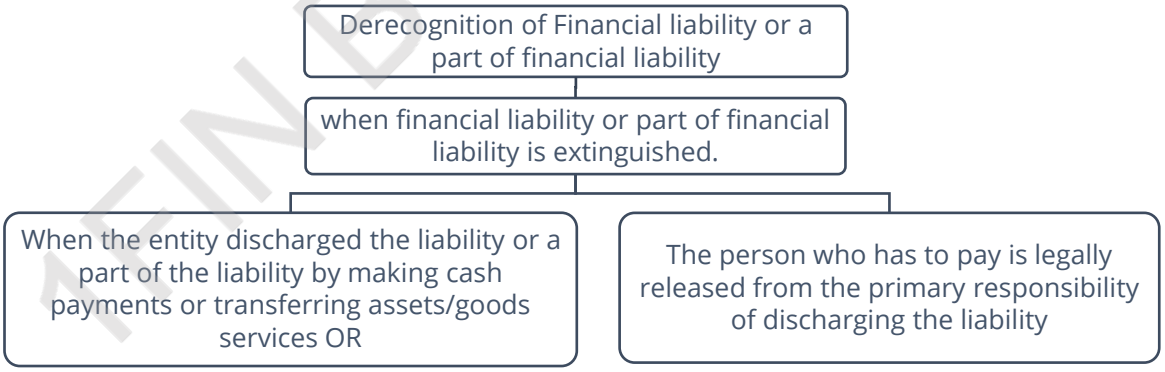


Continuous involvement in the financial asset: Entity involved in the financial asset even after transfer of financial asset.

17 De-recognition of Financial Liability

17.1 Derecognition of FL

Derecognition of Financial liability or a part of financial liability -> only when financial liability or part of financial liability is extinguished.

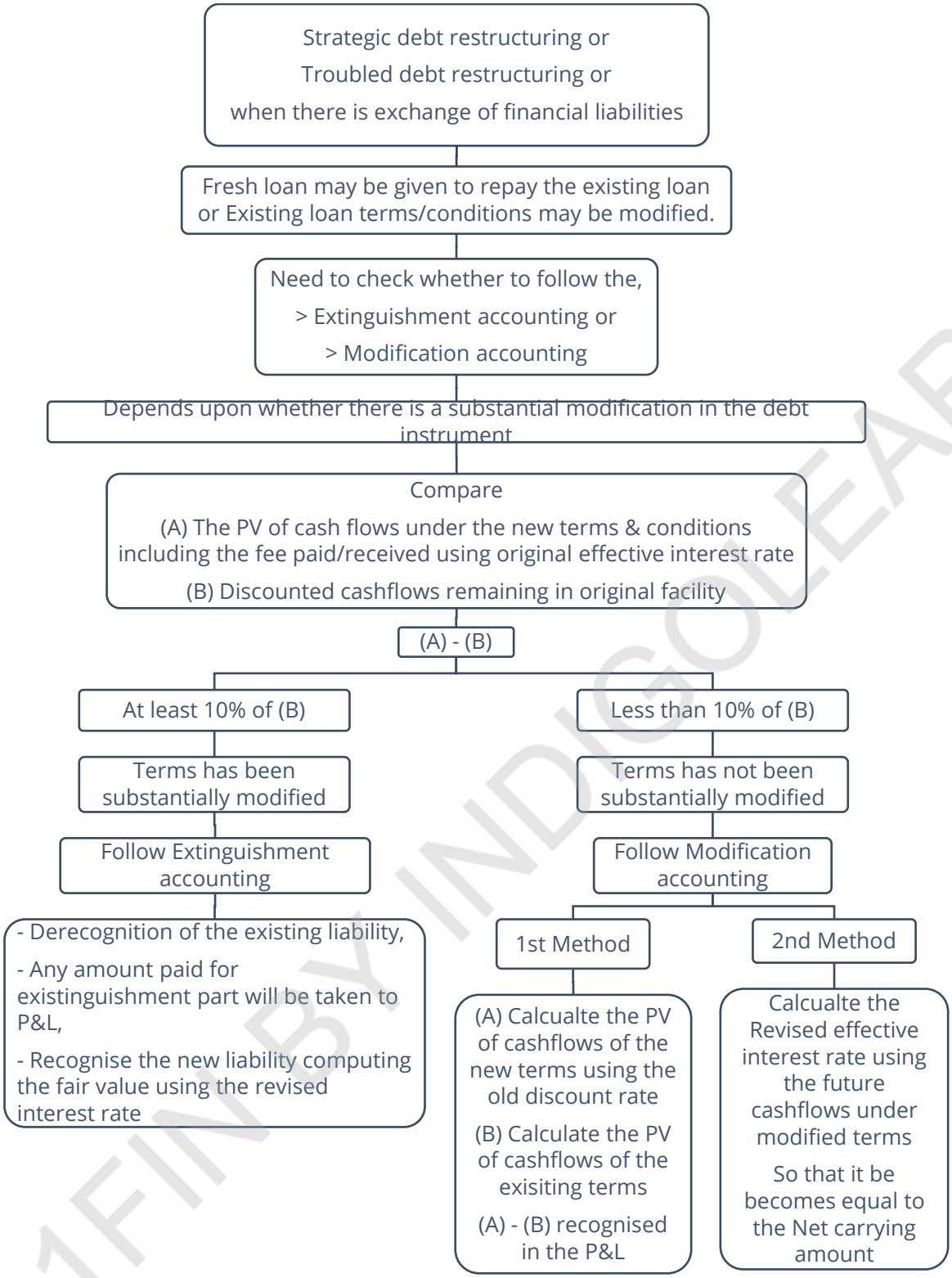


Eg:

- Advance received from customers (Financial liability) → Extinguished when customer is provided with goods or services
- Entity A has to receive Rs.1000 from Entity B & Entity B taken over by Entity C. Then Entity C is responsible for making payment to Entity A. Now Entity released from the primary responsibility of discharging the liability

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17.2 Modification of cashflows (Debt restructuring)



Transaction cost

- is adjusted from the carrying amount of FL if there is no substantial modification.
- Is transferred to P&L if there is substantial modification

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17.3 Conversion of debt to equity (Debt for Equity swap)

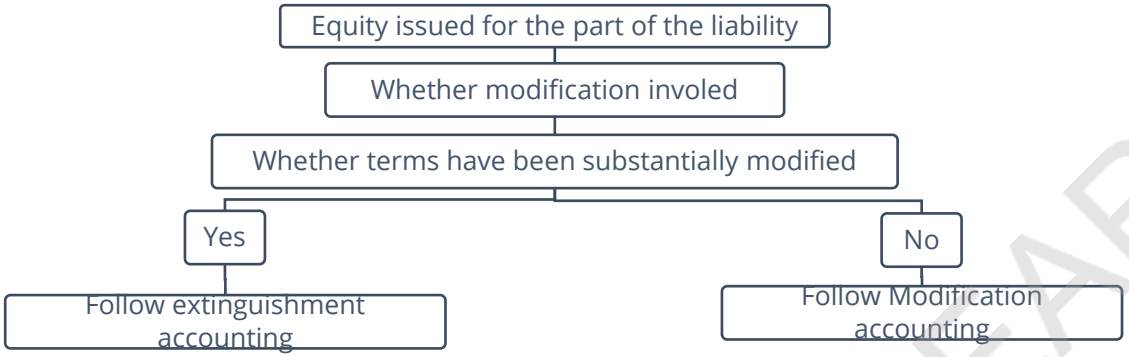
Financial liability will be derecognised only when derecognition principles are met

↓

Equity instrument which is issued is measured at the fair value. If FV of Equity cannot be measured reliably, then consider FV of liability which is being exchanged.

↓

Difference between carrying amount of liability and consideration received is recognised in P&L.



Accounting for debt for equity swap is not applicable in 3 situation

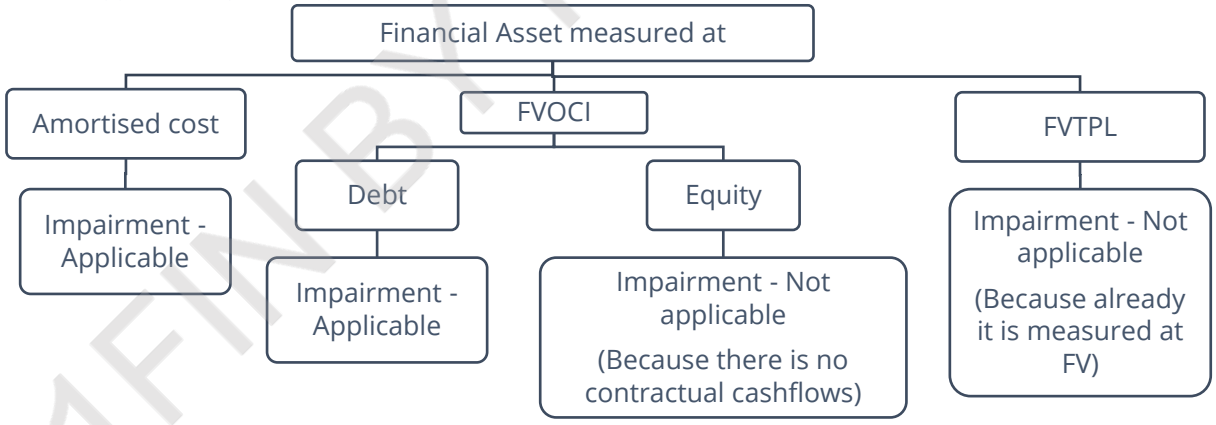
1) Where the creditor is acting in capacity of a shareholder

2) Where the borrower and lender are controlled by the same entity before and after modification. The substance of the transaction either to issue equity or take back the equity

3) Where equity is been issued as a part of the original agreement.

18 Impairment of Financial Asset

18.1 Applicability of Impairment



Note:

Impairment applicable to the following, if it is Financial asset

- Lease receivables
- Trade receivables
- Contract assets
- Financial guarantee / Loan commitment

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18.2 Expected Credit loss

Contractual cashflows (A):
Payment of Principle &
Payment of interest

Expected Cashflows (B):
Expected payment/
Collection from selling of assets/
Collection from invoking the guarantee

Difference between (A) and (B) discounted to its PV is called the **Expected credit loss**

Discounting rate --> Effective interest rate
Exception: If there are purchased or originated credit impaired assets --> Discounted at credit adjusted discount rate

Expected credit loss

12 months Expected credit loss
Expected credit loss over the next 12 months period

Life time Expected credit loss
Expected credit loss over the entire life time of financial asset
Higher when compare to 12 months Expected Credit loss

Note: Entity has to make provisions for Expected Credit loss either of the above based on the condition of the financial asset.

Criteria to decide the stage of the financial asset:

1) Credit risk of the financial asset
2) How are the financial assets priced in the market?
3) Pricing of credit default swaps

Depending on the stage that the financial asset falls → calculate the Expected Credit loss

Simplified Approach

For trade receivables, lease receivables and contract assets

Compute the Expected life time Credit losses

Approach for purchase or originated credit impaired assets

Compute the effective interest rate considering the FV on the date of transaction and expected cashflow

IF the Expected cashflows deteriorate provide for impairment

3 Stage Model (General approach)

Stage 1	Stage 2	Stage 3
Financial asset where there has not been any significant increase in the credit risk	There is significant increase in the credit risk, but there is no credit impairment which is visible	There is significant increase in the credit risk and there is clear evidence of credit impairment
Provide for 12 months Expected credit loss & recognise income on the gross carrying amount of the financial asset	Provide for life time Expected credit loss & recognise income on the gross carrying amount of the financial asset	Provide for life time Expected credit loss & recognise income on the net carrying amount of the financial asset

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When can an entity consider that the credit risk has increased significantly?

If the payment is not received for the period for 30 days after due date
--> Presume that the credit risk has increased significantly

Above presumption can be rebutted if the entity can demonstrate that this credit risk has not increased significantly

Whether the asset is credit impairment

>> Significant financial difficulty
>> Breach of contract
>> Borrower has received concession from other lenders
>>Probability of the borrower that they will file for bankruptcy
>> Disappearance of an active market for the financial asset because of financial difficulty
>> Borrower has issued further bonds at deep discounted prices

Whenever measuring Expected credit loss

Calculate various loss case scenarios

Assign probability

Accordingly determine the expected credit loss

Note:

- Whenever entity is looking at different outcomes it should not spend undue amount of efforts, time and cost to determine the ultimate outcome.
- An entity may use practical experience in case of calculation of expected credit losses
- Simplified approach will not be applied when the trade receivables has a significant financing component
- Even if the trade receivable, lease receivables or contract assets have significant financial component but as a matter of accounting policy, entity decides to provide for life time expected loss

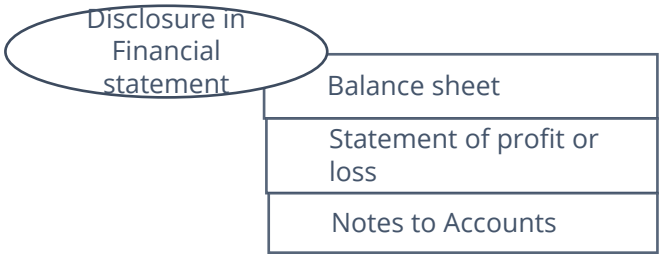
19 Reclassification of Financial Instrument

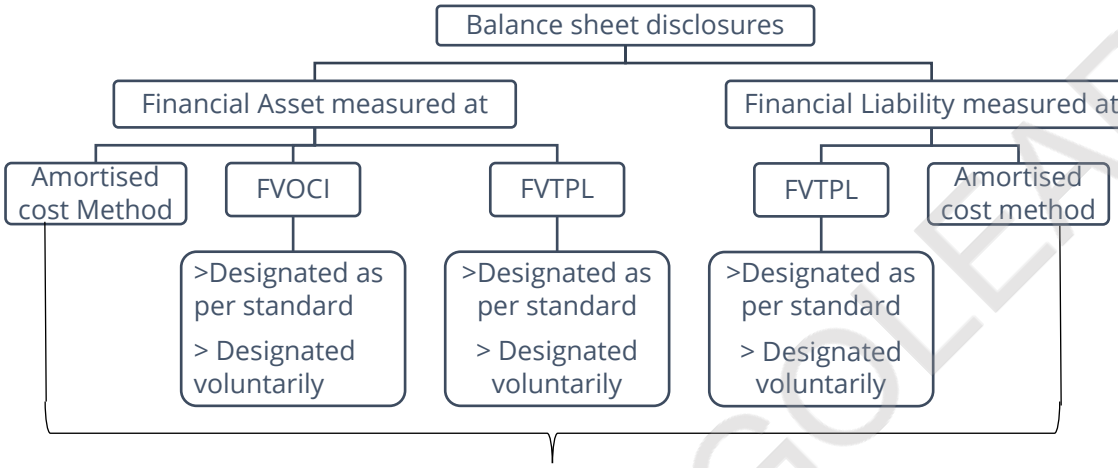
Financial liabilities cannot be reclassified

Financial assets can be reclassified
only if there is a change in the business model

	From ACM	From FVTOCI	From FVTPL
To ACM	-	Transfer @ Fair Value (+/-) Adjust Accumulated balance in OCI	Transfer @ Fair Value New EIR has to calculate
To FVTOCI	Transfer @ Fair Value Difference recognized in OCI	-	Transfer @ Fair Value New EIR has to calculate
To FVTPL	Transfer @ Fair Value Difference recognized in P&L	Transfer @ Fair Value Transfer Accumulated balance in OCI to P&L	-

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Separate disclosure for each

Financial asset could have been Amortised cost/ FVTPL Entity opted to designated as FVTPL Additional disclosure:	Financial liability designated as FVTPL Separate Disclosure:	Investment in Equity instruments designated as FVTOCI Additional Disclosures:
•Credit Risk Exposure • Derivatives entered into?	•Changes in FV •Changes attributable to Credit risk •Amount recognised at derecognition	•Instruments designated as FVTOCI •Reason for designated so •FV of such investment at end of reporting period •Dividend recognised during the period •Gain/loss reclassified within equity

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Reclassification Disclosure

For each reclassification of Financial asset, an entity shall disclose:

a) the date of reclassification

b) a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statement

c) the amount reclassified into and out of each category

Financial Asset reclassified from FVTPL to FVTOCI/Amortised cost:

a) the effective interest rate determined on the date of reclassification and

b) the interest revenue recognised

Financial Asset reclassified from FVTPL to FVTOCI/Amortised cost & from FVOCI to Amortised cost:

a) FV of FA at end of reporting period: &

b) FV gain or loss that would have been recognised in P&L or OCI if not for reclassification

Offsetting Financial Asset & Financial Liability

Additional Disclosure

Provide effect or potential effect of netting arrangements on the entity's financial position:

a) gross amount of those recognised FA & FL:

b) amount set-off as per Ind AS 32

c) net amount presented in the balance sheet

Financial Asset given as security - Collateral

Disclosure

a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with Ind AS 109; and

b) the terms and conditions relating to its pledge

Allowance for credit losses of FA which are FVTOCI → Not reduced from balance of FA → Seperate disclosure

Defaults & Breaches

Disclosure for loan & payables at the end of the year:

a) details of any defaults during the period of principal, interest, sinking fund or redemption terms of those loan payable:

b) Carrying amount of the loans payable in default at the end of the reporting period;

c) Whether the defaults was remedied, or the terms of the loans payable were renegotiated, before the financial statements were approved for issue.

Defaults during the period - Disclosure required

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Other disclosure

Hedge accounting:

> Entity's risk management strategy for each category - what & how its applied:

> Effect on future cashflows - amount, timing & uncertainity

> Effect that hedge accounting has had on the entity's balance sheet, statement of profit and loss and statement of change in equity

Accounting policies

Disclosure - Statement of Profit & loss

Income, Expense, gains or losses

An entity shall disclose the following items of income, expense, gains or losses either in the statement of profit and loss or the notes:

a) Net gain or net losses

b) total interest revenue and total interest expense (calculated using the Effective interest method) for

i. FA @ amortised cost

ii. FA @ FVTOCI

iii. FL @ FVTPL

c) Fee income and expense (other than amounts included in determining the EIR)

Separate Disclosure:

i) FA& FL@ FVTPL (FA/FL designated as FVTPL need separate disclosure for which is mandatory designation as per Ind AS 109 and Voluntary designation)

ii) Financial liabilities measured a amortised cost

iii) Financial assets measured a amortised cost

iv) investment in equity instruments designated at FVOCI

v) FA measured at FVTOCI

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Fair Value

> For each class of financial assets and financial liabilities

> an entity shall disclose the fair value of that class of assets and liabilities

> in a way that permits it to be compared with its carrying amount

Offset them only to the extent that their carrying amount are offset in the balance sheet

Disclosure of fair value are not required:

> When the carrying amount is a reasonable approxiamation of fair value,

> For a contract containing a discretionary participation feature (as described in Ind AS 104) if the fair value of that feature cannot be measured realibly; or

> for lease liabilities

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Disclosure

Risk arising from Financial Instrument

An entity shall disclose:

> information that enables users of its financial statements

> to evaluate the nature and extent of risks arising from financial instruments

> to which th entity is exposed

> at end of the reporting period

Qualitative disclosure (for each type of risk)

a) the exposure to risk and how they arise;

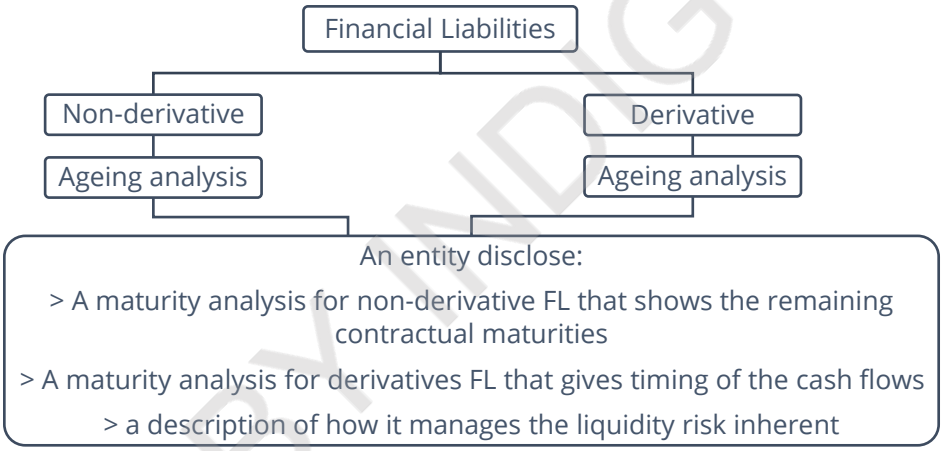
b) its objectives, policies and process for managing the risk and the methods used to measure the risks; and

c) any changes in (a) or (b) from the previous period

Quantitative disclosure (for each type of risk)

a) summary quantitative data generated about its exposure at the end of the reporting period.

b) Credit Risk, Liquidity Risk & Market Risk



Market Risk

a) sentivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;

b) the method and assumptions used in preparing the sensitivity anlysis; and

c) changes from the previous period in the methods nad assumptions used, and the reasons for such changes

.

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1. Illustration

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.

Amount repayable at end of 6th Year = 10,00,000 x 1.12 x 1.12 =12,54,400
FV = PV (at beginning of 5th year) x (1+r)^n
= 10,00,000 x (1.12)^2
Amount demanded for one time settlement = 13,00,000
Additional amount = 45,600

Financial Assets, Financial Liabilities & Equity

1. Illustration

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.

Answer

The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest 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.

2. Illustration

Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer. Analyse the nature of cash flows.

3. Illustration

a. 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

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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.

b. 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.

c. 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.

d. 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.

e. 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.

f. 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.

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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.

4. Illustration

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 Rs. 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.

5. Illustration

Containers Ltd provides containers for use by customers for multiple purposes. The containers are returnable at the end of the service contract period (3 years) between Containers Ltd and its customers. In addition to the monthly charge, there is a security deposit that each customer makes with Containers Ltd for Rs. 10,000 per container and such deposit is refundable when the service contract terminates. Deposits do not carry any interest. Analyse the fair value upon initial recognition in books of customers leasing containers. Market rate of interest for 3 year loan is 7% per annum

6. Illustration

Loan amount – Rs. 10,00,000
Tenure of Loan – 5 years
Rate on loan – 5%
Market rate – 8 %
Upfront fee paid by the borrower – Rs. 1,20,000

Prepare interest amortisation schedule.

7. Illustration

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A Ltd has made a security deposit for lease 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.

Date of Security Deposit (Starting Date)	1-Apr-20X1
Date of Security Deposit (Finishing Date)	31-Mar-20X6
Total Lease Period	5 years
Discount rate	12.00%
Security deposit (A)	10,00,000

Present value factor at the 5th year 0.567427

8. Illustration FVTOCI & ACM

Investment in Debentures – Rs. 1,00,000
Transaction cost – Rs. 2,000
ROI on debentures – 10%
Tenure – 3 years
Effective Interest rate – 9.207%

Pass journal entries.

9. Illustration

An entity acquires a financial asset for CU 100 plus a purchase commission of CU 2. Initially, the entity recognises the asset at CU 102. The reporting period ends one day later, when the quoted market price of the asset is CU 100. If the asset were sold, a commission of CU 3 would be paid. How would transaction costs be accounted in books of the entity?

Initial recognition

Financial Asset Dr.	102	
To Bank.		102

At year end

OCI Dr.	2	
To Financial Asset		2.

10. Illustration

Metallics Ltd. has made an investment in equity instrument of a company – Castor Ltd. for 19% equity stake. Significant influence not exercised. The investment was made for Rs. 5,00,000 for 10,000 equity shares on 01 April 20X1. On 30 June 20X1 the fair value per equity share is Rs. 45. The Company has taken an irrevocable option to measure such investment at fair value through other comprehensive income

11. Illustration

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.

Amount lent – Rs. 1,00,000

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Market rate of Interest is 10%
Rate of interest under the loan – 5%

FV of Loan = Rs. 80,000
FV of Investment in Equity of C = Rs. 20,000

In the books of Company C
Financial Liability – Rs. 80,000
Equity – Rs. 20,000

12. Illustration

Silver Ltd. has made an investment in optionally convertible preference shares (OCPS) of a Company – Bronze Ltd. at Rs. 100 per share (face value Rs. 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.

13. Illustration

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.

14. Illustration

A Ltd has made a borrowing from RBC Bank for Rs. 10,000 at a fixed interest of 10% per annum. Loan processing fees were additionally paid for Rs. 500 and loan is payable after 5 years in bullet repayment of principal.

Details are as follows:

Loan amount	Rs. 10,000
Date of loan (Starting Date)	1-Apr-20X1
Date of repayment	31-March-20X6
Interest rate	10.00%
Interest to be charged and paid yearly	
Upfront fees	Rs. 500

How would loan be accounted in books of A Ltd?

15. Illustration

A Ltd has made a borrowing from RBC Bank for Rs. 10,000 at a fixed interest of 12% per annum. Loan processing fees were additionally paid for Rs. 500 and loan is payable 4 half-yearly instalments of Rs. 2,500 each.

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Details are as follows:

Loan amount	Rs. 10,000
Date of loan (Starting Date)	1-Apr-20X1
Date of loan (Finishing Date)	31-March-20X3

Repayment of loan starts from 30-Sept-20X1 (To be paid half yearly)

Instalment amount	Rs. 2,500
Interest rate	12.00%

Interest to be charged quarterly

Upfront fees	Rs. 500

How would loan be accounted in books of A Ltd?

Consider IRR is 16.60% p.a.

16. Illustration

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.

17. Illustration

A Ltd. issued compulsorily convertible preference shares (CCPS) at Rs. 100 each (Rs. 10 face value + Rs. 90 premium per share) for Rs. 10,00,000. These are convertible into equity shares at the end of 10 years, where the number of equity shares to be issued shall be determined based on fair value per equity share to be determined at the time of conversion.

Evaluate if this is financial liability or equity? What if the conversion ratio was fixed at the time of issue of such preference shares?

18. Illustration

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 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.

Dr. Equity 2 Crores (assumed PV)
Cr. FL 2 Crores

19. Illustration

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 Rs. 1,000. Parent P receives a payment of Rs. 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.

1000/(1.12)^2 = 797.19 = PV of Liability [Recognise liability]

Correspondingly – 797 will be recognised under equity.

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20. Illustration

CBA Ltd. issues convertible debentures to RQP Ltd. for a subscription amount of Rs. 100 crores. Those debentures are convertible after 5 years into equity shares of CBA Ltd. using a pre- determined formula.
The formula is:
100 crores X (1 +10%)^5 divided by Fair value on date of conversion

Examine the nature of the financial instrument.

21. Illustration

DF Ltd. issues convertible debentures to JL Ltd. for a subscription amount of Rs. 100 crores. Those debentures are convertible after 5 years into 15 crore equity shares of Rs. 10 each.
Examine the nature of the financial instrument.

22. Illustration

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 Rs. 50 per share at any time during a period of 3 months. Holder paid an initial premium of Rs. 2 per option. Examine whether the financial instrument will be classified as equity.

23. Illustration

WC Ltd. writes an option in favour of GT Ltd. wherein the holder can purchase issuer's equity instruments at prices that fluctuate in response to the share price of issuer.
As per the terms, if the share price of issuer is less than Rs. 50 per share, option can be exercised at Rs. 40 per share. If the share price is equal to or more than Rs. 50 per share, option can be exercised at Rs. 60 per share. Explain the nature of the financial instrument.

24. Illustration

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.

25. Illustration

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.

26. Illustration

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.

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27. Illustration

On 1 January 20X1, PG Ltd. subscribes to convertible preference shares of BG Ltd. at Rs. 100 per preference share. The preference shares are convertible in the ratio of 10:1 i.e. 10 equity shares for each preference share held. On a fully diluted basis, PG Ltd. is entitled to 30% stake in BG Ltd. If subsequent to the issuance of these convertible preference shares, BG Ltd. issues any equity instruments at a price lower than Rs. 10 per share, conversion ratio will be changed to compensate PG Ltd. for dilution in its stake below the expected dilution at a price of Rs. 10 per share. Examine the nature of the financial instrument.

28. Illustration

On 1 January 20X1, NG Ltd. subscribes to convertible preference shares of AG Ltd. at Rs. 100 per preference share. On a fully diluted basis, NG Ltd. is entitled to 30% stake in AG Ltd.
The preference shares are convertible at fair value, subject to, NG Ltd.'s stake not going below 15% and not going above 40%. Examine the nature of the financial instrument.

29. Illustration

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 a prospectus filing 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.

30. Illustration

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

31. Illustration

Optionally Convertible Debentures – Rs. 20,00,000
Coupon – 6%
Tenure – 3 Years
Rate without conversion option – 9%
Conversion option – 1,000 shares
Compute the amount of Financial Liability and Equity

32. Illustration

Optionally Convertible Debentures – Rs. 20,00,000

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Coupon – 6%
Tenure – 3 Years
Rate without conversion option – 9%
Transaction cost incurred. -Rs. 1,00,000
Conversion option – 1,000 shares
Compute the amount of Financial Liability and Equity

33. Illustration

D Ltd. issues preference shares to G Ltd. for a consideration of Rs. 10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime up to a period of 3 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 3 years. The preference shares carry a coupon of RBI base rate plus 1% p.a. 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.

34. Illustration

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 after conversion	10	
Effective interest rate		15.86%

35. Illustration

K ltd. issued 500,000, 6% convertible debentures @ Rs. 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

36. Illustration

On 1 April 20X1, an 8% convertible loan with a nominal value of Rs. 6,00,000 was issued at par. It is redeemable on 31 March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each Rs. 200 worth of loan.

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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	@ 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?

37. Illustration

X Ltd. issues Rs. 1.5 crore convertible bonds on 1st April, 2018. The bonds have a life of 8 years and a face value of Rs. 10 each and offer interest @ 5.5% p.a. payable at the end of each financial year.

Bonds are issued at their face value and each bond can be converted into one ordinary share of X Ltd. at any time in the next eight years.

Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 7% p.a.

You are required to:
(i) Provide the journal entries from financial year 2018-2019 to financial year 2021-2022;
(ii) Calculate the interest expenses across all eight years of the life of the convertible bonds;
(iii) Give the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the fourth year (after receiving interest for the fourth year).

(14 Marks)

Financial Assets, Financial Liabilities & Equity

1. Illustration

Entity PQR borrows Rs. 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

2. Illustration

Company A, an Indian company whose functional currency is Rs. enters into a contract to purchase machinery from an unrelated local supplier, company B. The functional currency of company B is also Rs. . 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.

Contract/order date	9 September 20X1
Delivery/payment date	31 December 20X1

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Purchase price	USD 1,000,000	
USD/Rs. Forward rate on 9 September 20X1 for 31 December 20X1 maturity	67.8	
USD/Rs. Spot rate on 9 September 20X1	66.4	
USD/Rs. 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.

3. Illustration

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 froma 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 Rs. 30,000 per MTto 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 theoil 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 invalue. The remaining contractsare 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 Ind AS 109 or are executory contracts outside the scope of Ind AS 109.

Recognition & Derecognition of Financial Instruments

1. Illustration

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Entity A makes a five-year interest-bearing loan (the 'original asset') of Rs. 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 Rs. 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 derecognised.

2. Illustration

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.

3. Illustration

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 if 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.

4. Illustration

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.

5. Illustration

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 Rs. 91.5 crores, less a servicing charge of Rs. 1.5 crores (net proceeds of Rs. 90 crores), in exchange for 100% of the cash flows from short-term receivables.
The receivables have a face value of Rs. 100 crores and carrying amount of Rs. 95 crores.

The customers will be instructed to pay the amounts owed into a bank account of the factoring company. Entity C also writes a guarantee to the factoring company under which it will reimburse any credit losses up to Rs. 5 crores, over and above the expected credit losses of Rs. 5 crores. The guarantee is estimated to have a fair value of Rs. 0.5 crores. Calculate the amount of continuing involvement asset.

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6. Illustration

On 1 January 20X0, XYZ 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 therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ 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.

XYZ Ltd. determines that the market interest rate on 1 January 20X5 for borrowings on similar terms is 11%.

7. Illustration

On 1 January 20X0, XYZ Ltd. issues 10 year bonds for Rs. 1,000,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for Rs. 1,000,000. No costs or fees are incurred. The effective interest rate is therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ Ltd. and the bondholders agree to a modification in accordance with which:

- no further interest payments are made
- the bonds are redeemed on the original due date (31 December 20X9) for Rs. 1,600,000;
- legal and other fees of Rs. 50,000 are incurred.

On 1 January 20X5, the discounted present value of the remaining cash flows of the original financial liability is Rs. 10,00,000.

8. Illustration

Wheel Co. Limited borrowed Rs. 500,000,000 from a bank on 1 January 20X1. The original terms of the loan were as follows:

- Interest rate: 11%
- Repayment of principal in 5 equal instalments
- Payment of interest annually on accrual basis
- Upfront processing fee: Rs. 5,870,096 Effective interest rate on loan: 11.50%

On 31 December 20X2, Wheel Co. Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

- Interest rate 15%
- Repayment of outstanding principal in 10 equal instalments starting 31 December 20X3
- 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

9. Illustration

JK Ltd. has an outstanding unsecured loan of Rs. 90 crores to a bank. The effective interest rate (EIR) of this loan is 10%. Owing to financial difficulties, JK Ltd. is unable to service the debt and approaches the bank for a settlement.

The bank offers the following terms which are accepted by JK Ltd.:

- 2/3rd of the debt is unsustainable and hence will be converted into 70% equity interest in JK Ltd. The fair value of net assets of JK Ltd. is Rs. 80 crores.

- 1/3rd of the debt is sustainable and the bank agrees to certain moratorium period and decrease in interest rate in initial periods. The present value of cash flows as per these revised terms calculated using original EIR is Rs. 25 crores. The fair value of the cash flows as per these revised terms is Rs. 28 crores

10. Illustration

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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. At reporting date, the entity determines no change in PoD. Calculate loss allowance.

Amount o/s	1,000,000
Loss	25%
PoD	0.5%
ECL (12m)	1,000,000 x 25% x 0.5% = 1,250

11. Illustration

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
	Total value of loan	Loss rate
X	2,00,000	600/200,000 = 0.3%
Y	3,00,000	450/300,000 = 0.15%

12. Illustration

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
Company M uses following default rates for making provisions:	

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	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%

13. Illustration

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

Comprehensive Illustrations

14. Illustration

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 principal along with the interest. The market rate of interest is 10% per annum for comparable loans. Y lent Rs. 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

15. Illustration

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

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Dividend rate 0.0001%
Market rate of interest 12% per annum
Present value factor 0.56743

PV of 100,000,000 at 12% = 0.56743 x 100,000,000
=56,743,000

16. Illustration

On 1st January 20X1, SamCo. Ltd. agreed to purchase USD ($) 20,000 from JT Bank in future on 31st December 20X1 for a rate equal to Rs. 68 per USD. SamCo. Ltd. did not pay any amount upon entering into the contract. SamCo Ltd. is a listed company in India and prepares its financial statements on a quarterly basis. Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchase of USD.
For the purposes of accounting, please use the following information representing marked to market fair value of forward contracts at each reporting date:

31-Mar : (25,000)
30-Jun : (15,000)
30-Sep : 12,000
Spot rate on 31-Dec : 66 per USD (FV = 20,000 x (66-68) i.e (40,000)

17. Illustration

Entity A (an Rs. functional currency entity) enters into a USD 1,000,000 sale contract on 1 January 20X1 with Entity B (an Rs. functional currency entity) to sell equipment on 30 June 20X1.

Spot rate on 1 January 20X1: Rs. /USD	45
Spot rate on 31 March 20X1: Rs. /USD	57
Three-month forward rate on 31 March 20X1: Rs. /USD	45
Six-month forward rate on 1 January 20X1: Rs. /USD	55
Spot rate on 30 June 20X1: Rs. /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.

18. Illustration

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.

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Mr. S, pre-pays Rs. 200,000 on 31 December 20X2, reducing the outstanding principal as at that date to Rs. 400,000. Record journal entries in the books of Wheel Co. Limited considering the requirements of Ind AS 109.

19. Illustration – Nov-22 [12 Marks]

On 1st April, 2021 "Fortunate Bank" has provided a loan of ` 25,00,000 to Mohan Limited for 4 years at 10% p.a. and the loan has been guaranteed by Surya Limited, which is a holding company for Mohan Limited. Interest payments are made at the end of each year and the principal is repaid at the end of the loan term. If Surya Limited had not issued a guarantee, 'Fortunate Bank' would have charged Mohan Limited an interest rate of 14% p.a. Surya Limited does not charge Mohan Limited for providing the guarantee.

On 31st March 2022, there is 2% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

On 31st March 2023, there is 4% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

On 31st March 2024, there is 5% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

You are required to provide accounting treatment of financial guarantee as per Ind AS 109 in the books of Surya Limited on initial recognition and in subsequent periods till 31st March, 2024.

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Contents

- Terms used in "Business Combination"
- Differences between Ind AS 103 and AS 14
- Purchase Consideration
- Goodwill
- Contingent payments to employee shareholders and acquirer share-based payment awards exchanged for awards held by the acquiree's employees.
- Subsequent measurement and accounting principles for reacquired rights, contingent liabilities, indemnification assets and contingent consideration
- Disclosure requirements under Ind AS 103

1 Introduction

A **business combination** is a transaction in which the acquirer obtains control of another business (the acquiree). These are the most common form of business transactions through which companies grow in size rather than organic activities.

2 Scope of Ind AS 103

Ind AS 103 is applicable to a transaction or other event that meets the definition of a business combination. It is not applicable to

a. The formation of a **joint arrangement**.
b. The acquisition of an asset or a group of assets that does not constitute a business i.e. it is an **asset acquisition**.

3 Control of a business

An entity obtains control of a business by

a. Acquiring net assets or acquiring its significant equity interest
b. Contract in which case the acquirer would neither have acquired net assets nor equity interest. (Controlling interest = zero and non-controlling interest = 100%).

4 Definition and Elements of Business

4.1 Definition of Business

Ind AS 103 defines business as

- an integrated set of activities and assets
- that is capable of being conducted and managed
- for the purpose of providing goods or services to customers,
- generating investment income (such as dividends or interest) or
- generating other income from ordinary activities.



Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as business

4.2 Elements of Business

The three elements of a business are defined as follows:

(a) Input: Any economic resource that creates outputs or has the ability to contribute to the creation of outputs, when one or more processes are applied to it.

For Example:

Non-current Assets, intellectual property, ability to obtain access to necessary materials or rights and employees.

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(b) Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates output or has the ability to contribute to the creations of outputs.

For Example:

Strategic management processes, operational processes and resource management processes

(c) Output: The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.

4.3 Acquisition of Shell Company

The shell company does not contain an integrated set of activities and assets and so does not constitute a business. Consequently, acquirer should account for the purchase of the shell company in the same way as the incorporation of a new subsidiary.

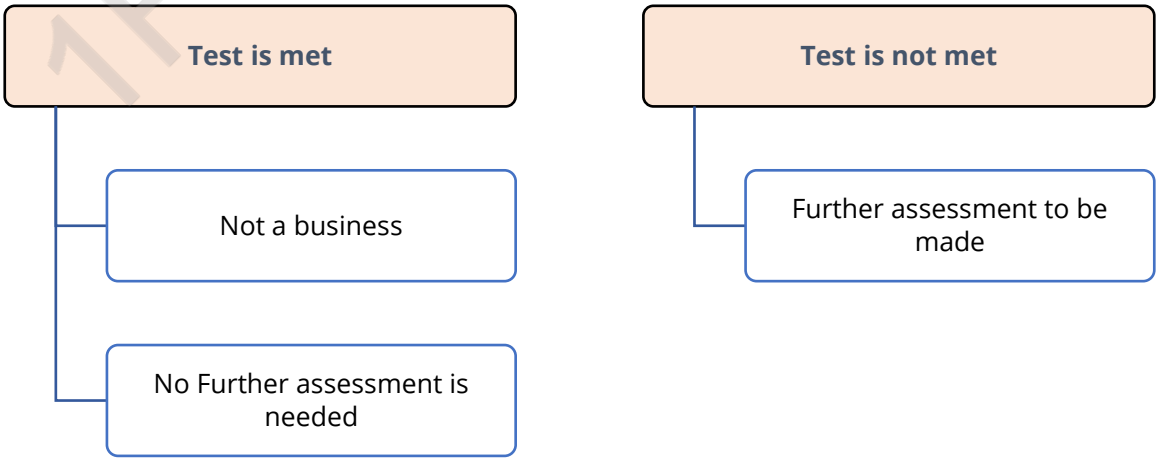
4.4 Further Assessment – Substantive Process

To be capable of being conducted and managed for the purpose identified in the definition of a business, an integrated set of activities and assets requires two essential elements—inputs and a substantive processes applied to those inputs.

To determine whether **acquired process is substantive**, following has to be considered:

No Output	Output is present
(i) It is critical to the ability to develop or convert an acquired input or inputs into outputs.	(i) It is critical to the ability to continue producing outputs.
(ii) The inputs acquired include a. Organised workforce that has the necessary skills, knowledge, or experience to perform that process b. Other inputs that the organised workforce could develop or convert into outputs.	(ii) The inputs acquired include an organised workforce with the necessary skills, knowledge, or experience to perform that process
	(iii) Activities when applied to an applied inputs, significantly contributes to the ability to continue producing outputs and a. Is considered unique or scarce b. Cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs

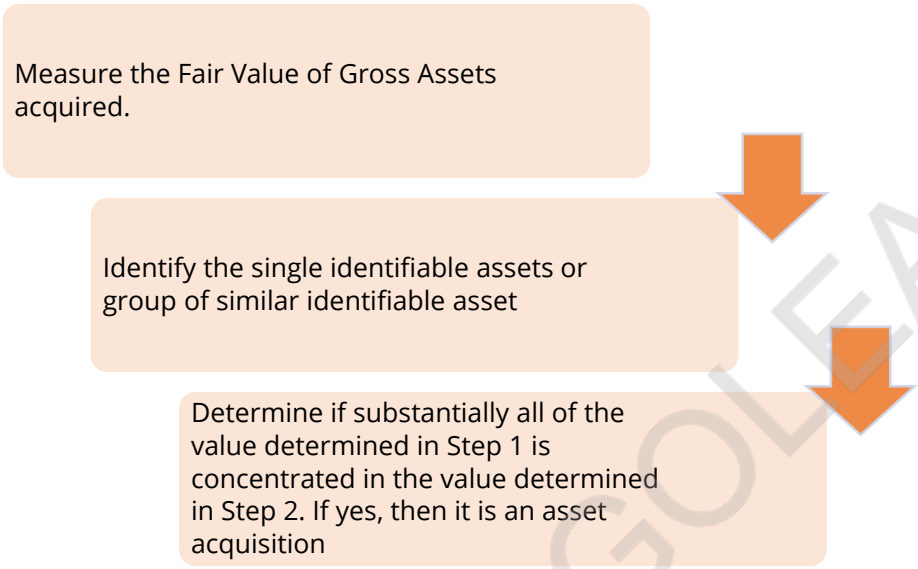
4.5 Asset Concentration Test (Optional)



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This test has been introduced to permit a simplified assessment of whether an acquired set of activities and assets is not a business. This test is optional and the decision to apply is made on a transaction-to-transaction basis.

Conditions:
The concentration test is met **if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets**.
Three Step process for concentration test:



For the concentration test –

(a) Gross assets acquired shall
- **Exclude** cash and cash equivalents, deferred tax assets, and goodwill resulting from the effects of deferred tax liabilities
- In fair value of the gross assets acquired shall **include** any consideration transferred (plus the fair value of any non-controlling interest and the fair value of any previously held interest) in excess of the fair value of net identifiable assets acquired.

(b) a single identifiable asset shall include
- Any asset or group of assets that would be recognized and measured as a single identifiable asset in a business combination
- A tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset (or from an underlying asset subject to a lease, as defined in Ind AS 116, Leases), without incurring significant cost, or significant diminution in utility or fair value to either asset

(c) When assessing whether assets are similar, an entity shall consider the nature of each single identifiable asset and the risks associated with managing and creating outputs from the assets

(d) The following shall not be considered similar assets:
(i) a tangible asset and an intangible asset
(ii) tangible assets in different classes unless they are considered a single identifiable asset
(iii) identifiable intangible assets in different classes
(iv) a financial asset and a non-financial asset
(v) financial assets in different classes; and
(vi) Identifiable assets that are within the same class of asset but have significantly different risk characteristics.

Fair Value of gross asset:

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(a) Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held)
(b) Fair value of liabilities assumed.
(c) Cash and cash equivalent and deferred tax assets and goodwill resulting from DTL's.

5 Business Combination – Definition

Business combination occurs when an entity obtains control of a business by acquiring net assets or acquiring its significant equity interest. The entity acquiring the business is called the acquirer and the entity transferring/selling the business is called acquiree.

A business combination may be structured in a variety of ways for legal, taxation or other reasons :

a. one or more businesses become subsidiaries of an acquirer : Tata acquired 1mg
b. the net assets of one or more businesses are legally merged into the acquirer : Kotak acquiring net assets of ING Vysya bank
c. The owners transfer their equity interests to another combining entity or its owners : Flipkart founders (Bansals) transferring stake to Walmart.
d. all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity : Vodafone and Idea form a new entity VodafoneIdea (VI)
e. a group of former owners of one of the combining entities obtains control of the combined entity. : Bjyu's owners controlling Byju's +Akash

6 Differences between Business Combination and Acquisition of group of assets

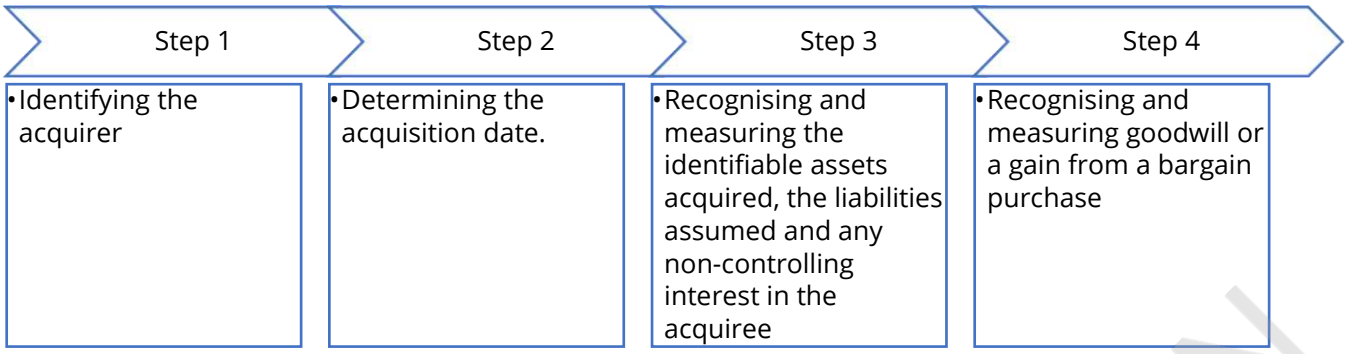
A business combination is different from acquisition of group of assets. A group of assets may not meet the definition of business as explained above.

Particulars	Business Combination	Acquisition of group of assets
Intangible Assets	Recognise at fair value, if they are separately identifiable	Recognised and measured based on an allocation of the overall cost of the transaction with reference to their relative fair values
Goodwill	Recognised as a separate asset	No goodwill would be recognised
Acquisition related costs	Expensed in the period in which such costs are incurred.	Capitalised as a component of the cost
Deferred Tax Accounting	Deferred taxes are recorded on temporary differences of assets acquired (other than goodwill) and liabilities assumed in a business combination.	No deferred taxes are recognised for temporary differences on asset acquisitions (on initial recognition).
Gain on bargain purchases	Gain is recognised by the acquirer in other comprehensive income and accumulates the same in equity as capital reserve.	No gain is recognised for a bargain purchase.
Contingent liabilities assumed	To be recognised if represents present obligation that arises from past events and its fair value can be measured reliably with subsequent changes to profit or loss.	Not recognised, subject to Ind AS 37.

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7 Acquisition Accounting for Business Combinations

The following key steps are involved in the acquisition accounting for business combinations



8 Identifying Acquiring Enterprise

8.1 The Acquiring enterprise / Acquirer

The acquiring enterprise is the enterprise which obtains control (control is defined in Ind AS 110)

As per Ind AS 110 'Consolidated Financial Statements', 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.
(c) The ability to use its power over the investee to affect the amount of the investor's returns.



In order to ascertain control do not look at the voting rights only. Evaluate otherfactors also like board control, potential voting rights etc.

Control assessment does not depend only on voting rights. It also depends upon the following

(a) Potential voting rights
(b) Rights of non-controlling shareholders; and
(c) Other contractual right of the investor if those are substantive in nature.

8.2 Acquisitions through payment of cash or incurring of liability

In these cases, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

8.3 Acquisitions through issue of equity instrument

In these cases, the acquirer is usually the entity that issues its equity interests. However, in case of "reverse acquisitions" the issuing entity is acquiree.

Other Relevant facts and circumstances in identifying the acquirer effected by exchanging equity interests

Facts and circumstances	Acquirer
Relevant voting rights in combined entity after the business combination	Combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity An entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.

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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:	Combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity
The composition of the governing body of the combined entity:	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
The composition of the senior management of the combined entity:	Combining entity whose (former) management dominates the management of the combined entity.
The terms of the exchange of equity interests	Combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.

8.4 Acquisitions involving Shell Company and Reverse Acquisition

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. For e.g Entity A legally acquires Entity B by issuing shares to owners of Entity B. Post acquisition, the shareholders of B hold 70% of stake in combined entity. Though for legal purpose, Entity A is the acquirer, for accounting purpose Entity B is considered as the acquirer since in substance owners of B controls the combined entity.

Reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. The public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired.

Public Entity	Acquiree for the accounting purpose. It must meet the definition of a business for the transaction to be accounted for as a reverse acquisition. (Ind AS 103 will apply)
Private Entity	Acquirer for accounting purposes

9 Determining the Acquisition Date

Acquisition date is

(a) The date on which the acquirer obtains control of the acquire.
(b) Acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquire
(c) Acquiree's results are consolidated from this date

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10 Determination of the Purchase Consideration

Purchase consideration is

(a) Fair Value of assets transferred (including cash) to the former owners + liabilities incurred by the
(b) FV of Contingent consideration
(c) Equity interests issued by the acquirer.



Acquirer's share-based payment awards exchanged for awards held by the acquiree's employees *shall be measured in accordance with the requirements of Ind AS 102*

Situation	Action point
Consideration transferred includes assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date	The acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in the statement of profit and loss.
Transferred assets or liabilities remain within the combined entity after the business combination and the acquirer therefore retains control of them	• The acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date • Shall not recognise a gain or loss in statement of profit and loss on assets or liabilities it controls both before and after the business combination. • The asset transferred will affect the amount of NCI and goodwill that is recognised.

10.1 Business Combination achieved in stages (Step Acquisition)

When an entity acquires another entity step by step through series of purchase, then the acquisition date will be the date on which the acquirer obtains control.

In step acquisition, the acquirer shall

(i) Remeasure its previously held equity interest in the acquiree at its acquisition-date fair value
(ii) Recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

The amount that was recognised in other comprehensive income in prior periods shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

When a party to a joint operation, obtains control of a joint operation business, the transaction will be considered as a business combination achieved in stages. The acquirer should re-measure its previously held interest in the joint operation at fair value at the acquisition date.

10.2 Business Combination achieved without the transfer of Consideration

These circumstances include

(a) The acquiree **repurchases a sufficient number of its own shares** for an existing investor (the acquirer) to obtain control

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(b) **Minority veto rights lapse** that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.

(c) The acquirer and acquiree agree to combine their businesses by **contract** alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously.



The equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the non-controlling interest.

10.3 Direct Cost of Acquisition

Any direct cost of acquisition should be recorded directly in profit and loss account and should not be included in purchase consideration

For Example: finder's fees, due diligence cost accounting, legal fees, investment banker fees, bonuses paid to employees for doing a successful acquisition

10.4 Contingent Consideration

The acquirer shall recognise the acquisition-date **fair value** of **contingent consideration** as part of the consideration transferred in exchange for the acquire.

The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity on the basis of the definitions of an equity instrument and a financial liability (or) shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.

11 Purchase Price Allocation

The acquirer shall and measure all the assets and liabilities acquired on the acquisition date at FV.

11.1 Recognition

(a) Identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities at the acquisition date.

(b) Assets and liabilities which have been assumed as a part of the business combination deal should only be recorded. Any other assets which are not related to the acquisition should be accounted as per applicable Ind As.

(c) Assets / Liabilities not recognised by acquiree would also be recognised if it meets the recognition criteria.

For example:

The acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

11.2 Measurement

(a) The acquirer shall measure the **identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.**

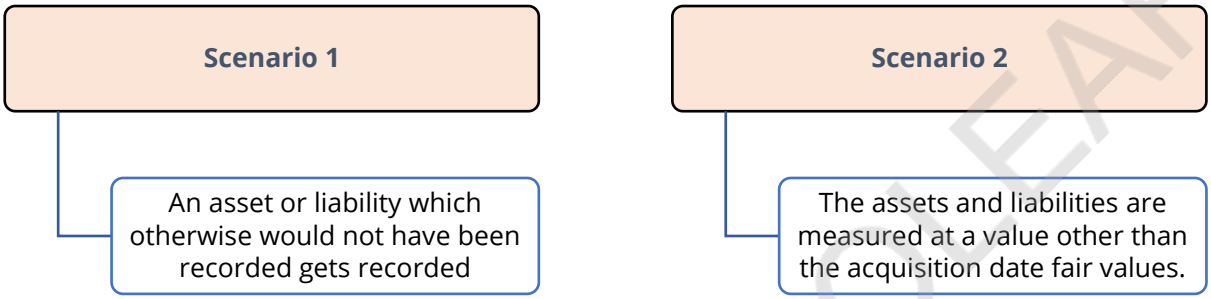
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(b) For each business combination, the acquirer shall measure at the acquisition date components of **non-controlling interest in the acquiree** that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either

(i) fair value; or
(ii) proportionate share in the recognised amounts of the acquiree's identifiable net assets

11.3 Exception to the recognition and measurement principle

These exception principles are only limited to acquisition date accounting and may be different than the requirements of other accounting standards. This will result in



<table>
<tr><th colspan="2">Recognition Exceptions</th></tr>
<tr><td>Contingent Liability</td><td>
<table>
<tr><th>Outcome</th><th>Ind AS 37</th><th>Business Combination</th></tr>
<tr><td>Possible Obligation</td><td>Not recognised</td><td>Not recognised</td></tr>
<tr><td>Present obligation – not probable that an outflow of economic benefits will occur</td><td>Not recognised</td><td>Recognised if reliably measured at Fair Value.</td></tr>
<tr><td>Present obligation – probable that an outflow of economic benefits will occur, but cannot be measured reliably</td><td>Not recognised</td><td>Not recognised</td></tr>
</table>
The FV of contingent liability is considered on date of acquisition.
</td></tr>
<tr><th colspan="2">Both Recognition and Measurement Exceptions</th></tr>
<tr><td>Income Taxes</td><td>(a) No deferred tax consequence should be recorded on initial recognition of deferred tax except assets and liabilities acquired during business combination. (Ind AS 12)
(b) The acquirer shall account for the potential tax effects of temporary differences and carry forwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with Ind AS 12.</td></tr>
<tr><td>Post retirement obligation</td><td>The acquirer records the fair value of the obligations for any post retirement obligation as per the principles of Ind AS 19 which is an exception of the general fair value rule</td></tr>
<tr><td>Indemnification Assets</td><td>The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a</td></tr>
</table>

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	specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item (liability) measured on the same basis as the indemnified item
Leases	**Acquiree is a lessee:** (i) The acquirer shall recognise right-of-use assets and lease liabilities for leases and measure at same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms. (ii) The acquirer shall measure the lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the acquisition date. (iii) The acquirer is not required to recognise right-of-use assets and lease liabilities for - leases for which the remaining lease term ≤ 12 months of the acquisition date; or leases for which the underlying asset is of low value. **Acquiree is a lessor:** In measuring the acquisition-date fair value of an asset, the acquirer shall take into account the terms of the lease. The acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms.
Assembled workforce	The acquirer subsumes into Goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date.
Measurement Exceptions	
Reacquired rights	These are the rights which the acquirer before acquisition may have granted to the acquiree to use certain assets which belongs to the acquirer. The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract without considering the effect of potential renewals.
Intangible Assets	The acquirer shall record separately from Goodwill, the identifiable intangible acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion.
Share based transactions	Measured in accordance with the method in Ind AS 102, Share-based Payment, at the acquisition date.
Assets held for sale	Measured in accordance with Ind AS 105, at fair value less costs to sell in accordance with that Ind AS.

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11.4 Intangible Assets

Recognition of Intangible Asset in Business Combination	Transaction meets the definition of Asset
	Asset is identifiable either by Contractual/Legal criteria or separability Criteria

Contractual Legal Criteria:
An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations.
For Example:
Technology patent, nuclear power plant

Separability Criteria:
Sometimes, an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability.

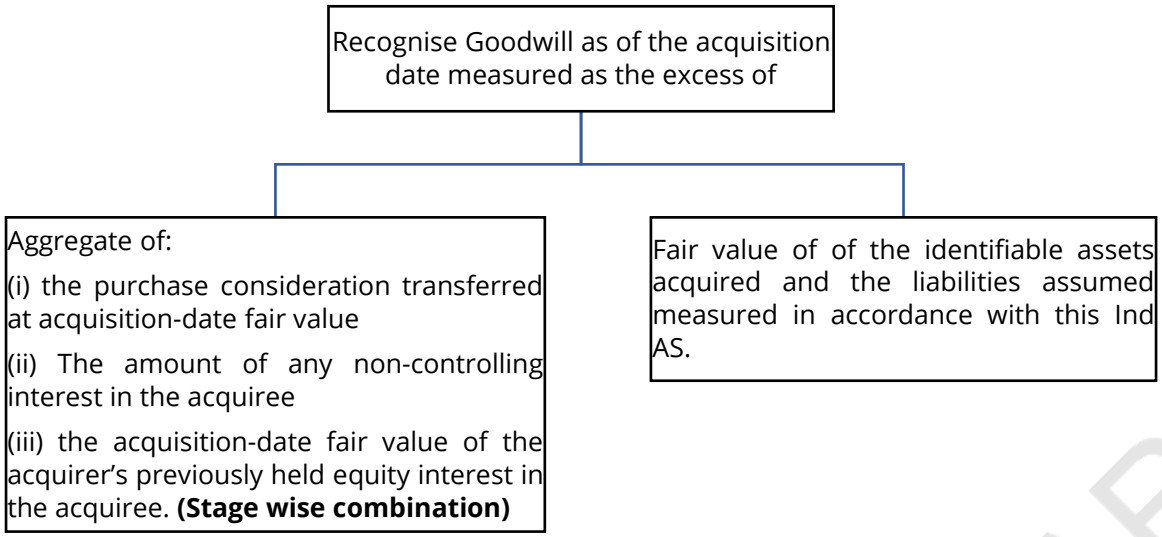
Assembled Workforce and other items that are not identifiable:
Assembled workforce is not an identifiable asset to be recognised separately from goodwill. Any value attributed to it is subsumed into goodwill.
An assembled workforce does not represent the intellectual capital of the skilled workforce—the knowledge and experience that employees of an acquiree bring to their jobs.

Reacquired Rights
A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill.If the terms of the contract giving rise to a reacquired right are favourable or unfavourable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognise a settlement gain or loss.

11.5 Goodwill recognition and measurement

Fair value of	
- **Purchase consideration (**Including contingent consideration)	1
- **Existing Stake**	2
Value of NCI	
- **Fair value** - **Proportion of net assets**	3
Total [A]	1+2+3
Fair value of identifiable Net Assets (Including FV of contingent liabilities)	4
Total [B]	4
Goodwill (If A > B)	**A-B**
Bargain Purchase (If A < B)	**B-A**

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11.6 Goodwill Vs Bargain Purchase

Bargain purchase is a circumstance where the value of net assets acquired in a business combination exceeds the purchase consideration.

The acquirer shall recognise the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve, if the reason for bargain purchase gain is clear and evidence exist. If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognised directly in equity as capital reserve.

The gain shall be attributed to the acquirer and there will no allocation to the non-controlling shareholders.

A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion.



If consideration paid > Net assets, the difference is called as Goodwill
If consideration paid < Net assets, the difference is called gain on bargain purchase

11.7 Measurement period

Information not available on the acquisition date:

- Do the purchase price allocation on a provisional basis.
- 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 retrospectively
- Recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition 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.

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The measurement period shall not exceed one year from the acquisition date. 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:

- the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquire
- the consideration transferred for the acquiree (or the other amount used in measuring goodwill); • in a business combination achieved in stages, the equity interest in the acquire previously held by the acquirer; and
- The resulting goodwill or gain on a bargain purchase.

Any change i.e. increase or decrease in the net assets acquired due to new information available during the measurement period which existed on the acquisition date will be adjusted against goodwill. However, after the measurement period ends, any change in the value of assets and liabilities due to an information which existed on the valuation date will be accounted as an error as per Ind AS 8, Accounting policies, Changes in Accounting Estimates and Errors.

11.8 Determining what is part of the business combination transaction

The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. The acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, i.e. amounts that are not part of the exchange for the acquiree.

The following are examples of separate transactions that are not to be included in applying the acquisition method:

(a) a transaction that in effect settles pre-existing relationships between the acquirer and acquiree –e.g. a law suit or a supply contract.

(b) a transaction that remunerates employees or former owners of the acquiree for future services; and

(c) a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

11.9 Contingent Payment to Employees or Selling Shareholders

Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

Post acquisition compensation	**Contingent Consideration for acquisition**
Selling shareholders become employees and payment will not be made if service terminated.	*Selling shareholders become employees and payment will be made even if service terminated.*
Duration of employment equal or greater than contingent payment period	*Duration of employment is shorter than the contingent payment period.*
Compensation is reasonable	*Compensation is not reasonable (excess)*
	Selling shareholders who do not become employees receive less payment. In such cases the excess

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	compensation represents consideration for acquisition
Shareholders holding few shares continue as employees	*Shareholders holding high number of shares continue as employees*
Valuation is appropriate	*Valuation for the purpose of combination is at the lower end*
Contingent payment based on profit sharing arrangement	*Contingent payment based on multiple of earnings to determine valuation*

11.10 Acquirer SBP awards exchanged for Awards held by Acquiree's employees

Students are required to complete Ind AS 102 to understand this section better.

- An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree. Reliance acquired 1mg. The employees of 1mg had ESOPs granted by 1mg. Reliance can replace ESOPs granted by 1mg by its own ESOPs.

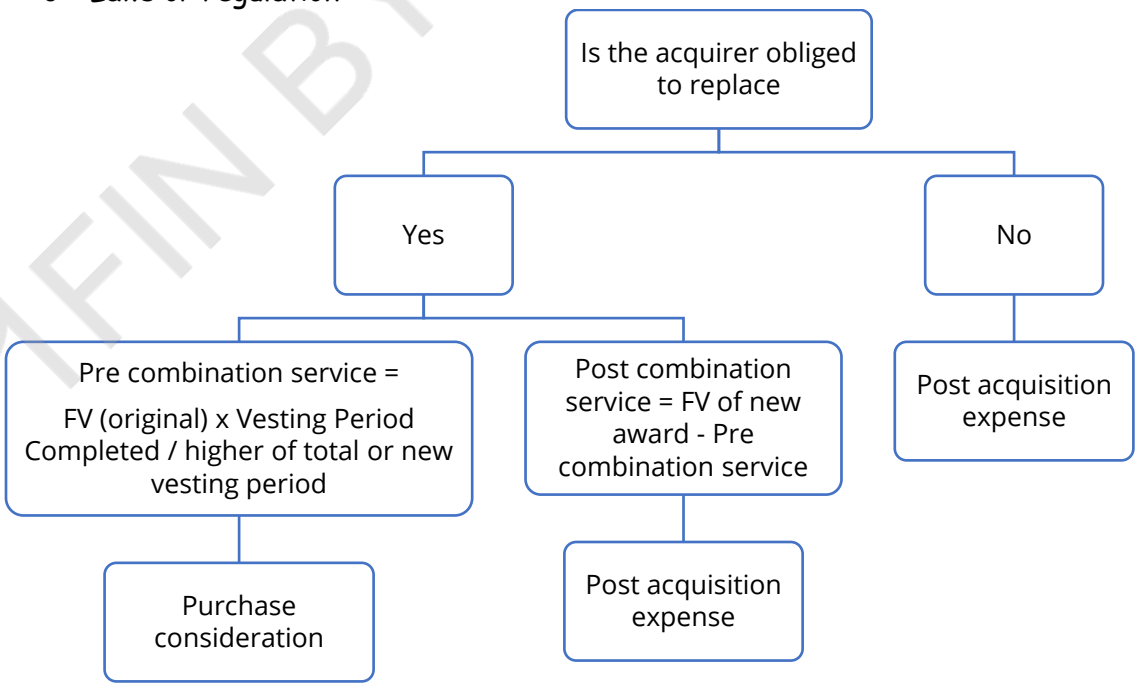
- The above share based payment awards will include vested and unvested shares.

- Exchanges of share options or other share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with Ind AS 102, Share based Payment.

- The replacement of awards will be considered to calculate consideration for acquisition.

- If acquiree SBP expire due to acquisition, then the replacement awards are considered to be post acquisition expenses.

- **Replacement awards which should be considered for determining purchase consideration are those which the acquirer is obliged** due to
  - Terms of acquisition agreement
  - Terms of existing SBP awards
  - Laws or regulation



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Total vesting period = Vesting Completed + New Vesting period

11.11 Non Replacement Awards

In some cases, the acquiree's awards are not replaced.

- In case shares are vested – These represent NCI and are measured at their market based measure.
- In case shares are unvested – Treat as per 11.10

12 Subsequent Measurement and Accounting

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable Ind AS for those items, depending on their nature. However, Ind AS 103 provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:

Asset acquired	Action point
Reacquired rights	Amortise over the remaining contractual period of the contract in which the right was granted. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.
Contingent Liabilities	Recognise at higher of (a) the amount that would be recognised in accordance with Ind AS 37 (b) the amount initially recognised less, if appropriate, the cumulative amount of income recognised.
Indemnification Asset	At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount The acquirer shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.
Contingent consideration	The acquirer shall account for changes in the fair value of contingent consideration as follows: (a) Contingent consideration classified as equity shall not be re-measured and its subsequent settlement shall be accounted for within equity. (b) Other contingent consideration that is measured at fair value with gain or loss recognised in P&L.

13 Common Control Business Combinations

- 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.
- Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group.

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- The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determining whether the combination involves entities under common control. This is because a partially-owned subsidiary is nevertheless under the control of the parent entity.
- The fact that one of the combining entities is a subsidiary that has been excluded from the consolidated financial statements of the group in accordance with Ind AS 27 is not relevant to determining whether a combination involves entities under common control.
- 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 ASs. 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.
- 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.

14 Method of accounting for common control business combinations

Business combinations involving entities or businesses under common control shall be accounted for using the **pooling of interest method.**

The pooling of interest method is considered to involve the following:

(i) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(ii) No adjustments are made to reflect fair values or recognise any new assets or liabilities. The only adjustments that are made is to harmonise accounting policies.

(iii) 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 earliest period presented 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.

Consideration:

The consideration may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets other than cash shall be considered at their fair values.

Balance of the retained earnings:

Balance appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.

Difference between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes.

15 Disclosures

The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

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a) during the current reporting period; or
b) after the end of the reporting period but before the financial statements are approved for issue.

Ind AS 103 requires detailed disclosures on Business Combination. The acquirer shall disclose the following information for each business combination that occurs during the reporting period:

a. the name and a description of the acquiree.
b. the acquisition date.
c. the percentage of voting equity interests acquired.
d. the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
e. a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.
f. the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
   I. cash;
   II. other tangible or intangible assets, including a business or subsidiary of the acquirer;
   III. liabilities incurred, for example, a liability for contingent consideration; and
   IV. equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.
g. for contingent consideration arrangements and indemnification assets:
   i. the amount recognised as of the acquisition date;
   ii. a description of the arrangement and the basis for determining the amount of the payment; and
   iii. an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

h. for acquired receivables:
   i. the fair value of the receivables;
   ii. the gross contractual amounts receivable; and
   iii. the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.

i. the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.

j. for each contingent liability recognised, the information required in paragraph 85 of Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:

   i. the information required by paragraph 86 of Ind AS 37; and
   ii. the reasons why the liability cannot be measured reliably.

k. the total amount of goodwill that is expected to be deductible for tax purposes.

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n. in a bargain purchase
   i. the amount of any gain recognised in other comprehensive income in accordance with paragraph 34;
   ii. the amount of any gain directly recognised in equity in accordance with paragraph 36A; and
   iii. a description of the reasons why the transaction resulted in a gain in case of (i) above.

o. for each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date:
   i. the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
   ii. for each non-controlling interest in an acquiree measured at fair value, the valuation technique(s) and significant inputs used to measure that value.

p. in a business combination achieved in stages:
   i. the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and
   ii. the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (see paragraph 42) and the line item in the statement of profit and loss in which that gain or loss is recognised.

If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are approved for issue, the acquirer shall disclose the information required as above unless the initial accounting for the business combination is incomplete at the time the financial statements are approved for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.

To meet the objective of the Ind AS 103 disclosure requirements, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

a) if the initial accounting for a business combination is incomplete for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally
   i. the reasons why the initial accounting for the business combination is incomplete;
   ii. the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete; and
   iii. the nature and amount of any measurement period adjustments recognised during the reporting period.

b) for each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:
   i. any changes in the recognised amounts, including any differences arising upon settlement;

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ii. any changes in the range of outcomes (undiscounted) and the reasons for those changes; and

iii. the valuation techniques and key model inputs used to measure contingent consideration.

c) for contingent liabilities recognised in a business combination, the acquirer shall disclose the information required by paragraphs 84 and 85 of Ind AS 37 for each class of provision.

d) a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:

i. the gross amount and accumulated impairment losses at the beginning of the reporting period.

ii. additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations.

iii. adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period

iv. goodwill included in a disposal group classified as held for sale in accordance with Ind AS 105 and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale

v. impairment losses recognised during the reporting period in accordance with Ind AS 36. (Ind AS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)

vi. net exchange rate differences arising during the reporting period in accordance with Ind AS 21, The Effects of Changes in Foreign Exchange Rates.

vii. any other changes in the carrying amount during the reporting period.

viii. the gross amount and accumulated impairment losses at the end of the reporting period.

e) the amount and an explanation of any gain or loss recognised in the current reporting period that both:

i. relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and

ii. is of such a size, nature or incidence that disclosure is relevant to understand the combined entity's financial statements.

Students are advised to read the disclosure couple of times to gain an understanding.

16 Significant difference between Ind AS 103 and AS 14

Basis	Ind AS	AS 14
Primary guidance	Ind AS 103 - Business Combination	AS 14 – Amalgamation AS 21 – Consolidated Financial Statements
Amalgamation methods	• Acquisition method only. • Pooling of interest method is applicable only when there is combination of entities which are under common control	• Purchase method • Pooling of interest method
Fair value	The consideration, identifiable assets, identifiable liabilities have to be fairly valued	No specific guidance under AS 14

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Non-controlling interest	Provides guidance. It is measured either at fair value or proportionate share in the fair value of net assets	No specific guidance in AS 14. AS 21 provides guidance to be measured at share in the net assets method.
Acquisition related costs	Acquisition related costs such as finder's fee, due diligence costs, etc. are expensed as incurred.	There is no specific guidance, but they are generally capitalised.
Goodwill or capital reserve (gain on bargain purchase)	Gain on bargain purchase is recognised in OCI if there is sufficient evidence that shows the appropriateness of bargain purchase gain. Goodwill is not amortised but tested for impairment annually	Difference between the purchase consideration and the net assets acquired is recorded as goodwill or capital reserve (presented as equity) as the case may be. Goodwill arising on amalgamation is amortised over its useful life not exceeding five years unless a longer period is justified. There is no specific guidance on goodwill arising on subsidiaries acquired which are not amalgamations. In practice, such goodwill is not amortised but tested for impairment.
Asset acquisition	Similar to Indian GAAP	The transactions that do not meet the definition of amalgamation / acquisition of a subsidiary, are accounted as asset acquisitions without any goodwill or capital reserve recognised separately and the consideration is apportioned to the various assets on a fair value basis as determined by competent valuers.
Contingent consideration	Initially recognised at acquisition date fair value **Subsequent measurement:** • Contingent consideration classified as equity is not remeasured. • Contingent consideration classified as liability generally remeasured at fair value with changes at every reporting period end until settlement, with changes in fair value recognised in profit or loss.	Contingent consideration is included in the purchase consideration as at the date of amalgamation, if payment is probable and a reasonable estimate of the amount can be made. In other cases, the adjustment is recognised in the profit and loss account as and when it becomes determinable. Others: There is no specific guidance. In practice, contingent consideration is recognised when the contingency is resolved.
In-process research and development	• Initially recognised at acquisition date fair value. • Subsequently measured in accordance with Ind AS 38	There is no specific guidance.

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Measurement period	Ind AS 103 provides for a measurement period after the acquisition date for the acquirer to adjust the provisional amounts recognised to reflect the additional information that existed as at the date of acquisition. The measurement period is limited to one year from the acquisition date.	There is no specific guidance
Step Acquisition	Any equity interest in the acquiree held by the acquirer immediately before obtaining the control over the acquiree is adjusted to acquisition-date fair value. Any resulting gain or loss is recognised in the profit or loss	If two or more investments are made over a period of time, the equity of the subsidiary at the date of investment is generally determined on a step-by-step basis.
Transactions between entities under common control	Appendix C to Ind AS 103 provides detailed guidance which is very similar to the pooling of interest method as specified by AS 14.	There is no specific guidance.

17 Carve-in and Carve-out from IFRS

	IFRS-3	**Ind AS 103**
Carve-out	Bargain purchase gain arising on business combination to be recognised in profit or loss as income	Bargain purchase gain to be recognised in other comprehensive income and accumulated in equity as capital reserve
Carve-in	Excludes from its scope business combinations of entities under common control.	Appendix C of Ind AS 103, Business Combinations gives guidance in this regard.

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1. Illustration

Bima Ltd. acquired 65% of shares on 1 June, 20X1 in Nafa Ltd. which is engaged in production of components of machinery. Nafa Ltd. has 1,00,000 equity shares of Rs. 10 each. The quoted market price of shares of Nafa Ltd. was Rs. 12 on the date acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 20X1 was Rs. 80,00,000.

Bima Ltd. wired Rs. 50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of shares of Bima Ltd. on the date of issue was Rs. 25 per share. Bima Ltd. also agrees to pay additional consideration of Rs. 15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds Rs. 1 crore over the next three years. On the date of acquisition, Nafa Ltd. assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is Rs. 9,80,000. Nafa Ltd. incurred Rs. 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value. How will the acquisition of Nafa Ltd. be accounted by Bima Ltd., under Ind AS 103? Prepare detailed workings and pass the necessary journal entry.

2. Illustration

On 1st April, 20X1, PQR Ltd. acquired 30% of the voting ordinary shares of XYZ Ltd. for Rs. 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:

	(Rs. 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 Rs. 8,850 crore (8,000 + 700 + 100 + 50).

On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash Rs. 25,000 crore.

The following additional information is relevant at that date:

	(Rs. 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?

3. Illustration

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:

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Consideration: Company A transfers cash of Rs. 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 Rs. 10 per share.

Contingent consideration: Company A agrees to pay additional consideration of
Rs. 7,00,000 if the cumulative profits of Company B exceed Rs. 70,00,000 over the next two years. At the acquisition date, it is not considered probable that the extra consideration will be paid. The fair value of the contingent consideration is determined to be
Rs. 3,00,000 at the acquisition date.

Transaction costs: Company A pays acquisition-related costs of Rs. 1,00,000.

Non-controlling interests (NCI): The fair value of the NCI is determined to be
Rs. 7,50,000 at the acquisition date based on market prices. Company A elects to measure non-controlling interest at fair value for this transaction.

Previously held non-controlling equity interest: Company A has owned 25% of the shares in Company B for several years. At 1st November, the investment is included in Company A's consolidated balance sheets at Rs. 6,00,000, accounted for using the equity method; the fair value is Rs. 20,00,000.

The fair value of Company B's net identifiable assets at 1st November is Rs. 60,00,000, determined in accordance with Ind AS 103.
Determine the accounting under acquisition method for the business combination by Company A.

4. Illustration

Company A acquired 90% equity interest in Company B on 1st April, 20X1 for a consideration of Rs. 85 crores in a distress sale. Company B did not have any instrument recognised in equity. The Company appointed a registered valuer with whose assistance, the Company valued the fair value of NCI and the fair value identifiable net assets at Rs. 15 crores and Rs. 100 crores respectively.
Find the value at which NCI has to be shown in the financial statements.

5. Illustration FVTOCI & ACM

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 Rs. 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.

6. Illustration

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

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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.?

7. Illustration

ABC Ltd. acquires PQR Ltd. for a consideration of Rs. 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 Rs. 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 Rs. 1,80,000 [(Rs. 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 Rs. 4,50,000.

How is the license accounted for as part of the business combination?

8. Illustration

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.

9. Illustration

On 1st January, 20X1, A Ltd. acquires 80 per cent of the equity interests of B Ltd. in exchange for cash of Rs. 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 Rs. 20 crore and the fair value of the 20 per cent non-controlling interest in B Ltd. at Rs. 4.2 crore. How should A Ltd. recognise the above bargain purchase?

10. Illustration

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.

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Comment on the treatment done by Bank F.

11. Illustration

Company A acquires 70 percent of Company S on 1st January, 20X1 for consideration transferred of Rs. 5 million. Company A intends to recognise the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitably qualified valuation professional, A measures the identifiable net assets of B at Rs. 10 million. A performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.
State whether the procedures followed by A and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process

Fair value of Net Assets - 10 Mio

Fair value of Consideration – 5 Mio
Value of NCI – 30 % x 10 Mio = 3 Mio

Total = 8 Mio

Gain on bargain purchase = 2 Mio.

12. Illustration

On 1 April 20X1, Alpha Ltd. acquires 80 percent of the equity interest of Beta Pvt. Ltd. in exchange for cash of Rs. 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 Rs. 500 and the liabilities assumed are measured at Rs. 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 Rs. 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?

13. Illustration

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
Rs. 6.50 and the market value of an equity share in JKL Ltd. was Rs. 6.

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- On 30th June, 20X2, 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, 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 Rs. 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 Rs. 2,50,00,000. On 31st March, 20X2, the fair value of the contingent consideration was Rs. 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 Rs. 6,00,00,000. On 1st July, 20X1, 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, 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.

14. Illustration

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:
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 Rs. 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 Rs. 1 crore.
   i. The fair value of the shares of A Ltd. on the date of acquisition is Rs. 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is Rs. 25 lakhs.
   ii. During the year ended 31 March 20X2, the profit before interest and tax of B Ltd. exceeded Rs. 1 crore. As on 31 March 20X2, the fair value of shares of A Ltd. is Rs. 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 Rs. 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds Rs. 1 crore. A Ltd. issued shares with Rs. 40 lakhs after a year.

15. Illustration

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 Rs. 35 crores. The fair value of ABR Ltd.' s net assets was Rs. 15 crores, but does not include:

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(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.

16. Illustration

Entity A acquires entity B. Entity A agrees with the former shareholders of entity B to pay Rs. 900, with an additional payment of Rs. 500 if the subsequent earnings of entity B reach a specified target in three years. The former shareholders also become employees. On the acquisition date, the fair value of the net assets of entity B amount to Rs. 850, and the fair value of additional payment is estimated at Rs. 200. At the acquisition date, the outflow of additional payment is not probable. Over the next three years, the cumulative earnings of entity B (before considering the effects of the additional payments) amount to Rs. 1,050. At the end of year three, entity A pays Rs. 500 as the conditions were met.

State the impact on the financial position and results of classifying the payments as remuneration and contingent consideration.

17. Illustration

X Ltd. agreed to takeover Y Ltd. as on 1 October, 2018. No Balance Sheet of Y Ltd. was prepared on that date: Summarised Balance Sheets of X Ltd. and Y Ltd. as at 31st March 2018 is as below.

Liabilities	X Ltd (Rs.)	Y Ltd (Rs.)	Assets	X Ltd (Rs.)	Y Ltd (Rs.)
Equity of Rs.10 each fully paid	20,00,000	15,00,000	Fixed assets	15,50,000	12,60,000
Reserves and Surplus:			Current Assets:		
Reserve	3,90,000	3,40,000	Stock	5,35,500	3,81,500
Profit & Loss A/c	3,30,000	1,60,000	Debtors	3,49,500	2,31,000
Creditors	85,000	75,000	Bank	3,40,000	1,80,000
			Miscellaneous Expenditure:		
			Preliminary Expenses	30,000	22,500
Total	28,05,000	20,75,000	Total	28,05,000	20,75,000

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Additional information available:

(i) For the six months period from 1st April 2018, X Ltd. and Y Ltd. made profits of Rs. 5,40,000 and Rs. 3,60,000 respectively, after writing off depreciation @ 10% per annum on their fixed assets.

(ii) Both the companies paid on 1 August 2018, equity dividends of 10%. Dividend tax at 15% was paid, by each of them on such payments.

(iii) Goodwill of Y Ltd. was valued at Rs.1,68,900 on the date of takeover. Stock of Y Ltd., subject to an abnormal item of Rs. 8,500 to be fully written off, would be appreciated by 20% for purpose of takeover.

(iv) X Ltd. would issue to Y Ltd.'s shareholders fully paid equity shares of Rs.10 each, on the basis of the comparative intrinsic values of the shares on the date of takeover.

You are required to:

(1) Calculate consideration to be transferred by X Ltd.

(2) Calculate Number of shares to be issued by X Ltd. to Y Ltd.

(3) Ascertain closing bank balance which will appear in the Balance Sheet of X Ltd. (After absorption of Y Ltd.).

18. Illustration

AX Ltd. and BX Ltd. amalgamated from 1st January, 20X2. A new Company ABX Ltd. with shares of Rs. 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-20X1

ASSETS	**AX(000)**	**BX(000)**
Non Current Assets		
Property, Plant and Equipment	8,500	7,500
Financial assets		
Investment	1,050	550
Current assets		
Inventory	1,250	2,750
Financial assets		
Trade receivables	1,800	4,000
Cash and Cash equivalent	450	400
Total	**13,050**	**15,200**
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of Rs. 10 each)	6,000	7,000
Other equity	3,050	2,700
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings (12% Debentures)	3,000	4,000
Current liabilities		
Financial liabilities		
Trade payables	1,000	1,500
Total	**13,050**	**15,200**

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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.

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

19. Illustration

The balance sheet of Professional Ltd & Dynamic Ltd is given below

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 Rs. 100 each of Dynamic Ltd. and Rs. 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

- 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 Rs. 40 per share.

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- The fair value exercise resulted in the following: (all nos in Lakh)
    - Fair value of PPE on 1st April, 20X2 was Rs. 350 lakhs.
    - 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 Rs. 10 lakh profit in the preceding year and expects to earn another Rs. 20 Lakh.
- In addition to above, Professional 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.
- 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:
    - Original award- Rs. 5 lakh
    - Replacement award-Rs. 8 lakh.
- Dynamic 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.
- 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.

20. Illustration

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(Rs. in crore)	Fair value(Rs. in crore)
ASSETS:		
Non-current assets		
Property, plant and equipment	40.0	90.0
Intangible assets	20.0	30.0
Financial assets		
- Investments	100.0	350.0
Current assets		
Inventories	20.0	20.0
Financial assets		

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Trade receivables	20.0	20.0
Cash held in functional currency	4.0	4.0
Other current assets		
Non-current asset held for sale	4.0	4.5
TOTAL ASSETS	**208**	
EQUITY AND LIABILITIES:		
Equity		
(a) Share capital (face value Rs. 100)	12.0	50.4
(b) Other equity	141.0	Not applicable
Non-current liabilities		
(a) Financial liabilities		
- Borrowings	20.0	20.0
Current liabilities		
(a) Financial liabilities		
- Trade payables	28.0	28.0
(b) Provision for warranties	3.0	3.0
(c) Current tax liabilities	4.0	4.0
TOTAL EQUITY AND LIABILITIES	**208.0**	

Other information:

Following is the statement of contingent liabilities of S Ltd. as on 1st January, 20X7:

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 embodyingeconomic benefits will berequired 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 embodyingeconomic benefits will berequired 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.

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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 Rs. 10,000 per share.

On 1st January, 20X7, H Ltd. has paid Rs. 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 20X9, 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, 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 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, 20X6 Rs. 350 per share
As on 1st January, 20X7 Rs. 395 per share
As on 31st March, 20X7 Rs. 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 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, 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 Rs. 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?

21. Illustration

AX Ltd. and BX Ltd. amalgamated from 1st January, 20X2. A new Company ABX Ltd. with shares of Rs. 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-20X1

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ASSETS	AX(000)	BX(000)
Non Current Assets		
Property, Plant and Equipment	8,500	7,500
Financial assets		
Investment	1,050	550
Current assets		
Inventory	1,250	2,750
Financial assets		
Trade receivables	1,800	4,000
Cash and Cash equivalent	450	400
Total	**13,050**	**15,200**
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of Rs. 10 each)	6,000	7,000
Other equity	3,050	2,700
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings (12% Debentures)	3,000	4,000
Current liabilities		
Financial liabilities		
Trade payables	1,000	1,500
Total	**13,050**	**15,200**

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 assuming that it is a common control transaction.

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

22. Illustration

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: (Rs. 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

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Current assets:	200	500	700
Less: Current liabilities	(25)	(400)	(425)
(B)	175	100	275
Total (A+B)	200	200	400
Financed by:			
Loan funds	-	300	300
Capital : Equity Rs. 10 each	25	-	25
Surplus	175	(100)	75
	200	200	400

Division Mobiles along with its assets and liabilities was sold for Rs. 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Enterprise Ltd. was holding 52% shareholding of the Company.

Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Enterprise Ltd.

(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).

(iii) Prepare the Balance Sheet of Turnaround Ltd.

23. Illustration

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as on 31st October X1 is given below.

	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 (fully paid up Rs. 10 per share_			50
Other Equity			650
(B)			700
Total (A+B)			**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 Rs. 10 each in the company

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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".

24. Illustration

	Amount (Rs. in thousands)	
Particulars	**Entity A**	**Entity B**
Current Assets	600	800
Non Current Assets	1,200	2,900
Total Assets	1,800	3,700
Current Liabilities	400	200
Non - Current Liabilities	300	1200
Total Liabilities	700	1400
Equity		
30,000 Shares of Rs. 10 Each 1,50,000 shares to SH of B Ltd	300	
60,000 Shares of Rs. 10 Each		600
Retained Earnings	800	1700
Total Equity	1100	2300
Total Equity and Liability	1800	3700

On 31 March 20X1, Entity A issues 2.5 shares in exchange for each share of Entity B. All of entity B's shareholders exchange their shares. The quoted market price of Entity B's share as at 31st March, .20X1 is Rs. 105 per share and Entity A's share price as at 31st March, 20X1 is Rs. 20 per share. Assume the fair value of Entity A's identifiable net assets as at 31st March, 20X1 are the same as carrying values and ignore tax effect.

You are required to compute Goodwill.

25. Illustration

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 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 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 Rs. 1,500.

The balance sheets of Entity A and Entity B immediately before the business combination are:

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	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 Rs. 600 and that the consolidated earnings for the annual period ended 31st March, 20X2 were Rs. 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.

26. Illustration

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

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15th June 90

What is the acquisition date and what is purchase consideration in the above scenario?
Examine whether the financial instrument will be classified as equity.

27. Illustration

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?

28. Illustration

Company X is engaged in the business of exploration & development of Oil & Gas Blocks.
Company X currently holds participating interest (PI) in below mentioned producing Block as follows:

Block Name	X	Y	Z	Total
AWM/01		30%	60%	10% 100%

For the above Block, Company X, Y & Z has entered into unincorporated Joint Venture.

Company Y is the Operator of the Block AWM/01. Company X & Company Z are the Joint Operators. Company Y incurs all the expenditure on behalf of Joint Venture and raise cash call to Company X & Company Z at each month end in respect of their share of expenditure incurred in Joint Venture. All the manpower and requisite facilities / machineries owned by the Joint venture and thereby owned by all the Joint Operators.'

For past few months, due to liquidity issues, Company Z defaulted in payment of cash calls to operators. Therefore, company Y (Operator) has issued notice to company Z for withdrawal of their participating right from on 01.04.20X1. However, company Z has filed the appeal with arbitrator on 30.04.20X1.

Financial performance of company Z has not been improved in subsequent months and therefore company Z has decided to withdraw participating interest rights from Block AWM/01 and entered into sale agreement with Company X & Company Y. As per the terms of the agreement, dated 31.5.20X1, Company X will receive 33.33% share & Company Y will receive 66.67% share of PI rights owned by Company Z.

Company X is required to pay Rs. 1 Lacs against 33.33% share of PI rights owned by Company Z.
After signing of sale agreement, Operator (company Y) approach government of India for modification in PSC (Production Sharing Contract) i.e. removal of Company Z from PSC of AWM/01 and government has approved this transaction on 30.6.20X1. Government approval for the modification in PSC is essential given the industry in which the joint operators operate.

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Additional

Particulars	Company X		Company Z	
	31.5.20X1	30.6.20X1	31.5.20X1	30.6.20X1
Assets				
Non-Current Assets				
Property, Plant & Equipment	5,00,000	10,00,000	1,50,000	3,00,000
Right of Use Asset	1,00,000	2,00,000	10,000	20,000
Development CWIP	50,000	1,00,000	50,000	1,00,000
Financial Assets				
Loan receivable	25,000	50,000	25,000	50,000
Total Non-Current Assets	6,75,000	13,50,000	2,35,000	4,70,000
Current assets				
Inventories	1,00,000	2,00,000	15,000	30,000
Financial Assets				
Trade receivables	1,50,000	3,00,000	50,000	1,00,000
Cash and cash equivalents	2,00,000	4,00,000	1,00,000	2,00,000
Other Current Assets	2,25,000	50,000	25,000	50,000
Total Current Assets	6,75,000	9,50,000	1,90,000	3,80,000
Total Assets	13,50,000	23,00,000	4,25,000	8,50,000
Equity and Liabilities				
Equity				
Equity share capital	3,00,000	3,00,000	1,00,000	1,00,000
Other equity	2,00,000	3,00,000	75,000	2,50,000
Total Equity	5,00,000	6,00,000	1,75,000	3,50,000
Liabilities				
Non-Current Liabilities				
Provisions	4,00,000	8,00,000	1,00,000	2,00,000
Other Liabilities	1,50,000	3,00,000	50,000	1,00,000
Total Non-Current Liabilities	5,50,000	11,00,000	1,50,000	3,00,000
Current Liabilities				
Financial Liabilities				
Trade Payables	3,00,000	6,00,000	1,00,000	2,00,000
Total Current Liabilities	3,00,000	6,00,000	1,00,000	2,00,000
Total Liabilities	13,50,000	23,00,000	4,25,000	8,50,000

Information:

1. Fair Value of PPE & Development CWIP owned by Company Z as per Market participant approach is Rs. 5,00,000 & Rs. 2,00,000 respectively.
2. Fair Value of all the other assets and liabilities acquired are assumed to be at their carrying values (except cash & cash equivalent). Cash and cash equivalents of Company Z are not to be acquired by Company X as per the terms of agreement.

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3. Tax rate is assumed to be 30%.
4. As per Ind AS 28, all the joint operators are joint ventures whereby each parties that have joint control of the arrangement have rights to the net assets of the arrangement and therefore every operator records their share of assets and liabilities in their books.

You need to determine the following:

1. Whether the above acquisition falls under business or asset acquisition as defined under business combination standard Ind AS 103?
2. Determine the acquisition date in the above transaction?
3. Prepare Journal entries for the above-mentioned transaction?
4. Draft the Balance Sheet for Company X based on your analysis in Part 1 above as at acquisition date.

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Internal Reconstruction

1 Introduction

When a company is facing consistent losses, the assets of the company gets overvalued and it is over capitalised. Such situation does not depict the true picture of financial statements. It brings the need for reorganising the affairs of the company.

Reconstruction is a process by which affairs of the company are reorganised by

- revaluation of assets,
- reassessment of liabilities and
- writing of losses already suffered

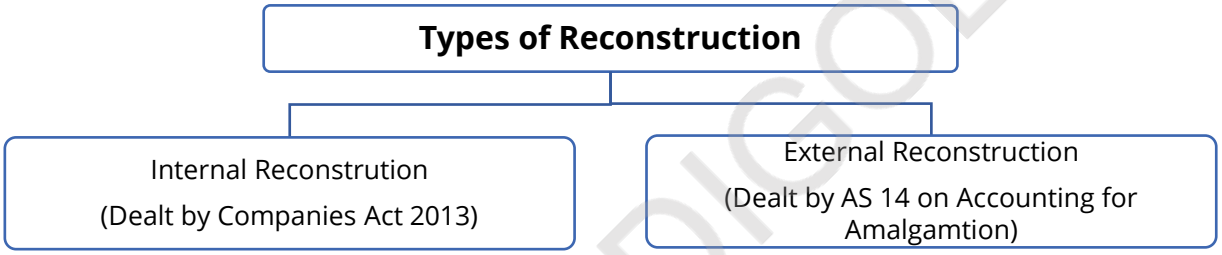
by

- reducing paid up value of shares and/or
- varying the rights attached to different classes of shares.

In simple words, reconstruction is an internal process of cleaning up the company's balance sheet in order to show more clearer picture of company's financial position and performance.

Objective of reconstruction

Reorganise the capital or compound with creditors so that company can get out of this loss-making journey **without winding up the existing company**.



2 Difference between Internal and External Reconstruction

Basis	Internal Reconstruction	External Reconstruction
Liquidation	The existing company is not liquidated and there is only rearrangement.	The existing company is liquidated to form a new company.
Reduction of Capital	There is reduction of share capital and sometimes outside liability holders also have to reduce their claim or waive off.	There is no reduction of capital, instead fresh capital is brought into the new company.
Legal Compliance	Internal reconstruction is done as per provisions of Sec 61& 66 of the Companies Act 2013.	External reconstruction is done as per provisions of Sec 232 of the Companies Act 2013.
Transfer of Assets and Liabilities	There is no transfer of Assets and liabilities in case of internal Reconstruction.	Assets and Liabilities of existing company are transferred to new company.

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3 Methods of Internal Reconstruction

The following methods are generally used in the process of internal reconstruction :

3.1 Alteration of Share Capital

According to Sec 61 of the companies act 2013, a limited company can alter its share capital, if authorised by articles, by passing an ordinary resolution in the general meeting.

Subdivision or Splitting of shares : The existing share capital is **sub divided into smaller denominations** with amount of remaining unaffected.

For example : A company having 10,000 shares having face value Rs 10, fully paid up, decides to split its one share of 10 Each to 10 Shares of Rs 1 each.
The journal entry would be passed as :

Equity Share Capital A/c (Rs 10)	Dr.	100,000	
To Equity Share Capital A/c (Rs 1)			100,000

(Being the subdivision of 10,000 shares of Rs 10 each into 100,000 Shares of Rs 1 each)

Consolidation of Shares : The existing share capital is **consolidated into higher denominations** with amount of share capital remaining same.

For example : A company having 10,000 shares having face value Rs 10, fully paid up, decides to Consolidate its 10,000 shares of 10 Each to 1000 Shares of Rs 100 each.
The journal entry would be passed as :

Equity Share Capital A/c (Rs 10)	Dr.	100,000	
To Equity Share Capital A/c (Rs 100)			100,000

(Being the Consolidation of 10,000 shares of Rs 10 each into 1000 Shares of Rs 100 each)

In real life such journal entries are not passed, there is only change in disclosure in balance sheet.

Conversion of Fully paid shares into Stock : According to Sec 61 of Companies Act 2013, a company can convert its fully paid shares into stock and reconversion of stock into shares.
However, it should be authorised by articles of company and should be backed by passing of ordinary resolution in a general meeting.

A stock is nothing but a bundle of fully paid up shares put together which may be divided into any amount and transferred into any fraction and subdivision without regard to the original face value of share.

For example : ABC Ltd having 10,000 shares having face value Rs 10, fully paid up, decides to Convert the issued shares to stock.

The journal entry would be passed as :

Equity Share Capital A/c	Dr.	100,000	
To Equity Stock A/c			100,000

(Being conversion of 10,000 shares of Rs 10 each into Rs 100,000 Equity stock)

Reconversion of Stock into shares :

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For example : ABC Ltd having Rs 100000 stock decides to Reconvert the stock into shares of 10 Each

The journal entry would be passed as :

Equity Stock A/c Dr. 100,000
To Equity Share Capital A/c 100,000
(Being Reconversion of Rs 100,000 Stock into 10,000 shares of Rs 10 Each)

3.2 Variation of Shareholders Rights

Sec 48 of the Companies Act 2013, provides that when a company has issued different classes of shares with differential rights or privileges attached to such shares,For example; rights as to dividend, voting rights etc. Any such rights can be alterned in any manner.
Students should note that there is no change in the amount of share capital.
For example : ABC Ltd having 9% 100,000 preference shares of Rs 10 Each decides to change the rate of dividend to 10% on those shares.

Then the following journal entry would be passed :

9% Preference shares A/c Dr 10,00,000
To 10% Preference shares A/c 10,00,000
(Being rate on 100,000 preference shares changed from 9% to 10%)

3.3 Reduction of Share Capital

Sec 66 of the Companies Act 2013 deals with reduction of share capital. Company on obtaining approval from tribunal and passing special resolution may reduce the share capital in the following manner :
This reduction is sacrifice by the shareholders and amount of reduction or sacrifice is credited to a new account called **Capital Reduction account (or Reconstruction Account)**

1) **Extinguishing or reducing the liability of the shareholders in respect of unpaid amount on shares held by them :**

In this case, the shareholders are not called to pay remaining amount on the shares held by them.

For example : XYZ Ltd having shares with face value of Rs 100 each (80 Paid up) decides to cancel the unpaid amount of Rs 20 and makes into shares with Rs 80, fully paid up.

The entry in this case would be :

Share Capital (Partly Paid up)A/c Dr Rs 80 (FV Rs 100) × No of shares
To Share Capital (Fully paid up) A/c Rs 80 (FV Rs 80) × No of shares
(Being shares of FV Rs 100 each became shares of Rs 80 each)

2) Paying off any excess paid up share capital :
When company is not able to use the share capital in an efficient manner, it may decide to refund the excess capital to its shareholders.

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For example : XYZ Ltd having 1000 shares with face value of Rs 100 each decides to pay off Rs 80 per share to make it of Rs 80 fully paid up.

The entry in this case would be :

Share Capital Account (Rs 100)	Dr	100,000	
To Share Capital Account (Rs 80)			80,000
To Sundry Shareholders A/c			20,000
Sundry Shareholders A/c	Dr	20,000	
To Bank A/c			20,000

(Being excess capital of Rs 20 per share paid off)

3) Cacelling any paid up shares which is lost or is unrepresented by available assets.

Reduction in Paid up value only : In this case the nominal value of share remains same and only the paid value is reduced.

For example : ABC Ltd Shareholders decide to reduce the paid up capital of Rs 100 per share to Rs 60 per share, i.e., sacrificing Rs 40 per share

The entry in this case would be :

Share Capital A/c	Dr	Rs 40 × No of Shares	
To Capital Reduction A/c			Rs 40 × No of shares

(Being the sacrifice of Rs 40 per share having face value of Rs 100)

Reduction in both nominal and paid up values : In this case both the paid up and nominal value of the shares are reduced.

Continuing the previous example, entry would be:

Share Capital A/c	Dr	Rs 100 × No of Shares	
To Capital Reduction A/c			Rs 40 × No of shares
To Share Capital A/c			Rs 60 × No of shares

(Being the old shares of face value Rs 100 became new shares of Face value Rs 60)

3.4 Compromise/Arrangements :

A scheme of compromise and arrangement is an agreement between a company and its member and outside liabilities when the company faces financial problems.

Such arrangement also involves sacrifice by shareholders,or creditors or debentureholders or by all of them.

For example : ABC Ltd Shareholders decide to give up their right over the reserves and accumulated profits totalling to Rs 100,000.

The entry in this case would be :

Reserves A/c	Dr	Rs 100,000	
To Capital Reduction A/c			Rs 100,000

(Being shareholders decides to forego their rights on Reserves of the company)

3.5 Surrender of Shares

In this method, shares are divided into smaller denominations in order to increase the number of outstanding shares and then shareholders are called upon to **surrender their shares** to the company. Then these **shares are allotted to debenture holders or creditors** so that their liabilities are reduced.

4 Entries in Case of Internal Reconstruction

a. Appreciation of Asset or reduction in Liability :

Asset/Liability A/c	Dr	Rs XXXX	
To Capital Reduction A/c			Rs XXXX

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(Being Appreciation in the value of asset or reduction in value of liability being transferred to Capital reduction account)

b. **Over Valuation of Assets and Debit balance in Profit and loss account** :

Capital Reduction A/c Dr Rs XXXX
General Reserve A/c (if any) Dr Rs XXXX
To Asset A/c Rs XXXX
To Profit and Loss A/c Rs XXXX
(Being Overvaluation of asset and debit balance in P&L written off)

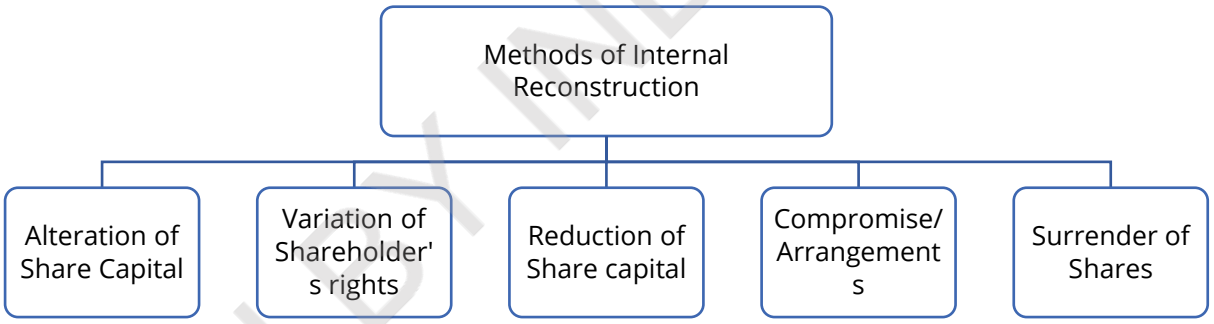
Any debit balance in P&L Account is written off against the surplus in capital reduction account even if not specified in question.

c. **Balance appearing in Capital Reduction Account** :

Capital Reduction A/c Dr Rs XXXX
To Capital Reserve A/c Rs XXXX
(Being excess balance in capital reduction account is transferred to Capital Reserve account)

Any balance in Capital Reduction account is adjusted against general reserves of the company.

5 Summary :



Few important points to be kept in mind by students while preparing balance sheet:

1) After the name of the company the words "**And Reduced**" should be added only if the court orders so.
2) In case of **fixed Assets,** the **amount written off** under the scheme of reconstruction must be shown for **five years**.
3) The balance in the reconstruction account to be transferred to **Capital Reserve** and should be shown under the head **Reserves and Surplus**.

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6 Illustrations

1. Illustration

The Balance Sheet of A & Co. Ltd. as on 31-12-2011 is as follows:

Assets	₹	₹
Fixed Assets:		
Freehold property	4,25,000	
Plant	50,000	
Patent	37,500	
Goodwill	1,30,000	6,42,500
Traded Investments (at cost)		55,000
Current Assets:		
Trade receivables	4,85,000	
Inventory	4,25,000	9,10,000
Profit and Los Account		5,35,000
Total		**21,42,500**
Liabilities		
Share Capital:		
4,000 6% Cumulative Preference Shares of ₹100 each	4,00,000	
75,000 Equity Shares of ₹10 each	7,50,000	11,50,000
6% Debentures (Secured on Freehold Property)	3,75,000	
Accrued Interest	22,500	3,97,500
Current Liabilities:		
Bank Overdraft	1,95,000	
Trade payables	3,00,000	
Directors' Loans	1,00,000	5,95,000
Total		**21,42,500**

The Court approved a Scheme of re-organisation to take effect on 1-1-2011, whereby:

i. The Preference shares to be written down to ₹ 75 each and Equity Shares to ₹ 2 each.

ii. Of the Preference Share dividends which are in arrears for four years, three fourths to be waived and Equity Shares of ₹2 each to be allotted for the remaining quarter.

iii. Accrued interest on debentures to be paid in cash.

iv. Debenture-holders agreed to take over freehold property, book value ₹ 1,00,000 at a valuation of ₹1,20,000 in part repayment of their holdings and to provide additional cash of ₹ 1,30,000 secured by a floating charge on company's assets at an interest rate of 8% p.a.

v. Patents and Goodwill to be written off.

vi. Inventory to be written off by ₹ 65,000.

vii. Amount of ₹68,500 to be provided for bad debts.

viii. Remaining freehold property to be re-valued at ₹ 3,87,and 500.

ix. Trade Investments be sold for ₹ 1,40,000.

x. Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹ 2 each and as to 5% in cash, and balance 5% being waived.

xi. There were capital commitments totaling ₹ 2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

xii. Ignore taxation and cost of the scheme.

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You are requested to show Journal entries reflecting the above transactions (including cash transactions) and prepare the Balance Sheet of the company after completion of the Scheme

Solution 1

❖ **Process for Internal Capital reduction:**

- Written confirmation from the stakeholders for the alteration /rearrangement to be made.
- Special resolution has to be passed.
- Court should approve the scheme of Internal Capital reduction passed wide Special resolution by the company.
- Court ensures the stakeholders have given willing freely.

(i)

Journal entries in the books of A & Co Ltd

Date	Particulars	Dr ₹	Cr ₹
1st Jan 2011	6% Preference share capital (₹100) A/c Dr To Capital Reduction A/c To 6% Preference share capital (₹75) A/c (Being reduction Preference share capital as per the scheme from ₹100 to ₹75)	4,00,000	 1,00,000 3,00,000
"	Equity share capital (₹10) A/c Dr To Capital Reduction A/c To Equity share capital (₹2) A/c (Being reduction Equity share capital as per the scheme from ₹10 to ₹2)	7,50,000	 6,00,000 1,50,000
"	Capital Reduction A/c Dr To Equity share capital A/c (Being arrears of preference dividend satisfied by the issue of equity shares,25% of the amount due ,₹96,000)	24,000	 24,000
"	Freehold Property A/c Dr To Capital Reduction A/c (Being appreciation in the value of the property) [Note: 1]	82,500	 82,500
"	6% Debentures A/c Dr To Freehold Property A/c (Being claims of debenture holders , in part , in respect of principal discharged by transfer of freehold property vide scheme of Reconstruction)	1,20,000	 1,20,000
"	Interest Payable A/c Dr To Bank A/c (Being Debenture interest paid)	22,500	 22,500
"	Bank A/c Dr To 8% Debentures A/c (Being 8% Debentures issued for cash)	1,30,000	 1,30,000

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"	Bank A/c To Investment A/c To Capital Reduction A/c (Being Investment sold on profit)	Dr	1,40,000	 55,000 85,000
"	Director's Loan A/c To Bank A/c To Capital Reduction A/c To Equity share capital A/c (Being director's loan discharged by issue of equity shares of ₹90,000, Cash payments of ₹5,000 and surrender of ₹ 5,000, vide the scheme of reconstruction)	Dr	1,00,000	 90,000 5,000 5,000
"	Capital Reduction A/c To Patent A/c To Goodwill A/c To Inventory A/c To Provision for Doubtful Debts A/c To Bank A/c To profit and Loss A/c (Being goodwill, patents, profit and loss written off, and value of stock reduced and provisions for doubtful debts and payment	Dr	8,48,500	 37,500 1,30,000 65,000 68,500 12,500 5,35,000

(ii)

Balance sheet of A & Co. Ltd. (And Reduced) as at 1.4.2011

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholder's funds**		
	A	Share capital	1	5,64,000
2		**Non-Current liabilities**		
	A	Long-term borrowings	2	3,85,00
3		**Current liabilities**		
	A	Trade Payables		3,00,000
	B	Short term borrowings	3	68,500
		Total		**13,17,500**
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	4,37,500
	B	Intangible assets	5	-
2		**Current assets**		
	A	Inventories		3,60,000
	B	Trade receivables		4,85,000
	C	Cash and Cash equivalents		35,000
				13,17,500

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		Total		

Notes to accounts

S.no	Particulars		₹
1	**Share Capital** • **Equity share capital:** 1,32,000 Equity shares of ₹2 each (of the above 57,000 shares have issued for consideration other than cash) • **Preference share capital:** 4,000, 6% preference share capital of ₹75 each		2,64,000 3,00,000
	Total		**5,64,000**
2	**Long term borrowings** **Secured** 6% Debentures 8% Debentures		 2,55,000 1,30,000
	Total		**3,85,000**
3	**Short term provisions** **Provision for doubtful debts**		68,500 -
4	**Property, Plant and Equipment** **Freehold property** Add: Appreciation under the scheme of Capital reduction Less: Disposed of **Plant**	4,25,000 82,500 (1,20,000)	 3,82,500 50,000
	Net carrying value		**4,37,500**
5	**Intangible assets** **Goodwill** Less: written off under the scheme of Capital reduction	1,30,000 (1,30,000)	 -
	Net carrying value		**NIL**
	Patent Less: written off under the scheme of Capital reduction	37,500 (37,500)	
	Net carrying value		**NIL**

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2. Illustration

Given below is the summarized balance sheet of Rebuilt Ltd. as on 31.3.2011:

Liabilities	Amount	Assets	Amount

Authorized and issued capital:		Building at cost less depreciation	4,00,000
12,000, 7% Preference shares of ₹ 50 each (Note: Preference dividend is in arrear for five years)	6,00,000	Plant at cost less depreciation	2,68,000
15,000 Equity shares of ₹ 50each	7,50,000	Trademarks and goodwill at cost	3,18,000
Loan	5,73,000	Inventory	4,00,000
Trade payables	2,07,000	Trade receivables	3,28,000
Other liabilities	35,000	Profit and loss A/c	4,51,000
	21,65,000		**21,65,000**

The Company is now earning profits short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders.

A summary of the scheme is as follows:

(i) The equity shareholders have agreed that their ₹50 shares should be reduced to ₹ 2.50 by cancellation of ₹ 47.50 per share. They have also agreed to subscribe for three new equity shares of ₹ 2.50 each for each equity share held.

(ii) The preference shareholders have agreed to cancel the arrears of dividends and to accept for each ₹ 50 share, 4 new 5% preference shares of ₹ 10each, plus 6 new equity shares of ₹ 2.50 each, all credited as fully paid.

(iii) Lenders to the company for ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.

(iv) The directors have agreed to subscribe in cash for 40,000, new equity shares of ₹ 2.50 each in addition to any shares to be subscribed by them under (i) above.

(v) Of the cash received by the issue of new shares, ₹2,00,000 is to be used to reduce the loan due by the company

(vi) The equity share capital cancelled is to be applied:

- to write off the debit balance in the profit and loss A/c; and
- to write off ₹ 35,000 from the value of plant.

(vii) Any balance remaining is to be used to write down the value of trademarks and goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of the company after reconstruction.

The nominal capital as reduced is to be increased to ₹ 6,50,000 for preference share capital and ₹ 7,50,000 for equity share capital.

Solution 2

Journal entries in the books of Rebuilt Ltd

Date	Particulars	Dr ₹	Cr ₹

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31st March 2011	Equity share capital (₹50) A/c Dr To Capital Reduction A/c To Equity share capital (₹2.5) A/c (Being Equity capital reduced to nominal value of ₹2.50 each)	7,50,000	 37,500 7,12,500
"	Bank A/c Dr To Equity share capital A/c (Being 3 right shares against each share was issued and subscribed)	1,12,500	 1,12,500
"	7% Preference share capital (₹50) A/c Dr Capital Reduction A/c Dr To 5% Preference share capital (₹10) A/c To Equity share capital (₹50) A/c (Being reduction Preference share capital as per the scheme from ₹100 to ₹75)	6,00,000 60,000	 4,80,000 1,80,000
"	Loan A/c Dr To 5% Preference share capital A/c To Equity share capital A/c (Being loan to the extent of ₹1,50,000 converted share capital)	1,50,000	 1,20,000 30,000
"	Bank A/c Dr To Equity share capital A/c (Being shares subscribed by the directors)	1,00,000	 1,00,000
"	Loan A/c Dr To Bank A/c (Being loan repaid)	82,500	 82,500
"	Capital Reduction A/c Dr To profit and Loss A/c To Plant A/c To Trademarks and Goodwill A/c (Being losses and assets written off to the extent required)	6,52,500	4,51,500 35,000 1,66,500

Balance sheet of Rebuilt Ltd. (And Reduced) as at 31.3.2011

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholder's funds**		
	A	Share capital	1	10,60,000
2		**Non-Current liabilities**		
	A	Long-term borrowings	2	2,23,000
3		**Current liabilities**		

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	A	Trade Payables		2,07,000
	B	Other Current liabilities	3	35,000
		Total		
		Assets		
1		**Non-current assets**		
	A	Property, plant and equipment	4	**15,25,000**
	B	Intangible assets	5	
2		**Current assets**		
	A	Inventories		6,33,000
	B	Trade receivables		1,51,500
	C	Cash and Cash equivalents		4,00,000
		Total		3,28,000
				12,500
				15,25,000

Notes to accounts

S.no	Particulars		₹
1	**Share Capital**		
	Authorized capital:		
	65,000 Preference shares of ₹10 each	6,50,000	
	3,00,000 Equity shares of ₹2.50 each	7,50,000	14,00,000
	Issued, subscribed and paid up:	4,60,000	
	1,80,000 equity shares of ₹2.50 each	6,00,000	10,60,000
	60,000, 5% Preference shares of ₹10 each		
	Total		**24,60,000**
2	**Property, Plant and Equipment**		
	Building at cost less depreciation	4,00,000	
	Plant at cost less depreciation	2,33,000	6,33,000
3	**Intangible assets**		
	Trademarks and Goodwill		1,51,500
4	**Cash and cash equivalents**		
	Bank (1,12,500+1,00,000-2,00,0000)		12,500

3. Illustration

Following is the summary balance sheet of ABC Ltd as at 31st March 2011:

Assets	Amt (Rs)	Liability	Amt (Rs)

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Share Capital: 2,00,000 Equity shares of ₹ 10 each fully paid up 6000 8% Preference shares of ₹100 each	20,00,000 6,00,000	Fixed Assets: P&M F&F	 9,00,000 2,50,000
9% Debentures	12,00,000	Patents & Copyrights	70,000
Bank OD	1,50,000	Investments (at costs) (MV- ₹55,000)	68,000
Trade Payables	5,92,000	Inventory	14,00,000
		Trade Receivables	14,39,000
		Cash & Bank	10,000
		P&L a/c	4,05,000
	45,42,000		**45,42,000**

The following scheme of internal reconstruction was agreed upon.

i. Preference shareholders would give up 30% of their capital in exchange of allotment of 11% Debentures to them.

ii. Debenture holders having charge on P&M would accept P&M in full settlement of their dues

iii. Inventory equal to ₹ 5 lacs book value will be taken by trade payables in full settlement of their dues

iv. Investments to be reduced to market price

v. Company would issue 11% Debentures for ₹3 lacs and augment its working capital requirement after settlement of bank overdraft

Pass necessary journal entries and draft a balance sheet after reconstruction

Solution 3

Journal entries in the books of ABC Ltd

Date	Particulars	Dr ₹	Cr ₹
31st March 2011	8% Preference share capital A/c Dr To 11% Debentures A/c To Capital reduction A/c (Being 30% reduction in liability of Preference share capital as per the scheme and issue of 11% debentures)	6,00,000	 4,20,000 1,80,000
"	9% Debentures A/c Dr To Plant and machinery A/c To Capital reduction A/c (Being settlement of debenture holders by allotment of plant and machinery)	12,00,000	 9,00,000 3,00,000
"	Trade payables A/c Dr To Inventory A/c To Capital reduction a/c (Being settlement of creditors by giving Inventories)	5,92,000	 5,00,000 92,000

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"	Bank A/c To 11% Debentures A/c (Being fresh issue of debentures)	Dr	3,00,000	 3,00,000
"	Bank overdraft A/c To Bank A/c (Being settlement of bank overdraft)	Dr	1,50,000	 1,50,000
"	Capital Reduction A/c To Investment A/c To profit and Loss A/c To Capital reserve A/c (Being decrease in investment and profit and loss A/c (Dr.bal.); and balance of capital reduction account transferred to capital reserve)	Dr	5,72,000	 13,000 4,05,000 1,54,000

Capital Reduction A/c

	₹		₹
To Investment A/c	13,000	By Preference share capital A/c	1,80,000
To Profit and loss A/c	4,05,000	By 9% Debentures holders A/c	3,00,000
To Capital reserve A/c	1,54,000	By Trade payables A/c	92,000
	5,72,000		5,72,000

Balance sheet of Rebuilt Ltd. (And Reduced) as at 31.3.2011

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholder's funds**		
	A	Share capital	1	20,00,000
	B	Reserves and Surplus	2	1,54,000
2		**Non-Current liabilities**		
	A	Long-term borrowings	3	7,20,000
				15,25,000
		Total		
1		**Assets**		
	A	**Non-current assets**	4	2,50,000
	B	Property, plant and equipment	5	70,000
	C	Intangible assets	6	55,000
2		Non-current investment		
	A	**Current assets**		
	B	Inventories (₹14,00,000 - ₹5,00,000)		9,00,000
	C	Trade receivables		14,39,000
		Cash and Cash equivalents [Note: 1]		1,60,000

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		Total		**15,25,000**

Note: 1 - Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid
= ₹10,000 + ₹ 3,00,000 – ₹1,50,000 = ₹ 1,60,000

Notes to accounts

S.no	Particulars	₹
1	**Share Capital**	
	2,00,000 Equity shares of ₹10 each fully paid up	20,00,000
2	**Reserves and Surplus**	
	Capital reserves	1,54,000
3	**Long Term Borrowings**	
	11% Debentures (₹4,20,000 + ₹3,00,000)	7,20,000
4	**Property, Plant and Equipment**	
	• Plant & machinery 9,00,000	
	Less: Adjustment on scheme of Capital reduction (9,00,000)	-
	• Furniture & fixtures	2,50,000
5	**Intangible assets**	
	Patents & copyrights	70,000
6	**Non-Current Investments**	
	Investments (₹ 68,000 - ₹13,000)	55,000

4. Illustration

Repair Ltd. is in the hands of a receiver for debenture holders who holds a charge on all assets except uncalled capital. The following statement shows the position as regards creditors as on 30th June 2012:

Liabilities	₹	Assets	₹
6,000 shares of ₹ 60 each,		Property, machinery and Plant (Cost ₹3,90,000) Estimated at	1,50,000
₹30 paid up		Cash in hand of the receiver	2,70,000
First debentures	3,00,000	Charged under debentures	4,20,000
Second debentures	6,00,000	Uncalled capital	1,80,000
Unsecured trade payables	4,50,000	Sub-Total	6,00,000
		Deficiency	7,50,000
	13,50,000		**13,50,000**

The following scheme is proposed:

i. A holds the first debentures for ₹3, 00,000 and second debentures for ₹3, 00,000. He is also an unsecured creditor for ₹ 90,000. B holds second debentures for

ii. ₹3, 00,000 and is an unsecured trade payable for ₹ 60,000.

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ii. The following scheme of reconstruction is proposed:

iv. A is to cancel ₹ 2,10,000 of the total debt owing to him, to bring ₹ 30,000 in cash and to take first debentures (in cancellation of those already issued to him) for ₹ 5,10,000 in satisfaction of all his claims.

v. B is to accept ₹ 90,000 in cash in satisfaction of all claims by him.

vi. In full settlement of 75% of the claim, unsecured creditors (other than A and B) agreed to accept four shares of ₹ 7.50 each, fully paid against their claim for each share of ₹ 60. The balance of 25% is to be postponed and to be payable at the end of three years from the date of Court's approval of the scheme. The nominal share capital is to be increased accordingly.

vi. Uncalled capital is to be called up in full and ₹ 52.50 per share cancelled, thus making the shares of ₹ 7.50 each.

Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries.

Solution 4

Journal entries in the books of Repair Ltd

Date	Particulars		Dr ₹	Cr ₹
31st March 2011	First debentures A/c	Dr	3,00,000	
	Second debentures A/c	Dr	3,00,000	
	Unsecured creditors A/c	Dr		
	To A's A/c		90,000	6,90,000
	(Being A's total liability ascertained)			
"	A's A/c	Dr	2,10,000	
	To Capital reduction A/c			2,10,000
	(Being cancellation of debt upto ₹2,10,000)			
"	Bank A/c	Dr	30,000	
	To A's A/c			30,000|
	(Being cash received in course of settlement)			
"	A's A/c [Note: 1]	Dr	5,10,000	
	First debentures A/c			5,10,000
	(Being liability of A, discharged against first debentures)			
"	Second debentures A/c	Dr	3,00,000	
	Unsecured creditors A/c	Dr	60,000	
	To B's A/c			3,6,000
	(Being B's liability ascertained)			
"	B's A/c [Note: 2]	Dr	3,60,000	
	To Bank A/c			90,000
	To Capital reduction A/c			2,70,000
	(Being B's liability discharged)			
"	Unsecured trade payables A/c [Note: 3]	Dr	3,00,000	
	To Equity share capital A/c			1,12,500
	To Loan A/c (unsecured)			75,000
	To Capital reduction A/c			1,12,500

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	(Being settlement of unsecured creditors)		
"	Share call A/c Dr To share capital A/c (Being final call money due)	1,80,000	1,80,000
"	Bank A/c Dr To share call A/c (Being final call money received)	1,80,000	1,80,000
"	Share capital A/c (Face value ₹60) Dr To share capital A/c (Face value ₹7.50) To Capital reduction A/c (Being share capital reduced to ₹7.50 each)	3,60,000	45,000 3,15,000
"	Capital reduction A/c Dr To Profit and Loss A/c (Being Capital reduction surplus used to write off losses)	8,70,000	8,70,000

Note: 1

A	**1st Debentures ₹**	**2nd Debentures ₹**	**Creditors ₹**
Opening Balance	3,00,000	3,00,000	90,000
Total			**6,90,000**
Less : Cancelled			(2,10,000)
To be settled			4,80,000
Add: Fresh introduction of cash			30,000
New debt			**5,10,000**

Note: 2

B	**2nd Debentures ₹**	**Creditors ₹**
Before adjustment	3,00,000	60,000
Total		**3,60,000**
Less : To be paid in cash		(90,000)
Amount to be transferred to Capital reduction		**2,70,000**

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Note: 3

Unsecured Trade payables	₹
Balance given	4,50,000
Less: A	(90,000)
Less: B	(60,000)
	3,00,000
25% postponed (Unsecured Trade payables in Balance sheet)	(75,000)
(i)	**2,25,000**
No. of shares to be issued (2,25,000÷ 60) x 4	15,000
Total Value of shares to be issued (15,000 x 7.5) =>(ii)	**1,12,50+ .00**
Transferred to Capital reduction A/c (i) - (ii)	**1,12,500**

5. Illustration

The Summarized Balance Sheet of Revise Limited as at 31st March, 20X1 was as follows:

Liabilities	₹	Assets	₹
Authorized and subscribed capital:		Fixed Assets :	
10,000 Equity shares of		Machineries	1,00,000
₹ 100 each fully paid	10,00,000	Current assets :	
Unsecured Loans :		Inventory	3,20,000
12% Debentures	2,00,000	Trade receivables	2,70,000
Accrued interest	24,000	Bank	30,000
Current liabilities		Profit and loss account	6,00,000
Trade payables	72,000		
Provision for income tax	24,000		
	13,20,000		**13,20,000**

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from appropriate authorities. Accordingly, it was decided that:

i. Each share is sub-divided into ten fully paid up equity shares of ₹ 10 each.

ii. After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables as necessary.

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ii. Out of shares surrendered, 10,000 shares of ₹ 10 each shall be converted into 12% preference shares of ₹10 each, fully paid up.

iv. The claims of the debenture-holders shall be reduced by 75 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of ₹1, 00,000 which are converted out of shares surrendered.

v. Trade payables claim shall be reduced to 50 per cent, it is to be settled by the issue of equity shares of ₹10 each out of shares surrendered.

vi. Balance of profit and loss account to be written off.

vii. The shares surrendered and not re-issued shall be cancelled.

vii. You are required to show the journal entries giving effect to the above and the resultant Balance Sheet

Solution 5

Journal entries in the books of Revise Ltd

Date	Particulars		Dr ₹	Cr ₹
31st March 2011	Equity Share capital (₹100) A/c	Dr	10,00,000	
	To Share capital (₹10) A/c			5,00,000
	To Share surrender A/c			5,00,000
	(Being sub division of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)			
"	12% Debentures A/c	Dr	1,50,000	
	Interest payables A/c	Dr	18,000	
	To Capital reduction A/c			1,68,000
	(Transferred 75% of the claims of the debentures holders to capital reduction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
"	Trade payables A/c	Dr	72,000	
	To Capital reduction A/c			72,000
	(Transferred claims of trade payables to Capital reduction account, 50% of which is being clear reduction and equity are being issued in consideration of the balance)			
"	Share Surrender A/c	Dr	5,00,000	
	To 12% Preference share capital A/c			1,00,000
	To Equity share capital A/c			36,000
	To Capital reduction A/c			3,64,000

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	(Issued preference and equity shares to discharge the claims of the debentures holders and trade payables respectively as per scheme and the balance in share surrender account is being transferred to capital reduction account)		
"	Capital reduction A/c Dr To Profit and Loss A/c To Capital Reserve A/c (Being debit balance of P&L A/c adjusted against capital reduction and the balance in latter is transferred to capital reserves)	6,04,000	 6,00,000 4,000

Balance sheet of Revise Ltd. (And Reduced) as at 31.3.2011

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholder's funds**		
	A	Share capital	1	6,36,000
	B	Reserves and Surplus	2	4,000
2		**Non-Current liabilities**		
	A	Long-term borrowings	3	50,000
3		**Current liabilities**		
	A	Other Current liabilities	4	6,000
	B	Short term provisions	5	24,000
				15,25,000
		Total		
1		**Assets**		
	A	**Non-current assets**	6	1,00,000
		Property, plant and equipment		
2				
	A	**Current assets**		
	B	Inventories		
	C	Trade receivables		3,20,000
		Cash and Cash equivalents		2,70,000
				30,000
		Total		**15,25,000**

Notes to accounts

S.no	Particulars	₹

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1	**Share Capital**	
	• **Equity share capital:**	
	Issued Capital: 53,600 Equity Shares of ₹10 each	5,36,000
	• **Preference share capital:**	
	(Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	1,00,000
		6,36,000
	Total	
2	**Reserve and Surplus**	4,000
3	Capital Reserve	
	Long Term Borrowings	
	Unsecured Loans	50,000
	12% Debentures	
4	**Other current liabilities**	6,000
	Interest payable on debentures	
5	**Short-term provisions**	24,000
	Provisions for Income-tax	
6	**Property, plant and Equipment**	1,00,000
	Machinery	

Working note:

Capital Reduction A/c

	₹		₹
To Profit and loss A/c	6,00,000	By Debentures A/c	1,68,000
To Capital reserve A/c	4,000	By Trade payables A/c	72,000
			3,64,000
	6,04,000		6,04,000

Share Surrender A/c

	₹		₹
To 12% Preference share capital A/c	1,00,000	By Equity share capital A/c	5,00,000
To Equity share capital A/c	36,000		
To Capital reduction A/c (bal.fig)	3,64,000		
	5,00,000		5,00,000

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CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS OF GROUP ENTITIES

1 Introduction

Consolidated financial statements provide a complete overview of the operations and profitability of the entire group which is controlled by the parent. Separate financial statements present the financial position of a single entity for which the financial statements are prepared.

2 Requirement to prepare Consolidated Financial Statements

Section 129(3) of Companies Act, 2013 requires a company having subsidiary(s) to prepare consolidated financial statement of all the subsidiary(s) in the same form and manner as that of its own and to lay such consolidated financial statement before the Annual General Meeting of the company for adoption.

Ind AS 110 'Consolidated Financial Statements' provides the criteria for evaluation of whether an entity controls one or more other entities to treat them as subsidiaries of the entity. It also explains the procedures for preparation of consolidated financial statements including the requirements for elimination of inter-company transactions, accounting of non-controlling interests, accounting of loss of control over subsidiaries etc.

3 Consolidation Process

- Determine date of obtaining control. (Goodwill/ Capital reserve under Ind AS 103)
- Identify parent's stake and non-controlling interest
- Analysis of reserves (both pre-acquisition and post acquisition)
- Calculate goodwill/ bargain on purchase
- Determine carrying amount of non-controlling interest
- Determine parent's consolidated reserve balance
- Eliminate Inter-company balances & Unrealised profits
- Prepare consolidated balance sheet

4 Calculation of Goodwill/Capital reserve

Determine the fair value of consideration transferred
Determine the amount of non-controlling interest
Determine the fair value of subsidiary's identifiable net assets as per Ind AS 103
Determine goodwill / gain on bargain purchase (i.e. capital reserve)

5 Calculation of Goodwill/ Capital reserve in case of step acquisition

In a business combination achieved in stages, the acquirer shall

(a) remeasure its previously held equity interest (investment) in the acquiree at its acquisition-date fair value and

(b) recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income (depending classification as per Ind AS 109).

(c) the acquirer derecognises its investment asset in an entity in its consolidated financial statements when it achieves control.

6 Control obtained without transfer of consideration

These include –

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(a) The acquiree **repurchases** a sufficient number of its own shares for an existing investor (the acquirer) to obtain control. For e.g. if the acquiree buy backs shares from other investors, the acquirer's % holding would increase and control is obtained.
(b) **Minority veto rights lapse** that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.
(c) The acquirer and acquiree agree to combine their businesses **by contract** alone.

The acquirer shall remeasure its existing equity interest in the acquiree at its acquisition date fair value (and recognise the gain or loss on such remeasurement in profit or loss or other comprehensive income, as the case may be) and use that to compute goodwill or gain on bargain purchase.

In a business combination achieved by contract alone, the equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests (100%) in the acquiree are attributed to the non-controlling interest.

7 Measurement of Non Controlling Interest

The acquirer shall **measure at the acquisition date** components of non-controlling interest that give the holder ownership interest in the acquiree at either:

a) Fair value or
b) The present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

8 Consolidation Adjustments

8.1 Elimination of intra group transactions

Intra – group balances and intra – group transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intra – group transactions should also be eliminated unless cost cannot be recovered.

For Example:

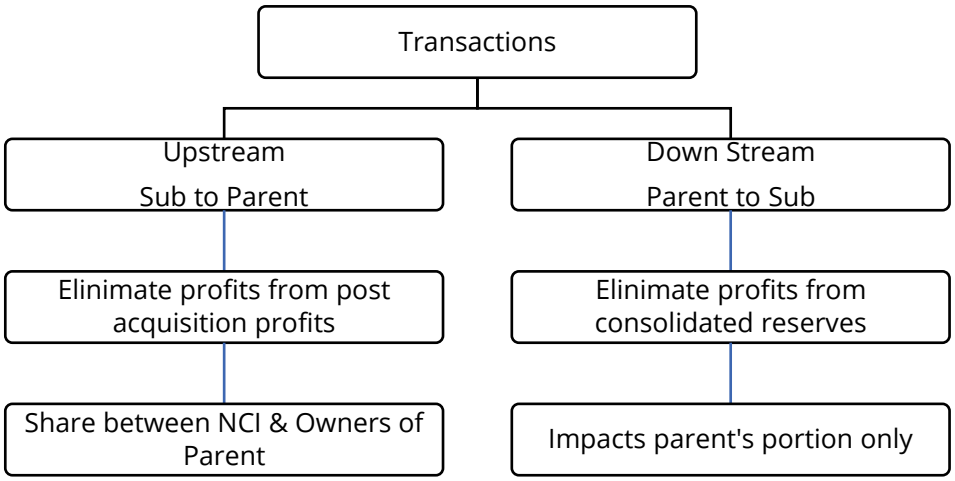
(a) Liabilities due to one group entity by another will be set off against the corresponding asset in the other group entity.
(b) Sales made by one group entity to another should be excluded from turnover and from purchase

8.2 Unrealised profit on transfer of assets

Unrealized profits resulting from intra-group transactions that are included in the carrying amount of assets, such as inventories and Property, Plant and Equipment, Intangible Assets and Investment Property, are eliminated in full.

The requirement to eliminate such profits in full applies to the transactions of all subsidiaries that are consolidated – even those in which the group's interest is less than 100%.

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In case non current assets like PPE are sold by one group company to another group company, the depreciation in stand alone financial statements is charged based on the acquisition price by the buyer. In consolidated financial statements, the difference in depreciation (calculated based on selling price and cost) should be adjusted

8.3 Dividends declared by subsidiary

Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting. Dividend is recognised in statement of profit and loss by holding when it obtains right to receive

8.4 Negative balance – Non Controlling Interest

(i) Do not adjust the loss of minority interest from parent company share
(ii) Show it as negative balance under equity

9 Uniform accounting policies

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

10 Chain holding under consolidation

10.1 Meaning:

Chain-holding refers to situations wherein a parent is controlling a subsidiary indirectly, i.e., having a controlling interest over a company indirectly.
For Example:
Parent company (P Ltd.) holding controlling interest in a subsidiary (S1 Ltd.).
S1 Ltd is holding a controlling interest in another company (S2 Ltd.).
In this case, P Ltd. is having an indirect control over S2 Ltd. through its direct subsidiary S1 Ltd.

10.2 Consolidation procedure in case of chain-holding

Situation 1 – Sub subsidiaries
Parent P □□80% □□Subsidiary 1 □□60% □□Sub-subsidiary (S2)
In the above case,

- P owns 80% of 60% = 48% of S2
- The non-controlling interest (NCI) in S1 owns 20% of 60% = 12% of S2

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- The non-controlling interest (NCI) in S2 itself owns the remaining 40% of the S2 equity.

The date the sub-subsidiary (S2) comes under the control of the holding company is either

- The date P acquired S1 if S1 already holds shares in S2, or
- If S1 acquires shares in S2 later, i.e. after the acquisition by P in S1, then such date of acquisition by S1.

Situation 2 - Direct holding in sub-subsidiaries:
Parent P holds 80% of shares in Subsidiary 1 and 10 percent of shares in subsidiary 2.
Subsidiary 1 holds 75% of shares in Subsidiary 2.

Particulars	Percentage
Direct non-controlling share (NCI) in S1	80%
Direct non-controlling share (NCI) in S2 (25-10)	15%
Indirect non-controlling share (NCI) in S2 of 20% x 75%	15%

The effective interest in sub-subsidiary is

Group (80% x 75%)	60%
Direct holding	10%
Control	70%

11 Loss of control in subsidiary

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

(a) Loss of control due to outright sale**(entire stake is sold off)**
(b) Loss of control due to partial sale **(parent retains interest as an associate, jointly controlled entity or a financial asset)**
(c) Deemed loss of control where no consideration is received but the parent's interest is diluted in some other manner such as
- voting rights issued to a new investor
- control on relevant activities
- consolidation of voting rights of other shareholders
- an investor acquiring substantial stake from the stock exchange.

11.1 Accounting treatment on loss of control of a subsidiary

Derecognise	Recognise	Reclassify	Recognise gain/loss
• The assets including any goodwill) and liabilities of the subsidiary • The carrying amount of any non-controlling interests in the former subsidiary	• The fair value of the consideration received • If loss of control involves a distribution of shares of the subsidiary to owners, then that distribution; and • any investment retained in the former subsidiary at its fair value at the date when control is lost	To profit or loss, or transfer directly to retained earnings if required by other Ind ASs, the amounts recognised in other comprehensive income in relation to the subsidiary.	Recognise any resulting difference as a gain or loss in profit or loss attributable to the parent
	The fair value at which the retained interest is recognized shall be regarded as	The parent shall account for all amounts previously recognized in other	

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	• 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.	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	

11.2 Loss of control of a subsidiary in two or more arrangements

The above requirement is relevant because Ind AS 110 requires an entity to record gain / loss on disposal of investment in subsidiary in profit or loss only when the control is lost.
A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction.

One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:

(i) They are entered into at the same time or in contemplation of each other.
(ii) They form a single transaction designed to achieve an overall commercial effect.
(iii) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
(iv) One arrangement considered on its own is not economically justified, unless it is considered together with other arrangements.

For Example:
When a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

12 Preparation of consolidated financial statements after applying consolidation principles

12.1 Preparation of consolidated balance sheet

- Assets and outside liabilities of the subsidiary company are combined with those of the parent company.
- Appropriate intra group elimination adjustments are recognised.
- The equity share capital of the subsidiary and investment of parent company are eliminated and goodwill / capital reserve and non-controlling interest are recognised.
- The parent's share in post-acquisition profits of the subsidiary company (added to appropriate concerned account of the parent company) are accounted in consolidated balance sheet.

12.2 Preparation of consolidated profit & loss

- The items of income and expenses are added on line by line basis.
- Intra-group transactions are eliminated in full

12.3 Preparation of consolidated profit & loss

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

13 Ind AS 110 – Theory concepts

13.1 Introduction

A parent that controls one or more subsidiaries should prepare consolidated financial statements.

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However, the parent entity that meets all of the following conditions **need not present consolidated financial statements:**

(i) The entity is a **wholly owned or partly owned subsidiary** of another entity and all the **owners** of the entity are **informed, and they do not object** to the entity not preparing consolidated financial statements

(ii) The **debt or equity instruments of the entity are not traded** in a public market (whether domestic or foreign stock exchange or an over-the-counter market, including local and regional markets)

(iii) The entity **has not filed 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**

(iv) The entity's **ultimate or any intermediate parent** produces financial statements that are **available for public use** and comply **with Ind AS**, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with Ind AS 110

13.2 Exceptions to consolidation

(i) Post-employment benefit plans or other long-term employee benefit plans to which Ind AS 19 'Employee Benefits' applies.

(ii) An investment entity that is required to measure all of its subsidiaries at fair value through profit or loss need not present consolidated financial statements

13.3 Investment Entity

An entity is an investment entity if it fulfils all the following conditions:

(i) **Obtains funds** from one or more investors for providing those investor(s) with investment management services.

(ii) Commits to its investor(s) that its business purpose is **to invest funds solely for returns** from capital appreciation, investment income, or both

(iii) Measures and evaluates the performance of substantially all of its investments on a **fair value basis**.

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

a. Acquisition, use, exchange or exploitation of the processes, assets or technology of an investee.
b. Joint arrangements or other agreements between the entity or another group member and an investee to develop, produce, market or provide products or services.
c. Financial guarantees or assets provided by an investee for borrowing arrangements of the entity or another group member.
d. An option held by a related party of the entity to purchase, from that entity or another group member, an ownership interest in an investee of the entity
e. Transactions between the entity or another group member and an investee that are
   - On terms that are unavailable to unrelated parties; or
   - Not at fair value; or
   - Represent a substantial portion of the investee's or the entity's or other group entities' business

Characteristics of an Investment Entity

(i) More than one investment

(ii) More than one investor

(iii) Investors are not related parties of the entity

(iv) Entity has ownership interests in the form of equity or similar interests

13.4 Control Evaluation

An entity controls another entity when all the 3 conditions are satisfied

(i) Power over the investee

(ii) Exposure, or rights, to variable returns from the investee
(iii) Ability to use power over the investee to affect the investor's returns

13.5 Power over the investee

An investor gets power over an investee if
(i) Existing rights that give it
(ii) the current ability
(iii) to direct the relevant activities of the investee

13.6 Identification of relevant activities

Relevant activities are activities of the investee that significantly affect the investee's returns. Relevant activities includes but not limited to
(i) Selling and purchasing of goods and services
(ii) Managing financial assets during their life (including upon default)
(iii) Selecting, acquiring or disposing of assets
(iv) Researching and developing new products or processes
(v) Determining a funding structure or obtaining funding
(vi) Establishing operating and capital decisions of the investee, including budgets
(vii) Appointing, terminating and remunerating an investee's key management personnel or service providers

13.7 Rights that give power to an investor

(i) Rights in the form of voting rights (or potential voting rights)
(ii) Rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities
(iii) Rights to appoint or remove another entity that directs the relevant activities
(iv) Rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor
(v) Other rights (such as decision-making rights specified in a management contract)

13.8 Substantive Vs Protective Rights

Protective rights:

Protective rights are the rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate
(i) These rights do not give investor power over the investee.
(ii) Relate to protect the interest of the party holding those rights without giving the holder the right over the relevant activities of the investee.

For Example:

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

Substantive rights:

The general rule is that Substantive rights come from voting rights.
Substantive rights give the investor power over the investee and relate to the relevant activities of the investee. Holder must have the practical ability to exercise that right.

Factors to be considered while assessing whether the rights are substantive:

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(i) Whether there are any barriers that prevent the holder from exercising the rights. Such barriers include
   (a) Financial penalties and incentives
   (b) High exercise or conversion price
   (c) Terms and conditions that make it unlikely that the rights would be exercised
   (d) The absence of an explicit, reasonable mechanism in the founding documents of an investee or in applicable laws or regulations that would allow the holder to exercise its rights.
   (e) The inability of the holder of the rights to obtain the information necessary to exercise its rights.
   (f) Operational barriers or incentives. For example, in case of a venture capital fund managed by an asset manager, there is absence of other managers willing or able to provide specialised services or provide the services and take on other interests held by the existing manager.
   (g) Legal or regulatory requirements.

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

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

13.9 Evaluation of right

Rights held by the Investor	Rights held by other party	Conclusion on Power
Substantive	Protective	Investor has power
Protective	Substantive	Other parties have Power
Substantive	Substantive	Further evaluation

13.10 Franchises

In a franchise agreement, the investee i.e., the franchisee usually give the franchisor the rights that are related to protect the franchise brand.

Salient features of a franchise agreement that indicate that rights of franchisor are protective rights:

   (a) Franchisor's right do not give it ability to direct the relevant activities of franchisee
   (b) Other parties have current ability to direct the relevant activities of the franchisee
   (c) Franchisor's rights do not affect the rights of others to take decisions about relevant activities
   (d) Franchisee operates the business for its own account

The lower the level of financial support provided by the franchisor and the lower the franchisor's exposure to variability of returns from the franchisee the more likely it is that the franchisor has only protective rights.

13.11 Power without a majority of voting rights

The general rule is that substantive rights come from voting rights. There can be certain cases where an investor can have power even if it holds less than a majority of the voting rights of an investee.

For Example:

   (a) Purpose and design of investee.
   (b) Rights from other contractual arrangements
   (c) The investor's voting rights. **(De-facto control)**
   (d) Special relation between investor and investee.

De-facto control:

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There may be certain situations where even though an investor is not holding majority of the voting rights, but the voting rights held by it are sufficient to give it practical ability to have power over the investee unilaterally. In assessing the sufficiency of the voting rights of an investor, one should consider the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders

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

Special relation between investor and investee:
Ind AS 110 provides guidance to enable the assessment of power whereby the investor shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. Following are some of the examples of such evidences

- The investor can appoint or approve the investee's key management personnel who can direct the relevant activities
- The investor can direct the investee to enter into, or can veto any changes to, significant transactions for the benefit of the investor
- The investor can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.
- The investee's key management personnel are related parties of the investor
- The majority of the members of the investee's governing body are related parties of the investor

Exposure or rights to Variable returns from Investee:
Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative.
An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns.

Variable returns include

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

Link between power and returns:
An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.
Thus, an investor with decision-making rights shall determine whether it is a **principal or an agent.** An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties.

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

- The scope of the decision-making authority
- Rights held by other parties **(Removal rights/Other substantive rights)**
- **Remuneration from the investee** – If the magnitude of, and variability associated with, the decision maker's remuneration relative to the returns expected from the activities of the investee is higher, then decision maker is principal. If the magnitude is lower, then decision maker is an agent.
- **Exposure to variable returns from other interests in the investee** - The magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate is higher, then decision maker is principal. If the magnitude is lower, then decision maker is an agent.

14 Ind AS 111 – Joint Arrangements

14.1 Assessment of Joint Arrangement

A joint arrangement is an arrangement of which two or more parties have joint control. The characteristics of joint arrangement are

- The parties are bound by a contractual arrangement
- The contractual arrangement gives two or more of those parties joint control of the arrangement

14.2 Contractual Arrangement

One of the essential elements of a joint arrangement is that there has to be a contractual arrangement between the parties to the arrangement. The contractual arrangement generally deals with such matters as

- Purpose, activity and duration of the joint arrangement
- How the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed.
- Decision making process such as matters requiring decisions from the parties, voting rights of parties and the required level of support for those matters.
- Capital or other contributions required of the parties
- How the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement.

14.3 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.

In order to assess the joint control, an entity that is a party to an arrangement should first assess that whether the contractual arrangement gives all the parties or a group of the parties control over the arrangement. All the principles of control assessment, would be relevant while doing the assessment of joint control by the parties

- Power over the relevant activities of the investee
- Exposure to returns
- Ability to use the power to affect the returns of the investee

14.4 Types of Joint Venture

The entity needs to determine whether the joint arrangement is a joint operation or a joint venture depending upon the rights and obligations of the parties to the arrangement to determine the way the joint arrangement is accounted for i.e. whether it is a consolidation of assets, liabilities, income and expenses or use of equity method specified under Ind AS 28.

Joint Operation:

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators

Joint Venture:

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A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

If the joint arrangement is structured through a separate vehicle, then the entity shall consider

- The legal form of the separate vehicle
- The terms of the contractual arrangement
- When relevant, other facts and circumstances

15 Ind AS 28 – Investments in Associates and Joint Ventures

15.1 Scope

Ind AS 28 shall be applied by all entities that are

- investors with joint control of an investee (i.e. the investee is a joint venture of the investor) or
- significant influence over an investee (i.e. the investee is an associate of the investor)

15.2 Significant Influence

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. Substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

15.3 Presumption of significant influence

- If an entity holds (directly or indirectly through a subsidiary) 20% or more of the voting rights of an investee then it is presumed that the entity has significant influence, unless it can be clearly demonstrated that it is not the case.
- If the entity holds, (directly or indirectly through a subsidiary), less than 20% of¬ the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated.

15.4 Judgement required in assessment of significant influence

The investor shall consider following factors which generally demonstrate the existence of significant influence:

- Representation on the board of directors or equivalent governing body of the investee
- Participation in policy-making processes, including participation in decisions about dividends or other distributions
- Material transactions between the entity and its investee
- Interchange of managerial personnel
- Provision of essential technical information

15.5 Consideration of potential voting rights

- Potential voting rights that are currently exercisable are considered when assessing whether an entity has significant influence.
- Potential voting rights that are currently not exercisable are not considered for the assessment.
- In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances except
    - the intentions of management and
    - the financial ability to exercise those potential rights.

15.6 Loss of Significant Influence

An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee.
The loss of significant influence can occur with or without a change in ownership levels.

16 Equity method of Accounting in CFS

Investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income

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16.1 Application of equity method

Under the equity method of accounting, an investor shall pass following entries at various stages of investment:

- Initial entry to record investment done in associate or joint venture at cost
- Recording of investor's share in the profit / loss of the associate or joint venture after the date of acquisition
- Recording of investor's share in the other comprehensive income of the associate or joint venture after the date of acquisition
- Distributions received from an investee (dividends/share of profit)

16.2 Potential voting rights

The possible effect of exercise or conversion of any potential voting rights are not considered for applying equity method. Instruments with such potential voting rights are accounted for as per Ind AS 109.
But, if potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture. In such cases, the investor shall account for instruments with such potential voting rights as per equity method

16.3 Exemptions from Equity Method

Exemption 1

- Entity is wholly owned or partly owned subsidiary of another entity and all the owners of entity are informed and they do not object to entity not applying equity method.
- The entity's 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 Ind AS 110.

Public trading of instruments of the entity

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

Exemption 2

When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with Ind AS 109. Such election shall be made separately for each associate or joint venture at time of its initial recognition.

Exemption 3

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

16.4 Outstanding Preference shares classified as equity

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. No treatment is required if the shares are non cumulative.

16.5 Group's share in an associate or a joint venture

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For applying the equity method, an entity shall consider the share held by it directly or indirectly (through a subsidiary) in an associate or a joint venture. The holding by the entity's associate or joint venture in another associate or joint venture of the entity is ignored for this purpose.

When an associate or a joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's financial statements which include the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures.

16.6 Upstream and Downstream transactions

The entity shall record such gain / loss in its financial statements only to the extent of the unrelated investors' interests in the associate or joint venture. In other words, the portion of gain / loss attributable to the entity will be eliminated.

16.7 Long term interests in associate or joint venture

An entity might hold financial instruments in an associate or joint venture other than the investments accounted for using the equity method.

These include preference shares and long term receivables or loans but do not include trade receivables, trade payables any long-term receivables for which adequate collateral exists, such as secured loans.

An entity shall account such long-term interest in accordance with Ind AS 109.

16.8 Interest in share of losses

- In case of a loss making associate or joint venture, an entity's share of losses of such associate or joint venture may equal or exceed its interest in the associate or joint venture.
- In such case, the entity discontinues recognized its share of further losses.
- The interest in the associate or joint venture not only includes the carrying amount of the investment in the associate or joint venture determined using the equity method but also includes any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture.
- An entity should first apply Ind AS 109 to long-term interests and then apply the above requirement of allocating to such long-term interest any share in loss of associate or joint venture.
- An entity shall not take account of any adjustments to the carrying value of long-term interests that arise from applying Ind AS 28.
- Losses recognized using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (i.e. priority in liquidation).
- After the entity's interest is reduced to zero, additional losses are provided for, and a liability is recognized, only to the extent that the entity has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.
- If the associate or joint venture subsequently reports profits, the entity resumes recognized its share of those profits only after its share of the profits equals the share of losses not recognized.

17 Impairment of Joint Venture/ Associate

An entity shall determine whether there is an objective evidence that the entity's net investment in an associate or a joint venture is impaired.

The evidence of impairment arise as a result of

- One or more events that occurred after the initial recognition of the net investment (a 'loss event') and
- Loss event (or events) has an impact on the estimated future cash flows from the net¬ investment that can be reliably estimated.

17.1 Objective evidences of impairment

- Significant financial difficulty of the associate or joint venture
- Breach of contract, such as a default in payments by the associate or joint venture

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- The entity granting a concession to associate or joint venture (because of its financial difficulties)
- It becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganisation
- Disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture
- Adverse effect in the environment (technological, market, economic or legal) in which associate or joint venture operates
- Significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

17.2 Impairment of goodwill included in carrying value of associate/JV

Goodwill is not tested separately for impairment, rather the entire carrying amount of the investment is tested for impairment as a single asset when there is objective evidence of impairment as mentioned above. Any impairment loss recognized is not allocated to any asset, including goodwill, that forms part of the carrying amount of the net investment in the associate or joint venture.

18 Discontinuance of Equity method of Accounting

An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture.

Investment becomes subsidiary

Ind AS 103 requires revaluation of the previously held interest in the equity accounted investment at its acquisition date fair value, with recognition of any gain or loss in profit or loss.

Retained interest in the former associate or joint venture is a financial asset

It shall be measured at fair value. The entity shall recognise in profit or loss any difference between:

- the fair value of any retained interest and any proceeds from disposing of a part interest in¬ the associate or joint venture; and
- the carrying amount of the investment at the date the equity method was discontinued.

19 Accounting of Joint Operations

19.1 Accounting of Interest in Joint operations in separate and consolidated financial statement of joint operator

A joint operator shall recognise in its separate and consolidated financial statements in relation to its interest in a joint operation:

- its assets, including its share of any assets held jointly
- its liabilities, including its share of any liabilities incurred jointly
- its revenue from the sale of its share of the output arising from the joint operation
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.

  In case of joint operation, equity method is not applied and share of income, expenses, assets & liabilities are recognised.

19.2 Accounting for sales or contributions of assets to a joint operation in separate and consolidated financial statement of joint operator

When a joint operator sells or contributes any asset to the joint operation, it is in effect transacting with the other parties to the joint operation and hence the joint operator shall recognise gains and losses resulting from such transactions only to the extent of the other parties' interest in the joint operation.

19.3 Accounting for purchases of assets from a joint operation in separate and consolidated financial statement of joint operator

When a joint operator purchases any asset from the joint operation, it shall not recognise its share of the gains and losses until it resells those assets to a third party.

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19.4 Accounting by an entity that is a party to the joint operation but does not have joint control

A party that participates in, but does not have joint control of, a joint operation,

- Account as per requirements mentioned in the standard for a joint operator if the party has rights to the assets, and obligations for the liabilities relating to the joint operations.
- Account as per the Ind AS applicable to that interest if the party does not has rights to the assets, and obligations for the liabilities relating to the joint operations.

20 Accounting of Joint Ventures

20.1 Accounting in the consolidated financial statements

A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with Ind AS 28, unless the entity is exempted from applying the equity method as specified in that standard.

20.2 Accounting in the separate financial statements

In its separate financial statements, a joint venturer shall account for its interest in a joint venture in accordance Ind AS 27.

20.3 Accounting by an entity that is a party to the joint venture but does not have joint control

A party that participates in, but does not have joint control of, a joint venture shall also account for its interest in the arrangement in its separate and consolidated financial statements as follows:

- If the party do not have significant influence over the joint venture, account as per Ind AS 109.
- If the party has significant influence over the joint venture, account in separate and consolidated financial statements.

21 Ind AS 27 – Separate Financial Statements

The objective of Ind AS 27 is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

21.1 Scope

Ind AS 27 shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity

- elects, or
- is required by law,

to present separate financial statements.

It is to be noted that Ind AS 27 does not mandate which entities produce separate financial statements. It applies when an entity prepares separate financial statements that comply with Ind AS.

21.2 Separate Financial Statements

Separate financial statements are those presented by:

- a parent (i.e. an investor with control of a subsidiary) or
- an investor with investment in an associate or a joint venture,

in which the investments are accounted for at cost or in accordance with Ind AS 109 'Financial Instruments'.

How are separate financial statements are presented?

Separate financial statements are presented:

- in addition to consolidated financial statements or
- in addition to financial statements of an investor that does not have investments in subsidiaries but has investments in associates or joint ventures in which investments in associates or joint ventures are accounted for using the equity method.

There are two more scenarios in which separate financial statements are prepared:

Scenario 1

An entity that is exempted from:

- preparation of consolidated financial statements in accordance with Ind AS 110 (
- applying equity method as per Ind AS 28

may present separate financial statements as its only financial statements.

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Scenario 2

As Ind AS 110, an investment entity that has one or more subsidiaries and the purpose and activities of all those subsidiaries is not to provide services that relate to the investment entity's investment activities then such investment entity shall not prepare consolidated financial statements. Instead, such investments in subsidiaries are to be accounted at fair value through profit or loss as per Ind AS 109.

In such case, investment entity presents separate financial statements as its only financial statements.

21.3 Preparation of Separate Financial Statements

An entity shall prepare its separate financial statements in accordance with all the applicable Ind ASs except that it shall account for investments in subsidiaries, associates and joint ventures in one of the following ways:

- At cost, or
- In accordance with Ind AS 109 (i.e. either at fair value through profit or loss or at fair value through other comprehensive income)

The entity shall apply the same accounting for each category of investments.

Investments held by investment entities and similar entities

Ind AS 110 requires an investment entity to measure its investment in subsidiaries at fair value through profit or loss as per Ind AS 109. Then the investment entity shall account for those investments in the same i.e. at fair value through profit or loss in the separate financial statements.

21.4 Accounting

When a parent ceases to be an investment entity, or becomes an investment entity, it shall account for the change from the date when the change in status occurred, as follows:

When an entity ceases to be an investment entity

In such case, the entity shall account for an investment in a subsidiary in either of the following ways:

- Account at cost - The fair value of the subsidiary at the date of the change of status shall be used as the deemed cost at that date
- Continue to account in accordance with Ind AS 109

When an entity becomes an investment entity

In such case, the entity shall account for an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.

In that case, the difference between the previous carrying amount of the subsidiary and its fair value at the date of the change of status of the investor shall be recognized as a gain or loss in profit or loss. The cumulative amount of any fair value adjustment previously recognized in other comprehensive income in respect of those subsidiaries shall be reclassified to profit or loss as if the investment entity had disposed of those subsidiaries at the date of change in status.

21.5 Reorganisation of Group Structure

A parent may reorganise the structure of its group by establishing a new entity as its parent.

Ind AS 27 provides guidance on how to calculate the cost of investment when a parent reorganises the structure of its group by establishing a new entity as its parent in a manner that satisfies the following criteria:

- the new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;
- the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and
- the owners of the original parent before the reorganisation have the same absolute and relative interests in the net assets of the original group and the new group immediately before and after the reorganisation,

If above conditions are fulfilled and the new parent elects to account for its investment in the original parent at cost then the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.

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1. Illustration

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 Rs. 2,00,000 in each case

Case	Subsidiary	% 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.

2. Illustration

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. statement of financial position 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	

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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.

3. Illustration

Blue Heavens Ltd. pays ₹ 4,500 lakhs for the shares. At 31 March 20X3, i.e. one year after Blue Heavens Ltd. acquired Orange County Ltd., the individual statements of financial position and statements of comprehensive income of Blue Heavens Ltd. and Orange County Ltd. are:

Assets	Blue	Orange
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

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4. Illustration

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

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

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

Show by an entry how the dividend should be recorded in the books of XYZ Ltd. 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.

5. Illustration

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

6. Illustration

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

Pass journal entries to record the transaction.

Cash A/c Dr. 100 lakhs
To NCI 60 Lakhs (300 x 20%)
To Other Equity 40 Lakhs

7. Illustration

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

Pass journal entries to record the transaction.

Dr. NCI 2,000. [4,000/40% X 20%]

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Dr. Other equity	2,000 [Balancing figure]	
Cr. Cash		4,000

8. Illustration

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

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

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

9. Illustration

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

Rs. lakh

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

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

In CFS		
Dr. NCI	30	
Dr. Other equity	2	
Cr. Cash		32
In standalone		
Investments in Sub	32	
To Cash		32

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10. Illustration

Amla Ltd. Purchased a 100% subsidiary for Rs. 10,00,000 at the end of 20X1 when the fair value of the subsidiary Lal Ltd.'s net asset was Rs. 8,00, 000.
The parent sold 40% of its investment in the subsidiary in March 20X4 to outside investors for Rs. 9,00,000. The parent still maintains a 60% controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is Rs. 18,00,000 (including net assets of Rs. 16,00,000 & goodwill of Rs. 2,00,000).

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

Gain/Loss in standalone financial statements

Fair value of consideration received		9,00,000
Less: Cost of Investment	40% of 10,00,000	4,00,000
Gain on sale		5,00,000

In the consolidated financial statements, gain or loss on sale of stake is not recognised. The difference between amount recognised in NCI and consideration is adjusted directly under other equity.

Sale Proceeds		9,00,000
Less: NCI recognised (40% x 18,00,000)	7,20,000	
Other equity		1,80,000

11. Illustration

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:

	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 (Rs. 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	-	-

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	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.

Rs. in Lakhs

	S Ltd	SS Ltd
Reserves	80	60
Retained Earnings	20	30

(iv) Rs. 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.

12. Illustration

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

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

13. Illustration

A parent purchased 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 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 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 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.

14. Illustration

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

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the fair value of the investment in associate BT Ltd. Retained is proportionate to the fair value of the 60% sold, that is Rs. 45,00,000.
Calculate gain or loss on sale of proportion of BT Ltd. In AT Ltd.'s separate and consolidated financial statements as on 31st March 20X3.

Scenario II
AT Ltd. Disposes of a 90% interest for Rs. 85,50,000 leaving the AT Ltd. With a 10% investment. The fair value of the remaining interest is Rs. 9,50,000 (assumed for simplicity to be pro rata to the fair value of the 90% sold)
Calculate gain or loss on sale of proportion of BT Ltd. In AT Ltd.'s separate and consolidated financial statements as on 31st March 20X3.

15. Illustration

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 Rs. 2,50,000
Transaction 2: Sale of 55% stake for a cash consideration of Rs. 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 Rs. 9,00,000 and Rs. 1,80,000 respectively (assuming there were no earnings between the period of two transactions).
How MN Ltd. should account the transaction?

16. Illustration

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 (i.e 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 Rs. in millions)	Group carrying amount of S Pvt. Ltd. (Rs. 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**

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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 Rs. 3,000 millions.

17. Illustration

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 (Rs. In '000)	Group carrying amt Reliance JioInfocomm Ltd. (Rs. 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 Rs. 1000 thousand.

18. Illustration

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 Rs. 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 Rs. 16 crore and the net assets of BC Limited are carry valued at Rs. 60 crore.

These net assets include the following:

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

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(b) Net defined benefit liability of Rs. 6 crore that has resulted in a reserve relating to net measurement losses of Rs. 3 crore.
(c) Equity investments (considered not held for trading) of Rs. 10 crore for which irrevocable option of recognising the changes in fair value in OCI has been availed and related FVOCI reserve of Rs. 4 crore.
(d) Net assets of a foreign operation of Rs. 20 crore and related foreign currency translation reserve of Rs. 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?

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.
(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest."

Ind AS 110 also 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 .

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.

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 Rs. 5.4 crore (90% of Rs. 6 crore) attributable to the owners of the parent to the statement of profit or loss

OCI Dr.	*5.4*	
To P&L		*5.4*

(b) transfer the reserve relating to the net measurement losses on the defined benefit liability of Rs. 2.7 crore (90% of Rs. 3 crore) attributable to the owners of the parent within equity to retained earnings.

Retained Earnings Dr.	*2.7*	
To OCI		*2.7*

(c) reclassify the cumulative gain on fair valuation of equity investment of Rs. 3.6 crore (90% of Rs. 4 crore) attributable to the owners of the parent from OCI to retained earnings under equity as per Ind AS 109, Financial Instruments

OCI Dr.	*3.6*	
To Retained Earnings	*3.6*	

(d) reclassify the foreign currency translation reserve of Rs. 7.2 crore (90% × Rs. 8 crore) attributable to the owners of the parent to statement of profit or loss as per Ind AS 21which specifies that the cumulative

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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.

Dr. OCI	*7.2*		
To P&L		*7.2*	

The balance 10% attributable to NCI will be derecognised along with NCI balance.

Bank A/c Dr	*56*		
Investment A/c Dr.	*16*		
NCI Dr.		*6*	
To Net Assets			*60*
To Cons. P&L		*18*	

(Being disposal of subsidiary.)

19. Illustration

Summarise d Balance Sheets of PN Ltd. and SR Ltd. as on 31st March, 2018 were given as below:
(Amount in Rs.)

Particulars	PN Ltd.	SR Ltd.
Assets		
Land & building	4,68,000	5,61,600
Plant & Machinery	7,48,800	4,21,200
Investment in SR Ltd.	12,48,000	-
Inventories	3,74,400	1,13,600
Trade Receivables	1,86,500	1,24,800
Cash & Cash equivalents	45,200	24,900
Total Assets	**30,70,900**	**12,46,100**
Equity & Liabilities		
Equity Share Capital (Shares of Rs. 100 each fully paid)	15,60,000	6,24,000
Other Reserves	9,36,000	3,12,000
Retained Earnings	1,78,400	2,55,800
Trade Payables	1,46,900	34,300
Short-term borrowings	2,49,600	20,000
Total Equity & Liabilities	**30,70,900**	**12,46,100**

(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.

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(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.

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20. Illustration

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

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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**

You are required to prepare consolidated profit and loss statement.

21. Illustration

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?

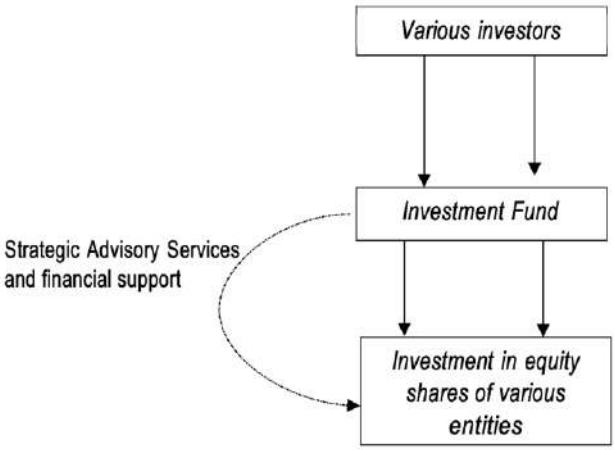
Secondly, if all other facts remain the same as above except that G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited, then explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements.

22. Illustration

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

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capital of various entities for the purpose of earning capital appreciation on those investments. Following is the existing structure of the fund.



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

23. Illustration

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 fellow 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 than market price.
Determine whether PQR Ltd. can be classified as investment entity.

24. Illustration

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.

25. Illustration

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?

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26. Illustration

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?

27. Illustration

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.

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28. Illustration

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?

29. Illustration

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?

30. Illustration

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?

31. Illustration

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

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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:

Liabilities	Rs.	Assets	Rs.
Capital	1,50,000	Machinery	2,50,000
Bank Loan	75,000	Cash	50,000
Other Loan	75,000		
	3,00,000		3,00,000

How should P record in its financial statements its rights and obligations in PQ?

32. Illustration

AB Ltd. and BC Ltd. have established a joint arrangement through a separate vehicle PQR. The legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture.

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Ltd. has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owned by PQR to a lender XYZ. AB Ltd. and BC Ltd. have rights to all other assets of PQR and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each)
PQR's balance sheet is as follows:

Liabilities	Rs.	Assets	Rs.
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?			

33. Illustration

Blue Ltd. acquired 25% of the equity share capital of Green Ltd. on the first day of the financial year for Rs. 1,25,000. As of that date, the carrying value of the net assets of Green Ltd. Was Rs. 3,00,000 and the fair value was Rs. 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 Rs. 40,000 and other comprehensive income of Rs. 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.

34. Illustration

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 Rs. 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 Rs. 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 Rs. 100.
The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

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A's consolidated financial statements

Assets	Rs.	Liabilities	Rs.
Investment in B	200	Equity	200
Total	200	Total	200

21.5.1.1

21.5.1.2 B's consolidated financial statements

Assets	Rs.	Liabilities	Rs.
Assets (from C)	1,000	Equity	1,000
Total	1,000	Total	1,000

After – B's Consolidated Financial statements

Assets	Rs.	Liabilities		Rs.
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

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?

35. Illustration

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 Rs. 10,00,000. This included profit of 10% on the transaction price i.e. profit of Rs. 1,00,000. Out the above inventory, M Ltd. sold inventory of Rs. 6,00,000 to outside customers. Hence, the inventory of Rs. 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.

36. Illustration

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 Rs 8,00,000. The asset's carrying value in X Ltd.'s books was Rs. 10,00,000. Determine how should X Ltd. account for the sale transaction in its books.

Assume the same facts as above scenario 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.

37. Illustration

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.

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- 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 – Rs. 10,00,000
- Preference shares – Rs. 5,00,000
- Long-term loan – Rs. 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 sharesas 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.

38. Illustration

AB Limited holds 30% interest in an associate which it has acquired for a cost of Rs. 300 lakhs. On the date of acquisition of that stake, the fair value of net assets of the associate was Rs. 900 lakh. The value of goodwill on acquisition was Rs. 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 Rs. 360 lakhs. The associate has now issued equity shares to some investors other than AB Limited for a consideration of Rs. 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?

39. Illustration

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 Rs. 300 lakhs including profit of Rs. 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?

M Ltd – Parent
N Ltd – Subsidiary
O ltd – Associate

In N Ltd's Consolidated financial statements
N Ltd will recognise Investment in Associate as per equity method.
Carrying amount of investment = 25% of 300 = 75
Share of profit = 25% of 40 = 10 Lacs

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In M Ltd's consolidated financial statement M ltd will recognise the investment in associate i.e at 75 Lakhs.

In M Ltd's consolidated P&L, M ltd will recognise share of profit

Attributable to M Ltd (owners of parent) – 90% of 10 lakhs – 9
Attributable to NCI. = 1 lakhs

40. Illustration

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 Rs. 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 Rs. 90,00,000 and their fair value was Rs. 1,10,00,000. Investor Ltd. has determined that the difference of Rs. 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 Rs. 8,00,000. XYZ Ltd. paid a dividend of Rs. 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 Rs. 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.

41. Illustration

On 1st April 20X1 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 20X1 and utilisation of the property started on 1st January 20X2 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 20X1. 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.

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Integrated Reporting

1 Introduction

1.1 What is Integrated Reporting (IR)?

- An integrated report is a concise communication about an organization's:
  - Strategy
  - Governance
  - Performance And
  - Prospects
- in the context of its external environment
- leads to the creation, preservation or erosion of value over:
  - Short,
  - Medium, and
  - Long term

1.2 Purpose of IR

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

Stakeholders who are benefitted by IR

- Employees
- Customers
- Suppliers
- Business partners
- Local communities
- Legislators
- Regulators and
- Policy-makers

2 Capitals

Integrated Reporting (IR) is a reporting framework that enables organizations to communicate their value creation story in a comprehensive and concise manner. It provides a holistic view of the organization's strategy, governance, performance, and prospects by considering various forms of capital. Capitals, in the context of Integrated Reporting, represent the different resources and relationships that organizations use and affect in the process of creating value.

The International Integrated Reporting Council (IIRC) has identified six types of capitals that are commonly used in Integrated Reporting. These capitals form the foundation for reporting on an organization's ability to create value over time.

Financial Capital

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The pool of funds

- available to an organization for use in the production of goods or the provision of services
- obtained through financing, such as debt, equity or grants; or
- generated through operations or investments.

Manufactured Capital

Manufactured physical objects (as distinct from natural physical objects) that are available to an organization for use in the production of goods or the provision of services, including:

- Buildings
- Equipment
- Infrastructure (such as roads, ports, bridges, and waste and water treatment plants).

Intellectual Capital

Organizational, knowledge-based intangibles, including:

- Intellectual property, such as patents, copyrights, software, rights and licences
- "Organizational capital" such as tacit knowledge, systems, procedures and protocols.

Human Capital

People's competencies, capabilities and experience, and their motivations to innovate, including their:

- Alignment with and support for an organization's governance framework, risk management approach, and ethical values
- Ability to understand, develop and implement an organization's strategy
- Loyalties and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate.

Social and Relationship Capital

The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being. Social and relationship capital includes:

- Shared norms, and common values and behaviours
- Key stakeholder relationships, and the trust and willingness to engage that an organization has developed and strives to build and protect with external stakeholders
- Intangibles associated with the brand and reputation that an organization has developed
- An organization's social licence to operate

Natural Capital

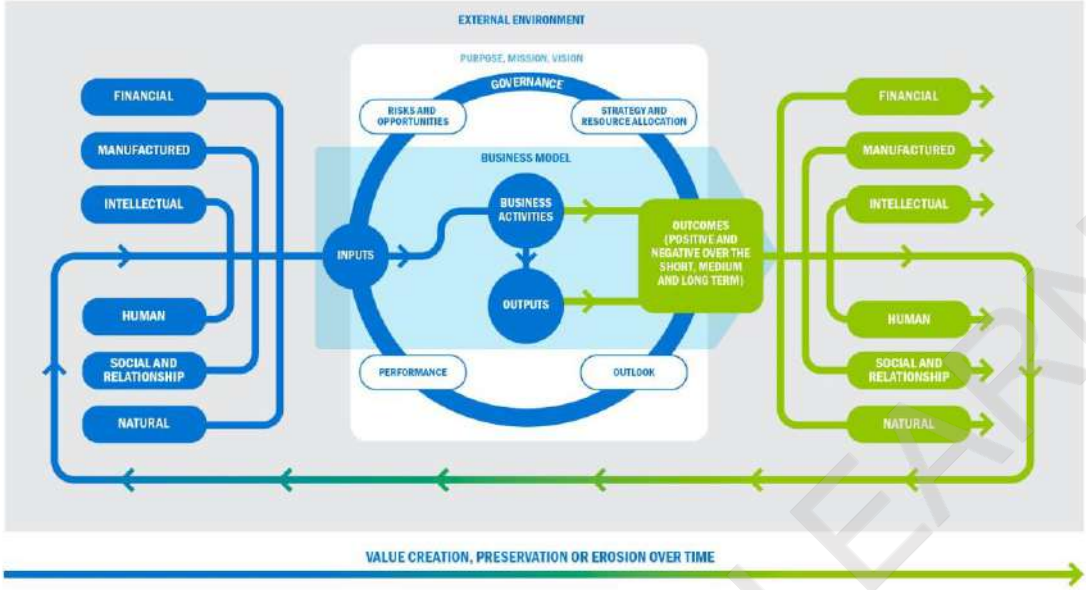
All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current or future prosperity of an organization.

It includes:

- Air, water, land, minerals and forests
- Biodiversity and eco-system health

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3 Contribution of Capital in IR



- In Integrated Reporting, the contribution of capitals plays a significant role in presenting a comprehensive view of an organization's value creation process and its ability to generate sustainable outcomes. The capitals provide a framework for understanding and reporting on the resources and relationships utilized and affected by the organization.

- At the core of the organization lies its business model, which utilizes various capitals as inputs and converts them into outputs (products, services, by-products, and waste) through business activities. These activities and outputs have consequences on the capitals. The adaptability of the business model to changes in inputs can impact the organization's long-term viability.

- Business activities involve planning, design, manufacturing, or the provision of services through specialized skills and knowledge. Cultivating an innovative culture is often crucial for generating new products, enhancing efficiency through technology, minimizing negative social or environmental impacts, and finding alternative uses for outputs. Outcomes refer to the positive and negative consequences for the capitals resulting from an organization's business activities and outputs.

- Continuous monitoring and analysis of the external environment, aligned with the organization's purpose, mission, and vision, help identify risks and opportunities that are relevant to the organization, its strategy, and its business model.

- Organizations strive to create value, which can sometimes involve the depletion of certain capitals, resulting in a decrease in the overall stock of capitals (i.e., erosion of value). Whether the net effect is an increase, decrease, or preservation of value depends on the chosen perspective.

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4 Salient Features of IR Framework

4.1 Principles-Based Approach:

The International <IR> Framework takes a principles-based approach, allowing flexibility in reporting. It does not prescribe specific indicators, measurement methods, or disclosure of individual matters. Those responsible for preparing the integrated report need to use judgment based on the organization's specific circumstances. The aim is to strike a balance between flexibility and comparability across organizations.

4.2 Applicability to Different Sectors:

While primarily focused on private sector, for-profit companies of any size, the Framework can be adapted for use by public sector and not-for-profit organizations as well.

4.3 Quantitative and Qualitative Information:

Quantitative indicators, including key performance indicators and monetized metrics, along with their context, can help explain value creation, preservation, and erosion. The best approach is to combine quantitative and qualitative information in reporting. However, an integrated report is not meant to quantify the organization's value or its impact on all capitals at a specific point in time.

4.4 Designated Communication:

An integrated report should be a distinct and identifiable communication. It can be a standalone report or part of another report or communication, but it should clearly show the connectivity of information and explicitly accept responsibility by those charged with governance. It goes beyond summarizing information from other reports and explicitly communicates how value is created, preserved, or eroded over time.

4.5 Financial and Non-Financial Elements:

The primary purpose of an integrated report is to explain to financial capital providers how an organization creates value over time. Therefore, it includes relevant financial and non-financial information.

4.6 Value Creation for the Organization and Others:

Value created, preserved, or eroded by an organization over time is reflected in changes to the capitals resulting from its business activities and outputs. This value has two aspects: value for the organization itself, impacting financial returns for capital providers, and value for other stakeholders and society at large.

5 Guiding Principles

5.1 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

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- Long term

Examples

- Highlighting significant risks, opportunities and dependencies flowing from the organization's market position and business model.

- The views of those charged with governance about:
  - The relationship between past and future performance, and the factors that can change that relationship
  - How the organization balances short-, medium- and long-term interests
  - How the organization has learned from past experiences in determining future strategic directions.

Extract of report

Building Natural Achievements and Social Capital

ABC's vision of sustainable and inclusive growth has led to the adoption of a Triple Bottom Line approach that simultaneously builds economic, social and environmental capital.

It's Social Investment Programmes, including Social Forestry, Soil & Moisture Conservation, Sustainable Agriculture, Livestock Development, Biodiversity, Women Empowerment, Education, Skilling & Vocational Training and Health & Sanitation, have had a transformational impact on rural India.

These Programmes strive to empower stakeholder communities to conserve, manage and augment their natural resources, create sustainable on and off-farm livelihood sources and improve social infrastructure in rural areas.

Through its Businesses and associated value chains, ABC has supported the generation of around 6 million livelihoods, touching the lives of many living at the margins in rural India. In line with its commitment to environmental goals, ABC has constantly strived to reduce the impact of its Businesses, processes, products and services and create a positive footprint.

ABC has adopted a low-carbon growth strategy through reduction in specific energy consumption and enhancing use of renewable energy sources.

ABC also endeavours to reduce specific water consumption and augment rainwater harvesting activities both on site and off site at watershed catchment areas, as well as minimise waste generation, maximise reuse & recycling and use external post-consumer waste as raw material in its units.

5.2 Connectivity of Information

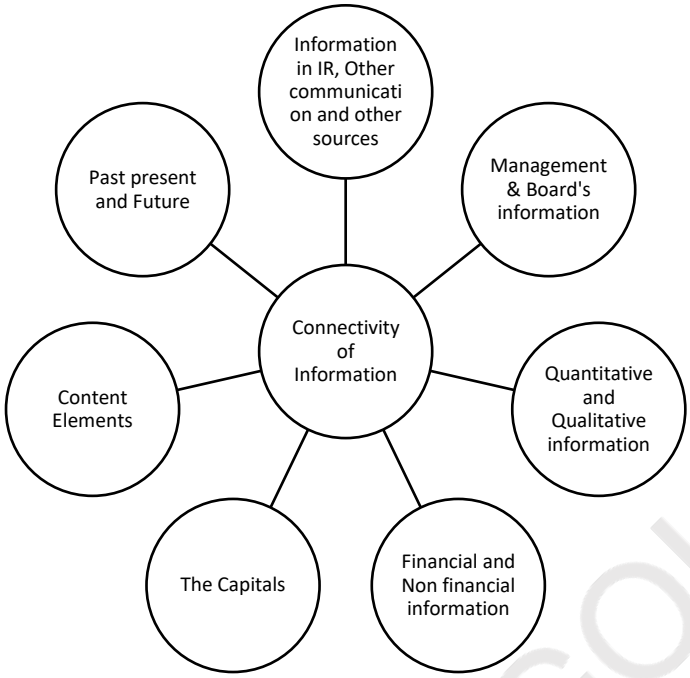
An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization's ability to create value over time

The connectivity of information and the overall usefulness of an integrated report is enhanced when

- it is logically structured,
- well presented,
- written in clear, understandable and jargon-free language, and
- includes effective navigation devices, such as clearly delineated (but linked) sections and cross-referencing.

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In this context, information and communication technology (online reports and dashboards) can be used to improve the ability to search, access, combine, connect, customize, re-use or analyze information.



5.3 Stakeholder's Relationship

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 interests.

5.4 Materiality

An integrated report should disclose information about matters that substantively affect the organization's ability to create value over:

- Short,
- Medium, and
- Long term

The materiality determination process for the purpose of preparing and presenting an integrated report involves:

- Identifying relevant matters based on their ability to affect value creation
- Evaluating the importance of relevant matters in terms of their known or potential effect on value creation
- Prioritizing the matters based on their relative importance
- Determining the information to disclose about material matters.

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5.5 Conciseness

An integrated report should be concise. An integrated report includes sufficient context to understand the organization's strategy, governance, performance and prospects without being burdened with less relevant information.

In achieving conciseness, an integrated report:

- Applies the materiality determination process
- Follows a logical structure and includes internal cross-references as appropriate to limit repetition
- May link to more detailed information, information that does not change frequently or external sources
- Expresses concepts clearly and in as few words as possible
- Favours plain language over the use of jargon or highly technical terminology
- Avoids highly generic disclosures, often referred to as "boilerplate", that are not specific to the organization.

5.6 Reliability and Completeness

An integrated report should include all material matters, both positive and negative, in a balanced way and without material error.

5.7 Consistency & Comparability

The information in an integrated report should be presented:

- On a basis that is consistent over time.
- In a way that enables comparison with other organizations to the extent it is material to the organization's own ability to create value over time.

6 Content Elements

The eight content elements suggested by the Framework are:

6.1 Organisational Overview and External Environment

Question to be answered through this element in the integrated reporting is

"What does the organisation do and what are the circumstances under which it operates?"

Organisational Overview

An integrated report identifies the organization's mission and vision, and provides essential context by identifying matters such as:

A. The organization's:

- Culture, ethics and values
- Ownership and operating structure
- Principal activities and markets
- Competitive landscape and market positioning
- Position within the value chain

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B. KQI: Key quantitative information
- Number of employees
- Revenue
- Number of countries in which the organization operates
- Significant changes from prior periods

C. Significant factors
- Significant factors affecting the external environment and the organization's response

External Environment

Significant factors affecting the external environment include aspects of:
- Legal
- Commercial
- Social
- Environmental
- Political context

That affects the organization's ability to create value in the short, medium or long term

6.2 Governance

Question to be answered through this element in the integrated reporting is

"How does the organisation's governance structure support its ability to create value in the short, medium and long term?"

An integrated report provides insight about how such matters as the following are linked to its ability to create value:

- The organization's leadership structure, including the skills, diversity, and experience of those responsible for governance, and whether regulatory requirements influence governance design.
- Processes used for strategic decision-making, establishing and monitoring the organization's culture, risk attitudes, and addressing integrity and ethical concerns.
- Actions taken by governance leaders to influence and oversee the organization's strategic direction and risk management approach.
- The organization's culture, ethics, and values reflected in its utilization and impact on the capitals, as well as its relationships with key stakeholders.
- Implementation of governance practices that go beyond legal requirements.
- The responsibility of governance leaders in promoting and enabling innovation.
- Linking remuneration and incentives to value creation in the short, medium, and long term, including their connection to the organization's use of and impact on the capitals.

6.3 Business Model

Question to be answered through this element in the integrated reporting is

"What is the organisation's business model?"

An integrated report describes the business model, including key:

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- Inputs
- Business activities
- Outputs
- Outcomes

6.4 Risks and Opportunities

Question to be answered through this element in the integrated reporting is
"What are the specific risks and opportunities that affect the organisation's ability to create value over the short, medium and long-term, and how is the organisation dealing with them?"

An integrated report identifies the key risks and opportunities that are specific to the organization, including those that relate to the organization's effects on, and the continued availability, quality and affordability of, relevant capitals in the short, medium and long term.

6.5 Strategy and Resource Allocation

Question to be answered through this element in the integrated reporting is
"Where does the organisation want to go and how does it intend to get there?"
An integrated report ordinarily identifies:

- The organization's short, medium and long term strategic objectives
- The strategies it has in place, or intends to implement, to achieve those strategic objectives
- The resource allocation plans it has to implement its strategy
- How it will measure achievements and target outcomes for the short, medium and long term.

6.6 Performance

Question to be answered through this element in the integrated reporting is
"To what extent has the organisation achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?"

An integrated report contains qualitative and quantitative information about performance that may include matters such as:

- Quantitative indicators with respect to targets and risks and opportunities, explaining their significance, their implications, and the methods and assumptions used in compiling them
- The organization's effects (both positive and negative) on the capitals, including material effects on capitals up and down the value chain
- The state of key stakeholder relationships and how the organization has responded to key stakeholders' legitimate needs and interests

- The linkages between past and current performance, and between current performance and the organization's outlook

6.7 Outlook

Question to be answered through this element in the integrated reporting is
"What challenges and uncertainties is the organisation likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?"

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An integrated report ordinarily highlights anticipated changes over time and provides information, built on sound and transparent analysis, about:

- The organization's expectations about the external environment the organization is likely to face in the short, medium and long term
- How that will affect the organization
- How the organization is currently equipped to respond to the critical challenges and uncertainties that are likely to arise.

6.8 Basis of Preparation and Presentation

Question to be answered through this element in the integrated reporting is
"How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?"
An integrated report describes its basis of preparation and presentation, including:

- A summary of the organization's Materiality determination process
- A description of Reporting boundary and how it has been determined
- A summary of Significant frameworks and methods used to quantify or evaluate material matters

7 General Reporting Guidelines

Disclosure of Material Matters:
The organization provides key information about material matters, including an explanation of their impact on strategy, business model, and capitals. It includes relevant interactions, the organization's perspective, actions taken, control over the matter, and quantitative/qualitative disclosures. Uncertainty surrounding a matter is also disclosed.

Disclosures about Capitals:
Disclosures regarding capitals focus on their effects on the organization's long-term value creation, regardless of ownership. Factors affecting availability, quality, affordability, and expectations of future flows are included.

Time Frames:
Time frames for reporting differ by industry/sector and the nature of outcomes. Strategic objectives in the automobile industry may span 8-10 years, while technology industry time frames are shorter. Some issues may have long-term impacts on natural or social/relationship capitals.

Aggregation and Disaggregation:
The organization determines the appropriate level of aggregation (e.g., by country, subsidiary, division) for information presentation. Over-aggregation can obscure performance, while unnecessary disaggregation creates clutter. Information is often presented based on financial reporting segments used by senior management and governance.

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8 International Accounting Standards Board

The International Accounting Standards Board (IASB) is currently studying and consulting on broader corporate reporting, including Integrated Reporting, as part of its efforts to improve communication. The IASB recognizes the limitations of narrow financial reporting and has taken steps towards wider corporate reporting by publishing the Management Commentary Practice Statement in 2010. This statement encourages managers to provide contextual information alongside financial statements, such as the nature of the business, objectives, strategies, risks, performance indicators, and prospects.

Integrated reporting has also evolved, with a focus on value creation over time and the audience of capital providers. The IASB aims to revise its Practice Statement to align with Integrated Reporting. In the meantime, it emphasizes that businesses seeking to communicate a broader story of value creation can use the International Integrated Reporting Framework alongside International Financial Reporting Standards (IFRS).

9 SEBI

SEBI, through its circular dated February 6, 2017 (SEBI/HO/CFD/CMD/CIR/P/2017/10), has advised the top 500 companies mandated to submit Business Responsibility Reports (BRR) under Regulation 34(2)(f) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 (SEBI LODR) to voluntarily adopt Integrated Reporting starting from the financial year 2017-18.

The objective of recommending voluntary adoption of Integrated Reporting is to enhance disclosure standards. Integrated Reporting aims to provide a concise overview of an organization's strategy, governance, performance, and prospects, demonstrating how they create value over time. This enables stakeholders to make well-informed investment decisions, as investors today seek both financial and non-financial information.

To improve disclosure standards, listed entities are advised, in consultation with industry bodies and stock exchanges, to adhere to the following:
(a) Integrated Reporting information can be provided separately in the annual report or incorporated into the Management Discussion & Analysis section or prepared as a separate report following the Integrated Reporting framework.
(b) If the relevant information has already been provided in any other report as per national/international requirements or frameworks, appropriate references can be made in the Integrated Report to avoid duplication of information.
(c) As an environmentally friendly initiative, companies are encouraged to host the Integrated Report on their website and provide appropriate references to it in their Annual Report.

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10 Traditional vs Integrated Reporting

Particulars	Current model	Integrated Reporting
Focus	Past, financial	Future, connected, strategic
Timeframe	Short term	Short, medium and long term
Detail	Long and complex	Concise and focus on material issues
Compliance	Rule bound	Responsive to circumstances
Presentation	Paper based	Technology based
Thinking	Silos (Individiual)	Integrated
Stewardship	Financial capital	All capitals (human, intellectual, social, natural and similar)

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1 Provisions of Section 135

1.1 Requirement

Every company having

- net worth of rupees five hundred crore or more, or
- turnover of rupees one thousand crore or more or
- a net profit of rupees five crore or more

during the immediately preceding financial year

shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more Directors, out of which at least one director shall be an independent director.

Provided that where a company is not required to appoint an independent director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee two or more Directors.

1.2 Role of Board

- Ensure that company spends – 2% of average net profits of the average net profits made in immediately three preceding financial years or less number of years if 3 years are not completed. (Subsection 5)
- Ensure the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:
- If the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount and, unless the unspent amount relates to any ongoing project referred to in sub-section (6), transfer such unspent amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.
- If the company spends an amount in excess of the requirements provided under this sub-section, such company may set off such excess amount against the requirement to spend under this sub-section for such number of succeeding financial years and in such manner, as may be prescribed.

1.3 Unspent Amount (Subsection – 6)

- It shall be transferred by the company within a period of thirty days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the **Unspent Corporate Social Responsibility Account,**
- The amount can be spent for CSR obligations within a period of three years form date of transfer.
- If the amount is not spent in time specified, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.

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- If the company spends an amount in excess of the requirements then it may set off such excess amount against the requirement to spend for such number of succeeding financial years and in such manner, as may be prescribed

1.4 Penalty for Default

If a company is in default in complying with the provisions of sub-section (5) – Contribution or sub-section (6),

Penalty on Company	Lower of
	▪ Twice the amount required to be transferred by the company to the Fund under Sch VII or Unspent Corporate Social Responsibility Account or ▪ One Crores
Officer	▪ 1/10th of the amount to be transferred or ▪ 2 lakhs

1.5 CSR Committee

Where the amount to be spent by a company under sub-section (5) does not exceed fifty lakh rupees, the requirement under sub-section (1) for constitution of the Corporate Social Responsibility Committee shall not be applicable and the functions of such Committee provided under this section shall, in such cases, be discharged by the Board of Directors of such company.

2 Key Terms

Rule 2
(h) "net profit" means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely:-

- any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
- any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

  Provided that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381, read with section 198 of the Act;

Section 2

Net worth means the aggregate value of
- the paid-up share capital and
- all reserves created out of the profits
- securities premium account and
- debit or credit balance of profit and loss account,

after deducting the aggregate value of the
- accumulated losses,

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- deferred expenditure and miscellaneous expenditure not written off,

as per the audited balance sheet,

but does not include

- reserves created out of revaluation of assets,
- write-back of depreciation and
- amalgamation;

3 CSR Committee & Board

- If a company is not required to have an independent director, CSR committee will be constituted without such director.
- a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;
- with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Act and another person shall be nominated by the foreign company.

Role of CSR committee

- The CSR Committee shall formulate and recommend to the Board, an annual action plan in pursuance of its CSR Policy, which shall include the following, namely:-

(a) the list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the Act;

(b) the manner of execution of such projects or programmes as specified in sub-rule (1) of rule 4;

(c) the modalities of utilisation of funds and implementation schedules for the projects or programmes;

(d) monitoring and reporting mechanism for the projects or programmes; and

(e) details of need and impact assessment, if any, for the projects undertaken by the company:

Provided that Board may alter such plan at any time during the financial year, as per the recommendation of its CSR Committee, based on the reasonable justification to that effect.

Responsibility of Board

(a) Disclose the composition of CSR Committee in its report

(b) Approve the recommended CSR Policy for the company

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(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 per cent of the average net profits of the company made during the three (or less number of years) immediately preceding financial years

4 Implementation of CSR Activities/Projects

- The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing),

- The Board may decide to undertake its CSR activities through

(a) a company established under section 8 of the Act or a registered trust or a registered society, established by the company, either singly or alongwith any other company, or

(b) a company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government or any entity established under an Act of Parliament or a State legislature

- A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.
- The CSR projects or programs or activities undertaken in India only shall amount to CSR expenditure.
- The CSR projects or programs or activities that benefit only the employees of the company and their Families shall not be considered as CSR activities in accordance with section 135 of the Act.
- Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure (including expenditure on administrative overheads) shall not exceed five percent of total CSR expenditure of the company in one financial year.
- Contribution of any amount directly or indirectly to any political party, shall not be considered as CSR activity.

5 Permissible CSR Activities

Activities which may be included by companies in their Corporate Social Responsibility Policies Activities relating to:—

(i) Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.

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(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga.

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts;

(vi) measures for the benefit of armed forces veterans, war widows and their dependents, Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows

(vii) training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports

(viii) contribution to the prime minister's national relief fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;

(ix) (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and

(b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs)

(x) rural development projects

(xi) slum area development.

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Explanation.- For the purposes of this item, the term `slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.

(xii) disaster management, including relief, rehabilitation and reconstruction activities.

6 Exclusions from CSR Activities

- The CSR projects or programs or activities that benefit only the employees of the company and their families
- One-off events such as marathons/ awards/ charitable contribution/ advertisement/sponsorships of TV programmes etc.
- Expenses incurred by companies for the fulfilment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.)
- Contribution of any amount directly or indirectly to any political party
- Activities undertaken by the company in pursuance of its normal course of business.

7 Accounting & Disclosure for CSR Transactions

- CSR Expense is an item in P&L
- Board must ensure that the administrative overheads shall not exceed 5% of total CSR expenditure for a FY.
- Any surplus arising out of the CSR activities shall not be part of the business profit and shall be ploughed back into the same project or shall be transferred to Unspent CSR Account.
- Provision for amount unspent must be created.
- Amount spent in excess of 2% can be shown as an asset if the entity wants to adjust such excess spends in the future.
- Notes to account should contain
    - Gross Amount required to be spent by the company during the year
    - Amount approved to be spent
    - Amount spent on
        - Construction / acquisition of asset
        - Other purposes
- Details of amount unspent and amount deposited to funds must also be disclosed.
- Details of ongoing projects must be disclosed.

7.1 Recognition Criteria

- Only items that meet the definition of an asset, a liability or equity are recognised in the balance sheet.
- Only items that meet the definition of income or expenses are recognised in the statement of profit and loss.
- An asset or liability is recognised only if recognition provides users of financial statements with information that is useful, i.e. with:
    - relevant information; and

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- a faithful representation
- of the asset or liability and of any resulting income, expenses or changes in equity.

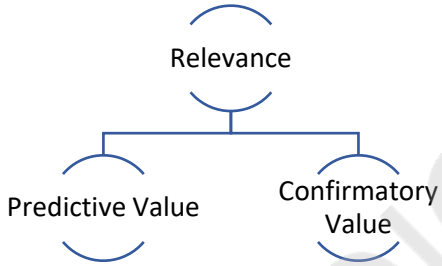
7.2 Derecognition

Derecognition is the removal of all or part of a recognised asset or liability from an entity's balance sheet. Derecognition normally occurs when that item no longer meets the definition of an asset or of a liability:

8 Qualitative Characteristics of Financial Statements

If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

8.1 Relevance



- Financial information is relevant if it is capable of making a difference in decisions made by users.
- Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes.
- Financial information with predictive value is employed by users in making their own predictions.
- Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.
- The characteristic of 'relevance' also includes the concept of materiality. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity

8.2 Faithful Representation

The financial information must faithfully present the substance of the events and transactions.

Fundamental Characterstics

- Complete - A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations

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- Neutral - A neutral depiction is without bias in the selection or presentation of financial information.
- Free from Error - Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects.

Enhancing Qualitative Characterstics

- **Comparability**: Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

- **Verifiability**: Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Verification can be direct or indirect.

- **Timeliness**: Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is.

- **Understandability**: Classifying, characterising and presenting information clearly and concisely makes it understandable. Excluding information about complex events from financial reports might make the information in those financial reports easier to understand.

9 The Cost Constraint on Useful Financial Information

Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.

Both the providers and users of financial information incur costs in reporting and analysing financial information.

In applying the cost constraint, the ICAI assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information.

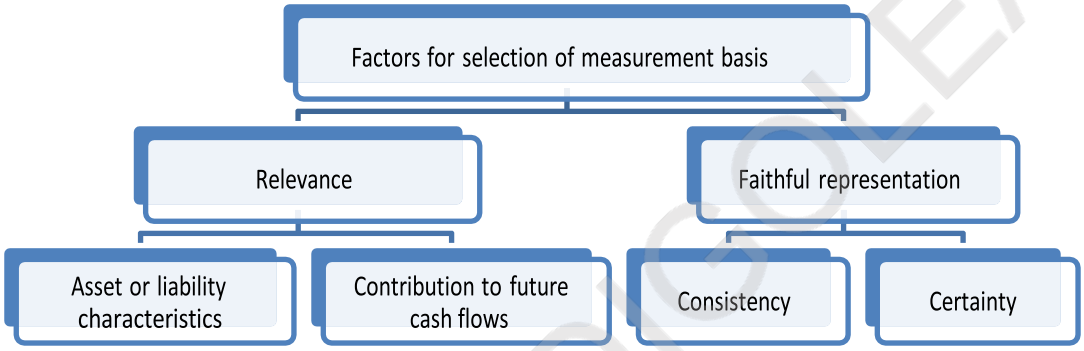
Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. ICAI seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities.

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10 Measurement of Elements

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

- **Historical Cost**
  - Asset – Consideration Paid + Transaction Price
  - Liability – Consideration Received – Transaction Cost
- **Current Value**
  - Entry Value – Current Cost
  - Exit Value
    - Fair value
    - Value in use for assets /Fulfilment value for liabilities



11 Capital Maintenance

Capital refers to net assets of a business.

$$P = (CA - CL) - (OA - OL) - C + D$$

Where: Profit = P

- Opening Assets = OA and Opening Liabilities = OL
- Closing Assets = CA and Closing Liabilities = CL
- Introduction of capital = C and Drawings / Dividends = D
- Retained Profit = P – D = (CA – CL) – (OA – OL) – C

A business should ensure that Retained Profit (RP) is not negative, i.e. closing equity should not be less than capital to be maintained, which is sum of opening equity and capital introduced.

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