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What Our Students have to say....

Sudeepta Benya

I took FR and AFM classes from 1FIN and secured good marks in both. I am deeply grateful to **Sriram Sir** and **Suraj Sir** for making my conceptual clarity very strong and making me fall in love with the subjects. I secured 70 marks in FR and 87 in AFM. Highly recommended.

AIR 27

Arun Kumar

I have watched SFM, FR and IDT classes from indigo learn I was using 1FIN platform from my CA Inter and I feel this platform is the only platform which focuses on concepts rather than focusing on only scoring marks.

Kanishka

Thank you so much Sir! I am excited to share that I have successfully cleared the CA Final exams and became A Chartered Accountant

Srinivasan

I really liked the way of teaching and conceptual clarity given by **Suraj Sir**

Bhoomi Makhecha

Suraj Sir's classes were comprehensive & helped me score 76 (Exemption) in FR

Yug Bhattad

From Foundation to Final, you have been a constant source of guidance. This journey would truly not have been possible without your support, belief, and mentorship. Your advice at every stage, whether academic or personal, gave me clarity and confidence when I needed it the most.

Venkata Naresh

Thank You IndigoLearn for the Conceptual Clarity and well illustrated Examples of the faculties, making my concepts very strong and assisted me in clearing my exams

Hannoch Matthew

1FIN is a perfect place for assistance in CA Exams. I had opted for FR and AFM. I found it well understandable and helped me to get through with the concepts. Their MCQ and material is very useful.

Himanshu Somani

Thank you so much to **Suraj** and **Sriram** sir for your support during my entire CA journey, will forever be grateful to you

Priyanka Udeshi

Thank you **Suraj sir!** Have successfully cleared CA Final with exemption in 5 subjects



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Our Rankers

AIR 1



Noor Singla

CA Final May-26

AIR 1



Diksha Goyal

CA Final Jan-26

AIR 49



Hamsa Gayatri

CA Final Sep-25

AIR 27



Sudeepta Benya

CA Final Nov-24

Disclaimer

This book is designed for students pursuing CA Final course, who are appearing for the Financial Reporting exam in **Nov-26 or afterwards**. The chapters in the book are not in the order provided by ICAI to ensure logical and comprehensive learning.

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Note from your Faculty

Dear Student,

We are pleased to present to you a comprehensive and simplified book on Financial Reporting for the CA Final examination. This subject is of utmost importance in the field of accounting and finance and mastering it will significantly enhance your professional competence.

Financial Reporting plays a crucial role in providing stakeholders with reliable and relevant information about the financial position, performance, and cash flows of an entity. We will delve into the conceptual framework, which serves as the foundation for accounting standards.

We will also cover the applicable Indian Accounting Standards that govern financial reporting. This includes standards related to revenue recognition, lease accounting, financial instruments, and consolidation of financial statements, among others.

It is essential to stay updated with the latest developments in financial reporting. Hence, we recommend referring to professional pronouncements, regulatory updates, and amendments to accounting standards issued by the relevant authorities. You should also read annual reports of listed entities to understand the practical application of what you learn in Financial Reporting.

Remember, financial reporting is not only a subject for examination but a vital skillset that will serve you throughout your professional career. Embrace this opportunity to strengthen your knowledge and practical application of financial reporting principles.

As you prepare for the examination ensure that you understand things conceptually and practice questions instead of just reading or watching the solutions. We wish you the best of luck in your studies and future endeavours.

CA Suraj Lakhotia
Director & Faculty,
1Fin by IndigoLearn

Illustration – 1 (Ind AS 116 with Ind AS 109 Masala)

[Created by CA Suraj Lakhotia (AIR 1,4,2) without AI]

X Ltd. (Lessee) entered into a lease agreement with Y Ltd. (Lessor) on 1st April 20X1 for an identified asset. X Ltd. also incurred initial direct costs of ₹10,000 (legal and negotiation costs directly attributable to obtaining the lease).

As per the terms, X Ltd. is required to pay ₹1,00,000 at the end of each year as fixed lease rentals. In addition, X Ltd. must pay the higher of ₹20,000 or 5% of its annual revenue as variable lease payments, also due at the end of each year. The revenue of X Ltd. for FY 20X1-20X2 is ₹10,00,000.

At the commencement of the lease, X Ltd. paid an interest-free refundable security deposit of ₹5,00,000 to Y Ltd., refundable at the end of the lease term. The market rate of interest for a similar deposit is 8% per annum.

The non-cancellable period of the lease is 4 years. X Ltd. has an option to extend the lease by a further 1 year, and it is reasonably certain that X Ltd. will exercise this extension option. X Ltd. also has an option to purchase the underlying asset at the end of the lease term for ₹25,000, and it is reasonably certain that this purchase option will not be exercised. The interest rate implicit in the lease is 11% per annum, but this is not known to X Ltd. The incremental borrowing rate of X Ltd. is 12% per annum.

Further, X Ltd. is contractually required to restore the underlying asset to its original condition upon termination of the lease, and the expected cost of such decommissioning at the end of lease term is ₹50,000. X Ltd considers 8% as an appropriate discount rate for such liabilities. The tax rate applicable to X Ltd is 30%.

The underlying asset has a useful economic life of 8 years, and X Ltd. follows the Straight-Line Method for depreciation of its right-of-use assets.

Required: In the books of X Ltd. (Lessee), as per Ind AS 116:

Pass Journal Entries at the commencement date (1st April 20X1) and at the end of Year 1 (31st March 20X2). Show extracts of Statement of Profit and Loss and Balance Sheet as on 31st March 20X2. Ignore deferred tax considerations.

Year	1	2	3	4	5
PV Factor @ 8%	0.9259	0.8573	0.7938	0.7350	0.6806
PV Factor @ 12%	0.8929	0.7972	0.7118	0.6355	0.5674
	@ 8%	@ 12%			
PVAF for 5 years	3.9927	3.6048			



Illustration – 2 (Ind AS 36 with 16,103 & 116)

Arka Ltd ("Arka"), a listed Indian company, holds **80%** of the equity of **Vega Ltd**, acquired three years ago in a business combination. At acquisition Arka made the policy choice, permitted by Ind AS 103, to measure the **non-controlling interest at its proportionate share of Vega's identifiable net assets**. Vega is managed as a single cash-generating unit (CGU) and the goodwill on acquisition has been allocated in full to that CGU. No impairment has been recognised in any earlier year.

In the current year Vega lost its principal operating licence renewal and one of its two anchor customers. Management has concluded that impairment indicators exist at the reporting date. The carrying amounts of the components of the Vega CGU at year-end are (₹ crore):

Component of the CGU	Carrying amount	Notes
Goodwill (as recognised in Arka's consolidated FS)	40	Relates to Arka's 80% interest only
Freehold building	60	Carried under the revaluation model (Ind AS 16); revaluation surplus of 4 relating to this building sits in OCI. Fair value less costs of disposal of the building alone is reliably measurable at 54
Plant & equipment	90	Cost model
Right-of-use asset — leased factory (Ind AS 116)	30	The related lease liability of 26 is recognised separately in Vega's balance sheet
Developed technology (finite-life intangible)	25	Cost model
Allocated share of a shared corporate hub (a corporate asset allocated to the CGU on a reasonable and consistent basis)	20	—

Recoverable amount. Fair value less costs of disposal of the Vega CGU as a whole is reliably estimated at **₹175 crore**. Management's *draft* value-in-use projection (the CGU's licence and anchor contract both lapse at the end of Year 5, and management can support no cash flows beyond that horizon) is set out below (₹ crore):

Cash flow	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
Operating cash inflows (before the items below)	60	62	64	62	60
Capital expenditure to keep the assets in their current condition	(10)	(10)	(10)	(10)	(10)
Savings from a restructuring to be tabled for board approval next quarter	8	10	10	10	10
One-off cost of restructuring referred above	(12)	—	—	—	—
Incremental inflows from a new production line management intends to build	—	6	12	15	15
Capital expenditure on that new production line	(20)	—	—	—	—
Income-tax payments	(9)	(10)	(11)	(11)	(10)
Finance costs on Vega's borrowings	(4)	(4)	(4)	(4)	(4)
Lease payments on the leased factory	(6)	(6)	(6)	(6)	(6)

Management intends to discount the cashflows at a **post-tax rate of 10%**. The **pre-tax rate of 13%** is appropriate to the risks specific to the CGU.

Discount factors —

13%: 0.885, 0.783, 0.693, 0.613, 0.543 (Yr 1–5);

10%: 0.909, 0.826, 0.751, 0.683, 0.621 (Yr 1–5).

Required

- Perform the impairment test and allocate the loss across the CGU's assets

Vindhya Cement Ltd. ("Vindhya") enters into a 15-year arrangement with **SunVolt Renewables Ltd.** ("SunVolt") on **1 April 2024** to secure renewable power for its plant. Terms:

- SunVolt will **construct, own and operate a 30 MW solar photovoltaic plant** on land **SunVolt owns**, adjacent to Vindhya's factory. The plant is **explicitly identified**, is physically fixed and cannot be relocated, and SunVolt has **no right to substitute** a different plant.
- The plant's **construction cost is ₹120 crore**, incurred by SunVolt; this equals its **fair value on 1 April 2024**. The plant has a **useful life of 30 years**, with an estimated residual value of **₹6 crore at the end of 30 years**. Its estimated **residual value at the end of the 15-year contract is ₹70 crore**, at which point the plant **reverts to SunVolt**, free to re-contract or dismantle.
- **Vindhya takes the entire electrical output** for 15 years. Consideration comprises a **fixed payment of ₹8 crore per annum**, payable in arrears on 31 March, **plus ₹2.80 per kWh** of electricity actually delivered. SunVolt is contractually prohibited from selling the output elsewhere. Expected annual generation is **≈ 5.4 crore kWh**.
- **SunVolt designed the plant** (capacity, technology, orientation, grid configuration) on its own engineering assessment, and **SunVolt operates, maintains and makes all operating decisions** throughout the term. Vindhya has **no right to instruct** SunVolt on operation and did not participate in design.
- SunVolt **retains the Renewable Energy Certificates (RECs)** and **claims accelerated tax depreciation** as owner.
- The **discount rate** relevant to the arrangement (rate implicit / SunVolt's rate) is **9% p.a.** The **annuity factor for 15 periods at 9% is 8.0607**.

Required:

(a) Determine whether this arrangement **contains a lease** under Ind AS 116 or whether SunVolt accounts for it under **Ind AS 115**.

(b) On the basis of your conclusion in (a), explain **how and when SunVolt would account for the transaction**.

(c) Suppose **Vindhya had specified and designed the plant** before construction, in a way that predetermines how and for what purpose it is used (all other facts unchanged, including that SunVolt physically operates it) – explain how the accounting would be done under applicable standards.

Solution

Part (a) — Does the contract contain a lease?

As per Ind AS 116, a contract contains a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Control requires **all three** of the following:

(i) Identified asset — Satisfied. The plant is explicitly specified in the contract, is physically distinct and fixed, and SunVolt has no substantive right to substitute it. Hence an identified asset exists.

(ii) Right to substantially all economic benefits from use — Satisfied. Vindhya takes 100% of the electricity, which is the primary output of the plant. The RECs retained by SunVolt are only a by-product; since electricity is the dominant benefit, this does not defeat "substantially all." The accelerated tax depreciation arises from *ownership*, not from *use*, and is therefore not considered in this test.

(iii) Right to direct the use — Not Satisfied. For a solar plant, the "how and for what purpose" decisions are largely predetermined by its design. In such cases, Ind AS 116 requires the customer to satisfy one of two conditions:

- **Right to operate** — Vindhya cannot operate the plant or direct its operation; SunVolt runs it.
- **Right to design** — SunVolt designed the plant, not Vindhya.

Since neither condition is met, Vindhya does not have the right to direct the use.

Effect of the fixed ₹8 crore payment: The question of whether a contract contains a lease depends on control over an identified asset, not on how the consideration is structured. A fixed payment neither creates a lease nor does a variable payment prevent one. Hence it has no bearing on this assessment.

Conclusion: Since the right-to-direct-use test fails, the contract **does not contain a lease**. Ind AS 116 does not apply. It is a contract to supply electricity, accounted for under **Ind AS 115**.

Part (b) – SunVolt's accounting (contract is not a lease)

Revenue (Ind AS 115): The supply of electricity is a series of distinct goods that are substantially the same and have the same pattern of transfer. It is therefore a **single performance obligation satisfied over time**, measured using an **output method (kWh delivered)**.

Transaction price = Fixed ₹8 crore p.a. + Variable ₹2.80 per kWh.

Revenue = ₹8 crore + (kWh delivered × ₹2.80) = ₹8 crore + (5.4 crore × ₹2.80) = ₹8 + ₹15.12 = **₹23.12 crore** in a normal year, recognised as the electricity is delivered.

Depreciation: As there is no lease and no sale, the plant remains SunVolt's own PP&E under Ind AS 16 and is depreciated over its 30-year useful life to its ₹6 crore residual value:

Annual depreciation = $(120 - 6) \div 30 = \text{₹3.8 crore p.a.}$

Depreciation is based on the ₹6 crore residual over 30 years – not the ₹70 crore residual or the 15-year term, which are relevant only if the arrangement is a lease.

Part (c) – If Vindhya had designed the plant

(i) The only criterion that failed in (a) was the right to direct use. If Vindhya designed the plant so as to predetermine how and for what purpose it is used, the **"right to design" condition is now satisfied**, even though SunVolt physically operates it. With the identified-asset and economic-benefits criteria already met, all three conditions are satisfied. Hence the contract **contains a lease** and **Ind AS 116 applies**, with SunVolt as **lessor**.

(ii) Finance vs operating classification - computation

The **₹2.80/kWh charge is a variable lease payment not based on an index or a rate** → **excluded** from the classification present value. Only the **fixed ₹8 crore p.a.** enters the test.

Indicator	Assessment
PV of fixed lease payments	$8 \times 8.0607 = \text{₹64.49 crore}$
...as a % of fair value (₹120 cr)	$64.49 \div 120 = \text{53.7\%}$ - not "substantially all"
Lease term vs economic life	$15 \div 30 = \text{50\%}$ - not a "major part"
Transfer of ownership / purchase option	None ; plant reverts to SunVolt

Specialised asset	No - a general solar plant SunVolt can re-contract
-------------------	--

SunVolt **retains the significant risks and rewards** of ownership.

Classification: operating lease.

(iii) Accounting for the operating lease.

- **The plant stays on SunVolt's balance sheet** as PP&E - an operating-lease conclusion does **not** derecognise the asset;

SunVolt continues to depreciate it over its **30-year** life to the **₹6 crore** residual → **₹3.8 crore p.a.** - the same ₹3.8 crore as in part (b). The character of the income changes between scenarios; the depreciation does not.

- **Fixed ₹8 crore payment → operating lease income on a straight-line basis** over the term (Ind AS 116.81), unless another systematic basis better represents the pattern of benefit. As the payment is level and output is broadly even, straight-line gives **₹8 crore p.a.** - but note the *principle* differs from part (b): here the fixed element is recognised on a **time/straight-line** basis, whereas under Ind AS 115 it followed the **output** measure of progress
- **₹2.80/kWh charge → variable lease payment not based on an index or rate.** It is **recognised as lease income in the period the electricity is generated** (~₹15.12 crore in a normal year) mechanically similar in timing to part (b), but presented as **lease income**, not revenue from a contract with a customer.
- **Operation-and-maintenance element → component separation.** The contract bundles the **lease of the plant** with SunVolt's **O&M service**. As lessor, SunVolt **separates the lease component from the non-lease (O&M) component** and **allocates the total consideration on a relative stand-alone-selling-price basis under Ind AS 115** (Ind AS 116.17). The lease component is operating-lease income (fixed straight-lined + variable as generated); the **O&M component is Ind AS 115 service revenue** recognised as the service is performed.
- **Initial direct costs**, if any, are **added to the carrying amount** of the plant and expensed over the lease term (Ind AS 116.83).

Vindhya Cement Ltd. — Solar Power Arrangement

Ind AS 116 vs Ind AS 115 — Lease identification & lessor accounting

QUESTION

Vindhya Cement Ltd. ("Vindhya") enters into a 15-year arrangement with SunVolt Renewables Ltd. ("SunVolt") on 1 April 2024 to secure renewable power for its plant. Terms:

- SunVolt will construct, own and operate a 30 MW solar photovoltaic plant on land SunVolt owns, adjacent to Vindhya's factory. The plant is explicitly identified, is physically fixed and cannot be relocated, and SunVolt has no right to substitute a different plant.
- The plant's construction cost is ₹120 crore, incurred by SunVolt; this equals its fair value on 1 April 2024. The plant has a useful life of 30 years, with an estimated residual value of ₹6 crore at the end of 30 years. Its estimated residual value at the end of the 15-year contract is ₹70 crore, at which point the plant reverts to SunVolt, free to re-contract or dismantle.
- Vindhya takes the entire electrical output for 15 years. Consideration comprises a fixed payment of ₹8 crore per annum, payable in arrears on 31 March, plus ₹2.80 per kWh of electricity actually delivered. SunVolt is contractually prohibited from selling the output elsewhere. Expected annual generation is ≈ 5.4 crore kWh.
- SunVolt designed the plant (capacity, technology, orientation, grid configuration) on its own engineering assessment, and SunVolt operates, maintains and makes all operating decisions throughout the term. Vindhya has no right to instruct SunVolt on operation and did not participate in design.
- SunVolt retains the Renewable Energy Certificates (RECs) and claims accelerated tax depreciation as owner.
- The discount rate relevant to the arrangement (rate implicit / SunVolt's rate) is 9% p.a. The annuity factor for 15 periods at 9% is 8.0607.

Required:

- (a) Determine whether this arrangement contains a lease under Ind AS 116 or whether SunVolt accounts for it under Ind AS 115.
- (b) On the basis of your conclusion in (a), explain how and when SunVolt would account for the transaction.
- (c) Suppose Vindhya had specified and designed the plant before construction, in a way that predetermines how and for what purpose it is used (all other facts unchanged, including that SunVolt physically operates it)

SOLUTION

Part (a) – Does the contract contain a lease?

As per Ind AS 116, a contract contains a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Control requires all three of the following:

(i) Identified asset – Satisfied.

The plant is explicitly specified in the contract, is physically distinct and fixed, and SunVolt has no substantive right to substitute it. Hence an identified asset exists.

(ii) Right to substantially all economic benefits from use – Satisfied.

Vindhya takes 100% of the electricity, which is the primary output of the plant. The RECs retained by SunVolt are only a by-product; since electricity is the dominant benefit, this does not defeat "substantially all." The accelerated tax depreciation arises from ownership, not from use, and is therefore not considered in this test.

(iii) Right to direct the use – Not Satisfied.

For a solar plant, the "how and for what purpose" decisions are largely predetermined by its design. In such cases, Ind AS 116 requires the customer to satisfy one of two conditions:

- Right to operate – Vindhya cannot operate the plant or direct its operation; SunVolt runs it.
- Right to design – SunVolt designed the plant, not Vindhya.

Since neither condition is met, Vindhya does not have the right to direct the use.

Effect of the fixed ₹8 crore payment:

The question of whether a contract contains a lease depends on control over an identified asset, not on how the consideration is structured. A fixed payment neither creates a lease nor does a variable payment prevent one. Hence it has no bearing on this assessment.

► **Conclusion: Since the right-to-direct-use test fails, the contract does not contain a lease. Ind AS 116 does not apply. It is a contract to supply electricity, accounted for under Ind AS 115.**

Part (b) – SunVolt's accounting (contract is not a lease)

Revenue (Ind AS 115):

The supply of electricity is a series of distinct goods that are substantially the same and have the same pattern of transfer. It is therefore a single

performance obligation satisfied over time, measured using an output method (kWh delivered).

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Revenue = ₹8 crore + (kWh delivered × ₹2.80) = ₹8 crore + (5.4 crore × ₹2.80) = ₹8 + ₹15.12 = ₹23.12 crore in a normal year, recognised as the electricity is delivered.

Depreciation:

As there is no lease and no sale, the plant remains SunVolt's own PP&E under Ind AS 16 and is depreciated over its 30-year useful life to its ₹6 crore residual value:

Annual depreciation = (120 – 6) ÷ 30 = ₹3.8 crore p.a.

Depreciation is based on the ₹6 crore residual over 30 years — not the ₹70 crore residual or the 15-year term, which are relevant only if the arrangement is a lease.

Part (c) — If Vindhya had designed the plant

(i) A lease now exists

The only criterion that failed in (a) was the right to direct use. If Vindhya designed the plant so as to predetermine how and for what purpose it is used, the "right to design" condition is now satisfied, even though SunVolt physically operates it. With the identified-asset and economic-benefits criteria already met, all three conditions are satisfied. Hence the contract contains a lease and Ind AS 116 applies, with SunVolt as lessor.

(ii) Finance vs operating classification — computation

The ₹2.80/kWh charge is a variable lease payment not based on an index or a rate → excluded from the classification present value. Only the fixed ₹8 crore p.a. enters the test.

Indicator	Assessment
PV of fixed lease payments	$8 \times 8.0607 = ₹64.49$ crore
(% of fair value (₹120 cr))	$64.49 \div 120 = 53.7\%$ - not "substantially all"
Lease term vs economic life	$15 \div 30 = 50\%$ - not a "major part"
Transfer of ownership / purchase option	None; plant reverts to SunVolt
Specialised asset	No - a general solar plant SunVolt can re-contract

SunVolt retains the significant risks and rewards of ownership.

► Classification: operating lease.

(iii) Accounting for the operating lease

- The plant stays on SunVolt's balance sheet as PP&E — an operating-lease conclusion does not derecognise the asset; SunVolt continues to depreciate it over its 30-year life to the ₹6 crore residual → ₹3.8 crore p.a. — the same ₹3.8 crore as in part (b). The character of the income changes between scenarios; the depreciation does not.
- Fixed ₹8 crore payment → operating lease income on a straight-line basis over the term (Ind AS 116.81), unless another systematic basis better represents the pattern of benefit. As the payment is level and output is broadly even, straight-line gives ₹8 crore p.a. — but note the principle differs from part (b): here the fixed element is recognised on a time/straight-line basis, whereas under Ind AS 115 it followed the output measure of progress.
- ₹2.80/kWh charge → variable lease payment not based on an index or rate. It is recognised as lease income in the period the electricity is generated (~₹15.12 crore in a normal year) mechanically similar in timing to part (b), but presented as lease income, not revenue from a contract with a customer.
- Operation-and-maintenance element → component separation. The contract bundles the lease of the plant with SunVolt's O&M service. As lessor, SunVolt separates the lease component from the non-lease (O&M) component and allocates the total consideration on a relative stand-alone-selling-price basis under Ind AS 115 (Ind AS 116.17). The lease component is operating-lease income (fixed straight-lined + variable as generated); the O&M component is Ind AS 115 service revenue recognised as the service is performed.
- Initial direct costs, if any, are added to the carrying amount of the plant and expensed over the lease term (Ind AS 116.83).

Meridian Alloys Ltd grants share options to its senior management cohort under a single scheme.

- **Grant date:** 1 April 20X3. **Vesting date:** 31 March 20X6.
- **Award:** 500 senior managers, each granted 200 options → exercise price ₹100 per share.
- **Share price at grant date:** ₹110.
- **Conditions attached (both must be satisfied for the options to vest):**
 - (i) the manager remains in employment throughout the three years; and
 - (ii) Meridian's share price reaches **₹180** by 31 March 20X6.
- **Valuation:** Using an option-pricing model that reflects the share-price target, the fair value of each option at grant date was **₹40**. Had the share-price target not been built into the model, the fair value would have been **₹52**.

Staff movement and share-price data:

	Managers who left during the year	Further managers expected to leave before vesting	Share price at year-end
31 Mar 20X4	30	50	₹120
31 Mar 20X5	25	35	₹150
31 Mar 20X6	40	—	₹165

The share price **peaked at ₹172** and did not reach ₹180 by the vesting date. The options therefore lapsed and none were exercised.

Tax: Meridian's tax rate is 25%. Under the applicable tax law, the employer is entitled to a deduction equal to the intrinsic value of the options at exercise (perquisite basis). The estimated future deduction at each reporting date is measured using the intrinsic value at that date.

Required:

(a) Calculate the share-based payment expense to be recognised in each of the three years, explaining your treatment of each condition and of the eventual lapse.

(b) Determine the deferred tax to be recognised each year, showing clearly the split between profit or loss and equity, and explain the position at 31 March 20X6.

Question — Konkan Petrochem Limited (10 marks)

Konkan Petrochem Limited commissioned a chemical processing unit on **leased coastal land on 1 April 2021** at a cost of **₹80,00,000**. Under the lease and applicable environmental law, the company has an **unconditional legal obligation, arising on installation, to dismantle the unit and restore the site** at the end of the unit's useful life.

The unit is depreciated on a straight-line basis over **8 years** with nil residual value under the cost model. At commissioning, the estimated cash outflow for dismantling and restoration at the end of year 8 was **₹18,50,930**; the **present value of this obligation on 1 April 2021 was ₹10,00,000**, using a discount rate of **8% p.a.**

While finalising the financial statements for the **year ended 31 March 2024**, the company discovered that **the decommissioning obligation was never recognised** — neither in the cost of the unit nor as a provision — and no unwinding had ever been recorded. The amounts are material.

Relevant *as-reported* figures (no dividends declared; ignore deferred tax and all other tax effects):

Statement of Profit and Loss	FY 2023-24	FY 2022-23
Depreciation	45,00,000	45,00,000
Finance costs	12,00,000	10,00,000
Profit for the year	75,00,000	60,00,000

Retained earnings (as reported): **₹1,50,00,000** at 1 April 2022; **₹2,10,00,000** at 31 March 2023; **₹2,85,00,000** at 31 March 2024.

The Finance Manager proposes to **charge the entire cumulative shortfall to the current year's Statement of Profit and Loss as a single prior-period item** since the final impact on retained earnings would be the same.

Required:

(a) Explain the correct treatment of this omission under Ind AS, and evaluate the Finance Manager's proposal.

(b) Prepare the restated extracts of the Financial Statements

Solution

(a) Nature of the item and correct treatment

This is a **prior period error**, not a change in estimate. The obligation is a **legal obligation arising at installation**; Ind AS 16 para 16(c) requires the initial estimate of dismantling and restoration costs to be **capitalised in the cost of**

the unit, with a corresponding **provision at present value** under Ind AS 37. Its complete omission is a misapplication of standards using information available at commissioning – an error under Ind AS 8.

Correction: apply **retrospective restatement** (Ind AS 8 para 42). As the error originated before the earliest period presented (1 April 2021), restate the **opening balances** of PPE, provision and retained earnings as at 1 April 2022, and restate the comparative (FY 2022-23).

Finance Manager's proposal is incorrect. Ind AS 8 prohibits routing prior period error corrections through current year profit. Ind AS has **no "prior period item" line** in the P&L (unlike erstwhile AS 5). His approach would **overstate FY 2022-23 profit** and **understate FY 2023-24 profit**, distorting both periods and per-share figures, even though closing equity coincidentally ties. Correct route = restate comparatives + restate opening equity + disclose.

Workings

W1 – Additional depreciation = $10,00,000 \div 8 = \text{₹}1,25,000$ p.a.

W2 – Unwinding of discount @ 8% (finance cost, Ind AS 37 para 60):

Year	Opening	Interest @8%	Closing
FY 2021-22	10,00,000	80,000	10,80,000
FY 2022-23	10,80,000	86,400	11,66,400
FY 2023-24	11,66,400	93,312	12,59,712

W3 – Total charge to profit each year:

FY 2021-22: $1,25,000 + 80,000 = \text{2,05,000}$ (adjusts opening RE at 1 Apr 2022)

FY 2022-23: $1,25,000 + 86,400 = \text{2,11,400}$

FY 2023-24: $1,25,000 + 93,312 = \text{2,18,312}$

(b) Restated Statement of Profit and Loss (extract)

	FY 2023-24 (Restated)	FY 2022-23 (Restated)
Depreciation (45,00,000 + 1,25,000)	46,25,000	46,25,000
Finance costs	12,93,312	10,86,400
Profit for the year	72,81,688	57,88,600

(FY24 finance cost $12,00,000 + 93,312$; FY23 $10,00,000 + 86,400$. Profit reduced by W3.)

(c) Restated Balance Sheet (extracts)

A **third balance sheet as at 1 April 2022** is required. Under **Ind AS 1 para 40A**, a retrospective restatement having a material effect on the opening balance

sheet of the preceding period mandates presentation of the opening balance sheet of that comparative period.

	1 Apr 2022	31 Mar 2023	31 Mar 2024
PPE – processing unit (carrying)	78,75,000	67,50,000	56,25,000
<i>(as reported)</i>	<i>(70,00,000)</i>	<i>(60,00,000)</i>	<i>(50,00,000)</i>
Decommissioning provision (non-current)	10,80,000	11,66,400	12,59,712
Retained earnings	1,47,95,000	2,05,83,600	2,78,65,288
<i>(as reported)</i>	<i>(1,50,00,000)</i>	<i>(2,10,00,000)</i>	<i>(2,85,00,000)</i>

Disclosure (Ind AS 8 para 49): nature of the error; the correction to each affected line item for each prior period presented; and the correction to opening balances of the earliest period.

Question

Vardhman Alloys Ltd. (functional & presentation currency ₹) is finalising its financial statements for the year ended **31 March 2026**. The **draft** Statement of Profit and Loss shows **profit after tax of ₹2,00,00,000**. Equity shares have a face value of ₹10 each.

On **1 April 2025**, the company issued **1,00,000 Optionally Convertible Preference Shares (OCPS)** of ₹100 each at par, raising ₹1,00,00,000. The terms are:

- Fixed **cumulative preference dividend of 6% p.a.**, which the company is **contractually obliged to pay each year**.
- On **31 March 2028**, the **holder** may elect **either** to convert each OCPS into **8 equity shares**, or to require the company to **redeem** each OCPS at par (₹100) in cash.
- The market rate of return for an equivalent preference instrument **without** the conversion option is **10% p.a.**

In preparing the draft accounts, the company:

- classified the entire **₹1,00,00,000** as **equity** (under "Preference Share Capital"), and
- paid the year-1 dividend of **₹6,00,000** and **debited it to retained earnings** as an appropriation.

Equity share movements during the year:

- Opening balance (**1 April 2025**): **40,00,000** equity shares.
- **1 October 2025**: issued **20,00,000** equity shares for cash at **fair value**.

Preference dividends are **not deductible for income tax**. Ignore deferred tax.

PV factors @ 10%: Year 1 – 0.909; Year 2 – 0.826; Year 3 – 0.751 (PVIFA 3 yrs = 2.486)

Required:

- Compute **Basic EPS** and **Diluted EPS**

QUESTION — Kalinga Semiconductors Ltd (10 marks)

On **1 April 20X3**, Kalinga Semiconductors Ltd ("Kalinga") granted share options to its 50 senior managers. Each manager was granted **4,000 options**, conditional on remaining in employment until **31 March 20X7** (a four-year vesting period).

The **exercise price is not fixed**. It steps down as the group achieves higher **cumulative revenue growth** measured over the four-year vesting period. Kalinga's advisers determined the following fair values of **each option at the grant date** under each possible outcome:

Cumulative revenue growth over vesting period	Exercise price per option	Grant-date fair value per option
25% or more	₹40	₹22
15% to below 25%	₹55	₹15
Below 15%	₹70	₹6

Further information:

- The grant-date fair value of **one Kalinga share** was ₹50.
- Year ended 31 March 20X4:** The board expected cumulative revenue growth to fall in the **15%–25%** band. It expected **4%** of the 50 managers to leave over the full vesting period. One manager actually resigned during the year. The share price at 31 March 20X4 was **₹58**, and the fair value of one option at that date was reassessed at **₹12**.
- Year ended 31 March 20X5:** Trading deteriorated. The board now expects cumulative revenue growth of **below 15%**, and revised its estimate of total leavers over the vesting period to **8%**. Two further managers resigned during the year. The share price at 31 March 20X5 was **₹47**, and the year-end fair value of one option was **₹4**.
- Kalinga's Chief Accountant proposes to carry the options at the **year-end fair value** each period, and has asked whether the change in expected exercise price should be treated as a **modification** of the scheme.

Required: Explain, with supporting calculations and journal entries, how Kalinga should account for the share option scheme — including deferred tax — in the years ended 31 March 20X4 and 31 March 20X5. **(10 marks)**

Solution

A. Principles applied (Ind AS 102)

The award is settled in the entity's own shares → **equity-settled share-based payment**. It is measured at the **grant-date fair value of the options** and is **not subsequently remeasured** for changes in that fair value. The reassessed year-end fair values (₹12 and ₹4), the share price, the share's own grant-date



fair value (₹50) and the dividend are therefore **not used** in measuring the charge.

The service condition and the revenue-growth condition are **non-market** conditions. They are excluded from the fair value and instead built into (i) the **number of options expected to vest** and (ii) the **scenario whose grant-date fair value is applied**, both of which are **trued up** at each reporting date. Because the exercise price steps with a non-market performance condition, Kalinga applies the grant-date fair value of the outcome currently expected. This is the operation of the **original terms** – it is **not a modification**.

B. Workings

W1 – Options expected to vest (best estimate of total forfeitures; actual resignations of 1 then 2 are ignored)

Year end	Managers expected to vest	Options
31 Mar 20X4	$50 \times 96\% = 48$	$48 \times 4,000 = \mathbf{1,92,000}$
31 Mar 20X5	$50 \times 92\% = 46$	$46 \times 4,000 = \mathbf{1,84,000}$

W2 – Grant-date fair value applied (driven by the expected performance band; fixed at grant date)

Year end	Expected growth band	Exercise price	FV per option
31 Mar 20X4	15% – <25%	₹55	₹15
31 Mar 20X5	Below 15%	₹70	₹6

W3 – Cumulative and annual charge ($W1 \times W2 \times \text{elapsed} \div 4$)

	Cumulative	Year charge
20X4	$1,92,000 \times ₹15 \times 1/4 = \mathbf{₹7,20,000}$	₹7,20,000
20X5	$1,84,000 \times ₹6 \times 2/4 = \mathbf{₹5,52,000}$	$5,52,000 - 7,20,000 = \mathbf{(₹1,68,000)}$

The cumulative charge **falls** in 20X5 despite a second year of service, because the expected scenario worsened (lower FV). A reversal is permitted for a non-market condition.

C. Journal entries

Year ended 31 March 20X4

Particulars	Dr (₹)	Cr (₹)
Employee benefits expense (P&L)	7,20,000	
To Share-based payment reserve (equity)		7,20,000
(Year-1 SBP charge – W3)		

Year ended 31 March 20X5



Particulars	Dr (₹)	Cr (₹)
Share-based payment reserve (equity)	1,68,000	
To Employee benefits expense (P&L)		1,68,000
<i>(Reversal on revised lower scenario – W3)</i>		



Vector Ltd (the lessee) leased a specialised machine from Nova Ltd on 1 April 20X3 under a non-cancellable arrangement running for four years to 31 March 20X7. At the end of the third year, only the lessor, Nova Ltd, holds a right to terminate the lease; Vector Ltd itself has no right of termination and cannot walk away. Lease rentals are payable at the end of each year and rise over the term : ₹10,00,000 in Year 1, ₹12,00,000 in Year 2, ₹14,00,000 in Year 3 and ₹16,00,000 in Year 4. Vector Ltd has guaranteed a residual value of ₹5,00,000 to Nova Ltd at the end of the lease. The asset is expected to have a value of ₹3,00,000 at the end of lease term. There are no initial direct costs, no restoration obligation and no purchase option, and the machine's useful life comfortably exceeds the lease term.

The interest rate implicit in the lease is not readily determinable, and Vector Ltd's incremental borrowing rate is 10% per annum. (Present value factors at 10%: Year 1 : 0.9091; Year 2 : 0.8264; Year 3 : 0.7513; Year 4 : 0.6830.)

The junior accountant of Vector Ltd classified the arrangement as an operating lease and charged the rentals to profit or loss on a straight-line basis carrying the excess of expense over cash paid as a rent-equalisation liability. The error was identified at the beginning of Year 2 (1 April 20X4), before the Year 2 books were closed.

Required: Applying Ind AS 116 and Ind AS 8, pass the journal entry to correct the error at the beginning of Year 2, together with the journal entries for Year 2. Show all supporting workings, and ignore tax.

Solution

WN 1 : Lease term (the trap).

Under Ind AS 116 paras B34–B35, a lessor-only termination right is ignored in setting the lease term : *"if only a lessor has the right to terminate, the non-cancellable period includes the period covered by that option."* Vector cannot avoid the lease, so **lease term = 4 years**, not 3. (A lessee has no "operating lease" category : Ind AS 116 requires ROU + liability.)

WN 2 : Lease payments include RV guarantee at expected amount (para 27(c)). Include only the amount **expected** to be payable = ₹5,00,000 guarantee – ₹3,00,000 expected FV = **₹2,00,000**

Initial ROU / lease liability = PV of rentals + PV of expected RVG:

	Amount	PVF	PV
Yr1	10,00,000	0.9091	9,09,100
Yr2	12,00,000	0.8264	9,91,680
Yr3	14,00,000	0.7513	10,51,820
Yr4	16,00,000	0.6830	10,92,800
RVG	2,00,000	0.6830	1,36,600



Total			41,82,000
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WN 3 : Liability schedule / WN 4 : Depreciation (SLM, 4 yrs = 41,82,000/4 = ₹10,45,500 p.a.):

Yr	Opening	Int @10%	Payment	Closing
1	41,82,000	4,18,200	10,00,000	36,00,200
2	36,00,200	3,60,020	12,00,000	27,60,220

WN 5 : Quantifying the Year 1 error (prior period error, Ind AS 8 paras 41–42 → retrospective restatement of opening retained earnings):

	Correct	Wrong (recognised)
Year 1 P&L charge	Interest 4,18,200 + Dep 10,45,500 = 14,63,700	Rent (SLM) 13,00,000

Profit was **overstated by ₹1,63,700** → debit opening retained earnings. Also to be removed: rent-equalisation liability of ₹3,00,000 (₹13,00,000 expensed – ₹10,00,000 paid in Year 1).

Journal Entry : Correction at 1 April 20X4

Particulars	Dr (₹)	Cr (₹)
Right-of-use asset (net of Yr1 dep: 41,82,000 – 10,45,500)	31,36,500	
Rent equalisation liability (reversed)	3,00,000	
Retained earnings (prior period error)	1,63,700	
To Lease liability		36,00,200

(Being prior period error corrected retrospectively : operating-lease treatment reversed and ROU asset/lease liability recognised per Ind AS 116)

Journal Entries : Year 2 (year ended 31 March 20X5)

Particulars	Dr (₹)	Cr (₹)
Depreciation (P&L) Dr	10,45,500	
To ROU asset (accumulated depreciation)		10,45,500
Finance cost (P&L) Dr (36,00,200 × 10%)	3,60,020	
To Lease liability		3,60,020
Lease liability Dr	12,00,000	
To Bank		12,00,000

Closing lease liability = **₹27,60,220**; ROU carrying amount = **₹20,91,000** (41,82,000 – 20,91,000 accumulated dep).

