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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

Bhoomi Makhecha

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

Srinivasan

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

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

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.

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

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.

Priyanka Udeshi

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

Our Rankers

AIR 1



Diksha Goyal
CA Final Jan-26

AIR 49



Hamsa Gayatri
CA Final Sep-25

AIR 27



Sudeepta Benya
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AIR 5



Sarthak
CA Inter May-23

AIR 19



Aman Mahajan
CA Inter Dec-21

AIR 33



Sundar B
CA Inter Dec-21

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Feb 2025 – 3rd Edition
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May 2026 - 5th Edition

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.

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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,
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CA FINAL PAPER 1 : FINANCIAL REPORTING 100 MARKS CHAPTER WISE WEIGHTAGE BASED ON PAST EXAM & ANALYSIS THEREOF											
S. No.	**CHAPTER NAME**	**Jan-26**		**Sep-25**		**May-25**		**Nov-24**		**Average**	**Weightage**
		MCQ	**Des**	**MCQ**	**Des**	**MCQ**	**Des**	**MCQ**	**Des**		
1	Conceptual Framework		4		4					15.50 M	10-15 %
2	Ind AS on Presentation of General Purpose FS										
	Unit 1 - Ind AS 1		4	2			4	4	4		
	Unit 2 - Ind AS 34	2					4		4		
	Unit 3 - Ind AS 7	2			4	2					
3	Ind AS on Measurement based on Accounting Policies										
	Unit 1 - Ind AS 8				4				4		
	Unit 2 - Ind AS 10										
	Unit 3 - Ind AS 113		4			2	4				
	TOTAL	**4**	**12**	**2**	**12**	**4**	**12**	**4**	**12**		
4	Ind AS on Income Statement - Ind AS 115 - Revenue	2	5	2	5	2	5	2	5	7.00 M	5-10%
	TOTAL	**2**	**5**	**2**	**5**	**2**	**5**	**2**	**5**		
5	Ind AS on Assets of the Financial Statements									25.00 M	15-25 %
	Unit 1: Ind AS 2: Inventories			2		4	5				
	Unit 2: Ind AS 16: Property, Plant and Equipment		8				6	2	11		
	Unit 3: Ind AS 116: Leases										
	Unit 4: Ind AS 23: Borrowing Costs				6						
	Unit 5: Ind AS 36: Impairment of Assets	2			5		8				
	Unit 6: Ind AS 38: Intangible Assets	2		2							
	Unit 7: Ind AS 40: Investment Property			2		2			8		
	Unit 8: Ind AS 105: NCA held for Sale and Disc Operations		6								
6	Ind As on Liabilities of Financial Statements										
	Ind AS 19		5		8						
	Ind AS 37	2		2				2			
	Total	**6**	**19**	**8**	**19**	**6**	**19**	**4**	**19**		

CA FINAL PAPER 1 : FINANCIAL REPORTING 100 MARKS

CHAPTER WISE WEIGHTAGE BASED ON PAST EXAM & ANALYSIS THEREOF

S. No.	CHAPTER NAME	Jan-26		Sep-25		May-25		Nov-24		Average	Weightage
7	Other Indian Accounting Standards										
	Unit 1 - Ind AS 20		8					2			
	Unit 2 - Ind AS 102			2		2	8		8		
	Ind AS 41 - Agriculture			2							
8	Ind AS on Items impacting the Financial Statements										
	Ind AS 12 - Income Taxes		6						6	18.50 M	15-20 %
	Ind AS 21 - Foreign Exchange	2			8	2					
9	Ind AS on Disclosures										
	Unit 1: Ind AS 24: Related Party Disclosures										
	Unit 2: Ind AS 33: Earnings Per Share	2			6	2	6				
	Unit 3: Ind AS 108: Operating Segments							2			
	TOTAL	**4**	**14**	**4**	**14**	**6**	**14**	**4**	**14**		
10	Accounting & Reporting of Financial Instruments	6	10	6	10	2	10	2	10	14.00 M	10-15%
	TOTAL	**6**	**10**	**6**	**10**	**2**	**10**	**2**	**10**		
11	Business Combination & Corporate Restructuring			2			5	6		21.75 M	10-20 %
12	Consolidation & Separate Financial Statements	6	14	2	14	6	14	4	14		
	TOTAL	**6**	**14**	**4**	**14**	**6**	**19**	**10**	**14**		
13	Ind AS 101 - First Time Adoption of Ind AS		5	2	5	2		2		6.00 M	5-10 %
14	Analysis of Financial Statements								5		
	TOTAL	**0**	**5**	**2**	**5**	**2**		**2**	**5**		
15	Accounting & Technology				5	2	5	2	5	7.00 M	5-10 %
16	Professional Ethics	2	5	2							
	TOTAL	**2**	**5**	**2**	**5**	**2**	**5**	**2**	**5**		
	Grand Total	**30**	**84**	**30**	**84**	**30**	**84**	**30**	**84**		

CA FINAL PAPER 2: STRATEGIC FINANCIAL MANAGEMENT QUESTION WISE TOPICS BASED ON PAST EXAM PATTERN										
#	Jan-26		Sep-25		May-25		Nov-24		May-24	
	Topic	M	Topic	M	Topic	M	Topic	M	Topic	M
COMPULSORY										
1 (a)	CFS of Holding & Subsidiary	14	CFS of Holding & Subsidiary	14	CFS of Holding & Subsidiary	14	Consolidation under Ind AS	14	CFS of Holding, Subsidiary & Associate	14
1 (b)										
OPTIONAL (4 of 5)										
2(a)	Ind AS 109 - Int free loan repayable on demand	10	Ind AS 109 - Derivative	10	Ind AS 109 - Derivative	10	Ind AS 109 - Derivative	10	Derivatives - Contracts in FC	10
2(b)	Ind AS 1 - Classification of loan rollover	4	Ind AS 7 - Cashflows	4	Ind AS 34 - Interim Financial Reporting	4	Ind AS 34 - Tax Expense	4	Ind AS - 1, Loan repayable on Demand	4
2(c)						.				
3(a)	Ind AS 16 - PPE in case of exchange with FOC, insurance	8	Ind AS 19 - Employee Benefits	8	Impairment - CGU	8	Ind AS 40 - BS values & Disclosures	8	Lease Modifications - Ind AS 116	8
3(b)	Ind AS 12 - Deferred tax computation, Associate, revaluation cases	6	Ind As 33 - Earnings per Share	6	Ind AS 33 - Earnings per Share	6	Ind AS 12 - Deferred Tax	6	Compound financial Instruments	6
3(c)										
4(a)	Ind AS 105 - Asset held for sale	6	Ind AS 23 - Borrowing Cost	6	Ind AS 16 - Property, Plant & Equipment	6	Ind AS 16 - Decommisioning	6	Defined benefit plans - Comprehensive	8
4(b)	Ind AS 20 - Government Grants : Multiple Cases	8	Ind AS 21 - The Effects of Changes in Foreign Exchange Rates	8	Ind AS 102 - Share Based Payments	8	Ind AS 102 - Share based payment	8	Government Grants - Treatment	6
5(a)	Ind AS 115 - Revenue from contract with Customers	5	Ind AS 115 - Revenue from contract with Customers	5	Ind AS 115 - Revenue Recognition	5	Ind AS 115 - Reward Points	5	Ind As 115 - discount on subsequent pur.	5
5(b)	Ind AS 101- First time adoption of IND AS	5	Ind AS 101- First time adoption of IND AS	5	Ind AS 111 - Joint Arrangements	5	Analysis of FS - Ind AS Impact report	5	Ind As 101- Exchange fluctuation capitalisation	5
5(c)	Need for Ind AS / Board Report	4	Conceptual framework	4	General Purpose FR	4	Ind AS 1 - Offseting or Enhancing Qualitative characterstics	4	Theory - Conceptual framework de/recognition or entities covered for Ind AS	4
6(a)	Profesional ethics	5	Accounting and technology	5	Accounting & Technology	5	Accounting & Tech	5	Cloud Computing	5
6(b)	Ind AS 19 - Leaves and Bonus plans	5	Ind AS 36 - Impairement of Assets	5	Ind AS 2 - Inventories	5	Ind As 16 - Revaluation	5	Ind As 105 - Held for sale	5
6(c)	Ind AS 113 : Compute Fair value	4	Ind AS 8 - Accounting Policies, Changes in Accounting Estimates and Errors	4	Ind AS 113 - Measuring Fair Value	4	Ind AS 8- Errors/Estimates	4	Interim financial reporting - Computation of profit	4
6 (d)										
		84		**84**		**84**		**84**		**84**

INDEX **Volume I**

No.		Chapter	Page No.
1		Introduction to IND AS	1.1 - 1.5
2	IND AS 2	Inventories	2.1 - 2.18
3	IND AS 16	Property Plant & Equipment	3.1 - 3.27
4	IND AS 38	Intangible Assets	4.1 - 4.17
5	IND AS 40	Investment Property	5.1 - 5.9
6	IND AS 23	Borrowing Cost	6.1 - 6.13
7	IND AS 20	Government Grants	7.1 - 7.16
8	IND AS 36	Impairment of Assets	8.1 - 8.24
9	IND AS 105	NCA held for sale & Discontinued Operations	9.1 - 9.17
10	IND AS 116	Leases	10.1 - 10.49
11	IND AS 37	Contingent Assets	11.1 - 11.20
12	IND AS 19	Employee Benefits	12.1 - 12.17
13	IND AS 1	Presentation of Financial Statements	13.1 - 13.14
14	IND AS 7	Cash Flow Statements	14.1 - 14.19
15	IND AS 115	Revenue from Contrect with Customers	15.1 - 15.55

INTRODUCTION TO IND AS

1. **Following is a snapshot of the audited Balance Sheet of Company A as on 31st March 2014. Company A's equity shares are listed on the Bombay Stock Exchange since 2010.**

Liabilities	₹ Cr	Assets	₹ Cr
Equity Share Capital	160	Fixed Assets	455
Securities Premium	200	Investments	200
General Reserve	150	Current Assets	50
Revaluation Reserve	40	Miscellaneous Expenditure not written off	80
Profit & Loss A/c	75		
Total	785	Total	785

   a. **As per roadmap, which Phase company A fall into? Will your answer change if Company A is an unlisted company?**
   b. **If the balance of profit and loss account is negative Rs. 375 crores, When Ind AS should be applicable to Company A? Will you answer change if Company A is an unlisted company?**

Solution:

a) Calculation of Net Worth:

Particulars	Rs. In crores
Equity Share Capital	160
Securities Premium	200
General Reserve	150
Profit and Loss A/c	75
Miscellaneous Expenditure not written off	(80)
Net Worth as per Section 2(57) of The Companies Act, 2013	505

Revaluation Reserve is excluded from Net Worth as per **Section 2(57)**.

- Company A is a **listed company**
- **Net Worth ≥ ₹500 crores**
- Hence, Company A falls under **Phase I** of the **Ind AS Roadmap**

Ind AS applicable for accounting periods beginning on or after 1st April 2016

If Company A is an unlisted company:

Since **Net Worth exceeds ₹500 crores**, it will **still fall under Phase I. Ind AS applicable from 1st April 2016**

(b) When Profit & Loss A/c has a Debit Balance of ₹375 Crores

Revised Net Worth Calculation

Particulars	₹ in Crores
Equity Share Capital	160
Securities Premium	200
General Reserve	150
Less: Debit balance of P&L A/c	(375)
Less: Miscellaneous Expenditure not written off	(80)
Net Worth	**55**



Analysis

- **Net Worth < ₹500 crores**
- Hence, **Phase I criteria not met**

However, as Company A is a listed company, it will irrespective be covered under Phase II as the first criteria of phase II states "companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore".

Hence, Ind AS would be applicable to Company A for the accounting periods beginning on or after 1st April 2017.

If Company A is an unlisted company, Ind AS would not be applicable until it breaches the net worth criteria mentioned in the roadmap.

2. The net worth of Company B (an unlisted company) was Rs. 600 crores as on 31st March 2014. However due to losses incurred in FY 14-15, the net worth of the company was Rs. 400 Crores as on 31st March 2015. From when company B shall apply Ind AS?

Solution:

The **net worth of Company B as on the cut-off date (31st March 2014)** was **greater than ₹500 crores**.Hence, Company B falls under **Phase I of the Ind AS Roadmap**.

A doubt may arise whether, since the **net worth as on 31st March 2015** is **₹400 crores**, the company should shift to **Phase II**. However, as per the **Ind AS Roadmap**, the **net worth shall be computed based on the stand-alone financial statements as on 31st March 2014 (cut-off date)**.

Once the net worth threshold is met, the company is **mandatorily required to apply Ind AS**, **irrespective of subsequent reduction in net worth**.

Company B shall apply Ind AS for accounting periods beginning on or after 1st April 2016, since it satisfied the **Phase I net worth criterion on the cut-off date**, even though its net worth later fell below ₹500 crores.

3. The net worth of Company C (an unlisted company) was Rs. 400 crores as on 31st March 2014. However, the net worth of the company was Rs. 600 Crores as on 31st March 2015. From when company B shall apply Ind AS?

Solution:

- This issue has been **specifically addressed in ITFG Bulletin 1, Issue 1**.
- Reference is made to **Clause 2(b) of the Companies (Indian Accounting Standards) Rules, 2015**, which states that:

"For companies which are not in existence on 31st March 2014 or for an existing company falling under any of the thresholds specified for the first time after 31st March 2014, the net worth shall be calculated on the basis of the first audited financial statements ending after that date in which the thresholds are met."

- Accordingly, **any company which meets the prescribed net worth threshold (₹500 crores)** in a **particular financial year**, shall be **required to apply Ind AS from the immediately succeeding financial year**.
  In the present case:
  - **Company C did not meet the threshold as on 31st March 2014**



- It first met the threshold (₹600 crores) as on 31st March 2015

- **Company C shall apply Ind AS for accounting periods beginning on or after 1st April 2016,**
  since it **first satisfied the Phase I net worth criterion in FY 2014–15**

4. **Company D is the parent company of Group A.**
   Company A is an unlisted company having a net worth of ₹60 crores as on 31st March 2014.

The following are the other companies in the group:

Company	Relationship	Net worth as on 31st March 2014
Company B (Unlisted)	Subsidiary of Company A	₹600 crores
Company C (Unlisted)	Subsidiary of Company B	₹150 crores

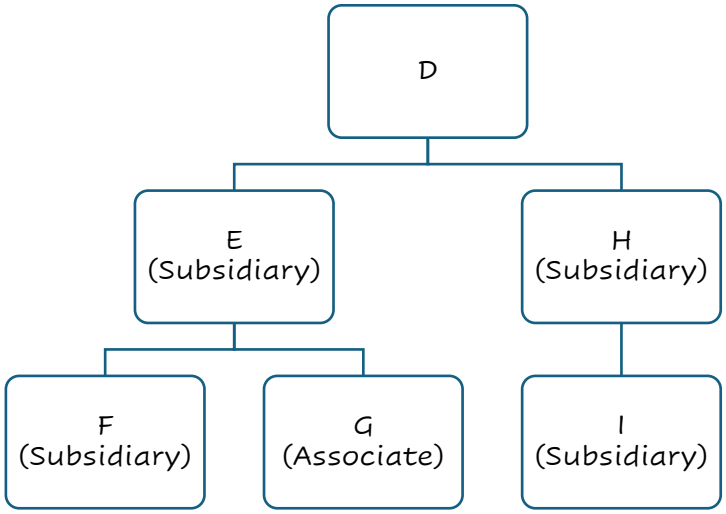
Required:
Whether Ind AS is applicable to Companies A, B and C?

Solution:

- **Company A** and **Company C** are **unlisted companies** and **do not individually exceed the net worth threshold of ₹500 crores**.
- **Company B**, being an **unlisted company with net worth exceeding ₹500 crores, meets the Phase I criterion** of the **Ind AS Roadmap**.
- Accordingly, **Ind AS shall be applicable to Company B** for preparation of its **financial statements**.
- As per the **Ind AS Roadmap, once Ind AS becomes applicable to any company**, it shall **also be applicable to its holding company and subsidiary company irrespective of their individual net worth**.
- Therefore:
  - **Company A** (parent of Company B)
  - **Company B** (entity meeting the threshold)
  - **Company C** (subsidiary of Company B)

  all fall within the scope of Ind AS.

5. **Following is the structure of Company D. All the companies in above structure are unlisted companies and the net worth of company E is Rs. 300 Crores and net worth of all the other companies is below Rs. 250 crores. To which company would Ind AS be applicable?**



Solution:

- As per the **Companies (Indian Accounting Standards) Rules, 2015**, **if Ind AS is applicable to a company**, it shall **also be applicable to its Holding Company, Subsidiary Company, Associate Company and Joint Venture**.
- Since the **net worth of Company E exceeds ₹250 crores**, it is **covered under Phase II of the Ind AS Roadmap**.
- Accordingly, **Ind AS shall be applicable with effect from 1st April 2017** to:
  - **Company E**, and
  - its **Subsidiary (Company F)**,
  - **Associate (Company G)**, and
  - **Holding Company (Company D),irrespective of their individual net worth**.

With respect to **other companies in the group**, guidance is provided in **ITFG Clarification Bulletin No. 15, Issue 10**, which states:

"Ind AS applies to holding, subsidiary, joint venture and associate companies of entities which meet the net worth or listing criteria. However, this requirement does not extend to another fellow subsidiary of a holding company merely because the holding company is required to adopt Ind AS due to one of its subsidiaries meeting the criteria."

The **holding company is mandatorily required to prepare both separate and consolidated financial statements under Ind AS**, if **any one of its subsidiaries meets the specified criteria**.

Therefore, **fellow subsidiaries (Company H and Company I)**:

- **are NOT statutorily required to adopt Ind AS**, but
- **may be required to furnish Ind AS–compliant financial information** for the purpose of **consolidation by the holding company**.

6. **ABC Inc., incorporated in a foreign country has a net worth of Rs. 700 Crores. It has two subsidiaries Company X whose net worth as on 31st March 2014 is Rs. 600 Crores and Company Y whose net worth is Rs. 150 Crores. Whether Company X and Y would be required to follow Ind AS from accounting periods commencing on or after 1st April 2016 on the basis of their own net worth or on the basis of the net worth of ABC Inc.?**

   Solution:

   Similar issue has been dealt in ITFG Clarification Bulletin 2, Issue 2. ITFG noted that as per Rule 4(1)(ii)(a) of the Companies (Indian Accounting Standards) Rules, 2015, Company X having net worth of Rs. 600 crores at the end of the financial year 2015-16, would be required to prepare its financial statements for the accounting periods commencing from 1st April, 2016, as per the Companies (Indian Accounting Standards) Rules, 2015. While Company Y Ltd. having net worth of Rs. 150 crores in the year 2015-16, would be required to prepare its financial statements as per the Companies (Accounting Standards) Rules, 2006.

   Since, the foreign company ABC Inc., is not a company incorporated under the Companies Act, 2013 or the earlier Companies Act, 1956, it is not required to prepare its financial statements as per the Companies (Indian Accounting Standards) Rules, 2015. As the foreign company is not required to prepare financial statements based on Ind AS, the net worth of foreign company ABC would not be the basis for deciding whether Indian Subsidiary Company X Ltd. and Company Y Ltd. are required to prepare financial statements based on Ind AS.

7. **As per the roadmap, Ind AS is applicable to Company X from the financial year 2017-18. Company X (non-finance company) is a subsidiary of Company Y (NBFC). Company Y is an unlisted NBFC company having net worth of Rs. 400 crores. What will be the date of applicability of Ind AS for company X and company Y? If Ind AS applicability date for parent NBFC is different from the applicability date of corporate subsidiary, then, how will the consolidated financial statements of parent NBFC be prepared?**



Solution:

In accordance with the roadmap, it may be noted that NBFCs having net worth of less than 500 crore shall apply Ind AS from 1 April, 2019 onwards. Further, the holding, subsidiary, joint venture or associate company of such an NBFC other than those covered by corporate roadmap shall also apply Ind AS from 1 April, 2019.
Accordingly, in the given case, Company Y (NBFC) shall apply Ind AS for the financial year beginning 1 April, 2019 with comparative for the period ended 31 March, 2019. Company X shall apply Ind AS in its statutory individual financial statements from financial year 2017-2018 (as per the corporate roadmap). However, for the purpose of Consolidation by Company Y for financial years 2017-2018 and 2018-2019, Company X shall also prepare its individual financial statements as per AS.



Ind AS 2
Inventories

1. Illustration (RTP) [Fixed Overhead]

A company normally produced 1,00,000 units of a high precision equipment each year over past several years. In the current year, due to lack of demand and competition, it produced only 50,000 units. Further information is as follows:

- **Material = Rs. 200 per unit;**
- **Labour = Rs. 100 per unit;**
- **Variable manufacturing overhead = Rs. 100 per unit;**
- **Fixed factory production overhead =Rs. 1,00,00,000;**
- **Fixed factory selling overhead = Rs. 50,00,000;**
- **Variable factory selling overhead = Rs. 150 per unit.**

Calculate the value of inventory per unit in accordance with Ind AS 2. What will be the treatment of fixed manufacturing overhead?

Solution:

Calculation of Inventory value per unit as per Ind AS 2:

Particulars	Value per unit(₹)
Raw material	200
Labour	100
Variable manufacturing overhead	100
Fixed production overhead (1,00,00,000/1,00,000)*	100
Total	**500**

Fixed manufacturing overheads are absorbed based on normal capacity i.e. 1,00,000 units. The rate is not revised if actual production is lower than normal capacity.

Fixed manufacturing overhead on 50,000 units (50,000 x 100.= 50,00,000), will be absorbed as inventory value. The remaining fixed manufacturing overhead ₹50,00,000 (1,00,00,000 - 50,00,000) will be charged to P&L.

Note: Selling costs are excluded from the cost of inventories and recognised as expense in the period in which they are incurred.

2. Illustration (ICAI SM, Dec-21,May25) [Joint & By-Product] ✪✪✪✪

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

Item	Unit	Amount	Output	Closing Stock 31-03-X1
Raw material	14,500	1,50,000	MP 1-5,000 units	250
Wages	-	90,000	MP II - 4,000 units	100
Fixed overhead	-	65,000	BP- 2,000 units	
Variable overhead	-	50,000		

Average market price of MP1 and MP2 is Rs. 60 per unit and Rs. 50 per unit respectively, by-product is sold @ Rs. 20 per unit. There is a profit of Rs. 5,000 on sale of by-product after incurring separate processing charges of Rs. 8,000 and packing charges of Rs. 2,000, Rs. 5,000 was realised from sale of scrap.

Required: Calculate the value of closing stock of MP1 and MP2 as on 31-03-20X1.

Solution:



1) Calculation of NRV of By-product BP :

Selling price of by-product	2,000 units x 20 per unit	40,000
(-) Separate processing charges of by- product BP		(8,000)
Packing charges		(2,000)
Net realizable value of by-product BP		**30,000**

2) Calculation of cost of conversion for allocation between joint products MP1 and MP2:

Raw material		1,50,000
Wages		90,000
Fixed overhead		65,000
Variable overhead		50,000
Less: NRV of by-product BP	30,000	
Less: Sale value of scrap	5,000	(35,000)
Joint cost to be allocated between MP1 and MP2		**3,20,000**

The net realisable value of by product and scrap is reduced form joint cost.

3) Determination of "basis for allocation" and allocation of joint cost to MP1 and MP2:

Joint costs are allocated on the basis of relative sales value.

	MP I	MP 2
Output in units (a)	5,000	4,000
Sales price per unit (b)	60	50
Sales value (a x b)	**3,00,000**	**2,00,000**
Ratio of allocation (based on sales)	3	2
Joint cost of ₹ 3,20,000 allocated in the ratio of 3:2 (c)	1,92,000	1,28,000
Cost per unit [c/a]	**38.4**	**32**

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

Particulars	**MP I**	**MP 2**
Closing stock in units	250 units	100 units
Cost per unit	38.4	32
Value of closing stock	9,600	3,200

3. Illustration [FIFO & Weighted Average]

The following information relates to 20X1-20X2

Date	Particular	Unit	Cost p.u.	Total Cost
April	Inventory	200	10	2,000
May	Purchases	50	11	550
September	Purchases	400	12	4,800
February	Purchases	350	14	4,900
	Total	1,000		12,250
June	Sales	150		
October	Sales	300		
November	Sales	150		

Physical inventory at 31.03.20X2 400 units. Calculate ending inventory value and cost of sales using:

1. **FIFO**
2. **Weighted Average**



Solution:

1. FIFO (First-In, First-Out)

In FIFO, the latest purchases remain in inventory. For 400 closing units, we take most recent purchases first:

Closing Inventory = 400 units

- 350 units @ ₹14 = ₹4,900
- 50 units @ ₹12 = ₹600
  Total = ₹5,500

Cost of Sales = Total Cost – Closing Inventory
= ₹12,250 – ₹5,500 = ₹6,750

Weighted Average Cost is determined by dividing the total cost by total quantity purchased.

Weighted Avg. Rate = ₹12,250 / 1,000 units = ₹12.25/unit

- **Closing Inventory = 400 × ₹12.25 = ₹4,900**
- **Cost of Sales = 600 × ₹12.25 = ₹7,350**

The above solution is given assuming periodic inventory system.

Under Perpetual inventory system –
FIFO

Date	Particulars	In/out Qtry	In/Out rate	Value	Closing	Rate	Closing stock
April	Inventory	200		2,000	200	10	2,000
May	Purchase	50	11	550	200	10	2,000
					50	11	550
					250		**2,550**
June (Sale)	Sales	(150)	10	(1,500)	50	10	500
					50	11	550
					100		**1,050**
September	Purchase	400	12	4,800	50	10	500
					50	11	550
					400	12	4,800
					500		**5,850**
October (Sale)	Sales	(300)		-	**200**	**12**	**2,400**
November (Sale)	Sales	(150)		-	**50**	**12**	**600**
February	Purchase	350	14	4,900	50	12	600
					350	14	4,900
					400		**5,500**

Note – The FIFO valuation will be same under both periodic as well as perpetual

Weighted Average – Closing weighted rate is updated after every purchase



Date	Particulars	In /Out Qty	In/Out Rate	In /Out Value	Closing units	Rate (Closing stock/ no of units)	Closing stock (Op + in – out)
April	Inventory	200	10	2000	200	10.00	2000
May	Purchase	50	11	550	250	10.20	2550 (2000 +550)
June (Sale)	Sales	-150	10.2	1530	100	10.20	1,020.00
September	Purchase	400	12	4800	500	11.64	5,820.00
October (Sale)	Sales	-300	11.64	3492	200	11.64	2,328.00
November (Sale)	Sales	-150	11.64	1746	50	11.64	582.00
February	Purchase	350	14	4900	400	13.71	5,482.00

4. Illustration (RTP May 2018) [NRV]✪ ✪ ✪

On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was Rs. 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is Rs. 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to Rs. 8 million. The estimated selling expense required to make the sales would Rs. 0.5 million. Financial statements were authorised by Board of Directors on 20th April 20X1.

As at 31st March 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market conditions have improved, estimated selling price of inventory is Rs. 11 million and estimated selling expenses are same Rs. 0.5 million.

What will be the value inventory at the following dates:

- **31st March 20X1**
- **31st March 20X2.**

Solution:

As per Ind AS 2 'Inventories', inventory is measured at lower of 'cost' or 'net realisable value'. Further, as per Ind AS 10: 'Events after Balance Sheet Date', decline in net realisable value below cost **provides additional evidence of events occurring at the balance sheet date** and hence shall be considered as 'adjusting events'.

a) In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be ₹10 million and net realisable value would be ₹7.5 million **(i.e. Expected selling price ₹8 million- estimated selling expenses ₹0.5 million).**

Accordingly, inventory shall be measured at ₹7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of ₹2.5 million would be recorded in income statement of that year.

It is assumed that the price as on 15th April 20X1 provides additional evidence of conditions existing on balance sheet date.

However, if it is assumed that the price as on 15th April 20X1 does not provide additional evidence of conditions existing on balance sheet date, the value of inventory would be



lower of Cost (₹10 million) and NRV (₹12 million – ₹0.5 million = 11.5 Million) i.e at ₹10 million only.

b) A new assessment is made of net realizable value in each subsequent period. If there is an increase in the net realizable value (NRV) of inventory due to improved economic conditions, any previous write-downs should be reversed. This ensures the inventory is recorded at the lower of cost or the revised NRV.

As of 31 March 20X2, the inventory will be valued at cost or NRV, whichever is lower.

- **Cost**: ₹1 million
- **NRV**: ₹10.5 million (calculated as the expected selling price of ₹11 million minus estimated selling expenses of ₹0.5 million).

Since the NRV (₹10.5 million) is higher than the cost (₹1 million), the inventory will now be recorded at ₹1 million (the cost). The inventory write-down of ₹2.5 million recorded in the previous year will be reversed accordingly.

5. Illustration (RTP May 20) [Overhead]✪ ✪ ✪

The following is relevant information for an entity:

- **Full capacity is 10,000 labour hours in a year.**
- **Normal capacity is 7,500 labour hours in a year.**
- **Actual labour hours for current period are 6,500 hours.**
- **Total fixed production overhead is Rs. 1,500.**
- **Total variable production overhead is Rs. 2,600.**
- **Total opening inventory is 2,500 units.**
- **Total units produced in a year are 6,500 units.**
- **Total units sold in a year are 6,700 units.**
- **The cost of inventories is assigned by using FIFO cost formula.**

How overhead costs are to be allocated to cost of goods sold and closing inventory?

Solution:

Hours taken to produce 1 unit = 6,500 hours / 6,500 units = 1 hour per unit.

Under Ind AS 2, fixed production overheads must be allocated based on **normal capacity**.
Fixed production overhead absorption rate:
= Fixed production overhead / labour hours for normal capacity
= ₹1,500 / 7,500
= ₹0.2 per hour

Therefore, fixed production overhead allocated to 6,500 units produced during the year (one unit per hour)
= 6,500 units x1 hour x ₹0.2 = ₹1,300.

The remaining fixed overhead incurred during the year of ₹200 (₹1500 – ₹1300) that remains unallocated is recognised as an expense.

Variable production overhead absorption rate:
= Variable production overhead/actual hours for current period
= ₹2,600 / 6,500 hours = ₹0.4 per hour

Management should allocate variable overhead costs to units produced at a rate of ₹0.4 per hour.



Closing inventory = Opening inventory + Units produced during year – Units sold during year = 2,500 + 6,500 – 6,700 = 2,300 units.

Per unit overhead cost = ₹0.4 +₹0.2 = ₹0.6
Total cost of OH in closing inventory = 2,300 units x 1 hour x (₹0.2 + ₹0.4) = ₹1,380

The remaining ₹2,720 [(₹1,500 + ₹2,600) – ₹1,380] is recognised as an expense in the income statement as follows:

Particulars	₹
Absorbed in cost of goods sold (FIFO basis) (6,500 – 2,300) = 4,200 x ₹0.6	2,520
Unabsorbed fixed overheads, not included in the cost of goods sold	200
Total	2,720

6. Illustration (ICAI SM) [Replacement Cost]

UA Ltd. purchased raw material @ Rs. 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is Rs. 300 per kg. How will you value the inventory of raw material?

Solution:

- Raw materials held for use in production are generally **not written down below cost** if the finished goods are expected to be sold at or above cost.
- However, when the **net realizable value of finished goods is expected to be lower than cost**, it indicates that the raw materials may also be impaired.
- In such cases, if the **net realizable value of raw material is not directly available**, the **replacement cost** can be used as the best available estimate of net realizable value.

Conclusion:
Since the finished goods in which the raw material will be used are expected to be sold below cost, and the replacement cost is ₹300 per kg, UA Ltd. should value the raw material at ₹300 per kg.
Total value of inventory = 10,000 kg × ₹300 = ₹30,00,000.

Note from faculty – Do not blindly apply replacement value / lower of cost or replacement value. Also note that inventory cannot be valued above cost.

7. Illustration (ICAI SM, Past Exam) [Customer default]

Sun Ltd. has fabricated special equipment (solar power panel) during 20X1-20X2 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31-03-20X3 are as follows:

- **Solar power panel (WIP) Rs. 85 lakhs**
- **Solar power panel (finished products) Rs. 55 lakhs**
- **Sundry Debtor (solar power panel) Rs. 65 lakhs**



The petition for winding up against the customer has been filed during 20X2-20X3 by Sun Ltd. Comment with explanation on provision to be made of Rs. 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 20X2-20X3.

Solution:

As per *Ind AS 2 – Inventories*, inventories are assets **held for sale in the ordinary course of business**, **in the process of production for such sale**, or **in the form of materials or supplies to be consumed** in production. In the given case, Sun Ltd. has fabricated **solar power panels** as per **customer specifications**, which qualify as inventories—whether in the form of **work-in-progress (₹85 lakhs)** or **finished goods (₹55 lakhs)**. According to *Ind AS 2*, inventories must be **measured at the lower of cost or net realisable value (NRV)** at the reporting date.

Due to the **liquidity crisis** faced by the customer, Sun Ltd. has been asked to **postpone delivery** and **halt production**. Since the goods are still under Sun Ltd.'s control, they must be considered as inventory under the **principles of Ind AS 2**. Even if the panels are customer-specific, if they are **marketable,** they may still carry an **NRV above zero**.

In such a case, Sun Ltd. should **estimate NRV** based on prevailing market conditions and **compare it with cost**. If NRV is greater than cost, the company should value inventory at cost of **₹140 lakhs** (WIP + Finished Goods.

If **NRV < cost**, the **difference must be recognised as a loss**. However, if the panels are **highly customised** with **no alternative use**, the **NRV would be nil**, and the **entire cost of ₹140 lakhs** (WIP + Finished Goods) must be **fully provided for** in the books.

Regarding the **sundry debtor balance of ₹65 lakhs**, since Sun Ltd. has filed a **winding-up petition** against the customer during the year, there is strong evidence of **credit impairment**. Under *Ind AS 109 – Financial Instruments*, trade receivables must be assessed using the **Expected Credit Loss (ECL)*** model. Given the legal and financial situation of the customer, the recoverability of the receivable appears doubtful. Hence, a **full provision of ₹65 lakhs** must be made by **recognising an impairment loss** in the **Statement of Profit and Loss**.

To summarise,

If **NRV of inventory is nil**, then **a total provision of ₹205 lakhs (₹140 lakhs for inventory and ₹65 lakhs for sundry debtors)** should be recognised in the **financial statements for FY 20X2–20X3**. Alternatively, if inventory has any **residual NRV**, only the **shortfall below cost** must be recognised as a **loss**, while the **full amount of ₹65 lakhs** should still be provided against debtors.

**ECL will be covered in financial instruments. Its like provision for bad debt. Don't worry at the moment ☺*

8. Illustration (ICAI SM, Past exam) [Empty bottles]

Night Ltd. sells beer to customers; some of the customers consumes the beer in the bars run by Night Limited. While leaving the bars, the consumers leaves the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling tenders.

(i) Decide whether the stock of empty bottle is an asset of the company;

(ii) If so, whether the stock of empty bottles existing as on the date of

Balance Sheet is to be considered as inventories of the company & valued as per Ind AS-2 or to be treated as scrap and shown at realized value with corresponding credit to 'Other Income'?



Solution:

As per the definition under the *Conceptual Framework for Financial Reporting*, an **asset** is a present economic resource controlled by the entity as a result of past events, which is expected to provide **future economic benefits**. In the given case, Night Ltd. regains possession of **empty beer bottles** when consumers leave them at its own bar premises. These bottles are subsequently **sold through tenders**, which indicates that the company derives **economic benefits from their disposal**. Thus, these bottles meet the recognition criteria of an **asset** for Night Ltd.

Further, in terms of their classification, *Ind AS 2 – Inventories* defines inventories as **assets held for sale in the ordinary course of business**, in the **process of production for such sale**, or **in the form of materials or supplies to be consumed**. The stock of empty bottles on the **balance sheet date** is intended for sale and forms part of the **operating cycle** of the company. Moreover, the company has established a **controlled internal accounting mechanism** for tracking these bottles, which supports their **materiality** and systematic recognition in financial statements.

Accordingly, the stock of empty bottles should be classified as **inventories** under *Ind AS 2* and must be **measured at the lower of cost or net realisable value (NRV)**. It would not be appropriate to treat these items as **scrap** and account for their proceeds under **'Other Income'**, since they are regularly retrieved and monetised in the normal course of business. Recognising them as inventory ensures proper matching of income and expenses and reflects the **true financial position** of the company.

9. Illustration (ICAI SM) [Imports]

ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X wasRs.1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.

The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this. Import duties (basic custom duties) ofRs.60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost ofRs.5,000 to have the components taken to its warehouse. Calculate the cost of inventory.

Solution:

Particulars	₹
Purchase price (1,000 x 1,200 x 95%)	11,40,000
Import duties (1,000 x 60)	60,000
Delivery cost	5,000
Cost of inventory	12,05,000

Note: The intention to take settlement discount is irrelevant

10. Illustration (ICAI SM) [Costs included/excluded]

ABC Ltd. manufactures control units for air conditioning systems. Each control unit requires the following:

- **1 component X at a cost ofRs.1,205 each**
- **1 component Y at a cost ofRs.800 each**
- **Sundry raw materials at a cost ofRs.150 each**

The company faces the following monthly expenses:
Factory rentRs.16,500
Energy costRs.7,500



- **Selling and administrative costsRs.10,000**

Each unit takes two hours to assemble. Production workers are paid Rs.300 per hour. Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours. Determine the cost of inventory.

Solution:

The cost of a single control unit :	₹
Materials:	
Component X	1,205
Component Y	800
Sundry raw materials	150
	2,155
Labour (2 hours x 300)	600
Production overhead [(16,500 + 7,500)/1,000 hours) x 2 hours]	48
	2,803

Note: The selling and administrative costs are not part of the cost of inventory.

11. Illustration (ICAI SM) [Damage and NRV]

ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of Rs.50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was Rs.40 per pack.

Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of Rs.15 per pack for repairing and reapplying glue to the envelopes. Calculate the net realizable value.

Solution:

Calculating the net realizable value:

- The estimated selling price is ₹40 per unit.
- The cost of repair to bring the goods to sellable condition is ₹15.00 per unit.

Net realizable value per unit = Estimated selling price per unit - Cost of repair to bring the goods to sellable condition.
= ₹40.00 - ₹15.00
= ₹25.
The net realizable value is $25 per unit.

Calculating inventory write-down (loss) amount:

- The closing inventory cost is ₹50 per unit.
- The net realizable value is ₹25 per unit.

Inventory write-down (loss) = Inventory cost per unit - Net realizable value per unit
= ₹50 - ₹25
= ₹25.

The inventory write-down (loss) amount is ₹25.00 per unit.

12. Illustration (ICAI SM) [Firm contract]✪ ✪

At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of Rs.10 per unit. The current market price is Rs.8 per unit at which these units can be sold.
Company P has a firm sales contract with Company Q to sell 60 units at Rs.11 per unit, which cannot be settled net.



Estimated incremental selling cost is Rs. 1 per unit. Determine the Net Realisable Value (NRV) of the inventory of Company P.

Solution:

If the company has a firm contract to sell, it can consider contract price to determine NRV. While performing NRV test, the NRV of 60 units that will be sold to Company Q is ₹ 10 per unit (i.e. 11-1).

NRV of the remaining 40 units is ₹ 7 per unit (i.e. 8-1).

Therefore, Company P will write down those remaining 40 units by ₹120 (i.e. 40x3).

Total cost of inventory would be:

Goods to be sold to Company Q	60 units x ₹ 10	₹600
Remaining goods	40 unit x ₹ 7	₹280
		₹880

13. Illustration (ICAI SM) [Item by Item]

In Year 2, A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:

	Cost	Estimated Sales Price	Selling costs
Inventory Item A1	**8,000**	**7,800**	**500**
Inventory Item A2	**14,000**	**18,000**	**200**
Inventory Item B1	**16,000**	**17,000**	**200**
Inventory Item C1	**6,000**	**7,500**	**150**

Determine the value of closing inventory in the financial statements of a business.

Solution:

The value of closing inventory in the financial statements:

Item of inventory	Cost	NRV (Estimated Sales price- Selling costs)	Measurement base (lower of cost or NRV)	Value
A1	8,000	(7,800 – 500) 7,300	NRV	7,300
A2	14,000	(18,000 – 200) 17,800	Cost	14,000
B1	16,000	(17,000 – 200) 16,800	Cost	16,000
C1	6,000	(7,500 – 150) 7,350	Cost	6,000
Value of Inventory				**43,300**

14. Illustration (ICAI SM) [Deferred Payment]

A dealer has purchased 1,000 cars costing Rs.2,80,000 each on deferred payment basis as 25,000 per month per car to be paid in 12 equal instalments.

At year end 31 March 20X1, twenty cars are in stock. What would be the cost of goods sold, finance cost and inventory carrying amount?

Solution:

If inventory is acquired on deferred credit terms, the cost of inventory would be the cash price. The excess amount paid is considered as interest expense

	₹
Deferred payment price (25,000 x 12)	3,00,000
Less: Cash price	2,80,000
Interest expense	20,000

		₹
Cost of inventory	20 cars x 2,80,000	56,00,000
Finance cost	1,000 cars x 20,000	2,00,00,000



Cost of goods sold	980 cars x 2,80,000	27,44,00,000

15. Illustration (ICAI SM, Past exam) [Valuation when OS is given]✪ ✪ ✪

Particulars		Kg	Rs.
Opening Inventory	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory	Raw Materials	900	
	Finished Goods	1,200	

The expected production for the year was 15,000 kg of finished product.
Due to fall in the market demand the sales price for the finished goods was Rs.20 per kg and the replacement cost for the raw material was Rs.9.50 per kg on the closing day.
You are required to calculate the closing inventory as on that date.

Solution:

As per *Ind AS 2 – Inventories*, inventories are to be valued at the **lower of cost and net realisable value (NRV)**.

Step 1: Computation of Quantity Produced

Particulars	Quantity (kg)
Opening finished goods inventory	1,000
Add: Sales during the year	10,000
Subtract: Opening finished goods inventory	(1,000)
Add: Closing finished goods inventory	1,200
Total quantity produced during the year	**10,200**

Opening FG + Production – Sales = Closing FG

Production = Sales + Closing FG – Opening FG

Step 2: Computation of Cost of Production

Particulars	₹
Cost of Raw Materials (10,200 kg × ₹10)	1,02,000
Direct Labour	76,500
Fixed Overheads	
(Allocated based on normal capacity of 15,000 kg):	
₹75,000 × 10,200 / 15,000	51,000
Total Cost of Production	**2,29,500**
Cost per Unit (229,500/10200)	**22.50**
NRV	**20**

Note : In this question the rate of Opening RM and Purchase is same. If the rates are different you can consider entire Opening RM cost and balance from current year purchase. Closing inventory will be from current year purchase (Assuming FIFO)

Since net realisable value is less than cost, closing inventory will be valued at ₹ 20.
As NRV of the finished goods is less than its cost, raw materials will be valued at replacement cost i.e. ₹ 9.50.
Therefore, value of closing inventory:

Finished Goods (1,200 x 20)	₹ 24,000



Raw Materials (900 x 9.50)	₹ 8,550
	₹ 32,550

16. Illustration (ICAI SM) [Retail method]

Mars Fashions is a new luxury retail company located in Lajpat Nagar, New Delhi. Kindly advise the accountant of the company on the necessary accounting treatment for the following items:

(a) One of Company's product lines is beauty products, particularly cosmetics such as lipsticks, moisturizers and compact make-up kits. The company sells hundreds of different brands of these products. Each product is quite similar, is purchased at similar prices and has a short lifecycle before a new similar product is introduced. The point of sale and inventory system is not yet fully functioning in this department.
The sales manager of the cosmetic department is unsure of the cost of each product but is confident of the selling price and has reliably informed you that the Company, on average, make a gross margin of 65% on each line.

(b) Mars Fashions also sells handbags. The Company manufactures their own handbags as they wish to be assured of the quality and craftsmanship which goes into each handbag. The handbags are manufactured in India in the factory which has made handbags for the last fifty years. Normally, Mars manufactures 100,000 handbags a year in their handbag division which uses 15% of the space and overheads of the head office factory. The division employs ten people and is seen as being an efficient division within the overall company.
In accordance with Ind AS 2, explain how the items referred to in a) and b) should be measured.

Solution

(a) Beauty Products (Cosmetics):

- As per Ind AS 2, inventories are valued at the **lower of cost and net realizable value (NRV)**.
- In this case, the company cannot track the exact cost of each cosmetic item because the inventory system is not fully working.
- Since the sales manager knows the **selling price** and **gross margin is 65%**, we can use the **retail method**.
- Under the retail method, cost is calculated by **reducing the selling price by the gross margin**.
  For example, if the selling price is ₹100, cost = ₹100 – ₹65 = ₹35.

(b) Handbags (Manufactured):

- The company manufactures its own handbags and has proper records for material, labour, and overheads.
- In such cases, Ind AS 2 allows the use of the **standard cost method**, as long as it **closely matches actual cost**.
- Since the production process is efficient and stable, and all cost details are available, standard costing is an appropriate method to value the inventory of handbags.

17. Illustration (ICAI SM) [Inclusions/Exclusions] ✪ ✪

Sharp Trading Inc. purchases motorcycles from various countries and exports them to Europe. Sharp Trading has incurred these expenses during 20X1:

(a) Cost of purchases (based on vendors' invoices) Rs. 5,00,000
(b) Trade discounts on purchases Rs. 10,000
(c) Import duties Rs. 200
(d) Freight and insurance on purchases Rs. 250



(e) Other handling costs relating to imports Rs. 100
(f) Salaries of accounting department Rs. 15,000
(g) Brokerage commission payable to indenting agents for arranging imports Rs. 300
(h) Sales commission payable to sales agents Rs. 150
(i) After-sales warranty costs Rs. 600

Advise as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per Ind AS 2.

Solution

Expense	Included in Inventory?	Reason	Amount (₹)
(a) Cost of purchases (based on vendors' invoices)	✅ Yes	Purchase cost	5,00,000
(b) Less: Trade discounts	❌ Deducted	Discount reduces purchase cost	(10,000)
(c) Import duties	✅ Yes	Directly attributable to purchase	200
(d) Freight and insurance on purchases	✅ Yes	Direct cost of bringing inventory	250
(e) Other handling costs relating to imports	✅ Yes	Directly related to bringing inventory	100
(f) Salaries of accounting department	❌ No	Administrative expense	–
(g) Brokerage commission for arranging imports	✅ Yes	Cost directly related to purchase	300
(h) Sales commission	❌ No	Selling expense	–
(i) After-sales warranty costs	❌ No	Not a cost to bring inventory to location/condition	–
		Total	4,90,850

Salaries of accounting department is excluded as it is an administrative cost not directly attributable to inventory. Sales commission and after sales warranty costs are excluded from cost of inventory.

18. Illustration (ICAI SM, May-23) [Customised product]

On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts.
On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for Rs. 5,50,000, including Rs. 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of Rs. 5,55,000 (including Rs. 5,000 loan-raising fees). The loan is secured by the inventories.
During January 20X1 the entity designed the corporate gifts for the customer. Design costs included:
cost of external designer = Rs. 7,000; and
labour = Rs. 3,000.

During February 20X1 the entity's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

materials, net of Rs. 3,000 recovered from the sale of the scrapped output = Rs. 21,000
labour = Rs. 11,000
depreciation of plant used to perform the modifications = Rs. 5,000

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:
consumable stores =Rs. 55,000
labour = Rs. 65,000



depreciation of plant used to manufacture the customised corporate gifts=Rs. 15,000

The customised corporate gifts were ready for sale on 1st March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.
Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

Solution

Particulars	Amount (₹)	Remarks
A. Cost of Purchase		
Raw material purchased	5,00,000	₹5,50,000 – ₹50,000 (refundable purchase taxes)
Consumable stores	55,000	Directly used in manufacturing
B. Cost of Conversion		
Direct labour (manufacturing)	65,000	Labour cost during production process
Depreciation of plant used in production	15,000	Depreciation of plant used to manufacture gifts
C. Product Design & Development Costs		
External designer	7,000	Specific design for customer
Design labour	3,000	Directly related to customer-specific design
D. Other Costs to bring inventory to saleable condition		
Materials used in testing phase	21,000	Net of scrap value recovered (₹24,000 – ₹3,000)
Labour in testing phase	11,000	Cost to modify as per specifications
Depreciation in testing phase	5,000	Part of cost to bring inventory to condition required by customer
E. Borrowing Costs	**–**	Expensed to P&L (Asset not qualifying as per Ind AS 23)
F. Loan Processing Fees	**–**	Adjusted in liability as per Ind AS 109 (not part of inventory cost)
	6,82,000	

19. Illustration (ICAI SM) [Imports]

A retailer company imported goods at a cost of Rs. 1,30,000 including Rs. 20,000 non-refundable import duties and Rs. 10,000 refundable purchase taxes. The risks and rewards of ownership of the imported goods were transferred to the retailer company upon collection of the goods from the harbour warehouse. The retailer company was required to pay for the goods upon collection. The retailer company incurred Rs. 5,000 to transport the goods to its retail outlet and a further Rs. 2,000 in delivering the goods to its customer. Further selling costs of Rs. 3,000 were incurred in selling the goods.
State whether delivery charges and selling expenses will form part of the cost of inventory. If not, then why? Also calculate the cost of inventory.

Solution

Value of inventory

Particulars	Amount (Rs.)
Purchase Price (1,30,000 – 20,000 – 10,000)	1,00,000
Non-refundable import duties	20,000
Transport cost	5,000
Total	1,25,000



Ind AS 2 excludes selling costs from the cost of inventory. Selling costs are incurred to make the sale, while distribution costs are incurred to deliver the goods to the buyer. Since neither of these costs contributes to bringing the goods to their current location and condition, they are excluded from inventory costs.

Therefore, both selling and distribution costs (e.g., ₹2,000 for delivery and ₹3,000 for other selling costs) are not included in the cost of inventories

20. Illustration (ICAI SM) [Retail Method]

An entity has following details regarding cost and retail price of the goods purchased and unsold at the beginning of the year:

	Cost (Rs.)	Retail Price (Rs.)
Opening inventory	6,250	8,000
Purchases	19,500	34,000
Inventory on hand		(23,000)
Sales for the period		19,000

Applying the retail method, compute the following:
(a) Percentage of cost price over retail price;
(b) Cost of closing inventory;
(c) Value of cost of sales (at cost); and
(d) Profit earned during the year on sale of inventory
Ignore the impact of mark-ups or mark-downs on the selling price.

Solution

S. No.	Particulars	Calculation	Amount (₹)
1.	Total cost of goods available for sale	Opening Inventory (₹6,250) + Purchases (₹19,500)	25,750
2.	Total retail value of goods available for sale	Opening (₹8,000) + Purchases (₹34,000)	42,000
(a)	Cost percentage of retail price	₹25,750 / ₹42,000	**61.31%**
(b)	Retail value of closing inventory	Given	23,000
	Cost of closing inventory	₹23,000 x 61.31%	**14,101**
(c)	Cost of goods sold	Total Cost (₹25,750) – Closing Inventory (₹14,101)	**11,649**
(d)	Sales Revenue (Given)		19,000
	Profit = Sales – Cost of Sales	₹19,000 – ₹11,649	**7,351**

The answer will be different if we round off the cost to 61%

(b)	Closing inventory (at cost)	23,000 x 61%	14,030
(c)	Cost of sales for the period	[(6,250 + 19,500) - 14,030]	11,720
	Sales for the period		19,000
(d)	Profit earned on sale of goods during the year	19,000 – 11,720	7,280

21. Illustration (ICAI SM) [Journal Entries] ✪ ✪

A Ltd. began operations in the year 20X1-20X2. In 20X1-20X2, it incurred the following expenditures on purchasing the raw materials for its product:

a. **Purchase price of the raw materials = Rs. 30,000;**
b. **Import duty and other non-refundable purchase taxes = Rs. 8,000;**



c. Refundable purchase taxes = Rs. 1,000;
d. Freight costs for bringing the goods from the supplier to the factory's storeroom for raw materials = Rs. 3,000;
e. Costs of unloading the materials into the storeroom for raw materials = Rs. 20; and Packaging = Rs. 2,000.

On 31st March, 20X2, A Ltd. received Rs. 530 volume rebate from a supplier for purchasing more than Rs. 15,000 from the supplier during the year.

A Ltd. incurred the following additional costs in the production run:
i. Salary of the machine workers in the factory = Rs. 5,000;
ii. Salary of factory supervisor = Rs. 3,000;
iii. Depreciation of the factory building and equipment used for production process = Rs. 600;
iv. Consumables used in the production process = Rs. 200;
v. Depreciation of vehicle used to transport the goods from the storeroom for raw materials to the machine floor = Rs. 400;
vi. Factory electricity usage = Rs. 300;
vii. Factory rental = Rs. 1,000; and
viii. Depreciation of the entity's vehicle used by the factory supervisor is Rs. 200.

During 20X1-20X2, A Ltd. incurred the following administrative expenses:
1. Depreciation of the administration building = Rs. 500;
2. Depreciation and maintenance of vehicles used by the administrative staff = Rs. 150; and
3. Salaries of the administrative personnel = Rs. 3,050.

Of the administrative expenses, 20% is attributable to administering the factory.

Remaining expenses are attributable, in equal proportion, to the sales and other non-production operations (eg financing, tax and corporate secretarial functions).

In 20X1-20X2, A Ltd. incurred the following selling expenses:
a) Advertising costs = Rs. 300;
b) Depreciation and maintenance of vehicles used by the sales staff = Rs. 100; and
c) Salaries of the administrative personnel = Rs. 6,000.

Pass necessary journal entries to record the cost of inventory in the books of A Ltd.

Solution

Journal Entires

S. No.	Date	Particulars	Dr. (₹)	Cr. (₹)
1	31-Mar-20X2	Inventory A/c Dr.	42,490	
		To Cash/Bank A/c (Cost of raw material incl. freight, packaging, etc.)		42,490
2	31-Mar-20X2	Inventory A/c Dr.	11,240	
		To Cash/Bank A/c (Direct labour)		5,000
		To Accum. Depreciation – Factory Equipment		600
		To Accum. Depreciation – Raw Material Delivery Vehicle		400
		To Cash/Bank A/c (Electricity)		300
		To Accum. Depreciation – Factory Supervisor's Vehicle		200
		To Cash/Bank A/c (Factory Supervisor Salary)		3,000
		To Cash/Bank A/c (Factory Rent)		1,000
		To Cash/Bank A/c (Admin staff – 20% to factory)		610
		To Accum. Depreciation – Admin Building (20%)		100
		To Accum. Depreciation – Admin Vehicles (20%)		30



3	31-Mar-20X2	Inventory A/c Dr.	200	
		To Inventory – Consumable Stores A/c (Issue of consumables to production)		200

Working Notes:

1. **Computation of costs of purchase**

Particulars	Amount (₹)
Purchase price of raw material	30,000
Add: Import duty and non-refundable taxes	8,000
Add: Freight to factory storeroom	3,000
Add: Unloading cost into storeroom	20
Add: Packaging	2,000
Less: Volume rebate received	(530)
Total Cost of Purchase	**₹42,490**

Note: Refundable taxes do not form part of the cost of inventories.

2. **Computation of costs of conversion**

Particulars	Amount (₹)
Direct labour (machine workers)	5,000
Depreciation – Factory equipment	600
Depreciation – Raw material transport vehicle	400
Depreciation – Vehicle used by factory supervisor	200
Factory electricity usage	300
Factory supervisor salary	3,000
Factory rental	1,000
Admin salaries attributable to factory (20% of ₹3,050)	610
Depreciation – Admin building (20% of ₹500)	100
Depreciation – Admin vehicles (20% of ₹150)	30
Total Cost of Conversion (excluding consumables)	**₹11,240**

22. Illustration (ICAI SM) [Free Items]

B Limited has valued its stock held for distribution as free items on claim by customers (on offers) at zero. The customers have a right to claim the free item within 14 days from the date of invoice. If the time limit of 14-day exceeds, the claim is foregone by the customer.

The majority of the free items require online registration by the buyers for participation in the contest conducted by the respective brand which needs to be done by the buyers within 3 days from the date of invoice.

Out of it, a few items under this category were found damaged. The replacement cost of such items would be Rs. 2,50,000.

Determine whether the entity has to book loss of inventory or provide for replacement cost of the goods that need to be given as free items to customers as per the principles of Ind AS.

Solution

Ind AS 2 governs inventory valuation. The stock of free items is valued at zero by B Limited since these items are distributed as part of promotional offers.
As per Ind AS 2, inventory should be carried at the lower of cost or net realizable value. **In this case, the free items do not generate direct revenue, so valuing them at zero is acceptable.**

The claim for free items is subject to conditions:



- Claim within 14 days of the invoice date.
- Online registration within 3 days of the invoice date.

These conditions make the claim contingent on customer actions. Until these actions occur, no obligation arises for B Limited.

As per Ind AS 37, a provision is recognized when:
a. There is a present obligation (legal or constructive) from a past event.
b. It is probable that an outflow of resources will be required to settle the obligation.
c. The amount can be reliably estimated.

In this case:
The sale occurred in the reporting year, **creating an obligation to fulfill the offer** if customers meet the claim conditions.

If it is probable that customers will register and claim the free items, a provision for ₹2,50,000 should be recognized in the financial statements for the reporting year.

If the time for claims expires without customer action, the provision can be reversed in the next financial year.

The question of booking loss of inventory does not arise since the inventory is anyways valued at nil.



Ind AS 16 – Property Plant & Equipment
ILLUSTRATIONS

1. Illustration (Computation of Cost of PPE) ✪✪

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?

Solution:

According to Ind AS 16, all costs required to bring an asset to ***its present location and condition for its intended use should be capitalised***.

The cost of asset to be recognised

	₹
List price	80,00,000
Less: Trade discount (10%)	(8,00,000)
	72,00,000
Import duty (Non refundable)	5,00,000
Delivery fees	1,00,000
Electrical installation costs	10,00,000
Pre-production testing	4,00,000
Total amount to be capitalised at 1st April, 20X1	**92,00,000**

Maintenance contract is **a separate contract to get service**, therefore, the maintenance contract cost of ₹ 7,00,000 should be taken as a **prepaid expense and charged to the profit or loss over a period of 5 years.**

In addition the settlement discount i.e cash discount received of ₹ 3,60,000 (₹ 72,00,000 x 5%) is to be shown as other income in the profit or loss.

2. Illustration (Cost of PPE) ✪✪

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 ₹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



Solution:

Particulars	₹ in 000 (As per Ind AS 16)
Site preparation costs	150
Direct Material	2,000
Direct labour cost (1160-10)	1150
Testing of various processes in factory	200
Consultancy fees for installation of equipment	300
Relocation of staff to new factory	-
General overheads	-
Estimated costs to dismantle (at present value)	200
Total Cost to be Capitalised as per Ind AS 16	**4000**

3. Illustration (Leasehold Improvement)

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

Solution:

As per *Ind AS 16 – Property, Plant and Equipment*, the cost of an item of PPE includes:

- Purchase price,
- Any cost directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating,
- **Initial estimate of costs of dismantling and removing the item and restoring the site** (commonly referred to as Asset Retirement Obligation or ARO), if the entity incurs the obligation when the asset is acquired or as a consequence of using it.

Analysis:

In the given case, XYZ Ltd. has incurred ₹25,00,000 to construct an internal wall in a leased property, which qualifies as a **leasehold improvement**. However, under the lease terms, XYZ Ltd. is also **obligated to dismantle** the wall and restore the premises at the end of the lease. The present value of this dismantling cost is ₹10,00,000.

As this dismantling obligation arises due to the construction activity, it is a **present obligation**, and the present value of ₹10,00,000 should be added to the cost of leasehold improvement.

Conclusion:

XYZ Ltd. should capitalise the total cost of leasehold improvement as follows:

Particulars	Amount (₹)
Cost of constructing internal wall	25,00,000
Present value of dismantling obligation	10,00,000
Total capitalised cost	**35,00,000**

4. Illustration – Cost of PPE - ✪✪✪

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

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 ₹1,00,000 had been spoiled and therefore wasted and a further ₹1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November, 20X0 and it is estimated that ₹22,000 of the labour 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 ₹40,00,000 on 1st April, 20X0 for construction of the building. The loan carried an interest rate of 8% per annum and is repayable on 1st April, 20X2.
Calculate the cost of the building that will be included in tangible non-current asset as an addition.

Solution:
Only those costs which are **directly attributable to bringing the asset into working condition for its intended use should be included**.
The following costs are excluded

- Administration and general overhead.
- Cost of abnormal amount of wasted material/ labour or other resources

Here, the cost of spoilt materials and faulty designs are assumed to be abnormal costs. Also it is assumed that the wastages and labour charges incurred are abnormal in nature. Hence, same are also not included in the cost of PPE.

Amount to be included in Property, Plant and Equipment (PPE):

	₹
Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Material (10,00,000 – 2,50,000)	7,50,000
Direct labour cost (4,00,000 – 22,000)	3,78,000
General overheads	Nil
Interest (Note)	Nil
Total to be capitalized	**45,78,000**

Note : Period for Construction of building is considered to not be a substantial period (i.e. 9 months), borrowing cost are not eligible for capitalisation.

5. Illustration – Cost of PPE ✪✪

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.

Solution:
According to Ind AS 16, these costs can be capitalized:

1.	Cost of the plant	25,00,000
2.	Initial delivery and handling costs	2,00,000
3.	Cost of site preparation	6,00,000
4.	Consultants' fees	7,00,000
5.	Net present value of estimated dismantling costs to be incurred after 7 years	3,00,000
		43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production



amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

6. Illustration – Exchange of Asset ✪✪

Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of ₹10 million. The fair value of such asset is ₹15 million. It exchanges the land and building for a private jet, which has a fair value of ₹20 million and pays additional ₹3 million in cash.
Show the necessary treatment as per Ind AS 16 and pass journal entry for the transaction.

Solution:

When an item of PPE is acquired in exchange for another non-monetary asset (or a combination of monetary and non-monetary assets), it is measured at the **fair value of the asset given up**, unless:

- The exchange transaction lacks commercial substance, or
- The fair value of the asset given up (or received) cannot be measured reliably.

If the fair value of the asset **received** is more clearly evident, then it is used.

- **Pluto Ltd.** is giving up **land and building** with:
  - Carrying amount = ₹10 million
  - Fair value = ₹15 million
- It receives a **private jet** and pays ₹3 million extra in cash.
- The transaction has **commercial substance**.

Hence, we use the **fair value of the asset given up (₹15 million)** to measure the exchange.

- **Cost of private jet = FV of asset given up + cash paid = ₹15 million + ₹3 million = ₹18 million**
- **Gain on disposal = FV of asset given up – Carrying amount = ₹15 million – ₹10 million = ₹5 million**

Particulars	Amount
Fair value of land & building given up	15,000
Less: Carrying value of land & building	(10,000)
Profit on exchange	**5,000**
Cash Paid	3,000
Total cost of private jet	18,000

Property, Plant & Equipment – Private Jet A/c	Dr. ₹18,00,000	
To Property, Plant & Equipment – Land & Building A/c		₹10,00,000
To Bank A/c		₹3,00,000
To Profit on Exchange of Asset A/c		₹5,00,000

7. Illustration – Overhauling Component ✪✪✪✪

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 ₹20 million with a 20-year life must have major overhaul every five years. The estimated cost of the overhaul at the five-year point is ₹5 million. However, the actual cost after 5 years turned out to be ₹6 million. You are required to explain the accounting treatment.

Solution:

Ind AS 16 requires **component accounting** where different components of an asset have different useful lives or consumption patterns. When **major inspections or overhauls** are required at regular intervals (e.g., dry-docking of ships), the **cost of such inspection/overhaul is capitalised as a separate component**, and the carrying amount of the replaced component is derecognised.



The depreciation charge for the first five years of the assets life will be as follows:

	Overhaul component (million)	Ship (other than overhaul component) (million)	Total
Cost	5	15	20
Years	5	20	
Depreciation per year	1	0.75	1.75
Depreciation for 5 years	5	3.75	8.75
Carrying Amount	Nil	11.25	11.25

Total accumulated depreciation for the first five years will be ₹ 8.75, and the carrying amount of the ship at the end of year 5 will be ₹ 11.25 million.

Assume, the actual overhaul costs incurred at the end of year 5 are ₹ 6 million. This amount will now be capitalised into the costs of the ship, to give a carrying amount of ₹ 17.25 million.

The depreciation charge for years 6 to 10 will be as follows:

	Overhaul component	Ship (other than overhaul component)
Cost	6	11.25
Years	5	15
Depreciation per year	1.2	0.75

Annual depreciation for years 6 to 10 will now be ₹ 1.95 million. This process will be continued for years 11 to 15 and years 16 to 20. By the end of year 20, the capital cost of ₹ 20 million will have been depreciated plus the actual overhaul costs incurred at years 5, 10 and 15.

8. Illustration – Change in Estimate

An entity acquired an asset 3 years ago at a cost of ₹5 million. The depreciation method adopted for the asset was 10 percent reducing balance method.
At the end of Year 3, the entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight –line method from that date so as to reflect the revised estimated pattern of recovery of economic benefits.
Show the necessary treatment in accordance of Ind AS 16. Calculate the depreciation charge for respective years.

Solution:
Change in Depreciation Method shall be accounted for as a change in an accounting estimate in accordance of Ind AS 8 and hence will have a prospective effect.
Depreciation Charges for year 1 to 11 will be as follows:

Year 1 – 3 based on WDV method @ 10% on opening balance.

Year	Opening balance of asset (a)	Depreciation @ 10% on (a)	Closing balance of asset (c) = (a)- (b)
1	50,00,000	5,00,000	45,00,000
2	45,00,000	4,50,000	40,50,000
3	40,50,000	4,05,000	36,45,000

Year 3 onwards method of depreciation has been changed from reducing balance method to straight line method for which it is assessed that the remaining useful life is 8 year.

Hence revised depreciation would be calculated as follows:
Revised depreciation as per straight line method =
(Carrying amount as at the end of the 3rd year – Residual value) / Remaining useful life.
= 36,45,000/8 years.
= Rs.4,55,625 per annum (for year 4 to year 11).

9. Illustration – Change in Estimate



An asset which cost ₹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 year.
Calculate the depreciation charge for the years 1,2,3.

Solution:

	Year-1	Year-2	Year-3
Cost/Carrying Amount	10,000	9,200	10,000
Depreciation for the year	**800**	**800**	**1600**
Carrying Amount	9,200	8,400	6,800

Depreciation for year 1 & 2 =

Depreciation for the year 1 & 2	$\frac{10,000 - 2,000}{10} = 800$
Depreciation for Year 3	$\frac{8,400 - 2,000}{4} = 1,600$

10. Illustration – Component Depreciation - ✪✪✪✪

MS Ltd. has acquired a heavy machinery at a cost of ₹1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 year. 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 year. The cost of a new turbine is ₹45,00,000. The discount rate assumed is 5%.
Can the cost of the new turbine be recognised as an asset, and, if so, what treatment should be used?

Solution:

Exam hint – Consider PV of future replacement cost as cost of component.

As per **Ind AS 16**, when a major component of an asset is replaced and meets the recognition criteria (i.e., future economic benefits are probable and cost can be measured reliably), it should be capitalised. Simultaneously, the **carrying amount of the replaced part** must be **derecognised**, even if the original cost of the component was not separately identified.

The new turbine will produce future economic benefits to MS Ltd., and the cost is measurable. Hence, the item should be recognised as an asset.

The original invoice for the machine did not specify the cost of the turbine; however, the cost of the replacement ₹ 45,00,000 can be used as an indication (usually by discounting) of the likely cost, six years previously.

If an appropriate discount rate is 5% per annum, **₹ 45,00,000 discounted back six years amounts to ₹ 33,57,900** [₹ 45,00,000/$(1.05)^6$], i.e., the approximate cost of turbine before 6 year.

The estimated cost of turbine at acquisition date is ₹ 33,57,900 which would have been originally depreciated over 10 year.
Depreciation per year = ₹ 3,35,790

Particulars	Turbine	Total
Cost	₹ 33,57,900	₹ 1,00,00,000
Depreciation per year	₹ 3,35,790	₹ 10,00,000
Depreciation for 6 years	₹ 20,14,740	₹ 60,00,000
Carrying amount	₹ 13,43,160	₹ 40,00,000
(-) Amount derecognised	₹ (13,43,160)	₹ (13,43,160)
Cost of new turbine	₹ 45,00,000	₹ 45,00,000



New Carrying Amount	₹ 45,00,000	₹ 71,56,840

The current carrying amount of the turbine which is required to be replaced of ₹ 13,43,160 would be derecognised from the books of account

Profit & Loss Dr. ₹ 13,43,160
To PPE ₹ 13,43,160

The new turbine is capitalised as under

Property, Plant & Equipment (Turbine) A/c Dr. ₹45,00,000
To Bank / Creditors A/c ₹45,00,000

11. Illustration – ✪✪✪✪

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

- **Preparation and levelling of the land – ₹3,00,000.**
- **Purchase of materials for the construction ₹6.08 million in total.**
- **Employment costs of the construction workers – ₹2,00,000 per month.**
- **Overhead costs incurred directly on the construction of the factory – ₹1,00,000 per month.**
- **Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – ₹50,000 per month.**
- **Income received during the temporary use of the factory premises as a car park during the construction period – ₹50,000.**
- **Costs of relocating employees to work at the new factory – ₹3,00,000**
- **Costs of the opening ceremony on 31st January, 20X2 – ₹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 ₹20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of ₹1 payable in 40 years' time at an annual discount rate of 8% is ₹ 0.046.
The construction of the factory was partly financed by a loan of ₹17.5 million taken out on 1st April, 20X1. The loan was at an annual rate of interest of 6%. Sun Ltd received investment income of ₹100,000 on the temporary investment of the proceeds.
Required:
Compute the carrying amount of the factory in the Balance Sheet of Sun Ltd at 31st March, 20X2. You should explain your treatment of all the amounts referred to in this part in your answer.

Solution:

Under **Ind AS 16**, the cost of an item of PPE includes:

- Purchase price (including legal duties),
- Costs directly attributable to bringing the asset to the location and condition necessary for its intended use,
- Initial estimates of dismantling/restoration costs if there's a present obligation.

Under **Ind AS 23**, borrowing costs directly attributable to the acquisition/construction of a **qualifying asset** must be capitalised. Any income earned on temporary investment of funds shall be deducted from such costs.



Cost of Factory

Description	Amount	Included in PPE	Explanation
Land (incl. legal costs)	10,000	☑ Yes	Directly attributable
Preparation and levelling	300	☑ Yes	Site prep is necessary
Materials	6,080	☑ Yes	Direct cost
Construction workers (₹2,00,000 × 7 months)	1,400	☑ Yes	Construction period: May–Nov
Direct overheads (₹1,00,000 × 7 months)	700	☑ Yes	Direct to construction
Allocated overheads (₹50,000 × 7 months)	—	✗ No	Not directly attributable
Temporary car park income	—	✗ No	Income to be credited to P&L
Relocation costs	—	✗ No	Not directly attributable
Opening ceremony	—	✗ No	Post-ready-for-use cost
Borrowing costs (₹17.5m × 6% × 8*/12 or 7*/12)	612.5	☑ Yes	Capitalised as per Ind AS 23
Less: Investment income	(100.0)	☑ Adjusted	Offset as per Ind AS 23
Restoration (₹20m × 0.046)	920.0	☑ Yes	Present value of legal obligation
Total	**₹19,912.5**		
Less: Depreciation	**₹107.38**		
Carrying Amount	**₹19,805.12**		

Depreciation calculation (4 months: Dec–Mar)

Component	Amount
Land	10,000
Depreciable Component (Excluding Land)	9,912.5
Roof (30%)	₹9,912.5 × 30% ÷ 20 × 4/12 = 49.56
Remainder (70%)	₹9,912.5 × 70% ÷ 40 × 4/12 = 57.82
Total Depreciation	107.38

Note – As per IFRS interpretations committee agenda decisions, if land is acquired for the purpose of construction of a building, the land would not be capable of being used for its intended purpose and evaluation should be done for both land and buildings together for capitalisation of borrowing cost.

12. Illustration – Revaluation Model

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.

Solution:

Gross Approach

Particulars	Amount (₹)
Original Cost	1,00,000
Useful Life	10 years
Depreciation Method	Straight Line
Depreciation (4 years)	40,000 (10,000 × 4)
Carrying Amount (before revaluation)	60,000
Fair Value (Revalued Amount)	80,000
Increase in Carrying Amount	20,000



% Increase over Carrying Amount	33.33%

Revaluation Model – Gross Approach

Particulars	Original (₹)	% Increase	Adjusted (₹)
Gross PPE	1,00,000	+33.33%	1,33,333.33
Accumulated Depreciation	(40,000)	+33.33%	(53,333.33)
Net Book Value (Post Revaluation)	—	—	80,000

Balance Sheet Presentation

Equity & Liabilities	Before	After	Assets	Before	After
Equity	60,000	60,000	PPE		
OCI	0	20,000	Gross	1,00,000	133,333.33
			Depreciation	(40,000)	(53,333.33)
Total	60,000	80,000		60,000	80,000

PPE A/c Dr. ₹33,333.33
To Accumulated Depreciation A/c ₹13,333.33
To Revaluation Surplus (OCI) ₹20,000.00

PPE A/c			
Year 1 - To Bank	₹1,00,000.00		
Year 4 End		By bal c/d	1,33,333
To Revaluation Surplus	₹20,000.00		
To Acc. Dep	₹13,333.33		
Accumulated Depreciation			
End of Year 4		Year 1 to Year 4	
To bal c/d	53,333	By Depreciation	40,000
		By PPE A/c	13,333

Net Approach
PPE A/c Dr. ₹20,000
To Revaluation Surplus (OCI) ₹20,000.00

Balance Sheet Presentation

Equity & Liabilities	Before	After	Assets	Before	After
Equity	60,000	60,000	PPE		
OCI	0	20,000	Gross	1,00,000	1,20,000
			Depreciation	(40,000)	(40,000)
Total	60,000	80,000		60,000	80,000

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**

Case 5:

Particulars	**Year 1**	**Year 2**
Carrying Amount	**₹ 1,00,000**	**₹ 80,000**
Fair Value	**₹ 90,000**	**₹ 95,000**

Solution

Revaluation Model		
Particulars	Year 1	Year 2
Case 1		
Carrying amount	₹1,00,000.00	₹90,000.00
Fair Value	₹1,20,000.00	₹1,00,000.00
Increase/(decrease)	₹20,000.00	₹10,000.00
Dr PPE A/c	₹20,000.00	₹10,000.00
Cr To Revaluation Surplus	₹20,000.00	₹10,000.00
Case - 2		
Carrying amount	₹1,00,000.00	₹90,000.00
Fair Value	₹1,20,000.00	₹80,000.00
Increase/(decrease)	₹20,000.00	(₹10,000.00)
Dr PPE A/c	₹20,000.00	
Cr To Revaluation Surplus	₹20,000.00	
Dr Revaluation Surplus		₹10,000.00
Cr To PPE A/c		₹10,000.00
Case - 3		
Carrying amount	₹1,00,000.00	₹90,000.00
Fair Value	₹1,20,000.00	₹65,000.00
Increase/(decrease)	₹20,000.00	(₹25,000.00)
Dr PPE A/c	₹20,000.00	
Cr To Revaluation Surplus	₹20,000.00	



Dr Revaluation Surplus		₹20,000.00
Dr. Profit/Loss A/c		₹5,000.00
Cr To PPE A/c		₹25,000.00
Case - 4		
Carrying amount	₹1,00,000.00	₹80,000.00
Fair Value	₹90,000.00	₹85,000.00
Increase/(decrease)	(₹10,000.00)	₹5,000.00
Dr Profit/Loss A/c	₹10,000.00	
Cr To PPE A/cc	₹10,000.00	
Dr. PPE A/c		₹5,000.00
Cr. Profit/Loss		₹5,000.00
Case - 5		
Carrying amount	₹1,00,000.00	₹80,000.00
Fair Value	₹90,000.00	₹95,000.00
Increase/(decrease)	(₹10,000.00)	₹15,000.00
Dr Profit/Loss A/c	₹10,000.00	
Cr To PPE A/cc	₹10,000.00	
Dr. PPE A/c		₹15,000.00
Cr. Profit/Loss		₹10,000.00
Cr. To Revaluation Surplus		₹5,000.00

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.

Solution:

Particulars		
Original Cost	₹1,00,000.00	
Useful life - years	10	
Depreciation per year	₹10,000.00	1,00,000/10
Depreciation for 4 years	₹40,000.00	10,000 x 4
Carrying amount	₹60,000.00	1,00,000-40,000
Fair value	₹80,000.00	
Increase (80,000 – 60,000)	₹20,000.00	Revaluation surplus
Remaining useful life	6 years	



Revised depreciation	₹13,333.33	80,000 / 6
Depreciation on cost	₹10,000.00	
Extra depreciation (to be trf to retained earnings)	**₹3,333.33**	
PPE A/c Dr.	₹20,000.00	
To Revaluation Surplus		₹20,000.00
Depreciation A/c Dr	₹13,333.33	
To Acc. Dep		₹13,333.33
Revaluation Surplus A/c Dr	₹3,333.33	
To Retained earnings		₹3,333.33

15. Illustration – Change in estimates of decommissioning liability - ✪✪✪✪✪

H Limited purchased an item of PPE costing ₹ 100 million which has useful life of 10 year.The entity has a contractual decommissioning and site restoration obligation, estimated at ₹ 5 million to be incurred at the end of 10th year. The current market-based discount rate is 8%. The company follows SLM method of depreciation. H Limited follows the Cost Model for accounting of PPE.

Determine the carrying value of an item of PPE and decommissioning liability at each year end when:

(a) There is no change in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate

(b) At the end of Year 4, the entity expects that the estimated cash outflow on account of decommissioning and site restoration to be incurred at the end of the useful life of the asset will be ₹ 8 million (in place of ₹ 5 million, estimated in the past).

Determine in case (b), how H Limited need to account for the changes in the decommissioning liability?

Solution:

The present value of such decommissioning and site restoration obligation at the end of 10th year is ₹2.316 million [being 5 / $(1.08)^{10}$].

H Limited will recognise the **present value of decommissioning liability of ₹ 2.3106 million as an addition to cost of PPE and will also recognize a corresponding decommissioning liability.** Further, the entity will recognise the unwinding of discount as finance charge.

(a) PPE is recognised at ₹102.316

The following table shows the relevant computations, if there is no change in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate: (₹ in million):

Year	Opening Amount of PPE (₹ lakh)	Depreciation Charge (SLM - 10 yrs) (₹ lakh)	Carrying Amount of PPE at year-end (₹ lakh)	Opening Decommission-ing Liability (₹ lakh)	Unwinding of discount @ 8 % (₹ lakh)	Closing Decommission-ing Liability (Op + Int) (₹ lakh)
1	102.3160	10.2316	92.0844	2.3160	0.1853	2.5012
2	92.0844	10.2316	81.8528	2.5012	0.2001	2.7013
3	81.8528	10.2316	71.6212	2.7013	0.2161	2.9175
4	71.6212	10.2316	61.3896	2.9175	0.2334	3.1508
5	61.3896	10.2316	51.1580	3.1508	0.2521	3.4029
6	51.1580	10.2316	40.9264	3.4029	0.2722	3.6751



7	40.9264	10.2316	30.6948	3.6751	0.2940	3.9692
8	30.6948	10.2316	20.4632	3.9692	0.3175	4.2867
9	20.4632	10.2316	10.2316	4.2867	0.3429	4.6296
10	10.2316	10.2316	0.0000	4.6296	0.3704	5.0000
Total	**102.316**	**102.316**			**2.6840**	

ICAI has rounded off the PV of decommissioning liability to 2 digits.

(b) The changes to the estimate of expected decommissioning obligation:

- **Ind AS 16** requires any change in the **present value of a decommissioning liability** to be added to, or deducted from, the *carrying amount of the related PPE* and depreciated **prospectively** over the asset's remaining useful life.
- **Ind AS 37** states that the provision is re-measured at the **current best estimate**;

Particulars	Amount (₹ million)
Present value of revised obligation at end of **Year 4** (₹ 8 million payable after 6 years, discounted @ 8 %)	**8**/1.08^6 = **5.0413**
Carrying amount of liability already recognised (closing Year 4 schedule)	**3.1508**
Increase in liability / cost of PPE	**1.8905**
New Carrying Amount of PPE at end of Y4 [61.3896 + 1.8905]	**63.2801**
Depreciation per year considering 6 years balance life	**10.5466**

The journal entry will be:

PPE	Dr	₹1.8905 million	
To Provision for decommissioning liability			₹1.8905 million

- The following table shows the calculations for years 5 - 10:

Year	Opening Amount of PPE	Depreciation Charge (on SLM) for 10Years	Carrying Amount of PPE at the end of the year	Opening Decommissioning Liability	Unwinding of Interest @ 8%	Closing Decommissioning Liability
5	63.2801	10.5467	52.7334	5.0414	0.4033	5.4447
6	52.7334	10.5467	42.1867	5.4447	0.4356	5.8802
7	42.1867	10.5467	31.6400	5.8802	0.4704	6.3507
8	31.6400	10.5467	21.0934	6.3507	0.5081	6.8587
9	21.0934	10.5467	10.5467	6.8587	0.5487	7.4074
10	10.5467	10.5467	0.0000	7.4074	0.5926	8.0000
Total		**63.2801**				

- The asset should be tested for impairment as per Ind AS 36.

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.

Solution:

As per **Ind AS 16**, depreciation should be charged on the depreciable amount of an asset over its useful life.

Further, **Ind AS 8** requires that when there is a **change in estimate (e.g., useful life of an asset)**, the effect should be accounted for **prospectively** i.e., from the date of revision, the carrying amount is depreciated over the revised remaining useful life.

Particulars	Buildings	Plant & Machinery	Furniture & Fixtures	Total (₹)
Original Cost (₹)	1,50,00,000	1,00,00,000	35,00,000	2,85,00,000
Original Useful Life (Years)	15	10	7	–
Annual Depreciation (Original)	10,00,000	10,00,000	5,00,000	25,00,000
Depreciation till 31.03.20X4 (3 yrs)	30,00,000	30,00,000	15,00,000	75,00,000
Carrying Amount on 01.04.20X4	1,20,00,000	70,00,000	20,00,000	2,10,00,000
Revised Useful Life (Years)	10	7	5	–
Revised Annual Depreciation	12,00,000	10,00,000	4,00,000	26,00,000
Difference in Depreciation	2,00,000 (↑)	–	(1,00,000) (↓)	1,00,000 (↑)

The revised depreciation for FY 20X4–20X5 is ₹26,00,000 compared to the original ₹25,00,000—leading to an additional charge of ₹1,00,000 to the Profit and Loss statement.

17. Illustration – Revaluation

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 year. Ignore impact of deferred taxes.
Show the necessary treatment as per Ind AS 16 to calculate depreciation and revaluation surplus for 20X3-20X4.

Solution:

Particulars	Amount (₹)
Cost	9,00,000



Depreciation till 31st March, 20X3 (₹ 9,00,000 / 10 * 2)	1,80,000
Carrying value before revaluation	7,20,000
Revalued amount	9,60,000
Revaluation Surplus	2,40,000

Basis	Working	Amount (₹)
Historical cost basis	₹ 9,00,000 / 10	90,000
Revalued basis	₹ 9,60,000 / 8	1,20,000
Additional Depreciation	₹ 1,20,000 - ₹ 90,000	**30,000**

In the profit or loss for 20X3-20X4, a depreciation expense of ₹ 1,20,000 will be charged. A reserve transfer, which will be shown in the statement of changes in equity, may be undertaken as follows:

Revaluation surplus	Dr	30,000	
To Retained earnings			30,000

The closing balance on the revaluation surplus on 31st March, 20X4 will therefore be as follows:

Balance arising on revaluation (9,60,000 – 7,20,000)	240,000
Transfer to retained earnings	(30,000)
	210,000

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 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?

Solution:

On 31st March, 2X11, the plant is 10 years old.

Decommissioning liability at end of 10 years = 10,000 x $(1.05)^{10}$ = 16,288.95 or 16,300 (approx.)

Reduction in decommissioning liability = 8,000

New Liability = 8,300

Provision for decommissioning liability	Dr	8,000	
To Asset			8,000

Particulars	Amount (₹)
Original Asset Value	1,20,000
Less: Accumulated Depreciation	(30,000)
(120,000 x 10/40)	
Carrying Amount	**90,000**
Less: Decommissioning Liability Adjustment	(8,000)
Revised carrying amount	82,000
Revised depreciation (82,000/30)	2,733.33
Unwinding of discount for subsequent year 8,300 x 5%	415



19. Illustration – Changes in Decommissioning Liability ✪✪✪✪✪

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?

Solution:

Particulars	**Amount**	
PPE		
Cost of PPE	1,20,000.00	
Less: Depreciation for 3 years	9,000.00	
[120000 x 3/40]		
Carrying amount as on 31st Mar 20X4 [1]	1,11,000.00	
Revalued amount (net of decomm. Liab)	1,15,000.00	Given
Add: Decomm. Liab	11,600.00*	
Revalued amount [2]	**1,26,600.00**	
Revaluation surplus [2-1]	**15,600.00**	
Depreciation per year after revaluation	3,420	1,26,600/37 = 3,421
Carrying amount as on 31st March X5 [3]	**1,23,180**	**1,26,600-3,420**
Revalued Amount (net of obligation)	1,07,000	
Decommissioning liability	12,200	11,600 x 1.05 = 12,180
Reduction in Decommissioning Liability	(5,000)	
Revised Decommissioning liability	**7,200**	
Gross revalued amount of PPE [4]	114,200	107000 + 7200
Downward Revaluation [4-3]	(8,980)	123,180 – 114,200

Date	**Particulars**	**Debit (₹)**	**Credit (₹)**
31-Mar-X4	PPE A/c	15,600	
	To Revaluation Surplus A/c		15,600
	(Revaluation of PPE)		
31-Mar-X5	Depreciation A/c	3,420	
	To Accumulated Depreciation A/c		3,420
	(Depreciation for the year)		
31-Mar-X5	Accumulated Depreciation A/c	3,420	
	To PPE A/c		3,420
	(Transfer of accumulated depreciation to PPE)		
31-Mar-X5	Interest Expense A/c	600	
	To Provision for Decommissioning		600
	(Unwinding of discount)		



31-Mar-X5	Provision for Decommissioning	5,000	
	To Revaluation Surplus A/c		5,000
	(Reduction in liability recognised as revaluation gain)		
31-Mar-X5	Revaluation Surplus A/c	8,980	
	To PPE A/c		8,980
	(Downward revaluation of PPE)		

Reconciliation

	PPE	Decommissioning Liab	Revaluation Surplus
Balance on 31-Mar-X5	1,23,180	12,200	15,600
Reduction in Liab		(5,000)	5,000
Revaluation loss	(8,980)		(8,980)
Carrying amount	1,14,800	7,200	11,620

**The actual decommissioning liability works out to 11,576 which has been rounded off in the question to 11,600*

20. Illustration [Nov-19 8 Marks] - ✪✪✪

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?

Solution:

As per **Ind AS 16**, the **cost of an item of PPE** should be recognized as an asset **only if**:

- *It is probable that future economic benefits associated with the item will flow to the entity; and*
- *The cost of the item can be measured reliably.*

Additionally, the **cost of an item of PPE includes** all **directly attributable costs** to bring the asset to the location and condition necessary for it to operate as intended.

The standard **does not prescribe a unit of measure**—hence, in complex projects, the entire facility may be considered the unit for capitalisation.

M Ltd. incurs expenditure for developing an **electric substation** which is **essential for operating the factory**. M Ltd. **does not own** the substation, and it is also **accessible to public and other entities**. Hence, M Ltd does not separately control the substation.

However, **without this infrastructure**, M Ltd. would **not be able to operate** its factory and **generate economic benefits**. Hence, the expenditure, although **not on a tangible asset M Ltd. controls**, is **directly attributable** to bringing the main asset (factory) into working condition.

In view of this, even though M Ltd. may not be able to recognise expenditure incurred on electric-substation as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), **expenditure incurred may be capitalised as a part of overall cost of the project.**

Depreciation:



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

If the component (e.g., electric substation) has a **different useful life** or a **different pattern of consumption of economic benefits** compared to the main PPE (e.g., factory), it must be **depreciated separately**. (The reason to depreciate over shorter life is due to the fact that the company may have to incur the expenditure again). Where a cost is **capitalised as directly attributable** (e.g., electric substation for making factory operational), it is depreciated **over the useful life of the PPE** to which it relates.

Presentation:
The amount capitalised towards the electric substation will be shown **as part of the factory assets** under Property, Plant and Equipment in the balance sheet.

21. Illustration [MTP] – ✪✪✪✪✪

Fly wing 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**

Additional Information:

The construction staff was engaged in the production line, which took two months to make ready for use and was brought into use on 31 May 20X1.
The other overheads were incurred in the two months period ended on 31 May 20X1. They included an abnormal cost of Rs.3,00,000 caused by a major electrical fault.
The production line is expected to have a useful economic life of eight yea₹At the end of that time Flywing Airways Ltd is legally required to dismantle the plant in a specified manner and restore its location to an acceptable standard. The amount of Rs.2 million mentioned 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.

Solution:

Statement showing Cost of production line:

Particulars	**Amount (₹ '000)**
Purchase cost	10,000
Goods and services tax – recoverable goods and services tax not included	
Employment costs during the period of getting the production line ready for use (1,200 × 2 months ÷ 3 months)	800
Other overheads – abnormal costs	600
Payment to external advisors – directly attributable cost	500



Dismantling costs – recognised at present value where an obligation exists (2,000 × 0.68)	1,360
Total	**13,260**

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

Particulars	Amount (₹'000)
Cost of Production line	13,260
Less: Depreciation (W.N.1)	(1,694)
Net carrying value carried to Balance Sheet	**11,566**

Provision for dismantling cost:

Particulars	Amount (₹'000)
Non-current liabilities	1,360
Add: Finance cost (WN3)	57
Net book value carried to Balance Sheet	**1,417**

Extract of Statement of Profit & Loss:

Particulars	Amount (₹'000)
Depreciation (W.N.1)	1,694
Finance cost (W.N.2)	57
Amounts carried to Statement of Profit & Loss	**1,751**

Extract of Balance Sheet:

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

1. Calculation of depreciation charge:

Component	Capitalised Amount (₹ '000)	Useful Economic Life	Depreciation for the year (₹ '000) [10 Months]
Major overhaul component	3,000	4 years	625
Balance asset component	10,260	8 years	1,069
Total depreciation charged to P&L (31 March 20X2)	**13,260**		**1,694**

2. Finance costs:

Particulars	Amount (₹'000)
Unwinding of discount (Statement of Profit and Loss – finance cost) 1,360 x 5% x 10/12	57
To Statement of Profit & Loss for the year ended 31st March 20X2.	57

22. Illustration (Self practice)

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

	Amount ('000)
Gross carrying amount	₹ 200
Accumulated depreciation (straight-line method)	(₹ 80)



Net carrying amount **₹ 120**
Fair value **₹ 150**

The useful life of the machinery is 10 years and the company uses Straight line method of depreciation. The revaluation was performed at the end of 4 years.
Advise how should the company account for revaluation of plant and machinery and depreciation subsequent to revaluation. Support your answer with journal entries.

Solution:

As per Ind AS 16, When an item of property, plant and equipment is revalued, **the carrying amount of that asset is adjusted to the revalued amount.** The increase in value of PPE is recognised as a revaluation surplus (under OCI). Since the fair value of PPE is greater than carrying amount, revaluation surplus of ₹30,000 [₹150,000 – ₹120,000] is recognised.
At the date of the revaluation, the asset is treated in one of the following ways:
(a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.
In such a situation, the revised carrying amount of the machinery will be as follows:
Gross carrying amount ₹ 250 [(200/120) x 150]
Net carrying amount ₹ 150
Accumulated depreciation ₹ 100 (₹ 250 – ₹ 150)

Journal entry

Plant & Machinery Dr.		50	
To Acc. Depreciation			20
To Revaluation Surplus			30

Depreciation subsequent to revaluation
Since the Gross Block has been restated, the depreciation charge will be ₹ 25 per annum (₹ 250/10 years).
Journal entry
Accumulated Depreciation Dr. ₹ 25 p.a.
To Plant and Machinery (Gross Block) ₹ 25 p.a.
(b) The accumulated depreciation is eliminated against the gross carrying amount of the asset.
In this case, the gross carrying amount is restated to ₹ 150 to reflect the fair value and accumulated depreciation is set at zero.

Journal entry

Accumulated Depreciation	Dr.	₹ 80	
To Plant and Machinery (Gross Block)			₹ 80
Plant and Machinery (Gross Block)	Dr.	₹ 30	
To Revaluation Reserve			₹ 30

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

Journal entry
Accumulated Depreciation Dr. ₹ 25 p.a.
To Plant and Machinery (Gross Block) ₹ 25 p.a.

23 Illustration

An entity has the following items of property, plant and equipment. Determine the classes for reporting purpose.

Property	Asset Class
Property A — a vacant plot of land on which it intends to construct its new administration headquarters;	Land (admin)
Property B — a plot of land that it operates as a landfill site;	Land (landfill site)
Property C — a plot of land on which its existing administration headquarters are built	Land (admin)



Property D — a plot of land on which its direct sales office is built	Land (Admin)
Properties E1–E10 — ten separate retail outlets and the land on which they are built;	Land (RO) Buildings (RO)
Equipment A — computer systems at its headquarters and direct sales office that are integrated with the point of sale computer systems in the retail outlets;	Computers
Equipment B — point of sale computer systems in each of its retail outlets;	Computers - POS
Furniture and fittings in its administrative headquarters and its sales office;	Furniture & Fixtures (HO)
Shop fixtures and fittings in its retail outlets.	Furniture & Fixtures (RO)

Solution:

A class of assets is defined as a grouping of assets of a similar nature and use in an entity's operations.

The nature of land without a building is different to the nature of land with a building.

Land with different uses (vacant, landfill, admin, retail) should be shown in **separate classes**, since nature and function differ.

Retail buildings may be grouped together as a separate class from admin offices.

Computer equipment may be grouped if integrated in nature; otherwise, POS can be a separate sub-class.

Furniture used in admin offices vs. **shop fixtures in retail outlets** have different functions and may be shown separately.

24 Illustration - ✪✪✪ [6 Marks]

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

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

Prepare machinery account in the books of Heaven Ltd. over its useful life to record the above transactions.

Solution:

In the books of Heaven Ltd.

Machinery A/c

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
1.4.2X01	To Bank / Vendor	30,00,000	31.3.2X02	By Depreciation	2,50,000
			31.3.2X02	By Balance c/d	27,50,000
1.4.2X02	To Balance b/d	27,50,000	31.3.2X03	By Depreciation	2,50,000
			31.3.2X03	By Balance c/d	25,00,000
1.4.2X03	To Balance b/d	25,00,000	31.3.2X04	By Depreciation	2,50,000
			31.3.2X04	By Balance c/d	22,50,000
1.4.2X04	To Balance b/d	22,50,000	31.3.2X05	By Depreciation	2,50,000



			31.3.2X05	By Balance c/d	20,00,000
1.4.2X05	To Balance b/d	20,00,000	31.3.2X06	By Depreciation	2,50,000
			31.3.2X06	By Balance c/d	17,50,000
1.4.2X06	To Balance b/d	17,50,000	31.3.2X07	By Depreciation	2,75,000
	To Revaluation Reserve (10% Upward)	1,75,000	31.3.2X07	By Balance c/d	16,50,000
1.4.2X07	To Balance b/d	16,50,000	31.3.2X08	By Depreciation	2,75,000
			31.3.2X08	By Balance c/d	13,75,000
1.4.2X08	To Balance b/d	13,75,000	1.4.2X08	By Revaluation Reserve (Reversed)	1,25,000
			31.3.2X09	By Profit & Loss A/c (Downward Loss)	81,250
			31.3.2X09	By Depreciation	1,46,094
			31.3.2X09	By Balance c/d	10,22,656
1.4.2X09	To Balance b/d	10,22,656	31.3.2X10	By Depreciation	1,46,094
31.3.2X10	To P&L A/c (gain on Sale)	58,438	31.3.2X10	By Bank (Sale Value)	9,35,000

Working Notes:

Particulars	Calculation / Explanation	Amount (₹)
Useful Life of Machinery	Original Cost	30,00,000
	WDV after 5 years (1.4.2X06)	17,50,000
	Depreciation for 5 years = 30,00,000 – 17,50,000	12,50,000
	Depreciation per year	2,50,000
	Remaining useful life = 17,50,000 ÷ 2,50,000	7 years
	Total useful life	**12 years**
Depreciation after Upward Revaluation	Revalued amount = 17,50,000 + 10%	19,25,000
	Depreciation = 19,25,000 ÷ 7	**2,75,000 per year**
Depreciation after Downward Revaluation	WDV before revaluation (1.4.2X08)	13,75,000
	Downward Revaluation @15% = 13,75,000 × 15%	2,06,250
	Revised Book Value = 13,75,000 – 2,06,250	11,68,750
	Revised useful life	8 years
	New depreciation = 11,68,750 ÷ 8	**1,46,094 per year**
Revaluation Reserve to be Transferred	Total reserve created (1.4.2X06)	1,75,000
	Allocated annually = 1,75,000 ÷ 7	25,000
	Transferred in 2 years = 25,000 × 2	50,000
	Balance to offset downward revaluation	**1,25,000**
Downward Revaluation Charged to P&L	Total downward revaluation	2,06,250
	Less: Adjusted from revaluation reserve	(1,25,000)
	Charged to P&L	**81,250**
Loss on Sale of Machinery	Book value on 31.3.2X09	10,22,656



	Less: Dpereciation	1,46,094
	Carrying Amount	8,76,562
	Sale proceeds	9,35,000
	Gain on Sale	58,438

25 Illustration

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

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

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

- **Materials – ₹ 55,000**
- **Labour – ₹ 65,000**
- **Depreciation of plant and equipment used to perform the modifications – ₹ 15,000**

In January 20X1, the entity's production staff were trained in how to operate the new item of equipment. Training costs included:

- **Cost of an expert external instructor – ₹ 7,000**
- **Labour – ₹ 3,000**

In February 20X1 the entity's production team tested the equipment and the engineering team made further modifications necessary to get the equipment to function as intended by management. The following costs were incurred in the testing phase:

- **Materials, net of ₹ 3,000 recovered from the sale of the scrapped output – ₹ 21,000**
- **Labour – ₹ 16,000**

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

Solution:

The **cost of an item of PPE** includes:

- Purchase price (net of refundable taxes)
- Directly attributable costs to bring the asset to the location and condition necessary for its intended use
- Initial estimate of dismantling/restoration cost (discounted)

It **excludes**:

- Training costs
- Operating losses incurred before the asset achieves planned performance

Description	Calculation or Reason	Amount (₹)
Purchase price (net of refundable tax)	₹ 600,000 – ₹ 50,000 refundable taxes	5,50,000
Transport to site	Directly attributable	20,000
Installation costs	Directly attributable	1,00,000
Dismantling and restoration obligation (PV)	Required under Ind AS 16 (decommissioning liability)	1,00,000
Modification: Materials	Directly attributable	55,000
Modification: Labour	Directly attributable	65,000



Modification: Depreciation of tools used	Directly attributable	15,000
Testing phase: Materials (net of scrap)	₹ 21,000 (Net)	21,000
Testing phase: Labour	Directly attributable	16,000
Total Cost of Equipment		**₹ 9,42,000**

The following costs are not included

Item	Reason	Amount (₹)
Loan raising fees	Adjusted against financial liability as per Ind AS 109	5,000
Training costs (Instructor + Labour)	Not directly attributable to bringing to working condition	10,000
Operating loss in March	Not part of cost under Ind AS 16	23,000

26 Illustration

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

Solution:

As per **Ind AS 16**, the cost of PPE includes the **initial estimate** of dismantling and restoration costs if the obligation arises:

- At the time of **acquisition or installation**, or
- As a result of **using the asset** for **purposes other than producing inventories**.

However, if the restoration cost arises **due to the use of the asset in production of inventories**, then:

- It is **not added to the cost of PPE**, but
- Accounted as per **Ind AS 2**, i.e., added to the **cost of inventories**.

The ₹ **20,000** restoration cost was incurred due to **manufacturing activities**. Since the obligation to restore the site arises **not due to installation/acquisition** but **due to production**, Ind AS 16 is **not applicable for capitalization**. Hence, this cost should be **added to inventory cost** under **Ind AS 2**, as it is a cost of bringing the inventories to their present location and condition. Subsequently, inventories will be measured at the **lower of cost and NRV** as per Ind AS 2.

27 Illustration

Company X built a new plant that was brought into use on 1st April, 20X1. The cost to construct the plant was ₹ 1.5 crore. The estimated useful life of the plant is 20 years and Company X accounts for the plant using the cost model.
The initial carrying amount of the plant included an amount of ₹ 10 lakh for decommissioning, which was determined using a discount rate of 10%. On 31st March, 20X2, Company X remeasures the provision for decommissioning to ₹ 13 lakh.
Provide necessary journal entries at the end of the year i.e. 31st March, 20X2 for recording of depreciation and decommissioning provision.

Solution:



	₹ in lakh	₹ in lakh
Depreciation (profit or loss) Dr. To Accumulated depreciation (plant) (Being depreciation on plant recognised under straight-line method (1,50,00,000 x 1/20))	7.5	7.5
Interest expense (profit or loss) Dr. To Provision for decommissioning (Being unwinding of decommissioning provision @ 10% recognised in the books)	1.0	1.0
Plant Dr. To Provision for decommissioning (Being increase in decommissioning provision recognised [13,00,000 – (10,00,000 +1,00,000)] at the end of the year)	2.0	2.0

28 Illustration – ✪✪✪

On 1st October, 20X1, XY Ltd. completed the construction of a power generating facility. The total construction cost was ₹ 2 crore. The facility was capable of being used from 1st October, 20X1 but XY Ltd. did not bring the facility into use until 1st January, 20X2. The estimated useful life of the facility at 1st October, 20X1 was 40 years.
Under legal regulations in the jurisdiction in which XY Ltd. operates, there are no requirements to restore the land on which power generating facilities stand to its original state at the end of the useful life of the facility. However, XY Ltd. has a reputation for conducting its business in an environmentally friendly way and has previously chosen to restore similar land even in the absence of such legal requirements. The directors of XY Ltd. estimated that the cost of restoring the land in 40 years' time (based on prices prevailing at that time) would be ₹ 1 crore. A relevant annual discount rate to use in any discounting calculations is 5%. When the annual discount rate is 5%, the present value of ₹ 1 receivable in 40 years' time is approximately 0.142.
Explain and show how the above event would be reported in the financial statements of XY Ltd. for the year ended 31st March, 20X1. Ignore comments on potential future reclassification issues.

Solution:

- Depreciation begins from the **date the asset is available for use**, not from the date of actual use.
- Hence, depreciation begins from **1st October, 20X1**.

Constructive Obligation:

- Based on XY Ltd.'s past practices, it has a **constructive obligation** to restore the land.
- Future restoration cost (in 40 years): ₹ **1,00,00,000**
- Present value factor @ 5% for 40 years: **0.142**
- **Present Value of Provision = ₹ 1,00,00,000 × 0.142 = ₹ 14,20,000**

Item	Computation	Amount (₹)
Construction cost	Given	2,00,00,000
Add: Decommissioning liability (PV)	₹ 1,00,00,000 × 0.142	14,20,000
Total Asset Capitalised	PPE Cost	**2,14,20,000**
Depreciation Period	From 1-Oct-20X1 to 31-Mar-20X2 (6 months)	
Useful Life	40 years	



Depreciation	(2,14,20,000 ÷ 40) × 6/12	**2,67,750**
Closing Carrying Amount of PPE	2,14,20,000 – 2,67,750	**2,11,52,250**
Provision Recognised (Opening)	On 1-Oct-20X1	14,20,000
Add: Unwinding of Discount (6 months)	₹ 14,20,000 × 5% × 6/12	**35,500**
Closing Provision	₹ 14,20,000 + ₹ 35,500	**14,55,500**
Finance Cost Recognised	In P&L (unwinding of discount)	**35,500**

29 Illustration – ✪✪✪ [Jan-26 8 Marks]

Kagaz Limited, Chennai purchased a modern offset manufacturing machine from a supplier at Mumbai for ₹ 20.00 lakhs being Maximum Retail Price (MRP) on the following terms and conditions:

- The supplier would buy-back the existing machine of Kagaz Limited.
- The carrying value of the existing machine is ₹ 6.60 lakhs.
- The supplier would give a special discount of 5%;
- A cash payment of ₹ 15 lakhs would be made by Kagaz Limited to the supplier;
- Kagaz Limited will purchase from local market all accessories required to operate the machine at ₹ 3.00 lakhs (inclusive of all taxes);
- The supplier will, however, deliver free of cost certain heavy-duty cables etc., having MRP of ₹ 2.00 lakhs, required to install and operate the machine;
- Transit insurance will be borne by Kagaz Limited @ 3% of MRP of the machine only;
- Freight and other incidentals of ₹ 1.00 lakh is borne by Kagaz Limited.

Required:

Compute as per applicable Ind AS:
(a) the cost of the new machine for Kagaz Limited;
(b) the profit (loss) incurred by Kagaz Limited on the buy-back arrangement.

Also pass necessary journal entries in the books of Kagaz Limited.

Ignore any impact of GST.

Solution

As per **Ind AS 16 – Property, Plant and Equipment**, the cost of an item of PPE includes its purchase price (net of trade discounts) and all ***directly attributable costs*** necessary to bring the asset to the location and condition required for its intended use. When a PPE is acquired in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value of asset given up or asset acquired whichever is more evident. IN this case the fair value of new machine is more evident and hence the same would be considered.

The difference between fair value of new machine and cash payment can be considered as fair value of old machine transferred.

Particulars	**Amount (₹ in lakhs)**
MRP of new machine	20.00
Less: Special discount @ 5%	(1.00)
Net purchase price	**19.00**
Add: Accessories purchased locally	3.00
Add: Transit insurance (3% of MRP)	0.60
Add: Freight and other incidentals	1.00
Free-of-cost materials (heavy-duty cables)	2.00
Total cost of new machine	**25.60**



Particulars	Amount (₹ in lakhs)
Carrying value of old machine	6.60
Less: Buy-back value (19.00 +2.00 – 15.00)	(6.00)
Loss on buy-back	**0.60**

Particulars	Dr. (₹ in lakhs)	Cr. (₹ in lakhs)
Offset Printer (PPE) A/c Dr.	25.60	
Loss on Sale of Machine A/c Dr.	0.60	
To Bank A/c		19.6
To Old Machine (PPE) A/c		6.6



Ind AS 38
Illustrations

1. Illustration

Jupiter Ltd acquires new energy efficient technology that will significantly reduce its energy costs for manufacturing. Which costs can be considered for capitalisation?

	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

Solution:

As per **Ind AS 38**, the cost of an intangible asset includes:

- **Purchase price** (net of trade discounts),
- **Directly attributable expenditure** necessary to make the asset ready for use.

However, **training costs**, **general overheads**, and **operational losses during transition are not capitalised**. These are expensed to P&L.

Particulars	Amount (₹)	Capitalised?	Remarks
Cost of new solar technology	₹10,00,000	✅₹10,00,000	Purchase price of asset
Less: Trade discount	(₹1,00,000)	✅(₹1,00,000)	Deducted as per Ind AS 38
Training course for staff in new technology	₹50,000	❌ Nil	Expense, not capitalised
Initial testing of new technology	₹35,000	✅ ₹35,000	Directly attributable
Losses during shut down of other parts of plant (during testing/training)	₹25,000	❌ Nil	Not directly attributable
Total Cost		9,35,000	

2. Illustration

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.

The other expenditure incurred were:-

- **Purchase tax: Rs. 1,00,000**
- **Entry Tax: 10% (recoverable later from tax department) Legal fees: Rs. 87,000**
- **Consultancy fees for implementation:Rs.1,20,000 Cost of capital of the company is 10%.**

Calculate the cost of the software on initial recognition using the principles of Ind AS 38 Intangible Assets.

Solution:

Particulars	Amount (₹)	Remarks
Cash paid	6,00,000	Immediate payment
Deferred consideration (PV of ₹4,00,000 @ 10%)	3,63,636	₹4,00,000 ÷ 1.10
Purchase tax	1,00,000	Non-refundable tax
Legal fees	87,000	Directly attributable
Consultancy fees for	1,20,000	Part of cost to bring software to



implementation		use
Entry Tax (10% on ₹10,00,000)	–	Refundable – not capitalised
Total Initial Cost to be Capitalised	**₹12,70,636**	

Note: Entry tax will not be considered as it is a refundable tax.

3. Illustrations

A Company is preparing its accounts for the year ended 31st March, 20X2 and is unsure how to treat the following items.

- **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.**
- **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.**
- **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?

Solution:

1. Marketing and Advertising Campaign – ₹2,40,000

- Although it may generate future profits, **no identifiable asset is created**.
- Future benefits cannot be linked exclusively to the campaign.
- **Treatment:** *Expense entire amount in P&L.*

2. Development of New Product – ₹1,50,000

- **₹1,00,000 incurred before 30th Sept 20X1**: Before establishing technical feasibility ⇒ **treated as research** ⇒ *Expense in P&L.*
- **₹50,000 incurred after technical feasibility** (post 30th Sept): Meets recognition criteria ⇒ *Capitalised as intangible asset.*
- However, **recoverable amount is ₹70,000** (No impairment yet since carrying value is lower).

3. Training Programme – ₹3,00,000

- Even if profits are expected, **company cannot control the skills gained** by staff.
- **No identifiability or control** over future benefit ⇒ *Expense entire amount in P&L.*

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.**
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.**

Solution:

#	Sun Ltd. Books			Earth Ltd. Books		
			Rs. in lakhs			Rs. in lakhs
1)	Software	Dr.	5.00	Telecom license	Dr.	5.20
	To Telecom license		5.00	To Software		0.10



	(Profit on Exchange - Nil)	To Profit on Exchange 5.10
2)	Software Dr. 4.90 Loss on Exchange Dr. 0.10 To Telecom license 5.00	Telecom license Dr. 4.90 To Software 0.10 To Profit on Exchange 4.80
3)	Software Dr. 5.00 To Telecom license 5.00	Telecom license Dr. 0.10 To Software 0.10

5. Illustrations

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.

Solution:

When an intangible asset is acquired in exchange of another non-monetary asset and the exchange has commercial substance, the cost of acquired asset is measured as below

- If FV of **asset given up is available** – Consider FV of asset given up i.e Rs. 18,00,000.
- If FV of **asset given up is not evident but FV of asset received is available** – Consider FV of asset received i.e Rs. 20,00,000.
- Adjust the FV chosen for any cash received or paid.

Particulars	Scenario (a)	Scenario (b)
Fair Value of Asset Given Up (IPR)	₹18,00,000	₹18,00,000
Fair Value of Asset Acquired (Patent)	₹20,00,000	₹20,00,000
Cash Paid	Nil	₹2,00,000
Measurement Basis	FV of asset given up (available)	FV of asset given up + cash paid
Initial Recognition of Patent	**₹18,00,000**	**₹20,00,000 (₹18L + ₹2L)**

6. Illustrations

An entity is developing a new production process.
During 20X1-20X2, expenditure incurred was Rs. 1,000, of which
- **Rs. 900 was incurred before 1st March, 20X2 and**
- **Rs. 100 was incurred between 1st March, 20X2 and 31st March, 20X2.**

The entity is able to demonstrate that at 1st March, 20X2, the production process met the criteria for recognition as an intangible asset.
The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 500.
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.

Explain the accounting treatment of expenditure incurred in 20X1-20X2 and 20X2-20X3 as per relevant Ind AS.

Solution:

Under Ind AS 38:

- **Research phase expenditure** is always expensed.
- **Development phase expenditure** is capitalised **only from the date** when **all six recognition criteria** are demonstrably met.



- The carrying amount of capitalised intangible assets is tested for **impairment** as per **Ind AS 36**.

Year	Total Expenditure	Before Criteria Met	After Criteria Met (from 1st Mar 20X2)	Capitalised	Expensed
20X1–20X2	₹1,000	₹900	₹100	₹100	₹900
20X2–20X3	₹2,000	–	Entire amount	₹2,000	Nil
			Total	₹2,100	
			Recoverable Amount	₹1,900	
			Impairment Loss	₹200	

7. Illustrations

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.
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.

Solution:

	Particulars	Amount (Rs.)
A	Price for Acquisition	50,00,000
B	Net Assets transferred	30,00,000
C	Trade Mark	1,80,000
D	Sole Dist. Rights (1,50,000 x 4.36)	6,54,000
E	**FV of Assets taken by Earth (B+C+D)**	38,34,000
F	Goodwill on Acquisition (A – E)	11,66,000

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.
X Limited estimates the production of fertiliser as follows:

Year	*(In metric tons)*
1	*50,000*
2	*70,000*
3	1,00,000
4	1,20,000
5	1,10,000

At the end of the 1st year, it achieved its targeted production. At the end of 2nd year, 65,000 metric tons of fertiliser was being manufactured, and X Limited considered to revise the estimates for the next 3 years.
The revised figures are 85,000, 1,05,000 and 1,15,000 metric tons for year 3, 4 & 5 respectively.
How will X Limited amortise the technical know-how fees as per Ind AS 38?

Solution:

As per **Ind AS 38**, the **cost of an intangible asset with a finite useful life** is amortised over its **useful life** on a **systematic basis**. The amortisation method should reflect the pattern in



which the asset's future economic benefits are expected to be consumed. If that pattern cannot be determined reliably, the **straight-line method** is used.

One such acceptable method is the **units of production method**, where amortisation is based on the **actual usage/output** of the intangible asset relative to the **total expected output**.

The entity can amortise technical knowhow based on the estimated output over life. In year 1, the total estimated output over 5 years is 4,50,000 which is considered for amortisation.

In year 2, the output over Years 2-5 is revised to 3,70,000 (65,000 + 85,000 + 105,000 + 115,000).

Y	Cost / Opening WDV (₹)	Revised Total Estimated Output (MT)	Actual Output (MT)	Amortisation (₹)	Closing Carrying Amount (₹)
1	10,00,00,000	4,50,000	50,000	₹10,00,00,000 × 50,000 / 4,50,000 = **1,11,11,111**	8,88,88,889
2	8,88,88,889	3,70,000	65,000	₹8,88,88,889 × 65,000 / 3,70,000 = **1,56,15,616**	7,32,73,273
3	7,32,73,273	3,70,000	85,000	₹8,88,88,889 × 85,000 / 3,70,000 = **2,04,20,420**	5,28,52,853
4	5,28,52,853	3,70,000	1,05,000	₹8,88,88,889× 1,05,000/ 3,70,000 = **2,52,25,225**	2,76,27,628
5	2,76,27,628	3,70,000	1,15,000	₹8,88,88,889× 1,15,000/ 3,70,000= **2,76,27,628**	0

Note: Amortisation = Total Cost/Total expected output x Output for the year.

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?

Solution:

As per **Ind AS 38**, an intangible asset shall be recognised if:

- It is **identifiable** (either separable or arising from contractual/legal rights),
- The entity **controls** the future economic benefits,
- It is **probable** that future economic benefits will flow to the entity, and



- The **cost** can be **measured reliably**.

For **internally generated intangible assets**, **research expenditure** is always **expensed off**, while **development expenditure** can be **capitalised** only after meeting certain condition

S. No.	Transaction	Analysis	Accounting Treatment
1	Acquired license for 4 years – ₹1,00,00,000	✓ Meets recognition criteria: identifiable (contractual right), control, future economic benefit, reliable cost	📘**Recognise as intangible asset at ₹1 crore**. Amortise over 4 years based on pattern of economic benefits.
2	Brand acquired via business combination – ₹3,00,00,000	✓ Brand has identifiable fair value and future benefits. Acquired in business combination	📘 **Recognise brand at ₹3 crore**. Amortise over **15 years**. If not separable, include under **Goodwill**.
3	Advertising campaign – ₹1,00,00,000	✗ Advertising is considered part of promotional cost. Future benefits **cannot be directly linked or controlled**	📕 **Expense off ₹1 crore** in the year incurred. Not eligible for capitalisation.
4	Development of 'Drug-A' – total ₹10,00,00,000, with clinical success	✓ Assumed to be in **development phase** (technological feasibility established). Meets capitalisation criteria under Ind AS 38	📘 **Capitalize entire ₹10 crore** as intangible asset. Amortise over **5 years** from date available for use.
5	Development of 'Drug-B' – ₹50,00,000 (research phase)	✗ Only **research stage** so far. No technological feasibility.	📕 **Expense ₹50 lakhs** as it does not qualify for recognition.

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?

Solution:

(a) Payment for Skilled Staff – ₹30,00,000

- This payment **does not meet** the criteria for recognition as an intangible asset under Ind AS 38:
  - No **control** over the economic benefit.
  - Not **separable** or **identifiable** from the business.
- As per Ind AS 103, such cost is considered part of the overall **goodwill**.

(b) Non-Compete Fee – ₹50,00,000

- This meets the recognition criteria of an **intangible asset**:
  - **Identifiable**, **contractual** in nature.
  - Expected to bring **economic benefit** by restricting competition.

Hence, it should be **separately recognised** and **amortised over 5 years**.



Particulars	Rs. in Crs
Purchase Consideration	10.00
Less: Net fair value of assets received	(8.50)
Less: IA separately identified & capitalised (Non-Compete fee)	(0.50)
Goodwill	**1.00**

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?

Solution:
The franchise rights meet the recognition criterion as

- It is separately identifiable
- It arises from the contractual rights
- It's cost can be measured reliably
- It will generate future economic benefits and
- Control can be exercised on the benefits arising.

Franchise Rights – Recognise as IA and amortise it over 10 years.

Royalty paid – Charge to the profit and loss in the books of the X Ltd as it doesn't increase the life of asset nor does it substantially increase the future economic benefits.

12. Illustrations

An entity regularly places advertisements in newspapers advertising its products and includes a reply slip that informs individuals replying to the advertisement that the entity may pass on the individual's details to other sellers of similar products, unless the individual ticks a box in the advertisement.
Over a period of time the entity has assembled a list of customers' names and addresses. The list is provided to other entities for a fee. The entity would like to recognise an asset in respect of the expected future economic benefits to be derived from the list. Can the customer list be treated as an intangible asset under Ind AS 38?

Solution:

An item can be recognised as an **intangible asset** if:

- It is **identifiable** (i.e., separable or arising from contractual/legal rights),
- The entity has **control** over the future economic benefits,
- It is **probable** that economic benefits will flow to the entity, and
- The **cost can be measured reliably**.

Additionally, **Ind AS 38** requires that intangible items arising from **marketing or promotional activities** are generally **expensed as incurred**.

- The customer list in question was developed **indirectly through advertising**, using **reply slips**.
- Although the list has **economic value** (as it is sold/rented), the list was generated as a **by-product of advertising**.
- The entity **cannot demonstrate control** in the accounting sense, because:
  - The data depends on customer consent.
  - There are **no legal rights or exclusivity**.
- The **cost of generating the list** is also **not reliably measurable** apart from advertising expense.



Conclusion

The customer list should not be recognised as an intangible asset under Ind AS 38. Such a list does **not meet the recognition criteria**, particularly in terms of **control** and **reliable measurement of cost**, as it arises from **routine marketing efforts**.

Only if such a list is **purchased** or **contractually protected**, and has a **reliable cost**, can it be capitalised as an intangible asset.

13. Illustrations

A software company X Ltd. is developing new software for the telecom industry. It employs 100 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?

Solution:

To recognise an item as an **intangible asset**, the following conditions must be satisfied:

- The asset must be **identifiable** (i.e., separable or arising from legal or contractual rights),
- The entity must have **control** over the future economic benefits arising from the asset,
- It must be **probable** that economic benefits will flow to the entity, and
- The **cost** of the asset can be measured **reliably**.

The engineers employed by **X Ltd.**, though highly skilled and specialised, **do not qualify** as intangible assets. **Human resources cannot be controlled** as employees have the right to resign or leave the organisation. Good HR policies and employee retention expectations **do not amount to legal or contractual control**. Additionally, human skill sets **cannot be separated or sold**, nor can their value be **measured reliably**.

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?

Solution:

Under **Ind AS 38 (Intangible Assets)**, the cost of an intangible asset typically includes:

1. **Purchase Price** (after deducting any trade discounts).
2. **Any Directly Attributable Costs** necessary to bring the asset to its intended use (e.g., customization costs).
3. **Non-Refundable Taxes** or duties directly attributable to the acquisition of the asset.

However, **costs relating to ongoing services or maintenance** are generally **not** included in the cost of the intangible asset. Instead, such costs are expensed as incurred or accounted for separately.

Initial cost of the Asset:

Particulars	Amount (Rs.)



List Price	30,00,000
Less: Trade discount (5%)	(1,50,000)
Non-refundable purchase tax	50,000
Customisation cost	7,00,000
Total cost	36,00,000

Maintenance contract of Rs. 2,00,000 is considered as a Prepaid expense and charged to P&L over a period of 5 years, contract period.

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?

Solution:

Assets	**Amount (in Rs.)**	**Fair Market Value**
Property, Plant & Equipment	1,00,000	1,50,000
Intangible Asset 1	20,000	30,000
Intangible Asset 2	50,000	70,000
Cash & Bank	1,30,000	1,30,000
Total		3,80,000
Liabilities		
Trade payable	50,000	50,000
Net Assets		**3,30,000**

Goodwill is the difference between fair value of net assets acquired and purchase consideration paid Goodwill = Rs. 4,00,000 – Rs. 3,30,000 = Rs. 70,000.

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?

Solution:

As per Ind AS 38:



Research expenditure is always **expensed off**.

- **Development expenditure** can be **capitalised** once **technical feasibility** is established and other recognition criteria are met.

Acquired "in house research project"	Initially recognise at fair value i.e, Rs. 10,00,000.
Research cost of Rs. 5,00,000 and cost of Rs. 2,00,000 for establishing technical feasibility	Charge to P&L.
Costs Rs. 7,00,000 incurred from the technical feasibility point for development	Capitalise.

So, Intangible Asset value = Rs. 17,00,000 (Rs. 10,00,000 + Rs. 7,00,000).

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?

- **Solution:**
- As per Ind AS 38
- **Research Phase**: All costs are **expensed** as incurred.
- **Development Phase**: Costs are **capitalised** only when the conditions prescribed (technical feasibility, intention and ability to complete, ability to use or sell, future economic benefits etc) are met.

Expenditure	Amount (₹)	Phase	Accounting Treatment
(a) Salaries of program designers	2,00,000	Research phase	**Expensed**
(b) Other cost of completion of program design	5,00,000	Research phase	**Expensed**
(c) Cost of coding and establishing technical feasibility	2,00,000	Research phase	**Expensed**
(d) Direct cost after establishing feasibility	7,00,000	Development phase	**Capitalised**
(e) Testing costs after feasibility established	2,00,000	Development phase	**Capitalised**
(f) Conference cost for product introduction	70,000	Promotional activity	**Expensed**

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?

Solution:

	Charge to P&L	Capitalised value	Recoverable amount	Carrying amount
As at 31st Mar 20X2	2,700	900	1,000	900
As at 31st Mar 20X3		6,900		
As at 31st Mar 20X4			5,000	5,750
Impairment Loss			750	

Amortisation of IA

Depreciable value	Rs. 6900
Useful life	6 years
Amortisation per year = 6900/6 (for 20X3-X4)	Rs. 1150
Carrying Amount	Rs. 5,750

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?

Solution:

1/4/X1-31/3/X2	Depreciation $\frac{\text{Value = Cost – Residual Value}}{\text{Useful life}}$ = (3,00,000 – 0)/5	Rs. 60,000
	Carrying amount as on 31/3/X2 = 3,00,000 – 60,000	Rs. 2,40,000
1/4/X2-31/3/X3	Written down at beginning of year to market value to be amortised for 2 years	Rs. 1,50,000
	Loss (2,40,000 – 1,50,000) debited to P&L	Rs. 90,000
	Amortisation = 1,50,000/2	Rs. 75,000
	Carrying amount as on 31/3/X3 = 1,50,000 – 75,000	Rs. 75,000
1/4/X3-31/3/X4	Revalued upwards at beginning of year to be amortised for 4 years	Rs.3,00,000
	Revaluation gain (3,00,000 – 75,000)	Rs. 2,25,000
	Credit to P&L Credit to Revaluation surplus (2,25,000 – 90,000)	Rs. 90,000 Rs. 1,35,000
	Amortisation = 3,00,000/4	Rs. 75,000
	Carrying amount as on 31/3/X4 = 3,00,000 –	Rs. 2,25,000



	75,000	

Value as on March 31, 20X5 = 2,25,000 – 75,000 = Rs. 1,50,000
Value as on March 31, 20X6 = 1,50,000 – 75,000 = Rs. 75,000
Value as on March 31, 20X7 = 75,000 – 75,000 = Nil

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.
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?

Solution:

		Rs.	Rs.
R&D expenses	Dr.	3,00,000	
To Intangible assets			3,00,000
Impairment Loss on IA	Dr.	5,40,000	
To Intangible assets			5,40,000

Expenditure for April & May 20X5 = $\frac{18,00,000 \times 2}{12}$ = 3,00,000 should not be capitalised.

Carrying amount as on 1/4/20X5	Rs. 15,00,000
Recoverable value	Rs. 9,60,000
Impairment Loss (15,00,000 – 9,60,000)	Rs. 5,40,000

Carrying amount after Impairment – Rs. 9,60,000
No Amortisation – Asset not yet ready to use.

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.

Solution:

	Treatment
(i)	• Patent owned will be recognised at fair value by MNC Ltd. • Amortised over the remaining useful life of the asset i.e, 6 years. • Patent should be valued at Rs. 8 crore. Rs. 4 crore should only be disclosed as a contingent asset and not recognised.
(ii)	Patent will be measured at fair value (s per Ind AS 103) ie Rs. 19 crore on the acquisition date. Reasons • Patent developed has been approved for clinical use, • And it is an identifiable asset.
(iii)	As per Ind AS 103, grant asset will be recognised at fair value on the acquisition date by MNC Ltd. On acquisition date, the fair value of the license asset is Rs. 7 crore. But there is no fair value of identifiable liability, it is assumed that the fair value of the liability with respect to grant, for acquirer is nil. Therefore, only, the grant asset (license) would be recognised at Rs. 7 crore.

Intangible Assets acquired by MNC Ltd

(i)	Patent for which clinical trials are awaited	Rs. 8 crores
(ii)	Patent for which clinical trails approved	Rs. 19 crores
(iii)	License – Govt. grant	Rs. 7 crores

	Rs. in Crores
Fair value of assets of Akash Ltd	68
Add:	
Patents (Rs. 8 crores + Rs. 19 crores)	27
License (Rs. 7 crores)	7
Total	102
Less: Fair value of liabilities	(50)
Fair value of net assets	52
Purchase Consideration	38
Capital Reserve	**14**

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?

Solution:

Under **Ind AS 38**, an intangible asset requires the following key criteria to be met:

1. **Identifiability** – The asset must be separable (i.e., able to be sold, transferred, licensed, etc., either individually or together with a related contract or liability) or must arise from contractual or other legal rights.
2. **Control** – The entity must have power to obtain the future economic benefits flowing from the asset and to restrict the access of others to those benefits.



3. **Probable future economic benefits** – It must be probable that the asset will generate future economic benefits for the entity.
4. **Measurement reliability** – The cost of the asset must be measured reliably.

The entity (ABC Pvt. Ltd.) has entered into a binding contract that legally restricts the player from playing for any other entity for five years. This implies a legally enforceable right (arising from the contract). The entity can direct the use of the player's services (e.g., in matches) and restrict competitors from accessing the player's services for the contract duration.

The cost of acquiring the player's contract is known (the price paid to obtain these exclusive services). This typically can be measured reliably and the entity can earn future economic benefits.

Hence the cost incurred to obtain the rights can be recognised as intangible assets.

23. Illustration (RTP – May 21)

PQR Ltd. is a gaming developer company. Few years back, it developed a new game called 'Cloud9'. This game sold over 10,00,000 copies around the world and was extremely profitable. Due to its popularity, PQR Ltd. released a new game in the 'Cloud9' series every year. The games continue to be the bestseller. Based on Management's expectations, estimates of cash flow projections for the 'cloud9 videogame series' over the next five years have been prepared. Based on these projections, PQR Ltd. believes that cloud9 series brand should be recognised at INR 20,00,000 in its financial statement. PQR Ltd. has also paid INR 10,00,000 to MNC Ltd. to acquire rights of another video game series called the 'Headspace' videogame series. The said series have huge demand in the market.
Discuss the accounting treatment of the above in the financial statements of PQR Ltd.

Solution:

An intangible asset is an identifiable non-monetary asset without physical substance. An intangible asset can be recognised if it meets the criteria of **identifiability, control,** and **future economic benefits.**

Case Analysis:

1. Cloud9 Video Game Series (Internally Generated Asset):

- The series is internally developed and classified as a **brand.**
- As per Ind AS 38, internally generated brands and similar items cannot be recognized as intangible assets because:
  - Their costs cannot be distinguished from overall business development.
  - No separate cost is attributable to the development of the Cloud9 brand itself.
- **Conclusion:** Despite the expected cash flows, the Cloud9 brand **cannot** be recognized as an intangible asset.

2. Headspace Video Game Series (Separately Acquired Asset):

- Purchased for INR 10,00,000.
- **Ind AS 38 (Paragraphs 25-26):** When an intangible asset is separately acquired:
  - The price paid reflects the expectation of future economic benefits.
  - Probability recognition is assumed to be **always satisfied** for separately acquired intangible assets.
  - Cost is reliably measurable, especially when paid in cash.
- **Conclusion:** Headspace should be recognized as an **intangible asset** at its acquisition cost of INR 10,00,000.

Subsequent Measurement of Headspace:

- After recognition, the entity can use either the **cost model** or **revaluation model** as per Ind AS 38



24. Illustration (RTP – May 22)

D Ltd., a leading publishing house, purchased the copyright of a book from its author for publishing purposes.
As per the terms of the contract, D Ltd. has the following payment options:

- **If the payment is made upfront, a copyright consideration of ₹80,00,000 is to be paid (which aligns with general industry practice).**
- **If the payment is deferred for 2 years, D Ltd. will be required to pay ₹1,00,00,000.**

At what value should the intangible asset be recognized as per Ind AS 38?

Solution:

As per **Ind AS 38**, if payment for an intangible asset is deferred beyond normal credit terms, its cost is measured at the **cash price equivalent**. The difference between this amount and the total payment is recognized as **interest expense** over the credit period unless it qualifies for capitalization under **Ind AS 23, Borrowing Costs**.
In this case, the **cash price equivalent** of ₹80,00,000 should be used to record the intangible asset (copyright) initially. This represents the cost of the asset.
The difference of ₹20,00,000 (₹1,00,00,000 - ₹80,00,000) is treated as **interest expense** and recognized over the 2-year credit period, unless it qualifies for capitalization under Ind AS 23.

25. Illustration (May 21)

Super Sounds Limited had the following transactions during the Financial Year 2019-2020:

1. **On 1st April 2019, the company purchased the net assets of Music Limited for ₹13,20,000. The fair value of Music Limited's identifiable net assets was ₹10,00,000. Super Sounds Limited believes that due to the popularity of Music Limited's product, the life of goodwill is 10 years.**
2. **On 4th May 2019, Super Sounds Limited purchased a Franchise to organize musical shows from Armaan TV for ₹80,00,000 with an annual fee of 2% of the musical shows' revenue. The franchise expires after 5 years. The musical shows' revenue for 2019-2020 was ₹10,00,000. Projected revenue is ₹25,00,000 for 2020-2021 and ₹30,00,000 per year for the remaining 3 years.**
3. **On 4th July 2019, the company was granted a copyright applied for by Music Limited. During the year, Super Sounds Limited incurred ₹2,50,000 as legal costs to register the copyright and ₹7,00,000 to successfully prosecute a copyright infringement suit. The copyright is valid for 10 years.**

Super Sounds Limited amortizes all intangible assets on a straight-line basis (SLM) over the maximum period permitted by Ind AS, taking a full year's amortization in the year of acquisition.

Required:
(i) Prepare a schedule showing the Intangible Assets section in the Balance Sheet as of 31st March 2020.
(ii) Prepare a schedule of related expenses to appear in the Statement of Profit and Loss for the year ended 31st March 2020.

Solution:

(i) Balance Sheet (Extract)
Super Sounds Limited
As on 31st March 2020

	Note	₹
Assets		
(1) Non-current assets Intangible Asseets	1	**69,45,000**

Notes to Accounts (Intangible Assets):

		Gross			Depre.		Net	Net
Particulars	Op	Additions	Closing Balance	Op Bal	Additions	Closing	Op Bal	Closing Balance
Goodwill		3,20,000	3,20,000		-		-	3,20,000

Franchise		80,00,000	80,00,000		16,00,000	16,00,000		64,00,000
Copyright		2,50,000	2,50,000		25,000	25,000		2,25,000
Total		**85,70,000**	**85,70,000**		**16,25,000**	**16,25,000**		**69,45,000**

(ii) Statement of Profit and Loss (Extract)

Super Sounds Limited

For the year ended 31st March 2020

	Note No.	Amount
Revenue from Operations		10,00,000
Expenses		
(1) Amortization expenses	2	16,25,000
(2) Other expenses	3	7,20,000
Total Expenses		**23,45,000**

Notes to Expenses:

1. **Amortization Expenses:**

Particulars	**Amount (₹)**
Franchise	16,00,000
Copyright	25,000
Total	**16,25,000**

2. **Other Expenses:**

Particulars	**Amount (₹)**
Legal cost on copyright	7,00,000
Franchise fee (2% of revenue of ₹10,00,000)	20,000
Total	**7,20,000**

Working Notes:

1. **Goodwill:**
   Cost of acquiring Music Limited: ₹13,20,000
   Less: Fair value of net assets acquired: ₹10,00,000
   Goodwill: ₹3,20,000
   As per Ind AS 36, goodwill is not amortized but subject to annual impairment testing.
2. **Franchise:**
   Cost of acquisition: ₹80,00,000
   Amortization over 5 years: ₹80,00,000 ÷ 5 = ₹16,00,000 per year
   Balance to be shown in the Balance Sheet: ₹80,00,000 - ₹16,00,000 = ₹64,00,000
3. **Copyright:**
   Legal registration cost: ₹2,50,000
   Amortization over 10 years: ₹2,50,000 ÷ 10 = ₹25,000 per year
   Balance to be shown in the Balance Sheet: ₹2,50,000 - ₹25,000 = ₹2,25,000

   Irrespective of whether there is any indication of impairment, an entity shall test goodwill acquired in a business combination for impairment annually. This implies that goodwill is not amortised annually but is subject to annual impairment, if any.

   As per the information in the question, the limiting factor in the contract for the use is time i.e., 5 years and not the fixed total amount of revenue to be generated. Therefore, an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate and amortisation based on time can only be applied.

26. Illustration

A company engaged in Information Technology services incurred the following costs during the development phase of a software product to be offered to customers. The software product, incorporating third-party software and developed with external professional services, is set for market licensing. Costs for the year ending 31st March, 20X2 are:



Particulars	Amount (₹ in thousands)
Purchase price of imported software	600
Employment costs (Note 1)	1,200
Testing costs	1,800
Other costs directly related to customization	450
Professional fees for external software developers	220
Costs of training staff to operate the asset	195
Costs of advertising in the market	1,560
Administrative and general overheads	825

Notes:

1. **Software was developed in 9 months (ending 31st Dec 20X1) and was ready for intended use. Employment costs are for 12 months, up to 31st March 20X2.**
2. **Customization costs include ₹50,000 for abnormal repairs due to a security breach.**

Required: Determine the capitalizable software development cost and explain the treatment for each cost element.

Solution:

In line with **Ind AS 38**, the recognition of costs as an intangible asset requires that the costs are directly attributable to preparing the asset for its intended use. Any costs incurred after the asset is ready for use or unrelated to its development cannot be capitalized.

The amount of costs to be capitalised

Particulars	Amount (₹) '000	Capitalized Amount (₹) '000	Remarks
Purchase price of imported software	600	600	Directly attributable material cost to prepare the software for use.
Employment costs (Note 1)	1,200	900	Only 9 months of costs are capitalizable (9/12 × ₹1,200). Costs cease when the asset is ready.
Testing costs	1,800	1,800	Directly attributable to testing the software's functionality.
Other costs related to customization	450	400	Excludes ₹50 for inefficiencies (abnormal repair costs).
Professional fees for developers	220	220	Directly attributable to software development.
Costs of training staff	195	-	Training costs are not capitalizable (Ind AS 38, para 67).
Advertising costs	1,560	-	Selling and advertising expenses are not capitalizable (Ind AS 38, para 67).
Administrative/general overheads	825	-	General overheads cannot be capitalized.
Total	6850	3920	



Ind AS 40 **Investment Property**
ILLUSTRATIONS

1. Illustration

Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for Rs.5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying Rs. 6,25,000 as a one-time joining fee.
Netravati Ltd. wants to write off the one-time joining fees paid as an expense under Membership and Subscription Charges and value the investment property at Rs.5 crores. Advise.
Would you answer change if the office space was purchased with the intention of using it as an administrative centre of the company? (SM)

Solution:
Under **Ind AS 40, "Investment Property,"** an entity measures an investment property **initially at its cost**, which comprises:

1. **Purchase price**, and
2. **Any directly attributable expenditure** (such as legal fees, property transfer taxes, and other transaction costs required to bring the property to the condition necessary for its intended use).

Since the **one-time membership fee** is a **necessary cost** for acquiring the right to purchase/use the property within the complex, it qualifies as a **directly attributable** cost as per Ind AS 40.Therefore, this fee should be **capitalized** along with the purchase price of the office space.

The total cost of property is computed as given below :
Purchase Property: Rs. 5,00,00,000
Joining fee: Rs. 6,25,000
Price of Property: Rs. 5,06,25,000

Would the Answer Change if the Office Space is Used for Company's Administrative Purposes?

- If the **property is intended for owner-occupation** (i.e., used as the Company's administrative office), it would be accounted for under **Ind AS 16, "Property, Plant and Equipment,"** rather than Ind AS 40.
- **However, the principle remains the same**: directly attributable costs needed to bring the asset to its intended use are **capitalized**. Therefore, the **one-time membership fee** would still be added to the cost of the **Property, Plant & Equipment**.

2. Illustration

X Limited purchased a building for Rs.30,00,000 on 1st May, 20X1 with an intention to earn rentals.
The purchase price was funded by a loan, interest on which is payable @ 5%. Property transfer taxes and direct legal costs of Rs.1,00,000 and Rs.20,000 respectively were incurred in acquiring the building.
X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties.
Expenditures on redevelopment were:
a) Rs. 2,00,000 planning permission.
b) Rs.7,00,000 construction costs (including Rs.40,000 refundable purchase taxes)
What is the cost of the building as per Ind AS 40? (SM)

Solution:
Cost of investment property:

	Rs.
Purchase Price	30,00,000
Property Transfer Tax	1,00,000



Directly attributable Legal cost	20,000
Expenditure on Redevelopment - Planning	2,00,000
Construction cost (7,00,000 – 40,000)	6,60,000
Total	**39,80,000**

As the building is already ready, it is not a qualifying asset. Interest cost will not be capitalized.

3. Illustration

Sun Ltd acquired a building in exchange of a warehouse whose fair value is Rs.5,00,000 and payment of cash is Rs.2,00,000. The fair value of the building received by the Company is Rs.8,00,000. The company decided to keep that building for rental purposes.
Calculate the amount at which the building will be recognised. (SM)

Solution:
The cost of an item of Investment Property acquired in exchange for a non-monetary asset or a combination of monetary and non-monetary assets is measured at fair value **unless** (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable.

If the fair value of both the asset given up and the asset received can be reliably measured, the new asset is measured at the **fair value of the consideration given** (the "old" asset's fair value **plus any cash**), **unless** the fair value of the asset received is more clearly evident and is deemed more reliably measurable.

Fair value of assets given up = Rs. 7,00,000 (5 lakh + 2 lakh)
Journal Entry

Investment Property A/c	Dr.	7,00,000	
To Cash A/c			2,00,000
To PPE (Warehouse)			5,00,000

4. Illustration

Moon Ltd has purchased a building on 1st April, 20X1 at a cost of Rs.10 million. The building was used as a factory by the Moon Ltd and was measured under cost model. The expected useful life of the building is estimated to be 10 years.
Due to decline in demand of the product, the Company does not need the factory anymore and has rented out the building to a third party from 1st April, 20X5. On this date the fair value of the building is Rs.8 million. Moon ltd uses cost model for accounting of its investment property. (SM)

Solution:
Cost of Investment Property

Rs. in millions

Purchase Price (1 Apr, X1)	10
Life of asset – 10 yrs Depreciation (for 4 Years)	4
Carrying amount of Asset (1 Apr, X4)	6
Fair Value	8

Cost of Reclassified Investment Property = Rs. 6million

5. Illustration

X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1?
During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

(a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?
(b) Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?



(c) Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?

(d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2? (SM)

Solution:

(a) Once the property ceases to meet the definition of investment property and there is an evidence of change in use, transfer the property from Investment Property to property, plant and equipment.

(b) No, the carrying amount of the investment property will be the carrying amount of Property, plant and Equipment.

(c) As it is not a change in estimate, but it is a change in use. So Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors will not be applicable.

(d) As there is no actual evidence of change in use, entity will continue to show as Investment Property in its books as on 31st March, X2.

6. Illustration

X Limited has an investment property (building) which is carried in Balance Sheet on 31st March, 20X1 at Rs.15,00,000. During the year X Limited has stopped letting out the building and used it as its office premise. On 31st March, 20X1, management estimates the recoverable amount of the building as Rs.10,00,000 and its remaining useful life as 20 years and residual value is nil.

How should X Limited account for the above investment property as on 31st March, 20X1? (SM)

Solution

Under **Ind AS 40 (Investment Property)**, a transfer **from** investment property to owner-occupied property (i.e., **PPE** under **Ind AS 16**) occurs when there is a **change in use**.

- In this scenario, the building has stopped being rented out and is now used as X Limited's **office premise**.
- Hence, a transfer from Ind AS 40 to Ind AS 16 is required.

Property is reclassified on 31st March, 20X1 at its carrying amount Rs. 15,00,000.
Since the **recoverable amount** (₹10,00,000) is **lower** than the carrying amount (₹15,00,000), **X Limited** must recognize an **impairment loss** of:

Impairment loss Rs. 5,00,000 (Carrying amount – Recoverable amount)
Net Carrying Amount: Rs. 10,00,000 (depreciated over next 20 years)

7. Illustration

In financial year 20X1-20X2, X Limited incurred the following expenditure in acquiring property consisting of 6 identical houses each with separate legal title including the land on which it is built.

The expenditure incurred on various dates is given below:

On 1st April, 20X1 - Purchase cost of the property Rs.1,80,00,000.

On 1st April, 20X1 – Non-refundable transfer taxes Rs.20,00,000 (not included in the purchase cost).

On 2nd April, 20X1- Legal cost related to property acquisition Rs.5,00,000. On 6th April, 20X1- Advertisement campaign to attract tenants Rs.3,00,000.

On 8th April, 20X1 - Opening ceremony function for starting business Rs.1,50,000.

Throughout 20X1-20X2, incurred Rs.1,00,000 towards day-to-day repair maintenance and other administrative expenses.

X Limited uses one of the six houses for office and accommodation of its few staffs. The other five houses are rented to various independent third parties.

How X Limited will account for all the above-mentioned expenses in the books of account? (SM)



Solution:

Cost of Property	Rs.
Purchase Cost	1,80,00,000
Transfer taxes	20,00,000
Legal cost	5,00,000
Cost of Property	2,05,00,000
Cost of self occupied property (1/6th)	34,16,667
Cost of Investment Property (5/6th)	1,70,83,333

Advertisement Campaign and Opening ceremony Expenses will be charged to Profit and Loss A/c.

8. Illustration

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 20X1, X Ltd. purchased a large property (consisting of land) for Rs. 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were Rs.20,00,000.
On 31st March, 20X5, the fair value of the property was Rs.2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 20X5 and vacated the property on 30th September, 20X5.On 30th September, 20X5, the fair value of the property was Rs.2,90,00,000.
On 1st October, 20X5, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of Rs. 60,00,000 on this conversion project between 30th September, 20X5 to 31st March, 20X6. The project was incomplete at 31st March, 20X6 and the directors of X Ltd. estimate that they need to spend a further Rs.40,00,000 to complete the project, after which each flat could be sold for Rs.50,00,000.
Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 20X6 as per Ind AS. (SM)

Solution:

Rental Income – As per Ind AS 116, the rental income on operating leases is recognised on SLM basis over the lease term

- Lease active for 6 months (Apr–Sep 20X5): ₹20L per annum → ₹10L for half-year.

Bank A/c / Y Ltd. A/c Dr. ₹10,00,000
To Rental Income A/c ₹10,00,000

Presentation: Shown as **income in P&L** under "Other Income".

2. Reclassification – Investment Property → Inventory (Ind AS 40 Para 57)

- Reclassification occurs **only when there is a change in use**.
- On 1-Oct-20X5, the company **commences development with a view to sell** → qualifies for transfer to **Inventory (Ind AS 2)**.
- As per **Ind AS 40 Para 60**, reclassification is done **at carrying amount**, i.e., **₹2.00 Cr**
- **No gain/loss is recorded on reclassification.**

Inventory A/c Dr. ₹2,00,00,000
To Investment Property A/c ₹2,00,00,000

Cost of Conversion (Ind AS 2 – Inventory Cost)

- ₹60L spent on conversion from 1-Oct-20X5 to 31-Mar-20X6 is capitalized as part of inventory cost.



Inventory A/c Dr. ₹60,00,000
To Bank/Creditors A/c ₹60,00,000

4. Inventory Valuation (Ind AS 2 – Lower of Cost and NRV)

Particulars	Amount
Total Cost	₹2.00 Cr (property) + ₹0.60 Cr (conversion) = ₹2.60 Cr
NRV	(10 flats × ₹50L = ₹5 Cr) – ₹0.40 Cr (cost to complete) = ₹4.60 Cr
Valuation	Inventory to be valued at **₹2.60 Cr (Cost)**

9. Illustration

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

Following information is relevant for Building A for the year ending 31st March, 20X2:

Building A was initially purchased at the cost of Rs.10 crores. At that time, the useful life of the building was estimated to be 20 years; out of which 5 years have been expired as on 1st April, 20X1.The company follows straight line method for depreciation.

During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 20X1 at the cost of Rs.2 crores. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.

Further, during the year 20X1-20X2 the company earned/ incurred following direct operating expenditure relating to Building A and Building B:

Rental income from Building A	**=**	**Rs. 75 lakhs**
Rental income from Building B	**=**	**Rs. 25 lakhs**
Sales promotion expenses	**=**	**Rs. 5 lakhs**
Fees & Taxes	**=**	**Rs. 1 lakhs**
Ground rent	**=**	**Rs. 2.5 lakhs**
Repairs & Maintenance	**=**	**Rs. 1.5 lakhs**
Legal & Professional	**=**	**Rs. 2 lakhs**
Commission and brokerage	**=**	**Rs. 1 lakhs**

The company does not have any restrictions and contractual obligations against Property - A and B. For complying with the requirements of Ind AS, the management sought an independent report from the specialists so as to ascertain the fair value of buildings A and B. The independent valuer has valued the fair value of property as per the valuation model recommended by International valuation standards committee. Fair value has been computed by the method by streamlining present value of future cash flows namely, discounted cash flow method.

The other key inputs for valuation are as follows:

The estimated rent per month per square feet for the period is expected to be in the range of Rs. 50 - Rs. 60. And it is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at Rs. 10.50 crores. The treatment of fair value of properties is to be given in the financials as per the requirements of Indian accounting standards.

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

Solution:

Disclosure of Investment Property in Balance Sheet (Rs. In lakhs)

Gross amount			Depreciation			Opening Balance	Closing Balance
Opening	Addition	Closing	Opening	Addition	Closing		
1000	200	1200	250	55 (50+5)	305	750	895



Disclosure for items recognized in Profit and Loss

Particular	Amount (₹ Lakhs)
Rental Income	100.00 (75 + 25)
Direct Operating Expenses	13.00 *(Break-up below)*
Sales Promotion Expenses	5.00
Fees & Taxes	1.00
Ground Rent	2.50
Repairs & Maintenance	1.50
Legal & Professional Fees	2.00
Commission & Brokerage	1.00
Net Profit from Investment Property *(before depreciation & indirect expenses)*	**87.00**
Net Profit (after depreciation)	**32.00** *(87 – 55)*

Disclosure related to fair value of Investment Property

- Description
- Fair value
- Valuation by independent valuer
- Method of valuation by independent valuer
- Key assumption to arrive at fair value
- Restriction, if any

Disclosure Note on Investment Properties acquired by the entity

- The investment properties consist of Property A and Property B. As at March 31, 20X2, the fair value of the properties is Rs. 10.50 crores.
- The valuation is performed by independent valuers, who are specialists in valuing investment properties.
- A valuation model as recommended by International Valuation Standards Committee has been applied.
- The Company considers factors like management intention, terms of rental agreements, area leased out, life of the assets etc, to determine classification of assets as investment properties.
- The company has no restrictions on the realisability of its investment properties and no contractual obligations to purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

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

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

10. Illustration

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 20X1 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:

The notes to the financial statements state that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property.



Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts.
Advise the finance controller for resolving the query of the managing director?

Solution:
The query raised by Mr. Y regarding the perceived inconsistency in the treatment of **plant, equipment, owner-occupied property, and investment property** arises due to differences in the applicable **accounting standards** and policies chosen by the company.
As per **Ind AS 16**, Property, Plant, and Equipment (PPE) are accounted for on a **class-by-class basis**, meaning that **plant and equipment** are considered separate from **owner-occupied property**.

Ind AS 16 allows two measurement models: the **cost model**, under which assets are recorded at cost less accumulated depreciation, and the **revaluation model**, where assets are periodically revalued with **gains recorded in Other Comprehensive Income (OCI)** and **losses in profit or loss**, unless they reverse prior entries.

In this case, the company has applied the **cost model** to plant and equipment and the **revaluation model** to owner-occupied property. **Depreciation** is charged based on the asset's useful life, which is typically **longer for buildings (owner-occupied property)** than for plant and equipment, resulting in a **lower percentage depreciation** for the former.

Investment property, such as property rented out, falls under **Ind AS 40** and is treated differently. **Ind AS 40 mandates the cost model** for investment property, with **fair value disclosed but not recognized** in the financial statements.

Therefore, the treatments of these assets are **consistent with the respective standards** and are applied **uniformly within each class of asset**, aligning with the company's **policy choices and accounting requirements**.

11. Illustration

An entity owns a two-storey building. Floor 1 is rented out to independent third parties under operating leases. Floor 2 is occupied by the entity's administration and maintenance staff. The entity can measure reliably the fair value of each floor of the building without undue cost or effort. How the same will be classified/presented in the balance sheet as per relevant Ind AS? What will be the accounting treatment as per relevant Ind AS on the initial and subsequent date? (RTP Nov'22)

Solution:
Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:

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

(b) Sale in the ordinary course of business.

Property mentioned in (a) above would be covered under Ind AS 16 'Property, Plant, and Equipment'.

The building in question has two floors, and their accounting treatment differs based on their use, as per relevant Ind AS standards:

Floor 1 (Rented Out): This floor is classified as **investment property** under **Ind AS 40** because it is held to earn rental income. At the time of **initial recognition**, investment property is measured at **cost**, which includes the purchase price and directly attributable costs. For **subsequent measurement**, the **cost model** is applied, where the property is carried at cost less accumulated depreciation and impairment losses. However, as per **Ind AS 40**, the entity must disclose the **fair value** of investment property in the notes to the financial



statements, even though fair value is not used for measurement in the financial statements.

Floor 2 (Administrative Use): This floor is classified as **property, plant, and equipment (PPE)** under **Ind AS 16**, as it is used for administrative purposes. During **initial recognition**, PPE is measured at **cost**, which includes the purchase price and any directly attributable costs. For **subsequent measurement**, the entity can choose between two models:

1. **Cost Model**: The asset is carried at cost less accumulated depreciation and impairment losses.
2. **Revaluation Model**: The asset is periodically revalued, with gains recognized in **Other Comprehensive Income (OCI)** and losses recognized in **profit or loss**, unless they reverse prior entries.

12. Illustration

Besides manufacturing plants, A Ltd. has various other assets, not used for operational activities, e.g., freehold land, townships in different locations, excess office space rented to ABC, etc. Also, A Ltd. has some land that is kept vacant as per government regulations which require that a specified area around the plant should be kept vacant.

The details of these assets are as follows:

Property	Details
A Ltd.'s office building (registered office)	A Ltd.'s registered office in Delhi, is a 15 storey building, of which only 3 floors are occupied by A Ltd., whereas remaining floors are given on rent to other companies. These agreements are usually for a period of 3 years. According to A Ltd., such excess office space will continue to be let out on lease to external parties and have no plans to occupy it, at least in near future.
Flats in Township located in location 1	As regards township in Location 1, there are approximately 2,000 flats in the said township. It was built primarily for A Ltd.'s employees, hence, approximately 80% of the flats are allotted to employees and remaining flats are either kept vacant or given on rent to other external parties. A lease agreement is signed between A Ltd. and an individual party for every 12 months being 1st April to 31st March. The lease entered is a cancellable lease (cancellable at the option of any of the parties). Also, besides monthly rent, additional charges are levied by A Ltd. on account of electricity, water, cable connection, etc. According to A Ltd., there is no intention of selling such excess flats or allotting it to its employees.
Flats in township located in location 2	There are 1,000 flats in location 2 township, of which: • 400 flats are given to employees for their own accommodation. • 350 flats are given on rent to Central Government and State Government for accommodation of their employees. Average lease period being 12 months with cancellable clause in lease agreements. • 250 flats are kept vacant.
Hostel located in location 1	60 rooms in the hostel have been let out to G Ltd., to give accommodation to their personnel. Lease agreement is prepared for every 11 months and renewed thereafter. Besides the monthly rent amount, some charges are levied towards water, electricity and other amenities, e.g., cable connection, etc.
Land in location 1	In 20X4, A Ltd. purchased a plot of land on the outskirts of a major city. The area has mainly low-cost public housing and very limited public transport facilities. The government has plans to develop the area as an industrial park in 5 years' time and the land is expected to greatly appreciate in value if the government proceeds with the plan. A Ltd. has not decided what to do with the property.
Land in location 1	A portion of land has been leased out to C Ltd. for its manufacturing operations. Land has been given on lease on a lease rental of ₹10 lacs p.a. with a lease term of 25 years.
Land in location	A portion of the land has been given on rent to D Ltd. which has



2	constructed a petrol pump on such land. It has been leased for a period of 40 years and renewed for a further period of 40 years.

Determine the classification of properties which are not held for operational purposes, with suitable reasoning in the financial statements of A Ltd.

Solution:

Property	Simplified Classification & Reasoning
A Ltd.'s office building (registered office)	Out of 15 floors, only 3 are used by A Ltd., rest are let out on lease. A Ltd. has no plans to occupy the rented space and it is separately identifiable. Hence, **excess office space is an Investment Property**.
Flats in Township – Location 1	About 20% of flats are let out or vacant. There's no plan to sell or allot them to employees. Flats are separately identifiable and rental income is the main purpose. A Ltd. also charges its lessees on account of ancillary services, i.e., water, electricity, cable connection, etc., but the monthly charges in such cases are generally not significant as compared to rental payments. Hence, **rented flats are Investment Property**. Vacant flats: • If held to earn rent → **Investment Property** • If held for future employee use → **PPE**
Flats in Township – Location 2	350 flats are rented to govt. departments. If intention is to continue renting, they are **Investment Property**. 250 flats are vacant: • If to be rented → **Investment Property** • If for future employee use → **PPE**
Hostel – Location 1	Rooms rented to G Ltd. for use by their staff. Ancillary charges are minor compared to rent. Purpose is rental income. Hence, **Investment Property**.
Land – Location 1 (Vacant Land)	Purchased with expectation of value appreciation. No decision yet on use. As per Ind AS 40, if held for capital appreciation, then it is an **Investment Property**.
Land – Location 1 (Leased to C Ltd.)	Leased for 25 years to earn rent. Purpose is long-term rental income. Hence, **Investment Property**.
Land – Location 2 (Leased to D Ltd.)	Leased for 40 years (plus renewal). Purpose is to earn lease income over time. Hence, **Investment Property**.

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Indian Accounting Standard 23
BORROWING COST
ILLUSTRATIONS

1. 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.

Solution:

Particulars	*Factory (₹)*	*Office (₹)*
Amount Spent	10,00,000	20,00,000
Interest Rate	9%	9%
Period	12 months	12 months
Interest Expense	**90,000**	**1,80,000**
Surplus Funds (unutilised)	5,00,000	10,00,000
Interest Rate	7%	7%
Period	6 months	6 months
Income Earned	**17,500**	**35,000**
Borrowing Cost to be capitalised	**72,500**	**1,45,000**
Cost of PPE	**10,72,500**	**21,45,000**

2. Illustration

Beta Ltd had the following loans in place at the end of 31st March, 20X2 ('000)

Loan	1st April, 20X1	31st March, 20X2
18% Bank Loan	1,000	1,000
16% Term Loan	3,000	3,000
14% Debentures	-	2,000

14% debenture was issued to fund the construction of Office building on 1st July, 20X1 but the development activities has yet to be started. On 1st April, 20X1, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings.
Expenditure drawn down for the construction was: ₹ 500,000 on 1st April, 20X1 and ₹ 2,500,000 on 1st January, 20X2.
Calculate the borrowing cost that can be capitalised for the plant.

Solution:

Loan Type	**Amount (₹)**	**Interest Rate**	**Annual Interest (₹)**
18% Bank Loan	₹10,00,000	18%	₹1,80,000
16% Term Loan	₹30,00,000	16%	₹4,80,000
Total	₹40,00,000		₹6,60,000
Capitalisation rate		16.5%	**660,000 x 100% 40,00,000**
Date	**Amount (₹)**	**Period Outstanding**	**Borrowing Cost Capitalised**
01-Apr-20X1	₹5,00,000	12 months	₹5,00,000 × 16.5% × 12/12 = ₹82,500
01-Jan-20X2	₹25,00,000	3 months	₹25,00,000 × 16.5% × 3/12 = ₹1,03,125



Total	₹30,00,000		**₹1,85,625**

Alternatively capitalisation rate can be computed as below

Loan Amount (₹)	Weight	Rate of Interest	Weighted Rate (%)
₹10,00,000	0.25	18%	4.5%
₹30,00,000	0.75	16%	12%
₹40,00,000			**16.5%**

3. 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
	15,00,000	1,65,000

Compute the borrowing costs that need to be capitalised.

Solution:

Capitalisation Rate		
Particulars	**Avg Loan**	**Interest**
Long term loan	10,00,000	1,00,000
WC Loan	5,00,000	65,000
Total	**15,00,000.00**	**1,65,000.00**
Capitalisation rate	11%	

Borrowing costs to be capitalised

Date of expenditure	Amount (₹)	Rate	Period	Borrowing cost (₹)
1st July 20X1	2,50,000	11%	9/12	20,625
1st December 20X1	3,00,000	11%	4/12	11,000
Total borrowing cost to be capitalised				**31,625**

4. 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'.

Solution:



Borrowing	Principal (₹)	Rate	Months	Interest (₹)	Principal × Months
10% Debentures	20.00	10%	12	2.0000	240.00
Bank OD (till 30 Sept)	5.00	15%	9	0.5625	45.00
Bank OD (Oct–Nov)	5.00	16%	2	0.1333	10.00
Bank OD (Dec)	7.50	16%	1	0.1000	7.50
Total				**2.7958**	**302.50**
Average Borrowings					302.50 ÷ 12 = 25.21
Capitalisation Rate				(2.7958 ÷ 25.21) × 100 = **11.09% (approx.)**	

5. 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.

Solution:

Capitalisation of borrowing costs *begins when* ***all three*** *of the following conditions are met:*

1. ***Borrowing costs are being incurred*** → ✅ 15th May, 20X1
2. ***Expenditures on the qualifying asset are being incurred*** → ✅ 19th June, 20X1
3. ***Activities necessary to prepare the asset for its intended use or sale are in progress*** → ✅ 2nd June, 20X1

All three conditions are first satisfied on: 19th June, 20X1. Hence the borrowing cost would be capitalised from 19th June 20X1.

6. 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.

Solution:

As per **Ind AS 23 – Borrowing Costs**, Borrowing costs can be capitalized as part of the cost of a qualifying asset if the asset takes a **substantial period of time** to get ready for its intended use or sale. Capitalization continues until the asset is ready for its **intended use** or **sale**.

The commercial complex was **completed** on **31st May 20X1** and was ready to generate rental income (its intended use). The inability to fully rent out the complex by 31st March 20X2 is due to **market conditions**, not because the asset was incomplete or not ready for use. As per **Ind AS 23**, once the asset is ready for its intended use (completion date), the capitalization of borrowing costs should cease.



H Limited **cannot capitalize** the borrowing costs incurred after **31st May 20X1**.Borrowing costs incurred after the completion date should be recognized as an **expense** in the profit or loss for the period.

7. 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.

Solution:
As per **Ind AS 23**, a **qualifying asset** is an asset that **necessarily takes a substantial period of time** to get ready for its **intended use or sale**. An entity shall begin **capitalising borrowing costs** as part of the cost of a qualifying asset on the **commencement date**. The **commencement date** for capitalisation is the date when the entity first meets **all of the following conditions**:

a) It **incurs expenditures** for the asset.
b) It **incurs borrowing costs**.
c) It undertakes **activities that are necessary** to prepare the asset for its **intended use or sale**.

The **ship is a qualifying asset**, as it takes a **substantial period of time** for its construction. Thus, the **related borrowing costs** should be capitalised.

- **Marine Transport Limited** borrows funds and incurs expenditures in the form of **down payment** on **1st April, 20X0**. Thus, **condition (a)** and **condition (b)** are met.
- However, **condition (c)** is met **only on 1st March, 20X2**, and that too only with respect to **one ship**.

There is **no capitalisation of borrowing costs** during the financial year ended **31st March, 20X1**, as condition (c) was not met for any ship.

For the financial year ended **31st March, 20X2**, borrowing costs related to the **one ship**, whose construction commenced on **1st March, 20X2**, will be **capitalised** from **1st March, 20X2 to 31st March, 20X2**.
Borrowing costs related to the **other two ships** or for periods prior to the commencement of construction will be **expensed**.

8. 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

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.



Solution:

Step 1: Calculate Capitalisation Rate for General Borrowings

Loan Amount (₹)	Interest Rate	Interest (₹)
₹7,00,000	12%	₹84,000
₹9,00,000	11%	₹99,000
Total = ₹16,00,000		**₹1,83,000**

Capitalisation Rate = ₹1,83,000 / ₹16,00,000 = 11.4375%

Date	Amount (₹)	Type	Rate	Period	Interest (₹)
01-Apr-20X1	₹1,50,000	Specific	9%	10 months	₹11,250
01-Aug-20X1	₹2,00,000	₹50k Specific, ₹1.5L General	9% / 11.4375%	6 months	₹3,750 + ₹8,578
01-Oct-20X1	₹3,50,000	General	11.4375%	4 months	₹13,344
01-Jan-20X2	₹1,00,000	General	11.4375%	1 month	₹953
Total	₹8,00,000				**₹37,875**

Interest = Amount x Rate x Period/12

Date	Particulars	Dr (₹)	Cr (₹)
Various Dates	Capital Work-in-Progress (CWIP) A/c Dr.	8,00,000	
	To Bank A/c		8,00,000
	(Being construction cost incurred and recorded under CWIP)		
31-Jan-20X2	Interest Expense A/c Dr.	37,875	
	To Interest Payable A/c		37,875
	(Being borrowing cost accrued on specific and general borrowings)		
31-Jan-20X2	Building A/c Dr.	8,37,875	
	To Capital Work-in-Progress (CWIP) A/c		8,00,000
	To Interest Expense A/c		37,875
	(Being completed building capitalised including borrowing cost)		
	Single composite entry (alternative)		
31-Jan-20X2	Building A/c Dr.	8,37,875	
	To Bank A/c		8,00,000
	To Interest Payable / Bank A/c		37,875
	(Being completed building capitalised including borrowing cost)		

9. 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?

Solution:

Capitalisation Rate - General Borrowings

Loan Amt	Int Rate	Int Amt
10,00,000.00	12.50%	1,25,000
15,00,000.00	10%	1,50,000
25,00,000.00	**11%**	**2,75,000**
Capitalisation Rate = Interest / Total Loan		11.00%

Specific borrowings (Rs. 7,00,000) are used first and balance amount is used from General borrowings.

Date	Amount (₹)	Nature	Period	Rate	Interest (₹)
01-Apr-20X1	2,00,000	Specific	–	–	65,000-20,000
30-Jun-20X1	5,00,000	Specific	–	–	=45,000
30-Jun-20X1	1,00,000	General borrowing	9 months	11%	8,250
31-Dec-20X1	12,00,000	General borrowing	3 months	11%	33,000
31-Mar-20X2	2,00,000	General borrowing	0 months	11%	–
	22,00,000			**Total**	**86,250**

10. 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.**

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?

Solution:

Following is the treatment as per Ind AS 23 in standalone financial statements

Entity	Analysis	Borrowing Costs Eligible for Capitalization
Finance Company	- The Finance Company did not incur any expenditures on qualifying assets. - Therefore, it **cannot capitalize any borrowing costs**.	**₹ 0**
Real Estate Company	- The total interest cost is **₹ 70,000** (₹ 10,00,000 × 7%). - Expenditures on qualifying assets (₹ 15,40,000) exceed borrowings (₹ 10,00,000). - Thus, the **entire interest cost of ₹ 70,000** can be capitalized.	**₹ 70,000**
Construction Company	- The Construction Company has no borrowings, hence no interest costs are incurred. - Therefore, it **cannot capitalize any borrowing costs**.	**₹ 0**

Calculation Table for Parent Company (Consolidated Borrowing Costs)

Particulars	Amount (₹)
Total Borrowings	**₹ 30,00,000**
Borrowings by Real Estate Company	₹ 10,00,000
Borrowings by Finance Company	₹ 20,00,000
Total Interest Expenditures for the Group	**₹ 2,10,000**
Interest on ₹ 10,00,000 (Real Estate Co.)	₹ 70,000 (₹ 10,00,000 × 7%)
Interest on ₹ 20,00,000 (Finance Co.)	₹ 1,40,000 (₹ 20,00,000 × 7%)
Expenditures on Qualifying Assets	**₹ 24,00,000**
Real Estate Company (after eliminating profit margin)	₹ 14,00,000 (₹ 15,40,000 ÷ 1.1)
Construction Company	₹ 10,00,000
Capitalization Rate	**7%**
Borrowing Costs Eligible for Capitalization	₹ 1,68,000 (₹ 24,00,000 × 7%)
Borrowing Costs Capitalized	**₹ 1,68,000**
Remaining interest costs to be expensed	₹ 42,000 (₹ 2,10,000 – ₹ 1,68,000)

Hint : for CFS think of it as the Group as a single entity has borrowed funds.

11. 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.

Solution:

Computation of interest using EIR.

Year	Opening Balance (₹)	Interest (₹)	Payment (₹)	Closing Balance (₹)
1	1,80,000	24,102	20,000	1,84,102
2	1,84,102	24,651	20,000	1,88,753
3	1,88,753	25,274	20,000	1,94,027



4	1,94,027	25,973	2,20,000	–
Total		**1,00,000**		

Total interest to be capitalised = 24,102 + 24,651 = 48,753

Calculation of Effective Interest Rate i.e IRR (Not required for exams as already given in question)

Year	Amount (₹)	PVF @ 14%	PV @ 14% (₹)	PVF @ 13%	PV @ 13% (₹)
1	20,000	0.8772	17,543.86	0.8850	17,699.12
2	20,000	0.7695	15,389.35	0.7831	15,662.93
3	20,000	0.6750	13,499.43	0.6931	13,861.00
4	2,20,000	0.5921	1,30,257.66	0.6133	1,34,930.12
		Total PV	**1,76,690.30**		**1,82,153.17**

IRR Interpolation

Particulars	At 14%	At 13%
Initial inflow (₹)	1,80,000	1,80,000
NPV (₹)	+3,309.70	(2,153.17)

Difference in NPV = **5,463**
Change in rate = **1%**

Rate adjustment required = (2,153 ÷ 5,463) × 1 = **0.39%**

Effective Interest Rate (EIR) **= 13% + 0.39% = 13.39%**

12. 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?

Solution:

Under Ind AS 23, borrowing costs can be capitalised only for a **qualifying asset**—an asset that takes a **substantial period of time** to get ready for use.

Management considers **12 months** as substantial, and installation is completed on **30-04-20X2**, i.e., **13 months**.
So **Plant & Machinery + Additional assets** are qualifying assets and borrowing costs on these assets should be capitalised. Other borrowing costs should be expensed.

(₹ in lakh)



Purpose	Qualifying	Interest to be Capitalised	Interest to be Charged to Profit & Loss
Modernisation and renovation of Plant & Machinery	Yes	68.20 × (510 ÷ 620) = 56.10	–
Advance to suppliers for additional assets	Yes	68.20 × (54 ÷ 620) = 5.94	–
Working Capital	No	–	68.20 × (56 ÷ 620) = 6.16
Total		**62.04**	**6.16**

If renovation and modernisation finish **before 12 months**, then the assets **do NOT qualify as qualifying assets** unless management can prove that even a shorter period is substantial. Here, the question clearly says **management considers 12 months as substantial**, and the work finished **earlier (in less than 12 months)**.

Therefore, the assets are NOT qualifying assets. Since the assets are **not qualifying assets**, **entire interest is charged to profit and loss as expense.**

13. Illustration

LT Ltd. is in the process of constructing a building. The construction process is expected to take about 18 months from 1st January 20X1 to 30th June 20X2. The building meets the definition of a qualifying asset. LT Ltd. incurs the following expenditure for the construction:

1st January, 20X1	**₹5 crores**
30th June, 20X1	**₹ 20 crores**
31st March, 20X2	**₹ 20 crores**
30th June, 20X2	**₹ 5 crores**

On 1st July 20X1, LT Ltd. issued 10% Redeemable Debentures of ₹50 crores. The proceeds from the debentures form part of the company's general borrowings, which it uses to finance the construction of the qualifying asset, ie, the building. LT Ltd. had no borrowings (general or specific) before 1st July 20X1 and did not incur any borrowing costs before that date. LT Ltd. incurred ₹25 crores of construction costs before obtaining general borrowings on 1st July 20X1 (pre-borrowing expenditure) and ₹25 crores after obtaining the general borrowings (post-borrowing expenditure).
For each of the financial years ended 31st March 20X1, 20X2 and 20X3, calculate the borrowing cost that LT Ltd. is permitted to capitalize as a part of the building cost.

Solution:

Borrowing costs can be capitalized when a qualifying asset is being constructed, and all three conditions are met:

1. Expenditure on the qualifying asset.
2. Borrowing costs are incurred.
3. Activities to prepare the asset for its intended use or sale are in progress.

Financial Year 20X0-20X1

Expenditure Date	Amount (₹)	Capitalization Period (current year)	Weighted Average Accumulated Expenditure (₹)
1st Jan X1	5 crore	0	NIL

- **Borrowing Costs Eligible for Capitalization: ₹ 0**
- **Reason:** Borrowing costs were not incurred before 1st July 20X1.



Financial Year 20X1-20X2

Expenditure Date	Amount (₹)	Capitalization Period (current year)	Weighted Average Accumulated Expenditure (₹)
1st Jan X1	5 crore	9/12	3.75 crore
30th Jun X1	20 crore	9/12	15 crore
31st Mar X2	20 crore	0/12	NIL
Total	**25 crore**		**18.75 crore**

- **Borrowing Costs Eligible for Capitalization: ₹ 1.875 crore** (18.75 crore × 10%).

Financial Year 20X2-20X3

Expenditure Date	Amount (₹) crores	Capitalization Period (current year)	Weighted Average Accumulated Expenditure (₹)
1st Jan X1	5	3/12	1.25
30th Jun X1	20	3/12	5
31st Mar X2	20	3/12	5
31st Mar X2	1.875	3/12	0.47
30th Jun X2	5	0/12	NIL
Total			**11.72**
Alternatively			
Opening WIP	45	3/12	11.25
Int in WIP	1.875	3/12	0.47
30th June, 20X2	5	0/12	NIL
Total			**11.72 crore**

- **Borrowing Costs Eligible for Capitalization: ₹ 1.172 crore** (11.72 crore × 10%).

14. Illustration

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.
Following is the detail of the work done on different phases of the building during the current year (₹ in lakhs):

	Phase I (₹)	Phase II (₹)	Phase III (₹)	Phase IV (₹)
Cash Expenditure	10	30	25	30
Building Purchased	24	34	30	38
Total Expenditure	34	64	55	68

Total expenditure of all phases: ₹ 221
Loan taken @15% at the beginning of the year: ₹ 200
During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

Solution:

Particulars	Amount	Interest	
Loan Principal	₹2,00,00,000		
Annual Interest Rate	15%		
Total Annual Interest (Principal x 15%)	₹30,00,000		
Expenditure – Phase I	₹34,00,000	30,00,000 x 34/221 =	4,61,538
Expenditure – Phase II	₹64,00,000	30,00,000 x 64/221 =	8,68,779
Expenditure – Phase III	₹55,00,000	30,00,000 x 55/221 =	7,46,606
Expenditure – Phase IV	₹68,00,000	30,00,000 x 68/221 =	9,23,077
Total Expenditure	**₹2,21,00,000**		₹30,00,000



	Interest	**Capitalise**	**Expense**
Phase I& II (50% capitalise)	₹13,30,317	₹6,65,158.50	₹6,65,158.50
Phases III & IV	₹16,69,683	₹16,69,683	
Total Interest Capitalized		₹23,34,841.50	
Total Interest Expensed			₹6,65,158.50

1. **Phase I and Phase II**
   Since Phase I and Phase II became operational at the mid-point of the year, only half of the interest amount of ₹6,65,158.50 (i.e., ₹13,30,317 ÷ 2) attributable to Phases I and II is **capitalized**. This capitalized portion should be allocated between Phase I and Phase II based on their respective asset costs (i.e., 34:64) and added to each phase's asset value.

The **remaining half** of this interest amount (the other ₹6,65,158.50) **must be expensed** during the year, because interest incurred **after** the assets become operational cannot be capitalized.

2. Phase III and Phase IV

Interest of ₹16,69,683 relating to Phases III and IV should be **held in Capital Work-in-Progress (CWIP)** until the construction work for these phases is fully completed. Once they are completed and ready for use, this accumulated interest will be **capitalized** in proportion to each asset's respective cost. **No portion** of this interest should be charged to expenses for the current year, since the work on these phases has not yet been completed.

15. Illustration (RTP May 22)

X Ltd. commenced the construction of a plant (qualifying asset) on 1st September, 20X1, estimated to cost ₹ 10 crores. For this purpose, X has not raised any specific borrowings, rather it intends to use general borrowings, which have a weighted average cost of 11%. Total borrowing costs incurred during the period, viz., 1st September, 20X1 to 31st March, 20X2 were ₹ 0.5 crore.

The other relevant details are as follows:(₹ in crore)

Month	Cost of construction Accrued	Cash outflows (paid in advance at the start of each month)
September	1.50	3.00
October	0.50	1.70
November	1.50	2.50
December	0.50	-
January	1.80	1.00
February	0.70	-
March	3.00	1.50

Based on the above information, discuss the treatment of borrowing cost as per cash outflow basis and accrual basis and also suggest the appropriate amount of interest that should be capitalised to the cost of the plant in the financial statements for the year ended 31st March, 20X2?

Solution:

When an entity borrows funds generally to acquire a qualifying asset, it must determine the borrowing costs eligible for capitalization by applying a *capitalization rate* to the expenditures on that asset. This rate is the weighted average of the borrowing costs from all borrowings outstanding during the period. Borrowing costs from loans specifically taken for a qualifying asset are excluded from this calculation until the asset is substantially ready for its intended use or sale. Additionally, the total amount capitalized in any given period cannot exceed the total borrowing costs actually incurred in that period.



In applying this principle, one key question is whether the *expenditure* on which the capitalization rate is applied should be measured based on **costs accrued** or **actual cash outflows**. The following section provides a comparative illustration of borrowing cost calculations under both approaches.

Month	Cost of construction Accrued	Average capital expenditure	Cash outflows (paid in advance at the start of each month)	Average capital expenditure
September	1.50	1.50 x 7/12 = 0.875	3.00	3.00 x 7/12 = 1.75
October	0.50	0.50 x 6/12 = 0.25	1.70	1.70 x 6/12 = 0.85
November	1.50	1.50 x 5/12 = 0.625	2.50	2.50 x 5/12 = 1.04
December	0.50	0.50 x 4/12 = 0.17	-	-
January	1.80	1.80 x 3/12 = 0.45	1.00	1 x 3/12 = 0.25
February	0.70	0.70 x 2/12 = 0.12	-	-
March	3.00	3.00 x 1/12 = 0.25	1.50	1.50 x 1/12 = 0.125
	9.50	2.74	9.70	4.02

1. **Different Methods, Different Results**
   - Using **accrued costs** (₹2.74 crore) as the basis for calculating borrowing costs gives a capitalizable amount of ₹0.30 crore (₹2.74 crore × 11%).
   - Using **actual cash outflows** (₹4.02 crore) yields ₹0.44 crore (₹4.02 crore × 11%).
   - This sizable difference (₹0.30 crore vs. ₹0.44 crore) highlights how the chosen method significantly affects the capitalizable borrowing cost—especially for large projects where advance payments do not immediately translate into accrued expenses.
2. **Ind AS 23 Guidance (Paragraph 18)**
   - Only expenditures involving **actual outflow of cash**, transfers of other assets, or assumption of interest-bearing liabilities qualify for capitalization.
   - Such expenditures are reduced by any progress payments or grants related to the asset.
   - In most cases, the **average carrying amount** of the asset during the period (including any previously capitalized borrowing costs) is a suitable approximation for applying the capitalization rate.
3. **Cash Paid Before Costs Accrue**
   - If cash is paid in advance, interest starts accruing from the date of payment, not from when the cost is formally recognized.
   - Therefore, **actual cash flows** should form the basis for calculating interest eligible for capitalization, provided all other Ind AS 23 conditions are satisfied.
   - In this scenario, computing interest based on **cash outflows** (₹0.44 crore) is appropriate, rather than using accrued costs (₹0.30 crore).
4. **Overall Limit on Capitalization**
   - The total borrowing costs capitalized in a period cannot exceed the **actual borrowing costs incurred** in that period.
   - Since the actual borrowing costs here total ₹0.50 crore, **the maximum that can be capitalized** is ₹0.50 crore, ensuring compliance with the standard.

16. Illustration (RTP May 24)

PQR Limited is engaged in Tourism business in India. The company has planned to construct a Holiday Resort (Qualifying Asset) at Shimla. The cost of the project has been met out of borrowed funds of ₹ 100 lakhs at the rate of 12% p.a. ₹ 40 lakhs were disbursed on 1st April 20X2 and the balance of ₹ 60 lakhs were disbursed on 1st June 20X2. The site planning work commenced on 1st June 20X2, since the Chief engineer of the project was on medical leave.



The company commenced physical construction on 1st July 20X2 and the work of construction continued till 30th September 20X2 and thereafter the construction activities stopped due to landslide on the road which leads to construction site. The road blockages have been cleared by the government machinery by 31st December 20X2. Construction activities have resumed on 1st January 20X3 and has completed on 28th February 20X3.
The date of opening has been scheduled for 1st March 20X3, but unfortunately, the District Administration gave permission for opening on 16th March 20X3, due to lack of safety measures like fire extinguishers which had not been installed by then.
Determine the amount of borrowing cost to be capitalized towards construction of the resort when

(i) **Landslide is not common in Shimla and delay in approval from District Administration Office is minor administrative work leftover**
(ii) **Landslide is common in Shimla and delay in approval from District Administration Office is major administrative work leftover.**

Solution:

Under **Ind AS 23 (Borrowing Costs)**, an entity **starts capitalizing borrowing costs** when it:

1. **Incurs expenditures** for the asset,
2. **Incurs borrowing costs**, and
3. **Undertakes activities** necessary to prepare the asset for its **intended use**.

Capitalization **continues** unless there is an **abnormal** interruption, which requires a **suspension** of capitalization. Normal or **common** interruptions do **not** require stopping **capitalization**. Finally, **capitalization ceases** when **substantially all the activities** needed to make the asset ready for use are complete. Minor tasks do **not** affect the date on which the asset is deemed **ready**.

Scenario (i): Landslide Not Common + Minor Administrative Delay
Since **landslides are not common** in Shimla, the halt from **October** to **December** 20X2 is an **abnormal** delay, so **capitalization** of **borrowing costs** must be **suspended** for those three months. Construction **completes** on **28th February 20X3**, and the **delay in approval** is merely a **minor** leftover task, so **capitalization ends** on the date **physical construction** finishes. Hence, **capitalization** applies for **four months** (1st June to 30th September 20X2) plus **two months** (1st January to 28th February 20X3) → a total of **6 months**. At **₹1 lakh** interest per month (₹100 lakhs × 12% ÷ 12), the total **capitalized borrowing costs** equal **₹6 lakhs**.

Scenario (ii): Landslide Common + Major Administrative Delay
If **landslides are common** in Shimla, the **interruption** from **October** to **December** 20X2 is considered a **normal** delay. Therefore, **capitalization** of **borrowing costs continues** through that period. Furthermore, if the project can only function after **major** regulatory approvals (fire safety), it is **not** ready for use until **16th March 20X3**. Consequently, **capitalization** goes up to **15th March 20X3**, reflecting **9.5 months** of interest (from 1st June 20X2). At **₹1 lakh** per month, the **capitalized borrowing costs** total **₹9.5 lakhs**.



Ind AS 20
Accounting for Government Grants and Disclosure of Government Assistance
Illustrations

1. Illustration

A village of artisans in a district got devasted because of an earthquake. A Limited was operating in that district and was providing employment to the artisans. The government gave a grant of Rs.10,00,000 to A Limited so that 100 artisans are rehabilitated over a period of 3 years. Government releases Rs.2,00,000. Examine how the Government grant be recognised.

Solution:

As per **Ind AS 20**, a government grant is **recognised only when there is reasonable assurance** that:

1. **The entity will comply with the conditions** attached to the grant, and
2. **The grant will be received**.

Grants related to income are **recognised in profit or loss on a systematic basis** over the periods in which the related costs are incurred.

If the grant relates to future obligations, **it is initially deferred** and recognised in the P&L over the period the benefit is derived.

The grant has **specific conditions** and is **intended to compensate for costs incurred** over time. If there is reasonable assurance of fulfilling the conditions, **the entire ₹10,00,000 will be recorded as Deferred Government Grant** and will recognise it in its profit or loss over the period of three years.

The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government or in the form of a non-monetary asset.

Date	Particulars	Dr. (₹)	Cr. (₹)
recognition	Government Grant Receivable A/c	10,00,000	
	To Deferred Government Grant A/c		10,00,000
	(Being partial grant received towards rehabilitation of artisans)		
Receipt	Bank A/c Dr.	2,00,000	
	To Government Grant Receivable A/c		2,00,000
At year-end	Deferred Government Grant A/c	3,33,333	
	To Other Income / P&L A/c		3,33,333
	(Being 1/3rd of grant income recognised for the year)		

2. Illustration

A Limited received from the government a loan of Rs. 50,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant.
State how the grant will be recognized in the statement of profit or loss assuming:
Case 1: The loan is an immediate relief measure to rescue the enterprise.
Case 2: The loan is a subsidy for staff training expenses, incurred equally, for a period of 4 years



Case 3: The loan is to finance a depreciable asset.

Solution:

Calculation of Fair value of Loan			
Year	Outflow	PVF @ 12%	PV
1	2,50,000	0.8929	2,23,214.29
2	2,50,000	0.7972	1,99,298.47
3	2,50,000	0.7118	1,77,945.06
4	2,50,000	0.6355	1,58,879.52
5	52,50,000	0.5674	29,78,990.99
		Fair Value	37,38,328
		Loan	50,00,000
		Govt Grant	12,61,672
	Bank A/c Dr	50,00,000	
	To Govt Grant		12,61,672
	To Fin. Liability		37,38,328

Case 1: Immediate Relief Measure

- If the **entire grant** is merely to **rescue** the enterprise (i.e., no future performance or expense conditions), the grant is **recognized as income** in the **period** in which the entity receives it and meets the conditions.
- Hence the entity will **immediately** recognise the grant in the **Statement of Profit or Loss**.

Case 2: Subsidy for Staff Training Over 4 Years

- If the grant is to **cover staff training costs** incurred equally over **4 years**, the grant should be **matched** with those **training expenses**.
- The company would **defer** the ₹12.62 lakhs in a **Deferred Income** account and then **recognize it as income** in **equal instalments** (or in proportion to training costs) over the **4 years** of the training program.

Case 3 : Finance a depreciable asset

For a **grant** linked to the acquisition or construction of a **depreciable asset**, the company can

- **Deduct** the grant from the **carrying amount** of the asset, reducing **future depreciation**, or
- **Show it as Deferred Income** and **amortize** it over the asset's **useful life** in the Statement of Profit or Loss, matching the **depreciation expense**.

3. Illustration

A Limited wants to establish a manufacturing unit in a backward area and requires 5 acres of land. The government provides the land on a leasehold basis at a nominal value of Rs.10,000 per acre. The fair value of the land is Rs.1,00,000 per acre. Calculate the amount of the Government grant to be recognized by an entity.

Solution:



As per **Ind AS 20**, **non-monetary government grants** (such as land or other assets provided at concessional rates) should be **accounted for at fair value**, and the **benefit (difference between fair value and the nominal amount paid)** should be recognised as **government grant**.

Alternatively, entities **have the option** to record the asset **at the nominal amount paid**, in which case **no grant is recognised**.

Option 1: Recognise Land at Fair Value (Recommended)

- **Land shall be recognised at ₹5,00,000** and **Government grant of ₹4,50,000 (₹5,00,000 – ₹50,000)** is to be recognised

Date	Particulars	Dr. (₹)	Cr. (₹)
	Land A/c	5,00,000	
	To Bank A/c		50,000
	To Deferred Government Grant A/c		4,50,000
	(Being land recognised at fair value, grant deferred)		

Option 2: Recognise Land at Nominal Value

- Land is **recorded at ₹50,000** and **No government grant** is recognised under this method

Date	Particulars	Dr. (₹)	Cr. (₹)
	Land A/c	50,000	
	To Bank A/c		50,000
	(Being land recognised at nominal amount paid)		

4. Illustration

ABC Ltd. has received the following grants from the Government of Delhi for its newly started pharmaceutical business:

- **Rs. 20 lakhs received for immediate start-up of business without any condition.**
- **Rs. 50 lakhs received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:**
  - **that drugs should be available to the public at 20% cheaper from current market price; and**
  - **the drugs should be in accordance with quality prescribed by the World Health Organisation [WHO].**
- **Two acres of land (fair Value: Rs. 10 Lakhs) received for set up plant.**
- **Rs. 2 lakhs received for purchase of machinery of Rs. 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis.**

How should ABC Ltd. recognise the government grants in its books of accounts?

Solution:

1. ₹20 lakhs received for immediate start-up of business
   - Since there are **no conditions** attached, this grant is recognized **immediately** in the **Statement of Profit and Loss** as **income**.

2. ₹50 lakhs received for research and development (R&D)
   - **Conditions attached**:
     - The drugs must be sold at **20% below market price**, and
     - They must meet **WHO quality standards**.
   - **Recognition**:



- The grant should be recognized as **income on a systematic basis** over the periods in which the **related R&D costs** are incurred.
- ABC Ltd. must ensure **reasonable assurance** that it will comply with the conditions before recognizing the grant.

3. Two acres of land (Fair Value: ₹10 lakhs) received at no cost
   - **Accounting Treatment**:
     - **Option 1:** Recognize the land at **fair value** (₹10 lakhs) in the books. The grant (₹10 lakhs) is recorded as **deferred income** in the **balance sheet** and is amortized to the **Statement of Profit and Loss**.
     - **Option 2:** Record the Government Grant at **nominal value** (₹1 or 100).

4. ₹2 lakhs received for the purchase of machinery (Cost: ₹10 lakhs, Useful Life: 5 years)
   - **Accounting Treatment**:
     - **Option 1:** Recognize ₹2 lakhs as **deferred income** in the **balance sheet** and amortize ₹40,000 (₹2,00,000 ÷ 5 years) annually to the **Statement of Profit and Loss**, matching the depreciation period of the machinery.
     - **Option 2:** Deduct ₹2 lakhs from the **cost of the machinery** (₹10 lakhs – ₹2 lakhs = ₹8 lakhs), and calculate depreciation on the reduced cost. Depreciation = ₹8 lakhs ÷ 5 years = ₹1.6 lakhs per year.

5. Illustration

MNC Ltd. has received grant in the nature of exemption of custom duty on capital goods with certain conditions related to export of goods under Export Promotion Capital Goods (EPCG) scheme of Government of India. Whether the same is a government grant under Ind AS 20, Government Grants and Disclosure of Government Assistance? If yes, then how the same is to be accounted for.

Solution:

Yes, this is a **government grant** because it involves an assistance from the government in the form of a **custom duty exemption**. According to **Ind AS 20**, government grants are defined as assistance provided by the government in the form of transfers of resources, in return for compliance with certain conditions.

Types of Grants under Ind AS 20:

1. **Grants related to assets**: These are grants where the primary condition is that the entity must acquire long-term assets.
2. **Grants related to income**: These are grants that do not relate to the acquisition of assets.

How to Account for the Grant:

- **If the grant is related to assets** (i.e., for the purchase of capital goods):
  - The grant should be presented in the balance sheet as **deferred income**
  - The grant will then be **recognized in profit or loss** systematically over the useful life of the asset
  - Alternatively, the grant can be reduced from cost of asset.
- **If the grant is related to income** (i.e., if it compensates for operating expenses):
  - The grant should be presented in **profit or loss**, either separately or as part of other income
  - Alternatively, it can be **deducted from the related expenses**.

Recognition Based on Terms of the Grant:

- If the **EPCG scheme grant** is meant to **compensate the import cost of assets** subject to an **export obligation**, the grant should be recognized in profit or loss when the export obligation is fulfilled.
- If the export conditions are considered subsidiary, the grant can be recognized over the **useful life of the asset** (matching the recognition with depreciation of the asset).



Conclusion:
The grant received by MNC Ltd. should be evaluated based on the specific terms of the EPCG scheme. If the primary condition relates to the acquisition of capital assets, the grant should be treated as related to assets and recognized accordingly. If it compensates operating costs with export conditions, it should be recognized in profit or loss as the obligations are met.

6. Illustration

ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters" contribution have been recognised in capital reserve and treated as part of shareholders" funds in accordance with the provisions of AS 12, Accounting for Government Grants.

State whether the accounting treatment of the grants in the nature of promoters" contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

Solution:
Ind AS 20 does not cover **government participation in the ownership of the entity**.

ABC Ltd. must determine if the contributions received are:
- **Equity contributions** (provided as a shareholder); or
- **Government grants** (provided as assistance by the government).

Equity Contributions:
If the contributions are determined to be **shareholder contributions**, they should be recorded as part of **equity**.

Government Grants:
If the contributions are deemed **government grants**, Ind AS 20 requires:
- Recognition as **income** on a **systematic basis**, over the periods in which the entity recognizes the related costs as expenses.
- Grants cannot be directly credited to shareholders' funds or **capital reserves**, as was permitted under AS 12.

Retrospective Application:
As per **Ind AS 101** (First-Time Adoption of Ind AS), ABC Ltd. must retrospectively apply the requirements of Ind AS 20 if the contributions qualify as **government grants**.

Conclusion:
The accounting treatment under **AS 12** for grants in the nature of promoters' contribution (directly credited to capital reserves) is **not permitted** under Ind AS 20.
- If the contributions are **shareholder equity contributions**, they will be recorded in **equity**.
- If they are **government grants**, they will be recognized in the **Statement of Profit and Loss** systematically as income over the periods in which the related costs are incurred.

7. Illustration

Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of Rs. 1,00,000 each, relating to the following ongoing research and development projects:

(i) The first grant relates to the "Clean-river project" which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh.



However, no major steps have been completed by Rainbow limited to commence this research as at 31st march, 20X2.

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

In September 20X1, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months" sales figure prior to the floods, for which the company is required to submit an application form on or before 30th June, 20X2 with necessary figures. The financial statements of Rainbow Limited are to be adopted on 31st May, 20X2, by which date the claim form would not have been filed with the State Government.
Suggest the accounting treatment of, if any, for the two grants received and the flood- related compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2.
Solution:

First Grant: Clean-River Project

- The grant relates to **research** into the effects of chemical waste.
- As of **31st March, 20X2**, no major steps have been taken by Rainbow Limited to commence the research.

1. **If the grant is unconditional**:
    - Recognize the grant **immediately in profit or loss** for the year ended **31st March, 20X2**, since there are no conditions for repayment.
2. **If the grant is conditional** (e.g., expenditure on research):
    - The grant will be **recognized on systematic basis over the period** during which the expenditure is incurred.

Second Grant: Development of New Equipment

- The grant relates to the **commercial development of an eco-friendly equipment**, and the equipment will be available for sale by **April, 20X3**.
- This is a grant related to a **depreciable asset**.

Treatment:

1. **Initial Recognition**:
    - The grant should be recognized as **deferred income** until the asset is ready for use.
2. **Subsequent Recognition**:
    - Recognize the deferred income **systematically over the useful life** of the equipment to compensate for depreciation costs.

The entity should recognise a liability in its balance sheets as at 31st March, 20X2 and 31st March, 20X3. Once the equipment starts getting used in the manufacturing process, the deferred grant income of 100,000 should be recognised over the asset's useful life to compensate for depreciation costs.
Alternatively, **Ind AS 20** permits offsetting the grant against the **cost of the equipment** at the time the asset becomes available for use (e.g., **1st April, 20X3**).

Flood-Related Compensation

- Rainbow Limited is entitled to compensation based on sales figures prior to the floods but the claim form can only be submitted after **31st May, 20X2**. Since the claim was not submitted as on 31st March 20X2, the claim cannot be recognised. The compensation **should not be recognized** as income for the year ended **31st March, 20X2**



8. Illustration

An entity opens a new factory and receives a government grant of Rs. 15,000 in respect of capital equipment costing Rs. 1,00,000. It depreciates all plant and machinery at 20% per annum on straight-line basis.
Show the statement of profit and loss and balance sheet extracts in respect of the grant for first year under both the methods as per Ind AS 20.

Solution:

Deferred Income Approach

Statement of Profit and Loss (Year 1)

Particulars	Amount (₹)
Other Income **(Grant amortised: ₹15,000 × 20%)**	**3,000**
Expenses **– Depreciation (₹1,00,000 × 20%)**	**20,000**

Balance Sheet Extracts (End of Year 1)

Particulars	Amount (₹)
Assets	
Property, Plant & Equipment	1,00,000
Less: Accumulated Depreciation	(20,000)
Net PPE	**80,000**
Non-Current Liabilities	
Deferred Government Grant (15,000 – 3,000 – 3,000)	**9,000**
Current Liabilities	
Portion of Grant due to be recognised next year	**3,000**

Reduction from Cost of Asset Approach

Working Note

Particulars	**Amount (₹)**
Cost of Property, Plant & Equipment (PPE)	1,00,000
Less: Government Grant	(15,000)
Net Book Value of PPE	**85,000**
Depreciation @ 20% on ₹85,000	**17,000**

Statement of Profit and Loss (Year 1)

Particulars	Amount (₹)
Expenses **– Depreciation (₹85,000 × 20%)**	**17,000**

Balance Sheet Extracts (End of Year 1)

Particulars	Amount (₹)
Assets	
Property, Plant & Equipment (Net of Grant)	85,000
Less: Accumulated Depreciation	(17,000)
Net PPE	**68,000**



9. Illustration

A company receives a cash grant of Rs. 30,000 on 31 March 20X1. The grant is towards the cost of training young apprentices. Training programme is expected to last for 18 months starting from 1 April 20X1.

Actual costs of the training incurred in

- **20X1-20X2 was Rs. 50,000 and**
- **20X2-20X3 was Rs. 25,000.**

State, how this grant should be accounted for?

Solution:

Grant Allocation Based on Training Costs

Financial Year	Actual Training Cost (₹)	Proportion of Total Cost	Grant Allocated (₹)
20X1–20X2	50,000	50,000 / 75,000 = 66.67%	30,000 × 66.67% = 20,000
20X2–20X3	25,000	25,000 / 75,000 = 33.33%	30,000 × 33.33% = 10,000
Total	**75,000**		**30,000**

Particulars	20X0–20X1	20X1–20X2	20X2–20X3
Other Income	–	20,000	10,000
Training Expenses	–	50,000	25,000
Alternate Method			
Net Expense (Alt. method: net of grant)	–	30,000	15,000

Particulars	31-Mar-20X1	31-Mar-20X2	31-Mar-20X3
Current Liabilities			
Govt. Grant – Deferred Income	20,000	10,000	–
Non-Current Liabilities			
Govt. Grant – Deferred Income	10,000	–	–

Date	Particulars	Dr. (₹)	Cr. (₹)
31-Mar-20X1	Bank A/c	30,000	
	To Deferred Government Grant A/c		30,000
	(Grant received in advance)		
During 20X1–20X2	Deferred Government Grant A/c	20,000	
	To Other Income A/c		20,000
During 20X2–20X3	Deferred Government Grant A/c	10,000	
	To Other Income A/c		10,000

10. Illustration

Entity A is awarded a government grant of Rs.60,000 receivable over three years (Rs.40,000 in year 1 and Rs.10,000 in each of years 2 and 3), contingent on creating 10 new jobs and maintaining them for three years.

The employees are recruited at a total cost of Rs.30,000, and the wage bill for the first year is Rs. 1,00,000, rising by Rs.10,000 in each of the subsequent years.

Calculate the grant income and deferred income to be accounted for in the books for year 1, 2 and 3 in the following scenarios :



a. **There is a reasonable assurance that the entity will comply with the conditions related to the grant and that the grant would be received.**
b. **There is no reasonable assurance that the grant would be received**

Solution:

a) If there is a reasonable assurance that the conditions will be complied and the grant would be received, the entity will account for the grant of Rs. 60,000 as a receivable.

Grant Receivable A/c Dr. 60,000
To Deferred Grant Income 60,000

As per **Ind AS 20**, if there is **reasonable assurance** that the entity will comply with the conditions attached to the grant and that the grant will be received, the entity should **recognize the grant income on a systematic basis** over the period in which the related expenses (wages) are incurred.

Workings for Grant Income Allocation

Total Cost = ₹1,30,000 + ₹1,10,000 + ₹1,20,000 = ₹3,60,000
Total Grant Receivable = ₹60,000
Grant income is recognised in proportion to cost incurred each year.

Year	Cost Incurred (₹)	Grant Income (₹)	Deferred Income (Closing)
1	1,30,000	60,000 × 130,000 / 360,000 = **21,667**	60,000 – 21,667 = **38,333**
2	1,10,000	60,000 × 110,000 / 360,000 = **18,333**	38,333 – 18,333 = **20,000**
3	1,20,000	60,000 × 120,000 / 360,000 = **20,000**	20,000 – 20,000 = **0**
Total	**3,60,000**	**60,000**	

The grant income will be recognised in each year in ratio of labour costs incurred. The balance amount in Deferred Income will be recognised in Balance Sheet as a liability.

b) If there is no reasonable assurance that the grant would be received, the deferred income will be credited with the amount of government grant received.

Year 1 – on receipt of grant
Bank A/c Dr. Rs. 40,000
To Deferred Grant Income Rs. 40,000
Year 2 & Year 3
Bank A/c Dr. Rs. 10,000
To Deferred Grant Income Rs. 10,000

	Year 1	**Year 2**	**Year 3**	**Total**	**Deferred Grant**
Cost (₹)	**130,000**	**110,000**	**1,20,000**	**360,000**	**Closing**
Ratio	**13**	**11**	**12**	**36**	
Grant Received	40,000	10,000	10,000	60,000	
Grant Income					
Year 1	40,000x13/36 =14,445			14,445	40,000- 14445 = 25,555
Year 2	40,000x11/36 =12,222	10,000 x 11/23 =4,783		17,005	25,555+10,000-17005 = 18550
Year 3	40,000x12/36 =13,333	10,000 x 12/23 = 5,217	10,000	28,550	0
			–		

Grant Income = $\frac{\text{Cost in respective year x Grant Amount}}{\text{Total Cost}}$



Deferred Income Balance = Total Grant received till date - amount transferred to other income.

11. Illustration

X Ltd received a Govt. grant related to Income of Rs.5,00,000 in the year 20X1. X Ltd transferred Rs.1,00,000 to the statement of profit and loss systematically in the years 20X1 and 20X2 each. Due to certain non-fulfilment of conditions, government directed X Ltd. to repay the grant in 20X3.

How should X Ltd. reflect the grant repaid in the books of account, if

(i) the total grant of Rs.5,00,000 is repaid

(ii) the part of the grant of Rs.2,00,000 is repaid.

Solution:

Case (i): Total Grant of ₹5,00,000 is Repaid

Particulars	Amount (₹)	Remarks
Total grant received	5,00,000	Government grant related to income
Recognised in Profit & Loss	2,00,000	₹1,00,000 each in 20X1 and 20X2
Deferred grant balance	3,00,000	Yet to be transferred to P&L
Amount repaid	5,00,000	Full repayment required
Journal Entry		
Profit & Loss A/c Dr.	2,00,000	Balancing figure
Deferred Grant Account Dr.	3,00,000	Reverse unamortised balance
To Bank A/c	5,00,000	Payment of grant

Case (ii): Part of the Grant (₹2,00,000) is Repaid

Particulars	Amount (₹)	Remarks
Total grant received	5,00,000	Government grant related to income
Recognised in Profit & Loss	2,00,000	₹1,00,000 each in 20X1 and 20X2
Deferred grant balance	3,00,000	
Amount repaid	2,00,000	
Journal Entry		
Deferred Govt Grant A/c Dr	2,00,000	Reverse deferred Grant balance.
To Bank A/c	2,00,000	Payment of grant

12. Illustration

A Ltd. has received a grant of Rs. 10,00,00,000 in the year 20X1-20X2 from local government in the form of subsidy for selling goods at lower price to lower income group population in a particular area for two years.

A Ltd. had accounted for the grant as income in the year 20X1-20X2. While accounting for the grant in the year 20X1-20X2, A Ltd. was reasonably assured that all the conditions attached to the grant will be complied with.

However, in the year 20X5-20X6, it was found that A Ltd. has not complied with the above condition and therefore notice of refund of grant has been served to it. A Ltd. has contested but lost in court in 20X5-20X6 and now grant is fully repayable.

How should A Ltd. reflect repayable grant in its financial statements ending 20X5-20X6?

Solution:



Since the entire grant was **already recognised as income** in 20X1–20X2 and **no deferred income exists**, the **full refund** will now be **charged to Profit & Loss** in 20X5–20X6

Profit and Loss A/c Dr. ₹10,00,00,000
To Bank A/c ₹10,00,00,000
(Being refund of grant earlier recognised as income, now repaid due to non-compliance)

	Grant reduced from Cost of Asset		
Year	Opening Balance	Depreciation	WDV at end
1	3,00,000	60,000	2,40,000
2	2,40,000	60,000	1,80,000
	Carrying amount at end of Year 2		**1,80,000**
	Add: Refund of Grant		2,00,000
	Carrying amount		3,80,000
	Less: Additional Depreciation		80,000
	Revised carrying amount		3,00,000
	Plant A/c Dr	2,00,000	
	To Bank		2,00,000
	Depreciation charged less		
	Depreciation based on original cost		2,00,000
	Depreciation on reduced cost		1,20,000
	Depreciation to be recognised now		80,000
	-	-	-
	Depreciation A/c Dr	80,000.00	
	To Acc. Depreciation		80,000

13. Illustration (RTP Nov 21)

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

Solution:

Facts of the case

A Ltd. operates in backward areas and has incurred significant losses in previous years due to high operating costs. In March 20X1, the government announced a scheme to compensate A Ltd. for its past losses, and the company is eligible to receive ₹ 10 crores as compensation in October 20X1. There are no additional conditions to be met by the company for receiving this amount.



Key Principles from Ind AS 20:
According Ind AS 20, government grants should be recognized **only when there is reasonable assurance that:**

1. The entity will comply with any conditions attached to the grant.
2. The grant will be received.

A **government grant given as compensation for past expenses or losses** should be recognized **in the profit or loss of the period in which it becomes receivable** since there are no future conditions to be complied with. Even if the grant is received in a future period, it should be **accounted for in the financial statements of the period when the entitlement arises**, with proper disclosure to ensure clarity.

Conclusion:
In this case, since the **entitlement to the grant was confirmed in March 20X1**, A Ltd. **must recognize the government grant in the profit or loss for the financial year 20X0-20X1**, even though the actual payment will be received in October 20X1. Proper disclosure should be made to ensure transparency in financial statements.

14. Illustration (RTP May 22)

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

- **If a manufacturer installs certain pre-approved wastewater treatment plant, the government will provide an interest free loan equal to 50% of the cost of the plant;**
- **Such loan will be repayable to the government in 5 years from the date of disbursal;**
- **The manufacturer availing the benefit of this scheme must treat the wastewater of its factory using the specified plant before releasing it to the river. If this condition is violated, the entire loan shall become immediately repayable to the government along with a penalty of Rs. 10 lakh.**

Cost of the wastewater treatment plant to be installed to avail the benefit of the scheme is Rs. 50 lakh. A Limited decided to utilise this scheme because, if it were to obtain the similar loan from a bank, it would be available at a market interest rate of 12% per annum. Accordingly, A Limited applied for and obtained the government loan ofRs. 25 lakh on 1st April, 20X1. A Limited purchased and installed the plant such that it became ready for use on the same date.
A Limited has an accounting policy of recognising government grant in relation to depreciable assets in the proportion of depreciation expense. It has determined that the plant will be depreciated over a period of 5 years using straight-line method. In the month of March, 20X3, government officials conducted a surprise audit, and it was found that A Limited was not using the wastewater treatment plant as prescribed. Accordingly, on 31st March, 20X3, the government ordered A Limited to repay the entire loan along with penalty. A Limited repaid the loan with interest and penalty as per the order on 31st March, 20X3.

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

Solution:
Initial Recognition of Government Grant (As on 01-Apr-20X1)
As per **Ind AS 20**, a loan at a below-market interest rate is considered a **government grant**. The **grant is measured as the difference** between the **fair value of the loan** and **proceeds received**.



Particulars	Amount (₹)
Loan received from government	25,00,000
Fair value of loan (PV factor @12% for 5 years = 0.567)	14,17,500
Government grant (difference)	**10,82,500**

Journal Entry (01-Apr-20X1)

Date	Particulars	Debit (₹)	Credit (₹)
01-Apr-20X1	Bank A/c	25,00,000	
	To Loan A/c		14,17,500
	To Deferred Grant Income		10,82,500
	(Being government loan recognized at fair value and grant recognized separately)		

Accounting Treatment for FY 20X1-20X2

- **Depreciation (Straight-line method)**: ₹ **50,00,000 ÷ 5 years** = ₹ **10,00,000 per year**
- **Grant Recognition per year** (matching depreciation): ₹ **10,82,500 ÷ 5** = ₹ **2,16,500 per year**

Journal Entries for FY 20X1-20X2 (31-Mar-20X2)

Date	Particulars	Debit (₹)	Credit (₹)
31-3-X2	Depreciation A/c	10,00,000	
	To PPE A/c / Accumulated Dep A/c		10,00,000
	(Being depreciation provided for the year)		
31-3-X2	Deferred Grant Income A/c	2,16,500	
	To Profit or Loss A/c		2,16,500
	(Being grant recognized in profit or loss proportionate to depreciation)		

Deferred Grant Income Ledger Movement

Year	Opening Balance (₹)	Adjustment (₹)	Closing Balance (₹)
31-Mar-20X2	10,82,500	(2,16,500)	8,66,000

Impact of Government Grant Revocation (31-Mar-20X3)

- The company violated the **government's conditions**, leading to **full loan repayment + ₹ 10 lakh penalty**.
- As per **Ind AS 20** a government grant that becomes repayable **is treated as a change in estimate** and adjusted **against deferred grant income first**, with any excess recognized **as an expense in Profit or Loss**.

Journal Entries for Repayment (31-Mar-20X3)

Date	Particulars	Debit (₹)	Credit (₹)
31-Mar-20X3	Deferred Grant Income A/c	2,16,500	
	To Profit or Loss A/c		2,16,500
	(Being deferred income adjusted)		
31-Mar-20X3	Loan A/c	17,78,112	
	Deferred Grant Income A/c	6,49,500	
	Profit or Loss A/c (bal fig)	72,388	
	To Government Grant Payable A/c		25,00,000
	(Being refund of government loan due to non-compliance)		
31-Mar-20X3	Profit or Loss A/c	10,00,000	



	To Government Grant Payable A/c		10,00,000
	(Being penalty payable due to non-compliance)		
31-Mar-20X3	Govt Grant Payable A/c Dr.	35,00,000	
	To Bank A/c		35,00,000

Impact on Profit or Loss for FY 20X2-20X3

Particulars	Amount (₹)
Expense Due to Loan Revocation	72,388
Penalty Imposed	10,00,000
Total Impact on Profit or Loss	**10,72,388**

Working Notes

Loan Amortization Schedule (At Market Rate 12%)

Year	Opening Loan Balance (₹)	Interest @ 12% (₹)	Closing Balance (₹)
31-Mar-20X2	14,17,500	1,70,100	15,87,600
31-Mar-20X3	15,87,600	1,90,512	17,78,112

Deferred Grant Income Schedule

Year	Opening Balance (₹)	Adjustment (₹)	Closing Balance (₹)
31-Mar-20X2	10,82,500	(2,16,500)	8,66,000
31-Mar-20X3	8,66,000	(2,16,500)	6,49,500

If Grant is reduced from Cost of Asset

Cost of Plant	50,00,000
Less: Government Grant	10,82,500
Net Amount of PPE	39,17,500
Depreciation for 2 years (Useful life 5 years)	39,17,500x 2/5 =15,67,000
Carrying amount on date of repayment of grant	23,50,500
(+) Refund of Grant	10,82,500
Revised Carrying Amount	34,33,000
Shortfall in depreciation for 2 years	20,00,000 – 15,67,000 = 4,33,000
Carrying Amount after Refund	30,00,000

Loan A/c Dr.	17,78,112	
Plant A/c Dr.	10,82,500	
P&L A/c Dr.	72,388	
To Bank		25,00,000
To Acc. Depreciation		4,33,000

15. Illustration

A Ltd. has acquired equipment for Rs. 100 lakhs. The estimated useful life of the equipment is 10 years. Residual value at the end of useful life is Nil. Depreciation is recognised on a straight-line basis.

To encourage the acquisition of the assets, the Government will give a grant to A Ltd. towards the purchase of the equipment as follow:

- **If specified employment targets are achieved by the end of the 3rd year, A Ltd. will receive a grant of Rs. 10 lakhs.**
- **In all other cases, A Ltd. will receive a grant of Rs. 5 lakhs.**

On the date of acquisition as well as at the end of year 1, A Ltd. expects to receive a grant of Rs. 10 lakhs.



At the beginning of year 2, A Ltd. has revised the assessment in light of development and now expects that it will only receive a grant of
Rs. 5 lakhs.
There were no errors in the estimation of grants in the prior period.
A Ltd. has assessed and concluded that the grant is in nature of grants related to assets.
A Ltd. presents government grants related to assets in the balance sheet by deducting the grant in calculating the carrying amount of the asset.
Required
How is the change in the amount of grant-related assets is accounted for in the books of A Ltd.?

Solution:

Para 32 of Ind AS 20 under the heading "Repayment of Government Grants" inter alia states that a Government grant that becomes repayable shall be accounted for as a change in accounting estimate as per Ind AS 8. Repayment of a grant related to an asset shall be recognised by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognised in profit or loss to date in the absence of the grant shall be recognised immediately in profit or loss.

Further para 33 of the standard states that the circumstances giving rise to repayment of a grant related to an asset may require consideration to be given to the possible impairment of the new carrying amount of the asset.

Following the above guidance, below is depreciation computation for the first 2 years where the grant is deducted from the carrying amount of the assets:

Particulars	**Government grant received /receivable in case of**	
	₹10 lakhs	**₹5 lakhs**
Cost of Equipment	100.00	100.00
Less: Government Grant received	(10.00)	(5.00)
Cost of Equipment (Net of Grant)	**90.00**	**95.00**
Useful Life (years)	10	10
Depreciation (Year 1)	9.00	9.50
WDV of the equipment at the end of year 1	81.00	85.50
Depreciation (Year 2)	9.00	9.50
WDV at end of Year 2	72.00	76.00
Total Cumulative Depreciation (Years 1 & 2)	**18.00**	**19.00**

Drawing an analogy from the accounting of the repayment of government grants, similar accounting may be applied for a change in the amount of government grant receivable. The cumulative additional depreciation of Rs. 1 lakhs [i.e., Rs. 19 lakhs minus Rs. 18 lakhs], would have been recognized to date as an expense, had government grant receivable by entity from inception was INR 5.

Therefore, A Ltd. may pass the following journal entry to recognise change in the amount of grant received/receivable:

Particulars	**Dr. (₹ lakhs)**	**Cr. (₹ lakhs)**	**Remark**
Equipment A/c Dr.	4		76 lakhs– 72 lakhss
Depreciation A/c Dr.	1		Additional depreciation recognised in Profit & Loss A/c



To Bank / Grant Receivable A/c		5	Payment of grant / adjustment to grant receivable

A Ltd. to carry out impairment assessment of assets, as per Ind AS requirement, which may trigger in view of an increase in carrying amount of the assets due to repayment of government grant received/ receivable.



IND AS 36
Impairment of Assets
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.

Solution:

Cash-generating unit:

- It is a smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
- CGU of the building is Apex Ltd. as a whole as the primary purpose of the building is to serve as a corporate asset.

2. 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
Residual Value at 31st March, 20X9	500

- **Property, plant & equipment was purchased on 1st April, 20X1 for ₹ 20,000 lakh**
- **Useful Life was 8 Years**
- **Residual Value estimated at the end of 8 years – ₹ 500 lakh**
- **Fair value less cost to disposal – ₹ 10,000 lakh**

Calculate impairment loss, if any on the property, plant and equipment. Also calculate the revised carrying amount and revised depreciation of property, plant and equipment

Solution:

(a) Calculation of carrying amount as on 31.03.20x4:

	₹
Original cost on 1st April X1	20,000
Less: Residual value	500
Depreciation amount	19,500
Depreciation per year ($\frac{₹.19500}{8\ years}$)	2437.5
Depreciation for three years (₹. 2437.5* 3 years)	7312.5
Carrying amount as on 31 March 20x4 (₹.20,000-₹.7312.5)	12687.5

(b) Calculation of value in use:

Year	Cash Flow (₹ in lakh)	P.V.	Amount (₹)
20X4-20X5	2,000	0.869	1,738
20X5-20X6	3,000	0.756	2,268
20X6-20X7	3,000	0.658	1,974
20X7-20X8	4,000	0.572	2,288
20X8-20X9	2,000	0.497	994
Residual Value at 31st March, 20X9	500	0.497	1,242
Total			9,510



(c) Calculation of Recoverable amount:

Recoverable amount= "Value in use" or "fair value less cost of disposal" whichever is higher

Value in use = ₹. 9,510

Fair value less cost of disposal = ₹. 10,000

Recoverable amount = ₹. 10,000

(d) Calculation of Impairment Loss

= Carrying Amount – Recoverable Amount

= 12,687.5 – 10,000 = 2,687.5

(e) Calculation of Revised Carrying Amount:

Particulars	₹
Carrying amount	12,687
Less: Impairment Loss	(2,687)
Revised carrying amount	10,000

(f) Calculation of Revised Depreciation:

$$= \frac{\textit{Revised carrying amount} - \textit{Residual value}}{\text{Remaining life}}$$

$$= \frac{10{,}000 - 500}{5} = 1{,}900$$

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?

Solution:

Particulars	₹ in millions
Value in use excluding future recognition	36
Carrying value	40
Impairment loss	4

Note:

Ind AS 36 states that Value-in-Use should exclude future restructuring or reorganization benefits unless the reorganization is already committed as per Ind AS 37.

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 $



31st March, 20X2	₹ 48/US $
31st March, 20X3	₹ 51/US $
31st March, 20X4	₹ 55/US $

Calculate value in use as on 31st March, 20X1.

Solution:

First compute PV of USD Cashflows and then convert to INR

Year	Cash Flow ($)	PVF @ 10%	PV
20X1-X2	80	0.9091	72.73
20X2-X3	100	0.8264	82.64
20X3-X4	20	0.7513	15.03
TOTAL			170.40

Value in use ($) = $ 170.40
Exchange rate as on 31st March 20x1 = ₹ 45/US $
Value in use (₹) = $ 170.4 x ₹ 45/US $ = ₹ 7667.92

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.

Solution:

Years	Cash Flow	Present value factor	Present Value	Probability	Expected CF
1	1,000	0.9524	952.38	0.10	95.24
2	1,000	0.9027	902.73	0.60	541.64
3	1,000	0.8516	851.61	0.30	255.48
Expected value in use					892.36

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**

Solution:

a. **Impairment loss**
Impairment loss = Carrying amount of the asset – Recoverable amount
= ₹. 27.30 lakh – ₹.12 lakh
= ₹. 15.30 lakh

b. Treatment of impairment loss:
As per Ind AS 36, impairment loss (whether of an individual asset of a CGU) is recognised in the following manner:



- **Impairment loss of a revalued asset**: It is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. The balance, if any, is recognised as an expense in the statement of profit and loss.
- **Impairment loss of other assets**: Impairment loss of any other asset should be recognised as an expense in the statement of profit and loss.

Since, the asset in question has been revalued upwards, the impairment loss will be adjusted first against the revaluation surplus of ₹. 14 lakh. The balance amount of Rs. 1.30 lakh will be recognised as an expense in the profit and loss account.

c. Current year depreciation

Revised carrying amount (after impairment loss)	₹. 12,00,000
Remaining useful life	3 Years
Depreciation per year	₹. 4,00,000

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.

Solution:

a. Calculation of depreciation per year:

$$=\frac{\text{Original cost}-\text{Residual Value}}{\text{No. of years}}=\frac{2,40,000-0}{20\ years}=12,000$$

b. Calculation of carrying amount as on 31st December Year 2:

Particulars	₹
Original cost	2,40,000
Less: Depreciation for Year 1 & Year 2	24,000
carrying amount as on 31st December Year 2	2,16,000

c. Computation of Revaluation Surplus:
= Revalued amount as on 1st Jan Year 3 (-) Carrying amount as on 31st Dec Year 2
=₹. 2,50,000 (-) ₹. 2,16,000
=₹. 34,000

d. Computation of carrying amount as on 31st Dec Year 3

(i)	Revalued amount	₹. 2,50,000
(ii)	Remaining useful life	18 years
(iii)	Depreciation per year $(\frac{(i)}{(ii)})$	₹. 13,888.89
(iv)	Carrying amount as on 31st Dec Year 3 [(i)- (iii)]	₹. 2,36,111.11

e. Calculation of impairment loss for 31st December Year 4:



= Carrying amount as on 1st Jan Year 4– Recoverable amount as on 1st Jan Year 4
=₹. 2,36,111.11 – ₹. 1,00,000
=₹. 1,36,111.11
Note: Since impairment review had been done on 1st Jan Year 4, impairment loss had been computed on 1st Jan Year 4.

f. Treatment of revaluation surplus for year ended 31st December Year 4:
As per Ind AS 36, impairment loss (whether of an individual asset of a CGU) is recognised in the following manner:

- **Impairment loss of a revalued asset**: It is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

  The balance, if any, is recognised as an expense in the statement of profit and loss.
- **Impairment loss of other assets**: Impairment loss of any other asset should be recognised as an expense in the statement of profit and loss.

Since, the asset in question has been revalued upwards, the impairment loss will be adjusted first against the revaluation surplus of ₹. 34,000. The balance amount of ₹. 1,02,111.11 (1,02,111.11-34,000) will be recognised as an expense in the profit and loss account.
Assumption: The company didn't opt to transfer part of the revaluation surplus to retained earnings.

g. Computation of depreciation for the year ended 31st Dec Year 4:

(i)	Revised carrying amount	₹. 1,00,000
(ii)	Remaining useful life	10 years
(iii)	Depreciation($\frac{(i)}{(ii)}$)	₹. 10,000

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 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?
Solution:

a. Calculation of value in use:

Year	Cash Flow	PVF (@9%)	PV of CF
31st March X7	2,76,000.00	0.9174	2,53,202.40
31st March X8	1,92,000.00	0.8417	1,61,606.40



31st March X9	1,20,000.00	0.7722	92,664.00
31st March Y0	1,14,000.00	0.7084	80,757.60
Value in Use			5,88,230.40

b. Calculation of Recoverable amount as on 31st March 20x6

Recoverable amount= "Value in use" or "fair value less cost of disposal" whichever is higher

Value in use = ₹. 5,88,230.4

Fair value less cost of disposal = ₹. 6,00,000 - ₹. 5,04,000= ₹. 96,000

Recoverable amount = ₹. 5,88,230.4

c. Computation of Impairment loss:

	Particulars	₹
(i)	**Recoverable amount**	5,88,230.40
(ii)	**Carrying amount**	6,60,000
(iii)	**Impairment loss [(i) – (ii)]**	71,769.60

d. Treatment of revaluation surplus:

As per Ind AS 36, impairment loss (whether of an individual asset of a CGU) is recognised in the following manner:

- **Impairment loss of a revalued asset**: It is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. The balance, if any, is recognised as an expense in the statement of profit and loss.
- **Impairment loss of other assets**: Impairment loss of any other asset should be recognised as an expense in the statement of profit and loss.

Since, the asset in question has been revalued upwards, the impairment loss will be adjusted first against the revaluation surplus of ₹.36,000 . The balance amount of ₹. 35,769 (71,769-36,000) will be recognised as an expense in the profit and loss account.

e. Calculation revised depreciation of assets:

(i)	Revised carrying amount	₹. 5,88,230.40
(ii)	Remaining useful life	4 years
(iii)	Depreciation$(\frac{(i)}{(ii)})$	₹. 1,47,057.60

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?

Solution:

- The cash-generating unit's fair value less costs of disposal is ₹ 800.
- This amount considers restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be ₹. 700 (₹. 1,200 - ₹. 500).
- The carrying amount of the cash-generating unit is ₹. 500, which is the carrying amount of the mine (₹ 1,000) less the carrying amount of the provision for restoration costs (₹. 500).
- Therefore, the recoverable amount of the cash generating unit exceeds its carrying amount. Hence there is no impairment loss



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?

Solution:

	CGU 1	CGU 2	Total
Allocation of purchase consideration	33	17	50
Less: Acquired identifiable assets	(25)	(10)	(35)
Allocation of goodwill	8	7	15

11. Illustration

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.

Solution:
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.

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. Illustrartion

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.

Solution:
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. Illustration



Earth Infra Ltd has two cash-generating units, A and B. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for ₹ 20 million and CGU B for ₹ 30 million. The company has an office building which it is using as an office headquarter and has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of ₹ 10 million. The recoverable amounts are based on value-in-use of ₹ 18 million for CGU A and ₹ 38 million for CGU B. Determine whether the carrying values of CGU A and B are impaired.

Solution:

The office building is a corporate asset which needs to be allocated to CGU A and B on a reasonable and consistent basis:

	A	B	Total
Carrying value of CGUs	20	30	50
Allocation of office building (office building is allocated in the ratio of Carrying value of CGU's)	4	6	10
Carrying value of CGU's after allocation of corporate asset	24	36	60
Recoverable amount	18	38	56
Impairment loss	6	-	-

Impairment loss of ₹. 6 million to be allocated to CGU and building in the ratio of 20:4.

Building - ₹. 6 million * $\frac{4}{24}$= ₹. 1 million

CGU -₹. 6 million * $\frac{20}{24}$= ₹. 5 million

14. Illustration – Maximum amount of Impairment loss for individual asset

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			

Solution:

Calculation of impairment loss:

Total assets	3,50,000
Less: Recoverable amount	2,00,000
Impairment loss	1,50,000
Less: Goodwill impaired	50,000
Balance impairment loss	1,00,000
Less: impairment loss allocated to plant and machinery (Note 1)	50,000
Balance impairment loss	50,000

Allocation of impairment loss to Electric equipment and patents:

- Electric equipment = ₹. 50,000 * $\frac{40,000}{60,000}$= ₹. 33,333.33
- Patents= ₹. 50,000 * $\frac{20,000}{60,000}$= ₹. 16,666.67.

Computation of Revised carrying amount:

Assets	Carrying Amount	Fair Value less cost of disposal	Impairment	Revised carrying amount
Plant & Machinery	1,00,000	50,000	50,000	**50,000**
Building	80,000	85,000	-	**80,000**



Electric Equipment	40,000	-	33,333.33	**6,666.67**
Goodwill	50,000	NA	50,000	**0**
Patents	20,000	NA	16,666.67	**3,333.33**
Other Monetary assets	60,000	60,000	-	**60,000**

Note 1

Allocation of impairment loss to plant and machinery:

- Plant and machinery= ₹. 1,00,000 * $\frac{1,00,000}{1,00,000+40,000+20,000}$= ₹. 62,500.

  Since the Fair value less cost of disposal is ₹. 50,000, the carrying amount after impairment cannot be less than ₹. 50,000. Hence the maximum impairment loss allocated to Plant and machinery is ₹. 50,000.

15. Illustration – Corporate Asset

ABC Ltd. has three cash-generating units: A, B and C, the carrying amounts of which as on 31st March, 20X1 are as follows:

Cash-generating units	Carrying amount (₹ in crore) Remaining useful life
A	500 10
B	750 20
C	1,100 20

ABC Ltd. also has two corporate assets having a remaining useful life of 20 years

		(₹ in crore)
Corporate asset	Carrying amount	Remarks
X	600	The carrying amount of X can be allocated on a reasonable basis (i.e., pro rata basis) to the individual cash-generating units.
Y	200	The carrying amount of Y cannot be allocated on a reasonable basis to the individual cash- generating units.

Recoverable amount as on 31st March, 20X1 is as follows:

Cash-generating units	Recoverable amount (₹ in crore)
A	600
B	900
C	1,400
ABC Ltd.	3,200

Calculate the impairment loss, if any. Ignore decimals.

Solution:

Allocation of corporate assets

The carrying amount of X is allocated to the carrying amount of each individual cash-generating unit. A weighted allocation basis is used because the estimated remaining useful life of A's cash-generating unit is 10 years, whereas the estimated remaining useful lives of B and C's cash-generating units are 20 years.

	(₹ In crore)		
Particulars	A	B	C
Carrying Amount of CGU Assets	500	750	1,100
Remaining useful life	10	20	20
Weight based on useful life	1	2	2
Carrying amount (After assigning weight)	500	1,500	2,200



Pro-rata allocation of X	0	0	1
	(500/4200)	(1500/4200)	(2200/4200)
Allocation of carrying amount of X	72	216	312
Carrying amount (after allocation of X)	572	966	1,412

Calculation of impairment loss:

Step I: Impairment losses for individual cash-generating units and its allocation

(a) Impairment loss of each cash-generating units:

	(₹ In crore)		
Particulars	A	B	C
Carrying amount after allocation of X	572	966	1,412
Recoverable amount	600	900	1,400
impairment loss	-	66	12

(b) Allocation of the impairment loss

				(Rs. In crore)
Allocation to	B		C	
X	15	$66 * \frac{216}{966}$	3	$12 * \frac{312}{1412}$
Other assets in cash-generating units	51	$66 * \frac{750}{966}$	9	$66 * \frac{1100}{1412}$
Impairment loss	66		12	

Step II: Impairment losses for the larger cash-generating unit, i.e., ABC Ltd. as a whole

	(₹ In crore)					
Particulars	A	B	C	X	Y	ABC Ltd
Carrying amount	500	750	1,100	600	200	3,150
impairment loss (step 1)	-	(51)	(9)	(18)	-	(78)
Carrying amount	500	699	1,091	582	200	3,072
Recoverable amount						3,200
Impairment loss for the larger CGU						Nil

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.

Solution:

		(₹ In crore)	
Particulars	Goodwill	Plant A	Total
Historical cost	200	1,000	1200
Depreciation (20x1- 20x2)	-	(100)	



			(100)
Carrying amount	200	900	1,100

Since, the recoverable amount is ₹ 600 crore, there is an impairment loss of ₹ 500 crore. The impairment loss of ₹ 500 crore should be allocated to goodwill first, and then to the other identifiable assets, i.e., ₹ 200 crore to goodwill and ₹ 300 crore to identifiable assets of Plant A.

			(₹ In crore)
Particulars	Goodwill	Plant A	Total
Impairment loss	(200)	(300)	(500)
Carrying amount after impairment loss	-	600	600

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?
Solution:

Scenario 1

- Since the **machine does not generate independent cash inflows**, its **recoverable amount cannot be estimated separately**.
- The **recoverable amount of the production line (CGU) is greater than its carrying amount**, meaning **no impairment loss is recognized** for the machine.
- However, the **useful life or depreciation method** of the machine **should be reassessed** to reflect the new condition of the machine (e.g., a shorter useful life or an accelerated depreciation method).

Action: No impairment loss, but depreciation method/period may need revision.

Scenario 2

- Since management has decided to **replace the machine and sell it**, its **recoverable amount (fair value less costs of disposal) can now be estimated separately**.
- The **cash inflows from continuing use are negligible**, so the recoverable amount of the machine is its **fair value less costs of disposal**.
- If **fair value less costs of disposal < carrying amount**, then an **impairment loss should be recognized** for the machine.
- **No impact on the CGU (Production Line) as a whole**.

Action: Recognize impairment loss for the machine.

18. Illustration – Forecasting of cashflows

E Ltd. owns a machine used in the manufacture of steering wheels, which are sold directly to major car manufacturers.



- **The machine was purchased on 1st April, 20X1 at a cost of ₹ 5,00,000 through a vendor financing arrangement on which interest is being charged at the rate of 10% per annum.**
- **During the year ended 31st March, 20X3, E Ltd. sold 10,000 steering wheels at a selling price of ₹ 190 per wheel.**
- **The most recent financial budget approved by E Ltd.'s management, covering the period 1st April, 20X3 – 31st March, 20X8, including that the company expects to sell each steering wheel for ₹ 200 during 20X3-20X4, the price rising in later years in line with a forecast inflation of 3% per annum.**
- **During the year ended 31st March, 20X4, E Ltd. expects to sell 10,000 steering wheels. The number is forecast to increase by 5% each year until 31st March, 20X8.**
- **E Ltd. estimates that each steering wheel costs ₹ 160 to manufacture, which includes ₹ 110 variable costs, ₹ 30 share of fixed overheads and ₹ 20 transport costs.**
- **Costs are expected to rise by 1% during 20X4-20X5, and then by 2% per annum until 31st March, 20X8.**
- **During 20X5-20X6, the machine will be subject to regular maintenance costing ₹ 50,000.**
- **In 20X3-20X4, E Ltd. expects to invest in new technology costing ₹ 1,00,000. This technology will reduce the variable costs of manufacturing each steering wheel from ₹ 110 to ₹ 100 and the share of fixed overheads from ₹ 30 to ₹ 15 (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?

Solution:

Computation of cash inflows:

Particulars	X3-X4	X4-X5	X5-X6	X6-X7	X7-X8
Units sold [A]	10,000	10,500	11,025	11,576	12,155
Growth rate		5%	5%	5%	5%
Selling Price per unit [B]	200	206	212	219	225
Inflation		3%	3%	3%	3%
Cash inflow from sales [A*B]	20,00,000	21,63,000	23,39,285	25,29,882	27,36,112
Net disposal proceeds					80,000
Total cash inflow	20,00,000	21,63,000	23,39,285	25,29,882	28,16,112

Computation of cash outflows:

Particulars	X3-X4	X4-X5	X5-X6	X6-X7	X7-X8
Manufacturing cost [C]	160	162	165	168	171
Growth in cost		1%	2%	2%	2%
Total Cost [A x C]	16,00,000	16,96,800	18,17,273	19,46,257	20,84,476
Add: Maintenance			50,000		
Total Cash Outflows	16,00,000	16,96,800	18,67,273	19,46,257	20,84,476

Computation of value in use:



Particulars	X3-X4	X4-X5	X5-X6	X6-X7	X7-X8
Net Cash inflow [total cash inflow – total cash outflow]	4,00,000	4,66,200	4,72,012	5,83,624	7,31,636
PVF 8%	0.926	0.857	0.794	0.735	0.681
PV of Cashflows	3,70,360	3,99,673	3,74,683	4,28,964	4,97,952
Value in use	20,71,632				

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.

Solution:

Value in use of the machinery as on 31st March, 20X2 can be calculated as follows:

Financial year	Estimated cash flows (₹ In crore)	PVF @10%	Present value
20x2-x3	15	0.9091	13.63
20x3-x4	30	0.8264	24.79
20x4-x5	40	0.7513	30.05
20x5-x6	10	0.683	6.83
			75.31

The recoverable amount of the machinery is ₹ 75.31 crore (higher of value in use of ₹ 75.31 crore and fair value less costs to sell of ₹ 70 crore). Carrying amount of the machinery is ₹ 80 crore (after providing for one year depreciation @ ₹ 20 crore). Therefore, the impairment loss of ₹ 4.69 crore should be provided in the books.

20. Illustration – Impairment testing of Goodwill

On 1st April 20X1, Venus Ltd acquired 100% of Saturn Ltd for ₹ 4,00,000. The fair value of the net identifiable assets of Saturn Ltd was ₹ 3,20,000 and goodwill was ₹ 80,000. Saturn Ltd is in coal mining business. On 31st March, 20X3, the government has cancelled licenses given to it in few states.

As a result Saturn's Ltd revenue is estimated to get reduce by 30%. The adverse change in market place and regulatory conditions is an indicator of impairment. As a result, Venus Ltd has to estimate the recoverable amount of goodwill and net assets of Saturn Ltd on 31st March, 20X3.

Venus Ltd uses straight line depreciation. The useful life of Saturn's Ltd assets is estimated to be 20 years with no residual value. No independent cash inflows can be identified to any individual assets. So, the entire operation of Saturn Ltd is to be treated as a CGU. Due to the regulatory entangle it is not possible to determine the selling price of Saturn Ltd as a CGU. Its value in use is estimated by the management at ₹ 2,12,000.

Suppose by 31st March, 20X5 the government reinstates the licenses of Saturn Ltd. The management expects a favourable change in net cash flows. This is an indicator that an impairment loss may have reversed. The recoverable amount of Saturn's Ltd net asset is re-estimated. The value in use is expected to be ₹ 3,04,000 and fair value less cost to disposal is expected to be ₹ 2,90,000.

Calculate the impairment loss, if any. Also show the accounting treatment for reversal of impairment loss and the subsequent depreciation thereon.

Solution:



Calculation of Impairment loss:

	Goodwill	Other assets	Total
Historical Cost	80,000	3,20,000	4,00,000
Less: Accumulated Depreciation (3,20,000/20) x 2	-	32,000	32,000
Carrying amount	80,000	2,88,000	3,68,000
Impairment loss	(80,000)	(76,000)	(1,56,000)

Revised Carrying Amount

- Impairment Loss = Carrying Amount – Recoverable Amount (₹ 3,68,000 - ₹ 2,12,000) = ₹ 1,56,000 is charged in statement of profit and loss for the period ending 31st March, 20X3 as impairment loss.
- Impairment loss is allocated first to goodwill ₹ 80,000 and remaining loss of ₹76,000 (₹.1,56,000 – ₹80,000) is allocated to the other assets.

Reversal of Impairment loss

Reversal of impairment loss is recognised subject to:-

- The impairment loss on goodwill cannot be reversed.
- The increased carrying amount of an asset after reversal of an impairment loss not to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

Calculation of carrying amount of identifiable assets had no impairment loss is recognised:

	₹
Historical Cost	3,20,000
Accumulated Depreciation for 4 years (3,20,000/20) x 4	(64,000)
Carrying amount had no impairment loss is recognised on 31st March, 20X5	2,56,000

Carrying amount of other assets after recognition of impairment loss:

	₹
Carrying amount on 31st March, 20X3	2,12,000
Accumulated Depreciation for 2 years (2,12,000/18)*2	(23,556)
Carrying amount on 31st March, 20X5	1,88,444

- The impairment loss recognised previously can be reversed only to the extent of lower of re-estimated recoverable amount is ₹. 2,56,000 (higher of fair value less costs of disposal ₹.2,90,000 and value in use ₹.3,04,000)
- Impairment loss reversal will be ₹.67,556 i.e. (₹.2,56,000 – ₹.1,88,444). This amount is recognised as income in the statement of profit and loss for the year ended 31st March, 20X5.
- The carrying amount of other assets at 31st March, 20X5 after reversal of impairment loss will be ₹.2,56,000.
- From 1st April, 20X5 the depreciation charge will be ₹.16,000 i.e. (₹.2,56,000/16 years).

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.**

Solution:

I. Computation of carrying amount as on 31.03.2018

Particulars	Machine A (2013)	Machine B (2015)
Cost	10,00,000	5,00,000
Residual value	50,000	-
Depreciable amount	9,50,000	5,00,000
Useful life (years)	10	10
Depreciation per year	95,000	50,000
No of years elapsed	5	3
Accumulated depreciation	4,75,000	1,50,000
Carrying Amount (31.03.18)	5,25,000	3,50,000

II. Computation of Recoverable Amount for Machine A

A. Computation of value in use

Years	Cashflow	PVF (10%)	PV of Cashflows
1	1,50,000	0.909	1,36,365
2	1,00,000	0.827	82,650
3	1,00,000	0.751	75,140
4	1,50,000	0.683	1,02,465
5	1,00,000	0.621	62,100
5(Residual	50,000	0.621	31,050



value)			
	Value in use for Machine A		4,89,770

B. Computation of Fair value less cost of disposal:

Estimated Fair value	7,00,000
Less: Cost of disposal	
1. Dismantling Costs	1,50,000
2. Packaging	25,000
3. Legal fees	75,000
Total cost of disposal	2,50,000
FV less Cost of disposal	4,50,000

C. Computation of Recoverable amount:
Recoverable amount is higher of Fair value less cost of disposal and value in use. Hence, the recoverable amount is ₹. 4,89,770.

III. Computation of carrying amount of Machine A after impairment loss:

Particulars	₹
Recoverable amount	4,89,770
Less: Carrying Amount of Machine A as on 31st March 2018 (Note 1)	5,25,000
Impairment loss	35230
Carrying amount of Machine A (Note I)	5,25,000
Less: Impairment loss	35,230
carrying amount of Machine A after impairment loss	4,89,770

IV. Computation of revised carrying amount:

	Carrying Amount	Impairment loss	Revised Carrying Amount
Machine - A	489770	0	489770
Machine - B	350000	39770	310230
Inventory	200000	0	200000
Goodwill	150000	150000	0
Carrying Amount of CGU	1189770	189770	1000000
Recoverable Amount of CGU	1000000		
Impairment loss	189770		
Less: Goodwill	150000		
Balance	39770		

V. Computation of carrying amount as on 31.03.2019

	Machine A	Machine B
Carrying Amount (31.03.18)	4,89,770	3,10,230
Residual value	50,000	-
Depreciable Amount	4,39,770	3,10,230
Remaining life	5	7
Depreciation	87,954	44,319.47



Carrying Amount (31.03.19)	4,01,816	2,65,911.53

VI. Computation of impairment loss/excess:

Particulars	₹
Machine A	4,01,816.00
Machine B	2,65,911.43
Inventory	2,00,000.00
Goodwill	-
Total Carrying Amount of CGU	8,67,727.43
Recoverable amount	11,00,000.00
Excess	2,32,272.57

VII. Reversal of impairment loss:

Particulars	Machine A	Machine B	Inventory
Carrying amount before Impairment loss (31.03.18)	5,25,000.00	3,50,000.00	
Less: Depreciation on original cost basis	95,000.00	50,000.00	
Carrying Amount without impairment	4,30,000.00	3,00,000.00	2,00,000.00
Carrying Amount after impairment (Note V)	4,01,816.00	2,65,911.43	2,00,000.00
Reversal of impairment loss	28,184.00	34,088.57	-

22. Illustration (Students are advised to revisit this question after completing Ind AS 103)

A Ltd acquires 80% shares of a subsidiary B Ltd. for ₹ 3,200 thousand. At the date of acquisition, B Ltd.'s identifiable net assets is ₹ 3,000 thousand. A elects to measure NCI at proportionate share of net identifiable assets. It recognizes

	₹ in '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
Case (ii) ₹ 2,800
Calculate impairment loss allocable to Parent and NCI in both the cases.

Solution:
Note 1: Calculation of Goodwill

Particulars	Amount
Purchase Consideration	3,200
Add: NCI Share in net assets (20% of 3,000)	600
	3,800
Less: Net Assets	3,000
Goodwill (80%)	



	800
Notional Goodwill (20%)	200

Case (i)→Recoverable amount is ₹ 2,000

Carrying amount of goodwill as at the end of financial year:

	Other Assets	Goodwill	Total
Carrying Amount	2,700	800	3,500
Add: Notional Goodwill for NCI	0	200	200
Total Carrying Amount	2,700	1,000	3,700

Calculation of impairment loss:

	Other Assets	Goodwill	Total
Carrying Amount	2,700	1,000	3,700
Recoverable amount			2,000
Impairment loss		-	1,700

Allocation:

	Parent [80%]	NCI [20%]	Total
Goodwill	800	200	1,000
Other Net Assets	560	140	700
Total	1,360	340	1,700

Case (ii)→ Recoverable amount is ₹ 2,800

Carrying amount of goodwill as at the end of financial year:

	Other Assets	Goodwill	Total
Carrying Amount	2,700	800	3,500
Add: Notional Goodwill for NCI	0	200	200
Total Carrying Amount	2,700	1,000	3,700

Calculation of impairment loss:

	Other Assets	Goodwill	Total
Carrying Amount	2,700	1,000	3,700
Recoverable amount			2,800
Impairment loss		-	900

Allocation:

	Parent [80%]	NCI [20%]	Total
Goodwill	720	180	900
Total	720	180	900



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.

Solution:

Note 1: Computation of goodwill on acquisition

Particulars	Amount (Rs. In 000)
Cost of investment (8,00,000 x 2/5 x Rs. 4)	1,480
Fair value of non-controlling interest (2,00,000 x Rs. 1·4)	280
Fair value of identifiable net assets at date of acquisition	(1,300)
Goodwill	260

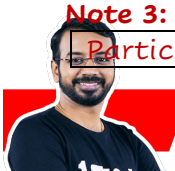
Acquisition costs are not included as part of the fair value of the consideration given under
Ind AS 103, Business Combination.

Note 2:

Unit	Carrying value			Recoverable amount	Impairment loss
	Before allocation	Allocation of goodwill (2:2:1)	After allocation		
A	600	104	704	740	-
B	550	104	654	650	4
C	400	52	452	400	52

Note 3: Calculation of closing goodwill

Particulars	₹



Goodwill arising on acquisition	260
(Note 1)	(56)
Impairment loss (Note 2)	204
Closing goodwill	

Note 4: Calculation of overall impairment:

Particulars	₹
Goodwill (Note 3)	56
Assets in unit C (450-400)	50
Total loss	106

₹. 21.2 (20%) of the above is allocated to the NCI with the balance allocated to the shareholders
of Sun 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 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.

Solutions:

Note 1: Computation of goodwill:

Particulars	Amount
Purchase Consideration	2,100
Add: NCI Share in net assets [20% of 1,500]	300
Total (a)	2,400
Identifiable net assets (b)	1,500
Goodwill (a-b)	900

Note 2: Computation of total goodwill for testing

Particulars	Amount
Partial goodwill	900
Less: Allocation to parent's CGU for impairment	500
Balance goodwill (80% of interest)	400
Notional goodwill (20% of interest)	100
Total goodwill for testing	500

Note 3: Computation of impairment loss:

	Goodwill	Other Assets	Total
Carrying Amount	400	1350	1750



Add: Notional Goodwill	100	0	100
Total	500	1350	1850
Recoverable Amount			1000
Impairment Loss	500	350	850

Note 4: Allocation of impairment loss:

The impairment loss of ₹ 850 should be allocated to the assets in the unit by first reducing the carrying amount of goodwill.

Therefore, ₹ 500 of the ₹ 850 impairment loss for the unit is allocated to the goodwill. If the partially-owned subsidiary is itself a cash-generating unit, the goodwill impairment loss should be allocated to the controlling and non-controlling interests on the same basis as that on which profit or loss is allocated. In this case, profit or loss is allocated on the basis of relative ownership interests. Because the goodwill is recognised only to the extent of Parent's 80% ownership interest in Subsidiary, Parent recognises only 80% of that goodwill impairment loss (i.e., ₹ 400).

The remaining impairment loss of ₹ 350 is recognised by reducing the carrying amounts of Subsidiary's identifiable assets.

Note 5: Allocation of the impairment loss for Subsidiary on 31st March, 20X2

	Goodwill of subsidiary(₹)	Net identifiable assets (₹)	Total (₹)
Carrying amount	400	1350	1750
Impairment loss	(400)	(350)	(750)
Carrying amount after impairment loss	-	1000	1000

25. Illustration (RTP May 21)

On 31 March 20X1, Vision Ltd acquired 80% of the equity shares of Mission Ltd for Rs. 190 million. The fair values of the net assets of Mission Ltd that were included in the consolidated statement of financial position of Vision Ltd at 31 March 20X1 were Rs. 200 million. It is the Group's policy to value the non- controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

On 31 March 20X4, Vision Ltd carried out its annual review of the goodwill on consolidation of Mission Ltd and found evidence of impairment. No impairment had been evident when the reviews were carried out at 31 March 20X2 and 31 March 20X3. The review involved allocating the assets of Mission Ltd into 3 cash- generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A Rs. in million	Unit B Rs. in million	Unit C Rs. in million
Intangible assets	30	10	-
Property, Plant and Equipment	80	50	60
Current Assets	60	30	40
Total	170	90	100
Value in use of unit	180	66	104

It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Mission Ltd are allocated in the table shown above.

The intangible assets of Mission Ltd have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Mission Ltd as a single cash- generating unit on 31 March 20X4 is Rs. 350 million.

Discuss and compute the accounting treatment of impairment of goodwill as per Ind AS 36?



Solution :

Computation of Goodwill

Particulars	Amount (₹ million)
Purchase Consideration (Paid for 80%)	190.00
Add: Non-Controlling Interest (20% of Net Assets)	40.00
Less: Fair Value of Net Assets Acquired	(200.00)
Goodwill on Consolidation	**30.00**

Identifying Impairment in Cash-Generating Units (CGUs) (31 March 20X4)

- **Unit A & Unit C:** No impairment as their **value in use > carrying amount**.
- **Unit B: Value in use (₹ 66 million) < Carrying Amount (₹ 90 million) → Impairment of ₹ 24 million**.
- **Goodwill is not allocated to CGUs**, so impairment must be tested at the overall **Mission Ltd. level**.

Allocation of Impairment Loss to Unit B Assets

Asset	Carrying Amount (₹ million)	Impairment (₹ million)	Revised Amount (₹ million)
Intangible Assets	10	(4)	6
Property, Plant & Equipment	50	(20)	30
Current Assets	30	Nil	30
Total	**90**	**(24)**	**66**

Note: *Current assets are not impaired as they are expected to be realized at carrying value. The impairment loss of Rs. 24 million is allocated in the ratio of carrying amount of other assets.*

Testing Mission Ltd. as a Single CGU (Including Goodwill)

Particulars	Carrying Amount Before Impairment (₹ million)
Goodwill (to be grossed up for 100%)	37.50 (30 × 100/80)
Unit A	170.00
Unit B (Revised)	66.00
Unit C	100.00
Total Carrying Amount	**373.50**
Recoverable Amount (Value in Use of Entire Business)	**350.00**
Total Impairment	**(23.50)**

The **₹ 23.50 million impairment** is **fully allocated to goodwill**.

Adjusting Consolidated Goodwill in Vision Ltd.

Particulars	Amount (₹ million)
Grossed-up Goodwill (100%)	37.50
Less: Impairment	(23.50)
Revised Goodwill (100%)	**14.00**
Revised Goodwill for 80% shareholding (14 × 80%)	**11.20**
Impairment Loss Recognized in Consolidated FS (23.50 × 80%)	**18.80**

Carrying amounts after impairment

Component	Pre-Impairment (₹ million)	Impairment (₹ million)	Post-Impairment (₹ million)
Goodwill (80%)	30.00	(18.80)	11.20
Unit A	170.00	Nil	170.00
Unit B (Revised)	66.00	Nil	66.00
Unit C	100.00	Nil	100.00
Total	**373.50**	**(23.50)**	**350.00**

26 **Illustration (RTP Nov 24)**

At 31st March, 20X1, the assets of a CGU are being reviewed for impairment. The



carrying value of the CGU's net assets is ₹65 lakhs (excluding any restructuring provision), and remaining useful economic life of recognised asset is eight years.

Management's approved budgets at 31st March, 20X1 include restructuring costs of ₹ 3,50,000 to be incurred in 20X2; the restructuring is expected to generate cost savings of ₹ 1,00,000 per annum from 20X3 onwards. Formal budgets have been prepared for the three years to 31st March, 20X4. A zero-growth rate is assumed, because market conditions are extremely competitive, and this is expected to continue for the foreseeable future. The future cash flow estimates are as follows:

Year	With restructuring consideration (Rs.)	Without restructuring consideration
20X1-20X2	5,20,000	8,70,000
20X2-20X3	10,00,000	9,00,000
20X3-20X4	10,50,000	9,50,000
20X4-20X5	10,50,000	9,50,000
20X5-20X6	10,50,000	9,50,000
20X6-20X7	10,50,000	9,50,000
20X7-20X8	10,50,000	9,50,000
20X8-20X9	10,50,000	9,50,000

In 20X2, the net cash flows without restructuring (₹ 8,70,000) exceed the net cash flows with restructuring (₹ 5,20,000) by the amount of the restructuring costs (₹ 3,50,000).

The future cash flows (which exclude inflation) have been discounted at a rate of 4%. For simplicity, it has been assumed that the cash flows arise at the end of each year.

Compute Impairment Loss at 31st March, 20X1 when-

(i) **Restructuring costs is recognised in the financial statements at 31st March, 20X1**

(ii) **Restructuring costs is not recognised in the financial statements at 31st March, 20X1**

Solution:

Computation of present value of cash flows under both the following conditions:

(Amount in ₹)

Year	Discount factor	With restructuring consideration		Without restructuring consideration	
		Future net cash flows	Present value	Future net cash flows	Present value
	(a)	(b)	(c)=(a)x(b)	(d)	(e)=(a)x(d)
20X1-20X2	0.962	5,20,000	5,00,000	8,70,000	8,36,000
20X2-20X3	0.925	10,00,000	9,25,000	9,00,000	8,32,000
20X3-20X4	0.889	10,50,000	9,33,000	9,50,000	8,45,000
20X4-20X5	0.855	10,50,000	8,98,000	9,50,000	8,12,000
20X5-20X6	0.822	10,50,000	8,63,000	9,50,000	7,81,000
20X6-20X7	0.790	10,50,000	8,30,000	9,50,000	7,51,000
20X7-20X8	0.760	10,50,000	7,98,000	9,50,000	7,22,000
20X8-20X9	0.730	10,50,000	7,67,000	9,50,000	6,94,000
Value in use			65,14,000		62,73,000

The impairment calculations at 31st March, 20X1 differ according to whether or not provision for the restructuring costs is recognised in the financial statements. This will depend on whether the requirements of Ind AS 37 have been met for recognition.

(i) **Provision for restructuring costs recognised at 31st March, 20X1**

If provision has been made for restructuring costs, the costs and benefits of the restructuring are taken into account in determining the CGU's value in use.

Here, the post – restructuring value in use (₹ 6,514,000) exceeds the CGU's carrying value (₹ 6,500,000 less restructuring provision of ₹ 350,000). Hence, there is no impairment of the CGU's assets.



In the year to 31st March, 20X1, the financial statements reflect the following charges.

Restructuring provision	₹ 350,000
Impairment loss	Nil

(ii) **No provision for restructuring costs recognised at 31st March, 20X1**

If no provision for restructuring costs is permitted by Ind AS 37, the costs and benefits of the restructuring have to be stripped out of the projections in determining the CGU's value in use.

Here, the CGU's carrying value (₹ 65,00,000) exceeds its pre- restructuring value in use (₹ 62,73,000). Therefore, there is an impairment loss of ₹ 2,27,000.

In the year to 31st March, 20X1, the financial statements reflect the following charges:

Restructuring provisions	Nil
Impairment loss	₹ 2,27,000



IND AS 105
NCA held for sale & Discontinued Operations
Illustrations

1. Illustration

Recognise the loss / gain on the recognised value of Disposal group held for sale from the following details:

Assets	Carrying amount at reporting date before classification	Carrying amount remeasured just before classification
Goodwill	1,500.00	1,500.00
PPE (Revaluation Model)	4,600.00	4,000.00
Building (at cost)	5,700.00	5,700.00
Inventory	2,400.00	2,200.00
Investments in Equity Sh.	1,800.00	1,500.00
Total Carrying amount	16,000.00	14,900.00

The entity has estimated that FV less costs to sell will be 13,000.00

Solution

As per Ind AS 105, When an entity classifies a disposal group as **held for sale**, it must measure the group at the **lower of its carrying amount and fair value less costs to sell**. In this case, before classification, the **total carrying amount was ₹16,000**, which was subsequently **remeasured to ₹14,900** in accordance with applicable standards. This reduction of **₹1,100 is not considered an impairment loss** but rather a normal accounting adjustment.

Upon classification as held for sale, the disposal group is measured at the **lower of ₹14,900 (remeasured carrying amount) and ₹13,000 (fair value less costs to sell)**. Since **₹13,000 is lower, an impairment loss of ₹1,900 is recognized**. The impairment loss is **first allocated to goodwill**, which is **completely written off**, and then distributed proportionately among other assets in ratio of their carrying amount. However, impairment loss is not allocated to **inventory and investments in equity instruments**, as they are measured separately under **Ind AS 2 and Ind AS 109**.

Allocation of Impairment Loss

Disposal Group	Carrying Amount before Classification (₹)	Remeasured Carrying Amount (₹)	Impairment Loss Allocated (₹)	Carrying Amount after Impairment (₹)
Goodwill	1,500	1,500	(1,500)	-
PPE (Revaluation Model)	4,600	4,000	(165) [400 x 4000/9700]	3,835
Building (at cost)	5,700	5,700	(235) [400 x 5700/9700]	5,465
Inventory	2,400	2,200	-	2,200
Investments in Equity Shares	1,800	1,500	-	1,500
Total	16,000	14,900	(1,900)	13,000



If, at the end of the reporting period, the **fair value less costs to sell increases to ₹15,500**, the **maximum reversal allowed is ₹1,900**, as this was the impairment loss recognized earlier. However, the **reversal cannot be applied to goodwill**, as **Ind AS 36 does not permit the reversal of goodwill impairment**. Instead, the reversal will be **distributed among the other impaired assets** in proportion to their original impairment allocation.

2. Illustrations

A freehold property was originally acquired for Rs.40,00,000. Some years later, after cumulative depreciation of Rs.11,00,000 has been recognised, an impairment loss of Rs.3,50,000 is recognised, taking the carrying amount to Rs.25,50,000, which represents the estimated value in use of the property. Shortly thereafter, as a consequence of a proposed move to new premises, the freehold property is classified as held for sale.
At the time of classification as held for sale:
• carrying amount is Rs.25,50,000; and
• fair value less costs to sell is assessed at Rs.25,00,000.

At the reporting date fair value less costs to sell is 26,50,000. After 6 months the fair value less cost to sell increases to 30,00,000.

Solution

Step 1: Initial Recognition & Impairment

Particulars	Amount (Rs.)
Original Cost	40,00,000
Less: Accumulated Depreciation	(11,00,000)
Carrying Amount Before Impairment	29,00,000
Less: Impairment Loss Recognised	(3,50,000)
Carrying Amount After Impairment	**25,50,000**

- The impairment loss of **Rs.3,50,000** is recognised, bringing the carrying amount to **Rs.25,50,000**, which reflects its value in use.

Step 2: Classification as Held for Sale

Particulars	Amount (Rs.)
Carrying Amount Before Classification	25,50,000
Fair Value Less Costs to Sell	25,00,000
Initial Write-Down on Classification	(50,000)
Carrying Amount After Classification	**25,00,000**

- Since **Fair Value Less Costs to Sell (Rs.25,00,000) is lower than Carrying Amount (Rs.25,50,000)**, a further write-down of **Rs.50,000** is recorded.
- **Depreciation ceases** from this point as per Ind AS 105.
- **Cumulative impairment loss is 3,50,000 +50,000 = 4,00,000**

Step 3: Reassessment at the Next Reporting Date

Particulars	Amount (Rs.)
Fair Value Less Costs to Sell (Revised)	26,50,000
Previous Carrying Amount	25,00,000
Impairment Reversal	1,50,000
Updated Carrying Amount	**26,50,000**

- Since the market value has increased, **Rs.1,50,000 of the previous impairment loss is reversed**, subject to the impairment loss reversal limit.



Step 4: Further Increase in Fair Value After 6 Months

Particulars	Amount (Rs.)
Fair Value Less Costs to Sell (Revised Again)	30,00,000
Previous Carrying Amount	26,50,000
Increase in value	3,50,000
Further Impairment Reversal (Restricted to total impairment recognised earlier less reversals) [4,00,000 – 1,50,000]	2,50,000
Updated Carrying Amount	**29,00,000**

- **Another Rs.2,50,000 impairment reversal** is recognised as the market value further increases, ensuring total reversal does not exceed earlier impairment loss.

Step 5: Final Sale Transaction

Particulars	Amount (Rs.)
Final Sale Price	30,00,000
Carrying Amount Before Sale	29,00,000
Gain on Sale Recognised	**1,00,000**

- Since the property is finally sold at **Rs.30,00,000**, a **gain of Rs.1,00,000** is recognised in the income statement.

3. Illustrations

Following is the extract of the consolidated financial statements of A Ltd. for the year ended on:

Asset/ (liability)	Carrying amount as on 31st March, 20X1 (In '000)
Attributed goodwill	200
Intangible assets	950
Financial asset measured at fair value through other comprehensive income	300
Property, plant & equipment	1100
Deferred tax asset	250
Current assets – inventory, receivables, and cash balances	600
Current liabilities	(850)
Non-current liabilities – provisions	(300)
Total	2,250

On 15th September 20X1, Entity A decided to sell the business. It noted that the business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with that standard.
The disposal group is stated at the following amounts immediately prior to reclassification as held for sale.

Asset/ (liability)	Carrying amount as on 15th September 20X1 (In '000)
Attributed goodwill	200
Intangible assets	930
Financial asset measured at fair value through other comprehensive income	360
Property, plant & equipment	1020
Deferred tax asset	250



Current assets – inventory, receivables, and cash balances	**520**
Current liabilities	**(870)**
Non-current liabilities – provisions	**(250)**
Total	**2160**

Entity A proposed to sell the disposal group at Rs.19,00,000. It estimates that the costs to sell will be Rs.70,000. This cost consists of professional fee to be paid to external lawyers and accountants.
As at 31st March 20X2, there has been no change to the plan to sell the disposal group and entity A still expects to sell it within one year of initial classification. Mr. X, an accountant of Entity A remeasured the following assets/ liabilities in accordance with respective standards as on 31st March 20X2:

Available for sale:	(In '000)
Financial assets	**410**
Deferred tax assets	**230**
Current assets- Inventory, receivables, and cash balances	**400**
Current liabilities	**900**
Non- current liabilities- provisions	**250**

The disposal group has not been trading well and its fair value less costs to sell has fallen to 16,50,000.
Required:
What would be the value of all assets/ labilities within the disposal group as on the following dates in accordance with Ind AS 105?
(a) 15 September, 20X1 and
(b) 31st March, 20X2
Solution:

(a) As at 15 September, 20X1

The disposal group should be measured at Rs. 18,30,000 (19,00,000-70,000). The impairment write down of Rs. 3,30,000 (Rs. 21,60,000 - Rs. 18,30,000) should be recorded within profit from continuing operations.
The impairment of Rs. 3,30,000 should be allocated to the carrying values of the appropriate noncurrent assets.

Asset/ (liability)	Carrying amount as on 15th September 20X1 (In '000)	Impairment	Revised carrying value as per IND AS 105
Attributed goodwill	200	(200)	-
Intangible assets	930	(62)	868
Financial asset measured at fair value through other comprehensive income	360	-	360
Property, plant & equipment	1020	(68)	952
Deferred tax asset	250	-	250
Current assets – inventory, receivables, and cash balances	520	-	520
Current liabilities	(870)	-	(870)
Non-current liabilities – provisions	(250)	-	(250
	2160	(330)	1830

The impairment loss is allocated first to goodwill and then pro rata to the other assets of the disposal group within Ind AS 105 measurement scope.
Following assets are not in the measurement scope of the standard
- financial asset measured at other comprehensive income,
- the deferred tax asset or the current assets.



In addition, the impairment allocation can only be made against assets and is not allocated to liabilities.

(b) As on 31 March, 20X2

All of the assets and liabilities, outside the scope of measurement under Ind AS 105, are remeasured in accordance with the relevant standards.

The assets that are remeasured in this case under the relevant standards are the Financial asset measured at fair value through other comprehensive income (Ind AS 109), the deferred tax asset (Ind AS 12), the current assets and liabilities (various standards) and the non-current liabilities (Ind AS 37).

Asset/ (liability)	Carrying amount as on 15 September, 20X1	Carrying Amount as on 31st March 20X2	Impairment	Revised carrying value as per Ind AS105
Attributed goodwill	-	-	-	-
Intangible assets	868	868	(29)	839
Financial asset measured at fair value through other	360	410	-	410
Property, plant & Equipment	952	952	(31)	921
Deferred tax asset	250	230	-	230
Current assets " inventory, receivables and cash balances	520	400	-	400
Current liabilities	(870)	(900)	-	(900)
Non-current liabilities "provisions	(250)	(250)	-	(250)
Total	1,830	1710	(60)	1,650

The carrying amount of disposal group is 17,10,000 and the fair value less costs to sell is 1650,000. Hence an impairment loss of 60,000 is recognised in ratio of carrying amount of intangible asset and PPE.

4. Illustrations

S Ltd purchased a property for 6,00,000 on 1st April, 20X1. The useful life of the property is 15 years. On 31st March, 20X3, S Ltd classified the property as held for sale. The impairment testing provides the estimated recoverable amount of 4,70,000.

The fair value less cost to sell on 31st March, 20X3 was 4,60,000.31190 On 31st March, 20X4 management changed the plan, as property no longer met the criteria of held for sale. The recoverable amount as at 31st March, 20X4 is 5,00,000.

Provide the accounting treatment of events for the year ending 31st March, 20X3 and 31st March, 20X4 and value the property at the end of 20X3 and 20X4.

Solution:

(a) Value of property immediately before the classification as held for sale as per Ind AS 16 as on 31 March 20x3

	₹
Purchase Price	6,00,000
Less: Accumulated Depreciation (40,000*2 years)	80,000
Carrying amount	5,20,000
Recoverable amount	4,70,000
Impairment loss	50,000
Carrying amount after impairment (5,20,000-	4,70,000



50,000)	
Fair value less cost to sell	4,60,000

On initial classification as held for sale on 31 March 20X3, the value will be lower of:

Carrying amount	4,70,000
Fair Value less Cost to sell	4,60,000

On 31 March 20X3 Non-current assets classified as held for sale will be recorded at ₹.4,60,000.

Depreciation of ₹.40,000 and Impairment Loss of ₹.60,000 (50,000 +10,000) is charged in profit or loss forthe year ended 31 March 20X3.

(b) On 31 March 20X4 held for sale property is reclassified as criteria doesn't met. The value will be lower of:

	₹
Purchase Price	6,00,000
Less: Accumulated Depreciation (40,000*2 years)	80,000
Less: Impairment	50,000
Carrying amount as on 31st March Year 3	4,70,000
Less: Depreciation that would have charged ($\frac{4,70,000}{13}$)	36154
Carrying amount had the asset is not classified as held for sale	4,33,846
Recoverable amount	5,00,000

Property will be valued at ₹. 4,33,846 on 31 March 20X4

Adjustment to the carrying amount of ₹.26,154 (₹.4,60,000 - ₹.4,33,846) is charged to the profit

5. Illustrations

On February 28, 20X1, Entity X becomes committed to a plan to sell a property. However, it plans certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months.

Can the property be classified as held for sale at the reporting date i.e. 31st March, 20X1?

Solution:

As per **Ind AS 105**, an asset is classified as **held for sale** only if:

1. **It is available for immediate sale in its present condition**, subject to normal sales terms.
2. **The sale is highly probable.**

In this case:

- The property **requires renovations**, which means it is **not immediately available for sale in its present condition**.
- Even though renovations will be completed in **two months**, it still **does not meet the immediate availability condition** as of the reporting date.

Conclusion:

Since the property is not available for sale **immediately**, it **cannot** be classified as **held for sale** under Ind AS 105.

6. Illustrations

On 1st March, 20X1, entity R decides to sell one of its factories. An agent is appointed and the factory is actively marketed. As on 31st March, 20X1, it is expected that the factory will be sold by 28th February, 20X2. However, in May 20X1, the market price of the factory deteriorated. Entity R believed that the market will recover and thus did not reduce the price of the factory. The company's accounts are authorised for issue on 26th June, 20X1. Should the factory be shown as held for sale as on 31st March, 20X1?

Solution:



As per **Ind AS 105**, a non-current asset is classified as **held for sale** if:

1. **The asset is available for immediate sale** in its present condition.
2. **The sale is highly probable.**

In this case:

- The factory was actively marketed, and a sale was expected by **February 28, 20X2**, fulfilling the **highly probable** condition.
- The **price deterioration in May 20X1** occurred **after** the reporting date and since the price has not been reduced, it is not market actively since May 20X1.
- It **does not affect the March 31, 20X1 classification since the price deterioration happened post balance sheet date.**

7. Illustration

Identify which of the following is a disposal group at 31 March 20X1:

- **On 21 March 20X1, XYZ announced the Board's intention to sell its shares in a subsidiary company, Alpha, contingent upon the approval of Alpha's shareholders. It seems unlikely that approval will be granted in the near future and no specific potential buyer has been identified.**

Solution:

According to **Ind AS 105**, a disposal group can only be classified as **held for sale** if it is **available for immediate sale** in its present condition and the **sale is highly probable**. In this case, the sale of XYZ's shares in Alpha is **contingent upon shareholders' approval**, which is **not guaranteed** and appears **unlikely in the near future**. This means the condition of **immediate availability** is **not met**.

Therefore, XYZ's **investment in Alpha** does **not qualify** as a **disposal group held for sale** as of the reporting date.

8. Illustration

Identify which of the following is a disposal group at 31 March 20X1:

- **PQR has entered into a contract to sell the entire delivery fleet of vehicles operated from its warehouse to a competitor, ABC, on 14 March 20X1. The assets will be transferred on 28 April 20X1 from which date the Group will outsource its delivery activities to another company, LMN**

Solution:

PQR's **delivery fleet of vehicles** qualifies as a **disposal group held for sale** as of **March 31, 20X1**. According to **Ind AS 105**, a disposal group is classified as **held for sale** if it is **available for immediate sale** in its present condition and the **sale is highly probable**.

In this case, PQR has **entered into a binding contract** with ABC on **March 14, 20X1**, to sell its entire delivery fleet, with the transfer scheduled for **April 28, 20X1**. The presence of a committed buyer and a definitive transfer date indicate that the **sale is highly probable**. Furthermore, PQR's decision to **outsource delivery activities** to LMN confirms that the fleet will no longer be used for operations. Since the sale meets both the **availability** and **high probability** conditions, the delivery fleet should be classified as a **disposal group held for sale** as of **March 31, 20X1**.

9. Illustration

Identify which of the following is a disposal group at 31 March 20X1:

- **On 16 January 20X1, DEF's management and shareholders approved a plan to sell its retail business in Mumbai and a consultant is hired to manage the sale. As at 31 March 20X1 heads of agreement had been signed although due diligence and the negotiation of**



final terms are still in process. The transaction is expected to be completed in April 20X1.

Solution:

Presented as held for sale

According to **Ind AS 105**, a disposal group is classified as **held for sale** if it is **available for immediate sale** in its present condition and the **sale is highly probable**.

In this case, **management and shareholders approved the sale plan** on **January 16, 20X1**, and a **consultant was hired** to facilitate the process. By **March 31, 20X1**, a **heads of agreement had been signed**, indicating a significant step toward finalizing the transaction. Although **due diligence and negotiations** are still in process, the **expected completion in April 20X1** supports the conclusion that the sale is **highly probable**.

Since the retail business is **actively marketed**, a **buyer has been identified**, and the sale is **expected to conclude soon**, it meets the **criteria of Ind AS 105**. Therefore, **DEF's retail business in Mumbai should be classified as a disposal group held for sale as of March 31, 20X1**.

10. Illustration

On 1st June, 20X1, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On 31st July, 20X1, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y.

However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by 30th November, 20X1 and the sale is expected to be completed by 31st March, 20X2. Entity X follows December year end.

The carrying value of assets and liabilities attributable to this manufacturing unit are as under:

Particulars	31st Dec 20X0	31st Jul 20X1
Goodwill	500	500
Plant and Machinery	1,000	900
Building	2,000	1,850
Debtors	850	1,050
Inventory	700	400
Creditors	(300)	(250)
Loans	(2,000)	(1,850)
	2,750	2,600

The fair value of the manufacturing unit as on 31st December, 20X0 is 2,000 and as on 31st July, 20X1 is 1,850. The cost to sell is 100 on both these dates. The disposal group is not sold at the period end i.e., 31st December, 20X1. The fair value as on 31st December, 20X1 is lower than the carrying value of the disposal group as on that date.

Required:

1. **Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?**
2. **The measurement of the manufacturing unit as on the date of classification as held for sale.**
3. **The measurement of the manufacturing unit as at the end of the year.**

Solution:

Assessing whether the manufacturing unit can be classified as held for sale:

The manufacturing unit can be classified as held for sale due to the following reasons:

(a) The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group must be classified as held for sale is 31st July, 20X1, i.e., the date at which management becomes committed to the plan.

(b) The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.

(c) A firm purchase agreement has been entered with the buyer.



(d) The sale is expected to be complete by 31st March, 20X2, i.e., within one year from the date of classification.

Measurement of the manufacturing unit as on the date of classification as held for sale:

Following steps need to be followed:
Step 1: Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS.

This has been done and the carrying value of the disposal group as on 31st July, 20X1 is determined at ₹. 2,600. The difference between the carrying value as on 31st December, 20X0 and 31st July, 20X1 is accounted for as per the relevant Ind AS.

Step 2: An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The fair value less cost to sell of the disposal group as on 31st July, 20X1 is ₹.1,750 (i.e. ₹.1,850 – ₹.100). This is lower than the carrying value of ₹.2,600. Thus, an impairment loss needs to be recognised and allocated first towards goodwill and thereafter pro-rata between non-current assets of the disposal group which are within the scope of Ind AS 105 based on their carrying value.
Thus, the assets will be measured as under:

Particulars	Carrying value – 31st July, 20X1	Impairment	Carrying value as per Ind AS 105 – 31st July, 20X1
Goodwill	500	(500)	-
Plant and Machinery	900	(115)	785
Building	1850	(235)	1615
Debtors	1050	-	1050
Inventory	400	-	400
Creditors	(250)	-	(250)
Loans	(1850)	-	(1850)
	2600	(850)	1750

Measurement of the manufacturing unit as on the date of classification as at the year end

- The measurement as at the year-end shall be on similar lines as done above.
- The assets and liabilities in the disposal group not within the scope of this Standard are measured as per the respective Standards.
- The fair value less cost to sell of the disposal group as a whole is calculated. This fair value less cost to sell as at the year-end shall be compared with the carrying value as at the date of classification as held for sale.
- It is provided that the fair value as on the year end is less than the carrying amount as on that date – thus the impairment loss shall be allocated in the same way between the assets of the disposal group falling within the scope of this standard as shown above.

11. Illustration

CK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June, 20X1. During the 3 months ended 30th June, 20X1 following events occurred:
On 1st April, 20X1, the Company has decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with the Company collecting any outstanding trade receivables relating to the division and settling any current liabilities:
On 1st April, 20X1, the carrying amount of the assets of the division were as follows:

- **Purchased Goodwill – 60,000**



- **Property, Plant & Equipment (average remaining estimated useful life two years) - 20,00,000**
- **Inventories - 10,00,000**

From 1st April, 20X1, the Company has started to actively market the division and has received number of serious enquiries. On 1st April, 20X1 the directors estimated that they would receive Rs. 32,00,000 from the sale of the division. Since 1st April, 20X1, market condition has improved and as on 1st August, 20X1 the Company received and accepted a firm offer to purchase the division for 33,00,000.

The sale is expected to be completed on 30th September, 20X1 and 33,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June, 20X1. During the period from 1st April to 30th June inventories of the division costing 8,00,000 were sold for 12,00,000.
At 30th June, 20X1, the total cost of the inventories of the division was 9,00,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

The Company has approached you to suggest how the proposed sale of the division will be reported in the interim financial statements for the quarter ended 30th June, 20X1 giving relevant explanations.

Solution:

CK Ltd.'s decision to sell the **division as a going concern** on **April 1, 20X1** means that from this date, the division is classified as **held for sale** under **Ind AS 105**. Since the division is **available for immediate sale, actively marketed, and expected to be sold within a year**, it meets the **held for sale** criteria.

The assets of the division should be measured at the **lower of carrying amount and fair value less cost to sell**. As of **April 1, 20X1**, the carrying amount of the division's assets is **₹30,60,000**, which is lower than the **fair value less cost to sell of ₹32,00,000**. Therefore, the division continues to be carried at **₹30,60,000**, with no impairment adjustment. The subsequent increase in expected selling price to **₹33,00,000** will not be accounted for since no impairment was recognized earlier.

Since the division is **classified as held for sale**, its **Property, Plant & Equipment (PPE) will no longer be depreciated after April 1, 20X1**. Thus, its carrying amount remains **₹20,00,000** as of June 30, 20X1. The **inventory will be reported at ₹9,00,000**, as its net realizable value exceeds its cost.

> The division is also considered a **discontinued operation** because it represents a **separate line of business** and is **held for sale at the reporting date**. The **Statement of Profit and Loss** should present the **post-tax profit or loss from discontinued operations as a single amount**. Additionally, as per **Ind AS 33**, **Earnings Per Share (EPS) should be disclosed separately** for discontinued operations.

In the **balance sheet**, the division's **major asset classes should be separately presented** either on the **face of the balance sheet or in the notes**, ensuring clear disclosure.

12. Illustration

A Ltd. Is to sell a non-current asset, being a piece of land. The piece of land has been contaminated and require the entity to carry out ₹ 1,00,000 of work in order to rectify the contamination. If the land was not contaminated, it could be sold for 3,00,000. With the contamination it is worth only ₹ 2,00,000. The work that is needed to rectify the contamination will extend the period of sale by one year from the date the land is first marketed for sale.
Required: In the following situations, examine with suitable reasons whether land can be classified as held for sale in accordance with Ind AS 105
Situation 1 - The land is marketed for ₹ 3,00,000 and A Ltd. Was not aware of the contamination till the time a firm purchase agreement was signed with a purchaser. The



purchaser found contamination through a survey. The purchaser signed the firm purchase commitment on condition that the contamination damage will be rectified.

Situation 2 - A Ltd. Marketed the land for ₹3,00,000, knowing about the contamination when the proposal to sale the land went in the market. However, A Ltd. Marketed with an agreement that it would carry out the rectification work within few months from signing the firm purchase commitment.

Situation 3- A Ltd. Knew about the contamination prior to float the proposal to sell the land and markets it for ₹ 2,00,000 with no obligation on itself to rectify or fix the contamination.

Solution:

Situation	Solution
Situation 1	As far as the entity was aware, the land was marketed and available for immediate sale in its present condition at a reasonable price. The event extending the one-year period was imposed by the buyer after the firm purchase commitment was received and the entity is taking steps to address it. The land qualifies as held for sale and continues to do so after it is required to carry out the rectification work.
Situation 2	The land is not available for immediate sale in its present condition when it is first marketed. It is being marketed at a price that involves further work to the land. It cannot be classified as held for sale when it is first marketed. It also cannot be classified as held for sale when a purchase commitment is received, because even then it is not for sale in its present condition and no conditions have been unexpectedly imposed. The land will not be classified as held for sale until the rectification work is actually carried out.
Situation 3	The land in this case is available for immediate sale in its present condition and it would qualify to be classified as held for sales since it is being marketed at reasonable price.

13. Illustration

PB Limited purchased a plastic bottle manufacturing plant for ₹ 24 lakh on 1st April, 2015. The useful life of the plant is 8 years. On 30th September, 2017, PB Limited temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of PB Limited decided to treat the plant as held for sale until the demand picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell. The accountant has also stopped charging depreciation for rest of the period considering the plant as held for sale. The fair value less cost to sell on 30th September, 2017 and 31st March, 2018 was ₹ 13.5 lakh and ₹ 12 lakh respectively.

The accountant has made the following working.

Carrying amount on initial classification as held for sale	₹	₹
Purchase price of Plant	24,00,000	
Less: Accumulated Depreciation [(₹24,00,000/8)x2.5 years]	7,50,000	16,50,000
Fair value less cost to sell as on 31st March 2017		12,00,000
The value lower of the above two		12,00,000

Balance Sheet extracts as on 31st March, 2018

Particulars	₹
Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	12,00,000

Required: Analyze whether the above accounting treatment is in compliance with the Ind AS. If not, advise the correct treatment showing necessary workings.



Solution:

As per Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations', an entity shall classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

For an Asset to be classified as held for sale it should be

- Available for immediate sale in present condition and
- Sale must be highly probable.

The Asset should be available for sale in present condition. The terms that are usual and customary for sale does not disqualify the Asset from being classified as held for sale. Its cannot be classified as held for sale if entity intends to sell it in distant future.

Sale is highly probable if:

- The appropriate level of management is committed to plan to sell.
- An Active Programme to trade a buyer is in Place.
- The Asset is marketed for sale at a price that is reasonable in relation to its current fair value.
- The sale if expected to be completed within 1 year.
- Significant charges or withdrawal from plan to sale the Asset are unlikely.

Ind AS 105 also states that entity shall not classify an Asset as held for sale if the Asset is abandoned. The Accountant of PB has treated the plant as held for which is not correct and not in accordance to Ind AS 105. It should not have stopped charging depreciation.

WORKINGS-I (COMPUTATION OF ACCUMULATED DEPRECIATION)

Particulars	₹
Purchase Price	24,00,000
Less: Accumulated depreciation $(\frac{2400000}{8\ years} * 3\ years)$	9,00,000
Carrying amount before impairment	15,00,000

WORKINGS-II (COMPUTATION OF IMPAIRMENT LOSS)

Carrying Amount	15,00,000
Recoverable Amount	12,00,000
Impairment Loss	3,00,000

INFERENCE:

RECOVERABLE AMOUNT IS HIGHER OF FAIR VALUE LESS COST TO SELL AND VALUE IN USE

Value in use = Nil (since it is not in use)

Fair value less cost to sale = 12,00,000

Recoverable amount = 12,00,000

Therefore, entity should have impaired the Asset as per Ind AS 36.

14. Illustration

Determine whether the following are discontinued operations

S. No	Particulars
1.	**MNO disposes of a component of the entity by selling the underlying assets. The sales transaction is incomplete at the reporting date.**
2	**PQR has ceased activities that meet the definition of a discontinued operation without selling any assets**
3.	**STU ceases activities and has already completed the sale of the underlying assets at the reporting date.**
4.	**VWX will sell or has sold assets that are within the scope of Ind AS 105, but does not discontinue any of its operations**

Solution:

Discontinued operations and assets held for sale

S. No	Particulars	Discontinued operation Yes/No	Assets held for sale Yes/No
1	MNO disposes of a component of	Yes	Yes



	the entity by selling the underlying assets. The sales transaction is incomplete at the reporting date.		
2	PQR has ceased activities that meet the definition of a discontinued operation without selling any assets.	Yes	No
3	STU ceases activities and has already completed the sale of the underlying assets at the reporting date.	Yes	No
4	VWX will sell or has sold assets that are within the scope of Ind AS 105, but does not discontinue any of its operations	No	Yes

15. Illustration

Sun Ltd is a retailer of takeaway food like burger and pizzas. It decides to sell one of its outlets located in Chandani Chowk in New Delhi. The company will continue to run 200 other outlets in New Delhi.

All Ind AS 105 criteria for held for sale classification were first met at 1st October, 20X1. The outlet will be sold in June, 20X2.
Management believes that outlet is a discontinued operation and wants to present the results of outlet as 'discontinued operations'. Analyse

Solution:

The chandani chowk outlet is a disposal group; it is not a discontinued operation as it is only one outlet. It is not a major line of business or geographical area, nor a subsidiary acquired with a view to resale.

16. Illustration – Nov 22 [8 Marks]

Violet Limited is a beverages manufacturing company having various plants across India. There is Machinery A in the Surat 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 be sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machinery A it cannotproduce output as well. The company considers this group of assets as a Cash Generating Unit and an Inventory amounting to Rs. 1.65 lakhs and Goodwill amounting to Rs. 1.50 lakhs is included in such CGU.

Machinery A was purchased on 1st April 2016 for Rs. 12 lakhs and residual value is Rs. 60 thousand. Machinery B was purchased on 1st April, 2018 for Rs. 5 lakhs with no residual value. The useful life of both Machinery 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 company is 10% p.a.

Year	Cash Flows from Machinery A
1	2,00,000
2	1,50,000
3	1,00,000
4	1,50,000
5	1,00,000 (Excluding Residual Value)
Total	7,00,000

On 31st March, 2021, the professional valuers have estimated that the current market value of machinery A is Rs. 8.5 lakhs. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is Rs. 1.60 lakhs. Specialized packaging cost would be Rs. 30,000 and legal fees would be Rs. 68,000.



The inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is Rs. 10 lakhs as on 31st March, 2021. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is Rs. 11 lakhs i.e. on 31st March, 2022. The recoverable value of Machinery A is Rs. 5,50,000 and combined for Machinery A and Machinery B is Rs. 8,00,000 as on 31st March, 2022.

You are required to:

(i) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2021 by providing all the relevant working notes to arrive at such calculation.

(ii) Compute the carrying value after considering prospective depreciation for the year 2021-2022 on the above assets.

(iii) Compute the carrying value of CGU as at 31st March, 2022.

(Note: Present value factor of Rs. 1 should be taken upto 4 decimals for the purpose of calculation)

Solution:

(i) Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss

- **Calculation of carrying value of Machinery A and B before impairment**

	Machinery A (₹)	Machinery B (₹)
Cost	12,00,000	5,00,000
Residual value	60,000	-
Useful life	10 years	10 years
Useful life already elapsed	5 years	3 years
Yearly depreciation $(\frac{Cost-Residual\ value}{useful\ life})$	1,14,000 $(\frac{12,00,000-60,000}{60})$	50,000 $(\frac{5,00,000}{10})$
WDV as at 31st March 2021 [Cost – (Yearly depreciation* useful life already elapsed)]	6,30,000	3,50,000

- **Calculation of Value-in-use of Machinery A**

Year	Cash flows	PVF @ 10%	PV
1	2,00,000	0.909	1,81,818
2	1,50,000	0.826	1,23,967
3	1,00,000	0.751	75,131
4	1,50,000	0.683	1,02,452
5	1,00,000	0.621	62,092
5	60,000	0.621	37,255
	Total		5,82,716

- **Calculation of Fair Value less cost of disposal of Machinery A**

Particulars	**₹**
Fair Value	8,50,000
Less:	
Dismantling cost	-1,60,000
Packaging cost	-30,000
Legal Fees	-68,000
Fair value less cost of disposal	5,92,000

- **Calculation of Impairment loss on Machinery A**

Particulars	**₹**
Carrying Value	6,30,000
Less: Recoverable Value i.e., higher of Value-in-use (₹. 5,82,704) and Fair value less cost of disposal (₹.5,92,000)	-5,92,000
Impairment Loss	38,000

- **Calculation of Impairment loss of CGU**

  1.First goodwill will be impaired fully and then the remaining impairment loss of CGU will be allocated to Machinery A and Machinery B.



2. After deduction of value of goodwill ₹ 1,50,000 from total impairment loss of CGU of ₹ 2,95,000, remaining impairment loss would be ₹ 1,45,000. If we allocate remaining impairment loss to Machinery A and B on pro-rata basis, it will come to ₹ 93,214 on Machinery A. However, the impairment loss of Machinery A cannot exceed ₹ 38,000 since its recoverable value is ₹.5,92,000. Hence, impairment loss to CGU will be as follows:

	Carrying value before impairment loss	**Impairment loss**	**Carrying value after impairment loss**
Machinery A	**6,30,000**	**38,000**	5,92,000
Machinery B	3,50,000	1,07,000*	2,43,000
Inventory	1,65,000	-	1,65,000
Goodwill	1,50,000	1,50,000	-
Total	12,95,000	2,95,000	10,00,000

* Balancing figure

(ii) Carrying value after adjustment of depreciation of 2021-2022

	₹
Machinery A [5,92,000– {(5,92,000 - 60,000)/5}]	4,85,600
Machinery B [2,43,000 – (2,43,000/7)]	2,08,286
Inventory	1,65,000
Goodwill	-
Total	8,58,886

Calculation of carrying value of CGU as on 31st March 2022

The revised value of CGU is ₹. 11 lakh. However, impaired goodwill cannot be reversed. Further, the individual assets cannot be increased above the lower of recoverable value or carrying value as if the assets were never impaired.

Accordingly, the carrying value as on 31st March 2022 assuming that the impairment loss had never incurred, will be:

	Carrying Value	Recoverable Value	Final CV as at 31st March 2022
Machinery A	5,16,000 [12,00,000 - (1,14,000 x 6)]	5,50,000	5,16,000
Machinery B	3,00,000 [5,00,000 – (50,000x4)]	2,50,000 (8,00,000 – 5,50,000)	2,50,000
Inventory	1,65,000*	1,65,000*	1,65,000*
Goodwill	-	-	-
	9,81,000	9,65,000	9,31,000

Hence, the impairment loss to be reversed will be limited to ₹. 72,114 only (₹. 9,31,000 – ₹. 8,58,886).

*Note: The question required valuation of CGU at the year-end 31st March 2022, for which value of inventory was required. In the absence of the value of inventory for the year ended 31st March 2022, it is assumed that the value of inventory for the year ended 31st March 2022 is same as it was for the year ended 31st March, 2021.

17. Illustration – RTP

X Ltd. acquires B Ltd. exclusively with a view to sale and it meets the criteria to be classified as discontinued operation as per Ind AS 105. Further, following information is available about B Ltd.:

Fair value of total assets excluding liabilities on acquisition – ₹ 360 Costs to sell as on



acquisition and on reporting date – ₹ 10
Fair value of liabilities on acquisition and reporting date – ₹ 80
Fair value of total assets excluding liabilities on the reporting date – ₹ 340
How discontinued operation pertaining to B Ltd. should be measured in consolidated financial statements of X Ltd. on acquisition date and reporting date?

Solution

X Ltd. acquires **B Ltd. exclusively with a view to sell**, meaning B Ltd. qualifies as a **disposal group held for sale** and a **discontinued operation** under **Ind AS 105**.

As per **Ind AS 105**, a **disposal group** should be measured at the **lower of carrying amount and fair value less costs to sell**. Since B Ltd. is acquired as part of a **business combination**, it must be measured at **fair value less costs to sell** on acquisition.

Measurement on Acquisition Date:

- **Fair value of total assets (excluding liabilities)** = ₹360
- **Less: Costs to sell** = ₹10
- **Fair value less costs to sell** = ₹350
- **Fair value of liabilities** = ₹80
- **Net assets at acquisition** = **₹270 (₹350 - ₹80)**

Measurement on Reporting Date:

- **Fair value of total assets (excluding liabilities) as on reporting date** = ₹340
- **Less: Costs to sell** = ₹10
- **Fair value less costs to sell** = ₹330
- **Fair value of liabilities** = ₹80
- **Net assets at reporting date** = **₹250 (₹330 - ₹80)**

Since the **fair value less costs to sell has decreased**, a **loss of ₹20 (₹270 - ₹250)** is recognised in the **Statement of Profit and Loss**.

Presentation in Financial Statements:

- The **assets and liabilities of B Ltd.** will be **separately presented** in the **consolidated balance sheet** under **held for sale classification**.
- The **loss of ₹20** due to the decline in fair value will be **reported in the Statement of Profit and Loss** under **discontinued operations**.

18. Illustration – RTP

Company X has identified one of its division (disposal group) to be sold to a prospective buyer and the Board has approved the plan to sell the division on 30th September, 20X1. The sale is expected to complete after one year but it still qualifies to be held for sale under Appendix B of Ind AS 105. Costs to sell the division is estimated to be ₹ 10 crores (to be incurred in March, 20X3). The fair value of the division is ₹ 400 crores (on 30th September, 20X1 and 31st March, 20X2) and carrying value is ₹ 500 crores.

How shall such a division (disposal group) be measured under Ind AS 105 on following reporting dates:

A. **30th September, 20X1**
B. **31st March, 20X2**

Consider the discounting factor @ 10% for 1 year to 0.909 and for 1.5 years to be 0.867.

Solution

Company X has identified a **division (disposal group) for sale**, and the **Board approved the plan on September 30, 20X1**. Since the sale is **expected to occur beyond one year**, **costs to sell must be measured at present value**.



Measurement on Reporting Dates:

A. As of September 30, 20X1:

The disposal group is measured at **fair value less costs to sell**:

- **Fair Value** = ₹ 400.00 crores
- **Present Value of Costs to Sell (₹ 10 crores × 0.867)** = ₹ 8.67 crores
- **Net Measurement Value** = ₹ **391.33 crores**

Since **₹ 391.33 crores is lower than the carrying value of ₹ 500 crores**, an **impairment loss of ₹ 108.67 crores (₹ 500 - ₹ 391.33 crores)** will be recognized in the **Statement of Profit and Loss**.

B. As of March 31, 20X2:

- **Fair Value** = ₹ 400.00 crores
- **Present Value of Costs to Sell (₹ 10 crores × 0.909)** = ₹ 9.09 crores
- **Net Measurement Value** = ₹ **390.91 crores**

The **increase in present value of costs to sell** by **₹ 0.42 crores (₹ 9.09 crores – ₹ 8.67 crores)** is recognized as a **financing cost in the Statement of Profit and Loss**,

Conclusion:

- The **disposal group is reported separately** in the financial statements.
- **An impairment loss of ₹ 108.67 crores** is recognized on **September 30, 20X1**.
- The **increase in costs to sell by ₹ 0.42 crores** is recorded as a **financing cost** on **March 31, 20X2**.



IND AS 116
LEASES
ILLUSTRATIONS

Identified Asset / Lease

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?

Answer:

An asset qualifies as **identified** under Ind AS 116 if it is **explicitly** or **implicitly specified** in the contract. In this case, the rolling stock is not **explicitly stated** in the contract (e.g., no serial number is mentioned). However, since **Supplier ABC owns only one such rolling stock**, it is **implicitly identified** as no other rolling stock exists for substitution. As a result, the rolling stock qualifies as an **identified asset** under Ind AS 116.

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?

Answer:

Meaning of Identified Asset:

An asset can still be considered **identified** even if it is **not yet constructed**, provided that its **specifications are predetermined**. In this case, the contract **specifies the car's brand, type, colour, and features**, which means that the asset is **predefined** and will be made available to Customer XYZ. Since the car is not interchangeable with another asset once built, it qualifies as 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?

Solution:

For an asset to be **identified**, the supplier should not have a **substantive substitution right**. In this case, the supplier owns **multiple identical servers** and has the **right and ability** to substitute one server with another. Additionally, the supplier benefits **economically** from optimizing server usage. Since the supplier has both the **practical ability** and **economic incentive** to replace the asset, it is **not considered an identified asset** under Ind AS 116.

However, if the customer could not readily determine whether the supplier had a substantive substitution right (for e.g., there is insufficient transparency into the supplier's operations), the customer would presume the substitution right is not substantive and conclude that there is an identified asset.

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?

Answer:

If a supplier does **not have the practical ability to substitute an asset** and **does not benefit economically** from such a substitution, the asset remains **identified**. In this case, the server is **customized** specifically for Customer XYZ, making substitution impractical. The supplier cannot replace it with another asset without affecting the functionality. As the **substitution right is not substantive**, the server qualifies as 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?

Answer:

A portion of an asset can be **identified** only if it is **physically distinct** or represents **substantially all of an asset's capacity**. In this case, the contract explicitly allocates **five specific fibres** out of the 25 available within the fibre optic cable, and these fibres are **dedicated exclusively** to Customer XYZ for the entire duration of the contract. Since these fibres are **explicitly stated and physically distinct**, they qualify as **identified assets**.



6. Illustration

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?

Answer:

*For an asset to be **identified**, the customer must control **substantially all of its capacity**. In this case, Customer XYZ is entitled to use **95% of the pipeline's capacity**, meaning it **effectively controls** the pipeline for the duration of the contract. Even though the pipeline as a whole is shared, the portion allocated to Customer XYZ represents **substantially all** of its usage, making it 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?

Answer:

*A leased portion of an asset must be **physically distinct** to qualify as an **identified asset**. In this case, Customer XYZ has the **exclusive right to use specific rooms** (Rooms 1 to 11) within the warehouse, which are **explicitly stated and physically distinct** from the rest of the warehouse. Additionally, Supplier ABC does **not have a substitution right**, reinforcing the identification of the leased space. Since these rooms are **separately allocated and identifiable**, they qualify as **identified assets**. In this case since the rooms are specifically allocated, the storage capacity is not relevant.*

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?.



Solution

As per **Ind AS 116**, an asset is considered identified if it is **physically distinct** or if the customer has control over **substantially all of its capacity**. In this case, **Entity X has the right to use 60% of the gas pipeline's capacity** and also holds a **right of first refusal** for the remaining 40%. This means Entity X has the first option to use the additional capacity before the supplier can offer it to others.

Whether the **pipeline qualifies as an identified asset** depends on whether the **right of first refusal is substantive**. If Entity X can **practically use the additional 40% capacity** and there are **no restrictions or excessive costs**, it is considered to have control over substantially all of the pipeline's capacity. However, if there are barriers that prevent Entity X from exercising this right, then the pipeline would **not be considered an identified asset**. The determination should be based on **whether Entity X can realistically use the additional capacity**.

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.

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?

Answer:

Under **Ind AS 116**, even if an asset is explicitly mentioned in a contract, it does **not qualify as an identified asset** if the supplier has a **substantive substitution right**. A **substitution right is substantive** if the supplier has both the **practical ability** and **economic benefit** in replacing the asset.

In this case, **Entity Y has the right to relocate Customer X** to another retail space within the shopping centre. However, the supplier would **only benefit** from relocating the customer **if a large new tenant were to occupy a significant portion of the space at a higher rate**. Since this scenario is **not certain at the inception of the contract**, the substitution right is **not substantive**. Therefore, the **retail space qualifies as an identified asset**, as Entity Y **cannot freely substitute it under normal circumstances**.

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?

Answer:

A customer **controls an asset** under **Ind AS 116** if it obtains **substantially all of the economic benefits** from its use. In this case, **Company MNO has a 15-year contract to purchase all the electricity produced by the solar farm**. Additionally, it receives **renewable energy credits**, which are financial benefits associated with using renewable energy.

Although **Power Company PQR owns the solar farm** and enjoys **tax benefits**, these **do not relate to the use of the asset** but rather to **its ownership**. Since **Company MNO gets all the electricity and renewable energy credits**, it effectively enjoys **substantially all of the economic benefits from the solar farm**. Hence, the **solar farm qualifies as an identified asset under Ind AS 116**.

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?

Answer:

To determine whether an arrangement contains a lease, we need to check **who controls the use of the asset**. According to **Ind AS 116**, a customer has the right to **direct the use of an asset** if it controls **how and for what purpose** the asset is used throughout the lease term.

In this case, although **Entity A designed the facility and set the production requirements**, it does **not control how and when the facility operates**. **Supplier H owns the facility and makes all operational decisions, including machinery operation, production schedule, and maintenance**. Entity A only decides the **quantity of parts and delivery timelines**, which does not amount to directing the use of the facility.

Since **Supplier H retains operational control**, this contract is considered a **supply agreement, not a lease**. Therefore, **Entity A does not have the right to use an identified asset** under Ind AS 116.

11. 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?

Answer:

As per **Ind AS 116**, a customer has the **right to direct the use of an identified asset** if it controls **how and for what purpose** the asset is used during the contract period. This can be established if:

1. The customer **determines how and for what purpose** the asset is used, or
2. The key decisions about its use are **pre-determined**, and the customer either:
    - **Operates the asset**, or
    - **Designed the asset in a way that determines its use**.

In this case, **Entity X enters into a contract with Entity Y** for installing an **air-conditioning plant** in its office. The plant is **customized as per Entity X's specifications**, ensuring it meets its needs. While **Entity Y handles operations and maintenance**, the key factor is that **Entity X decides how the air-conditioning plant is used**.

Entity X has full control over:

- **When the system will operate** (timing of cooling),
- **Which floors will receive cooling**, and
- **The temperature settings** throughout the office.

These decisions directly affect **how and for what purpose** the air-conditioning plant functions. Even though **Entity Y provides maintenance**, this role is **supportive in nature** and does not determine the **primary use of the asset**.

Since **Entity X makes the key decisions about the plant's usage**, it has the **right to direct the use of the identified asset**. As the air-conditioning plant is **customized, physically distinct, and under Entity X's control**, it qualifies as an **identified asset under Ind AS 116**.

12. 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 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?

Answer:

Under **Ind AS 116**, a customer has the **right to direct the use of an identified asset** if it determines **how and for what purpose** the asset is used throughout the period. However, in some cases, **decisions about asset use may already be predetermined** by the nature of the asset itself or its design.



In this case, **Entity X enters into a contract with Entity Y for the installation, operation, and maintenance of a solar power station**. The **location, design, and specifications of the power station are predetermined by Entity X**, and it has the **exclusive right to receive all energy produced**. The power station's output depends on **sunlight and its technical design**, meaning neither Entity X nor Entity Y actively makes decisions on how or when to generate energy.

Since **Entity X designed the power station and predetermined its functionality**, it has **indirect control** over how and for what purpose the asset is used. The supplier's role is **limited to operation and maintenance**, which does not affect Entity X's **right to direct use**. Therefore, **Entity X has the right to direct the use of the solar power station**, making it an **identified asset under Ind AS 116**.

13. 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?

Answer:

Ind AS 116 states that a **customer must obtain substantially all of the economic benefits** from using an asset to classify it as a lease. Economic benefits include **exclusive use, financial benefits, and other advantages derived from the asset**.

In this case, **Entity X leases a crossover for two years with a 1,50,000 km driving limit**. The **cap on mileage is meant to protect the supplier's asset value**, but it does not restrict Entity X's ability to derive **substantially all the benefits** from the vehicle within this limit.

Since **Entity X has exclusive use of the crossover and enjoys economic benefits within the defined mileage**, it still **obtains substantially all of the economic benefits** from the asset. The lease **remains valid** under Ind AS 116.

Self Study

Scenario 1: The 'last mile' is a dedicated cable that connects Entity Y's network with the end customer's device. The use of this cable is at the discretion of the customer. Entity Y decides the location of end points and has right to replace the lines (dedicated cable), however it is not practical to replace the lines, since replacement would require additional costs to be incurred without any corresponding benefit. Whether the arrangement would be within the scope of Ind AS 116?

Scenario 2: If it is practical for the Entity Y to replace the lines and Entity Y would benefit from this replacement, would the answer be different?

Case II
Customer X enters into a 10-year contract with a utility company, Entity Y, for the right to use three specified, physically distinct fibers within a larger cable connecting Mumbai to Delhi. Customer makes the decisions about the use of the fibers by connecting eachend of the fibers to its electronic equipment. Entity Y owns extra fibers but can substitute those for Customer's fibers only for reasons of repairs, maintenance or malfunction. The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116?

Case III



Customer X enters into a 10-year contract with Entity Y for the right to use a specified amount of capacity within a cable connecting Mumbai to Delhi. The specified amount is equivalent to Customer X having the use of the full capacity of three fiber strands within the cable (the cable contains multiple fibers with similar capacities). Entity Y makes decisions about the transmission of data (i.e., Entity Y lights the fibers, makes decisions about which fibers are used to transmit Customer's traffic). The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116?

Solution

Ind AS 116 applies to lease contracts where a customer has the **right to control the use of an identified asset**. A contract is **within the scope of Ind AS 116** if:

1. The contract conveys the **right to control the use of an identified asset** for a period of time in exchange for consideration.
2. The customer has **both**:
    - **The right to obtain substantially all economic benefits** from using the asset.
    - **The right to direct the use of the asset.**

Case I: 'Last Mile' Dedicated Cable Connection

Scenario 1: Customer's Discretion Over the Cable

- The **'last mile' cable is an identified asset** as it is **physically distinct** and is **explicitly specified** in the arrangement.
- Although **Entity Y** has the right to replace the lines, it **is not practical** due to the cost implications. Hence, **Entity Y does not have substantive substitution rights**
- **Conclusion:** The arrangement falls within the scope of **Ind AS 116**, as the customer controls the use of an **identified asset**.

Scenario 2: Entity Y Can Replace the Lines Practically & Beneficially

- If **Entity Y has the practical ability to replace the lines** and can economically benefit from it, then **Entity Y has substantive substitution rights** .
- **Conclusion:** The arrangement would **not** be within the scope of **Ind AS 116** as the asset is not exclusively controlled by the customer.

Case II: Lease of Three Specified Fibers in a Larger Cable

- **Identified Asset:** The contract specifies **three physically distinct fibers** within a larger cable, making them **identified assets** as per Ind AS 116.
- **Right to Control:** Customer **X** has the right to:
    - **Obtain all economic benefits** from using the fibers for 10 years.
    - **Direct the use** of the fibers by connecting them to its equipment (Para B24 & B25).
- **Limited Substitution Rights of Entity Y:**
    - **Entity Y can only substitute the fibers for repairs, maintenance, or malfunction**. As per **Para B18**, such substitution rights **do not prevent the arrangement from being a lease**.
- **Conclusion:** The arrangement **is covered under Ind AS 116**, as Customer X **controls** the use of the identified asset.

Case III: Lease of Capacity within a Fiber Optic Cable

- **No Identified Asset:**
    - The **contract provides a portion of capacity within a fiber optic cable**, but this portion is **not physically distinct** from the rest of the cable.



- **A portion of an asset is not an identified asset** unless it represents **substantially all of the capacity**.
- In this case, Customer **X only gets a part of the total fiber capacity**, which does not amount to controlling a distinct asset.

- **Control Over the Asset:**
  - **Entity Y (the supplier) makes all decisions** about data transmission, including **which fibers to use**.
  - Customer **X does not control how and for what purpose the asset is used**
- **Conclusion:**
  - The contract **does not contain a lease** as per Ind AS 116 because:
    - There is **no identified asset** (only a portion of a shared resource).
    - **Entity Y controls the transmission decisions** and **not Customer X**.
  - **Therefore, the contract is NOT within the scope of Ind AS 116.**

Final Summary of Cases

Case	Identified Asset?	Customer Controls the Asset?	Within Ind AS 116?
Case I - Scenario 1 (Dedicated cable, impractical to replace)	☑ Yes	☑ Yes	☑ **Yes**
Case I - Scenario 2 (Entity Y can replace cable practically)	✗ No	✗ No	✗ **No**
Case II (Lease of 3 specific fibers)	☑ Yes	☑ Yes	☑ **Yes**
Case III (Lease of fiber capacity, not distinct)	✗ No	✗ No	✗ **No**

Lease Term & Payment

14. 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?

Answer:

The **lease term** under **Ind AS 116** includes the **non-cancellable period** plus any additional periods where the lessee is **reasonably certain** to extend the lease.

In this case, **Entity ABC leases equipment for six years with a two-year renewal option** at market rates. There are **no penalties or other factors** indicating that Entity ABC is **reasonably certain to exercise the renewal option**.

Since **Ind AS 116 requires reasonable certainty** to consider renewal periods, the lease term at the **commencement date is six years**. The **two-year renewal period is not included** in the lease term as there is no strong indication that the entity will opt for renewal.

15. 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?

Answer:

Under **Ind AS 116**, a lease term includes **renewal periods if the lessee is reasonably certain** to extend the lease. One key indicator of renewal certainty is whether **significant leasehold improvements** would be lost if the lease is not renewed.

In this case, **Entity XYZ leases a building for eight years with a two-year renewal option**. Before occupying the building, Entity XYZ **invests in leasehold improvements**, which will still have significant value at the end of the eight-year period. If the lease is not renewed, the **value of these improvements would be lost**.

Since **abandoning valuable leasehold improvements would result in a financial loss**, Entity XYZ is **reasonably certain** to **exercise the two-year renewal option**. Thus, the **lease term is ten years (eight years non-cancellable + two years renewal)**.

16. 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?
Answer:

The **lease term** under **Ind AS 116** includes periods where the lessee **has the right to use the asset**. This applies even if the lease is for **specific months within a year**.

In this case, **Entity PQR leases a retail space in a shopping centre for three months per year (October to December) over a period of seven years**. Although the lease **only applies to three months each year**, the **supplier guarantees access to the same retail space every year**.

Since **Entity PQR has exclusive access to the retail space for three months per year over seven years**, the lease term is **calculated as 21 months (3 months × 7 years)**.

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.

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?

Answer:

Ind AS 116 requires a lessee to **reassess the lease term** if there is a **significant change in business decisions** that affects whether the lessee will **exercise a renewal option**.

In this case, **Retailer M initially signed a five-year lease for one floor, with two optional five-year renewal terms**. At lease commencement, Retailer M was **not reasonably certain to exercise the renewal option**. However, at the **end of the third year**, Retailer M **acquired**



another company and expanded operations, signing a **separate seven-year lease for an additional floor in the same building**.

Since **Retailer M now has a long-term commitment to the building**, it is **reasonably certain** to exercise the **five-year renewal option** on the original lease. Therefore, at the **end of the third year**, Retailer M **must reassess the lease term** to include the renewal period.

17. 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?

Answer:

Under **Ind AS 116**, a lessee must **reassess the lease term** if **external factors, such as government regulations,** make it impossible or impractical to continue the lease as originally planned.

In this case, **Company N leased 10 vehicles for five years with an extension option for another five years**. At lease commencement, **Company N was reasonably certain to extend the lease**, so it considered a **10-year lease term**. However, at the **end of the fourth year**, a **government regulation bans these vehicles from the road within one year due to environmental concerns**.

Since the **extension option is no longer viable**, Company N must **reassess the lease term** and **exclude the five-year extension option**. The revised lease term is now **five years (initial non-cancellable period), instead of ten years**.

18. Illustration (For understanding purposes only)

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.

Answer:

Computation of lease payment

Year	Fixed Payment	In substance fixed payment	Incentive	Purchase option	Lease payment
1	10	1			11
2	10	1			11
3	10	1	-1		10
4	5	1			6
5	5	1		5	11



Computation of implicit rate of return

Year	Lease payment	NPV @ 5%	NPV @ 10%
0	-40	-40	-40
1	11	10.48	10
2	11	9.98	9.1
3	10	8.64	7.5
4	6	4.94	4.1
5	11	8.62	6.8
	Total	2.65	-2.5

$IRR=5\% + \frac{2.647}{2.647+2.5}(10\%-5\%)=7.457\%$

Computation of NPV at 7.457%

Year	Lease payment	PVF	NPV
1	11	0.931	10.24
2	11	0.866	9.53
3	10	0.806	8.06
4	6	0.750	4.50
5	11	0.698	7.68
			~40

19. 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?

Answer:

Entity Q enters into a **seven-year lease** for machinery, where the **monthly lease payment varies based on usage**:

- If Q **uses** the machinery in a given month, the lease payment is **₹ 2,000**.
- If Q **does not use** the machinery, a **₹ 1,000 payment still accrues**.

Under **Ind AS 116**, lease payments should include **fixed and in-substance fixed payments** while excluding **purely variable payments**. In this case, although the payments vary based on usage, **₹ 1,000 is unavoidable each month**, regardless of whether the machinery is used or not. This qualifies as an **in-substance fixed payment**, meaning **₹ 1,000 per month (₹ 12,000 per year) is included in the lease liability measurement**.

20. 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.

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?

Answer:



Entity P enters into a **five-year lease for office space**, with a **monthly base rent of ₹ 1 lakh**. The rent increases annually based on the **higher of**:

1. **1% of Entity P's generated sales**, or
2. **2% of the previous rental rate**.

Under **Ind AS 116**, lease payments should include **fixed payments and in-substance fixed payments** while excluding **purely variable payments**. Since **Entity P is required to pay a minimum 2% annual increase**, irrespective of sales, this **minimum 2% increase qualifies as an in-substance fixed payment**. Therefore, lease payments will consist of the **₹ 1 lakh base rent plus the annual 2% increase**.

21. 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.

Answer:

Company N enters into a lease for a **production line**, where lease payments depend on **operating hours**:

- ₹ 1,000 per **hour of use**.
- **Minimum annual lease payment**: ₹ **10,00,000**.
- **Expected usage per year**: **1,500 hours** (implying an expected payment of ₹ 15,00,000).

Under **Ind AS 116**, lease payments should include **fixed payments** but exclude **variable payments linked to usage** unless they are **in-substance fixed payments**. Here, the **minimum ₹ 10,00,000 per year is unavoidable**, making it an **in-substance fixed lease payment**. The additional **₹ 5,00,000 (for extra 500 hours) is purely variable and not included** in the initial lease liability calculation.

22. 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%.

Answer:

An entity enters into a **10-year lease of property** with annual lease payments of **₹ 1,000**, paid **at the beginning of each year**. Payments are linked to the **Consumer Price Index (CPI)**:

- **CPI at lease commencement**: **100**.
- **CPI at the end of Year 1**: **105** (no adjustment yet).
- **CPI at the end of Year 2**: **108** (adjustment applies).



Under **Ind AS 116**, lease payments linked to an index **should be initially measured using the rate at lease commencement** (CPI = 100). Future changes in CPI **are not considered at lease inception**.

The lease liability will be computed considering Rs. 1,000 discounted at 8% for 10 years.
Payment is at beginning so present value factor = 1 + PVF @8% for 9 Years.

PVAF = 1 + 6.2468 = 7.2468

Lease liability at commencement = 1,000 x 7.2468 = 7,246.8

At the **end of Year 1**, since no payment change occurs, the lease liability remains unchanged. However, at the **end of Year 2**, when the CPI increases to **108**, the lease payments are **revised to ₹ 1,080 per year (₹ 1,000 × 108/100)** for the remaining **eight years**, and the lease liability is updated accordingly.
The new liability will be computed using original discount rate (discussed in remeasurement)

Payment is at beginning so present value factor = 1 + PVF @8% for 7 Years.

PVAF = 1 + 5.206 = 6.206

Lease liability = 1080 x 6.206 = 6702.

Lessee Accounting

23. 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 SOFR (Secured Overnight Financing Rate) each year. At the date of commencement of the lease, SOFR is 2 per cent.

Assume that the interest rate implicit in the lease is 5 per cent. How lease liability is initially measured?

Answer:
In the given case, the lease payments depend on a rate (i.e., SOFR) and h ence is included in measuring lease liability. As per Ind AS 116, the lease payments should initially be measured using the rate (i.e. SOFR) as at the commencement date. SOFR at that date is 2 per cent; therefore, in measuring the lease liability, it is assumed that each year the payments will increase by 2 per cent, as follows:

Year	Lease Payment	Discount factor @ 5%	PV of lease payments
1	1,00,000	1	1,00,000
2	1,02,000	0.952	97,102
3	1,04,040	0.907	94,364
4	1,06,121	0.864	91,689
5	1,08,243	0.823	89,084
6	1,10,408	0.784	86,560
7	1,12,616	0.746	84,012
8	1,14,869	0.711	81,672
9	1,17,166	0.677	79,321
10	1,19,509	0.645	77,083
			8,80,887

Therefore, the lease liability is initially measured at ₹ 8,80,887



24. 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 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?

Answer:

Entity XYZ, a **medical equipment manufacturer**, provides **Customer ABC with a medical laboratory machine at no cost**, while Customer ABC **must purchase consumables** for the machine at ₹100 each. The consumables **cannot be substituted** with other alternatives. However, the contract does **not require a minimum purchase quantity**.

Under **Ind AS 116**, lease payments include **fixed and in-substance fixed payments** but exclude **variable payments linked to usage** unless there is a **minimum commitment**. In this case, since there is **no minimum purchase obligation**, the **cost of consumables is not included** in the lease liability measurement since the payment is variable.

For **Entity XYZ (lessor)** and **Customer ABC (lessee)**:

- The arrangement contains **two components**: **a lease (for the equipment) and a non-lease component (for the consumables).**
- If **Customer ABC elects the practical expedient** to **combine lease and non-lease components**, the consumables' cost remains **variable** and **does not contribute to lease liability measurement**.
- Thus, **no lease payments are included in the initial measurement**, but the purchase of consumables is considered **a variable lease payment.**
- Otherwise, **Customer ABC will allocate payments** between lease and consumables based on **relative standalone prices**.

25. 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?

Answer:

An entity **leases an asset and guarantees that the lessor will recover ₹ 20,000 from reselling the asset** at lease-end. At lease commencement, the lessee estimates that **the residual value of the asset will be lower**, meaning the lessee **expects to owe ₹ 8,000 to the lessor**.



Under **Ind AS 116**, **residual value guarantees** should be included in **lease liability measurement** if the lessee **expects to make a payment under the guarantee**. Since the lessee **reasonably expects to owe ₹ 8,000**, this amount **must be included in lease payments** for liability measurement.

26. 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?

Answer:

Entity Y would calculate the right-of-use asset as follows:

Particulars	₹
Initial measurement of lease liability	8,50,000
Lease payments made to Entity Z at or before the commencement date	10,000
Lease incentives received from Entity Z	(50,000)
Initial direct cost	1,000
Initial measurement of right-of-use asset	8,11,000

27. 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?

Answer:

Company H leases an aircraft for **five years**. The contract requires a **mandatory maintenance check** after every **100,000 flight hours**. However, regardless of actual flight hours, **the check must be performed at lease-end**, with Company H either **carrying out the check or reimbursing the lessor for costs**.

Under **Ind AS 116**, costs that must be incurred **regardless of asset usage** are considered part of the **right-of-use (ROU) asset's cost**. Since the **check must be performed at lease-end**, Company H **must recognize a provision** for the expected cost at the **beginning of the lease term**. This amount is also **included in the cost of the ROU asset**, in accordance with **Ind AS 116**

28. 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.

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?

Answer:

At the commencement date, Entity ABC would initially recognise ROU Asset and the corresponding Lease Liability of ₹ 77,364 which is calculated as follows:

Year	Payments (Cash flows)	Discounting Factor @12%	Discounted Cash flows / Present Value
1	20,000	0.8929	17,858
2	30,000	0.7972	23,916
3	50,000	0.7118	35,590
	1,00,000		**77,364**

Then, the next step would be to prepare a schedule for Lease Liability and ROU Asset as follows:

Lease Liability:

Year	Lease Liability			
	Initial value	Lease payments	Interest expense @ 6%	Closing balance
	a	b	c = a x 6%	d = a-b + c
1	77,364	9,284	(20,000)	66,648
2	66,648	7,998	(30,000)	44,646
3	44,646	5,354*	(50,000)	-

* Difference of ₹ 4 is due to approximation.

ROU Asset (assuming no lease incentives, no initial direct costs, etc.):

Year	Opening balance	Depreciation	Closing balance
1	77,364	(25,788)	51,576
2	51,576	(25,788)	25,788
3	25,788	(25,788)	-

At lease commencement, Entity ABC would recognise the Lease Liability and the corresponding ROU Asset as follows:

ROU Asset	Dr.	77,364	
To Lease Liability			77,364
To initially recognise the Lease Liability and the corresponding ROU Asset			

The following journal entries would be recorded in the first year:

Interest Expense	**Dr.**	**9,284**	
To Lease Liability			**9,284**
To record interest expense and accrete the lease liability using the effective interest method (₹ 77,364 x 12%)			
Depreciation Expense	**Dr.**	**25,788**	



To ROU Asset		**25,788**
To record interest expense and accrete the lease liability using the straight-line method (₹ 77,364 / 3 years)		
Lease Liability Dr.	**20,000**	
To Cash / Bank		**20,000**
To record lease payment		

Following is the summary of the said lease contract's accounting (assuming no changes due to reassessment):

Particulars	Initially	Year 1	Year 2	Year 3
Cash lease payments		20,000	30,000	50,000
Lease Expense Recognised:				
Interest Expense		9,284	7,998	5,354
Depreciation Expense		25,788	25,788	25,788
Total Periodic Expense		35,072	33,786	31,142
Balance Sheet:				
ROU Asset	77,364	51,576	25,788	
Lease Liability	(77,364)	(66,648)	(44,646)	

29. 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?

Answer:

As per Ind AS 116, Company EFG would first calculate the lease liability as the present value of the annual lease payments, less the lease incentive paid in year 2, plus the exercise price of the purchase option using the rate implicit in the lease of approximately 9.04%.

PV of lease payments, less lease incentive (W.N. 1)	37,39,648
PV of purchase option at end of lease term (W.N. 2)	12,60,000
Total lease liability	₹ 49,99,648 or ₹ 50,00,000 (approx.)

The right-of-use asset is equal to the lease liability because there is no adjustment required for initial direct costs incurred by Company EFG, lease payments made at or before the lease commencement date, or lease incentives received prior to the lease commencement date.

Entity EFG would record the following journal entry on the lease commencement date.

Right-of-use Asset	Dr.	50,00,000	
To Lease Liability			50,00,000
To record ROU asset and lease liability at the commencement date.			

Since the purchase option is reasonably certain to be exercised, EFG would amortize the right -of use asset over the economic life of the underlying asset (40 years). Annual amortization expense would be ₹ 1,25,000 (₹ 50,00,000 / 40 years)



Interest expense on the lease liability would be calculated as shown in the following table. This table includes all expected cash flows during the lease term, including the lease incentive paid by Entity H and Company EFG's purchase option.

Year	Opening Bal	Payment	Bal for Int	Interest	Closing Bal
1	50,00,000	(5,00,000)	45,00,000	4,06,800	49,06,800
2	49,06,800	(3,15,000)	45,91,800	4,15,099	50,06,899
3	50,06,899	(5,30,450)	44,76,449	4,04,671	48,81,120
4	48,81,120	(5,46,364)	43,34,756	3,91,862	47,26,618
5	47,26,618	(5,62,754)	41,63,864	3,76,413	45,40,277
6	45,40,277	(5,79,637)	39,60,640	3,58,042	43,18,682
7	43,18,682	(5,97,026)	37,21,656	3,36,438	40,58,093
8	40,58,093	(6,14,937)	34,43,156	3,11,261	37,54,418
9	37,54,418	(6,33,385)	31,21,033	2,82,141	34,03,174
10	34,03,174	(6,52,387)	27,50,787	2,49,213	30,00,000
				(bal fig)	
			Less: Payment for purchase option		30,00,000
			Closing bal		-

*(5,00,000 + increased by 3% - lease incentive paid amounting to 2,00,000)
Although the lease was for 10 years, the asset had an economic life of 40 years. When Company EFG exercises its purchase option at the end of the 10-year lease, it would have fully extinguished its lease liability but continue depreciating the asset over the remaining useful life.

Working Notes

1. Calculating PV of lease payments, less lease incentive:

Year	Lease Payment (A)	Present value factor @ 9.04% (B)	Present value of lease payments (A x B = C)
Year 1	5,00,000	1	5,00,000
Year 2	3,15,000	0.92	2,89,800
Year 3	5,30,450	0.84	4,45,578
Year 4	5,46,364	0.77	4,20,700
Year 5	5,62,754	0.71	3,99,555
Year 6	5,79,637	0.65	3,76,764
Year 7	5,97,026	0.59	3,52,245
Year 8	6,14,937	0.55	3,38,215
Year 9	6,33,385	0.50	3,16,693
Year 10	6,52,387	0.46	3,00,098
			37,39,648

2. Calculating PV of purchase option at end of lease term:

Year	Payment on purchase option (A)	Present value factor @ 9.04% (B)	Present value of purchase option (A x B = C)
Year 10	30,00,000	0.42	12,60,000
			12,60,000

The discount rate for year 10 is different in the above calculations because in the earlier one its beginning of year 10 and in the later one its end of the year 10.



30. 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

Answer:

Computation of lease liability:

= Annual payment * PVF (6%, 9 years)

= ₹ 2,00,000 * 6.8017 = ₹ 13,60,338

Computation of ROU Asset

Particulars	₹
Lease liability	13,60,338
Add: Initial direct cost	20,000
Add Lease payment before commencement	2,00,000
Less: Lease incentive	5,000
ROU Asset	15,75,338

Journal Entry

Lessor's A/c	Dr.	2,00,000	
To Bank A/c			2,00,000
(₹ 2,00,000 paid as an advance before commencement)			
ROU Asset	Dr.	15,80,338	
To Lease liability A/c			13,60,338
To Bank A/c (Initial Direct cost)			20,000
To Lessor's A/c			2,00,000
(Entry made for ROU Asset)			
Bank A/c	Dr.	5,000	
To ROU Asset			5,000
(Reimbursement of Initial Direct Cost)			

31. 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.



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?

Answer:

Since Entity W is now reasonably certain that it will exercise its renewal option, it is required to remeasure the lease in the first quarter of 20X4.

The following table summarizes information pertinent to the lease remeasurement.

Remeasured lease term	5 years; 2 years remaining in the initial term plus 3 years in the renewal period
Entity W's incremental borrowing rate on the remeasurement date	6%
CPI available on the remeasurement date	125
Right-of-use asset immediately before the remeasurement	₹ 1,81,840 (Refer note 1)
Lease liability immediately before the remeasurement	₹ 1,95,244 (Refer note 1)

To remeasure the lease liability, Entity W would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 6%). The following table shows the present value of the future lease payments based on an updated CPI of 125. Since the initial lease payments were based on a CPI of 120, the CPI has increased by 4.167% approx. As a result, Entity W would increase the future lease payments by 4.167%. As shown in the table, the revised lease liability is ₹ 4,91,376.

Year	4	5	6	7	8	Total
Lease payment	1,04,167	1,04,167	1,14,583	1,14,583	1,14,583	5,52,083
Discount @ 6%	1	0.943	0.890	0.840	0.792	
Present value	1,04,167	98,230	1,01,979	96,250	90,750	4,91,376

To calculate the adjustment to the lease liability, Entity W would compare the recalculated and
original lease liability balances on the remeasurement date.

Revised lease liability	4,91,376
Original lease liability	(1,95,244)
	2,96,132

Entity W would record the following journal entry to adjust the lease liability.

ROU Asset Dr.	2,96,132	
To Lease liability		2,96,132
Being lease liability and ROU asset adjusted on account of remeasurement.		

Working Notes:

1. Calculation of ROU asset before the date of remeasurement

Year beginning	Lease Payment (A)	Present value factor @ 5% (B)	Present value of lease payments (A x B=C)
1	1,00,000	1.000	1,00,000
2	1,00,000	0.952	95,200
3	1,00,000	0.907	90,700
4	1,00,000	0.864	86,400
5	1,00,000	0.823	82,300



Lease liability as at commencement date	4,54,600

2. Calculation of Lease Liability and ROU asset at each year end

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 5%	Closing balance	Initial Value	Depreciation	Closing balance
	a	b	c = a x 5%	d = a-b + c	e	f	g
1	4,54,600	1,00,000	17,730	3,72,330	4,54,600	90,920	3,63,680
2	3,72,330	1,00,000	13,617	2,85,947	3,63,680	90,920	2,72,760
3	2,85,947	1,00,000	9,297	1,95,244	2,72,760	90,920	1,81,840
4	1,95,244				1,81,840		2,20,770

32. Illustration – Modification – Increase in Term

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?

Answer:

(The final answer might differ depending on number of digits after decimal. In exams use the actual PVF/PVAF given)

Calculation of Lease liability as at commencement date:

Particulars	Amount (₹)	Amount (₹)
Annual lease payment	1,00,000	1,00,000
PVAF (6%, 10 years)	7.359	7.360
Lease liability at commencement	**7,35,900**	**7,36,000**

Calculation of Lease liability immediately before modification date:

Year	Opening Balance (₹)	Lease Payment (₹)	Interest @ 6% (₹)	Closing Balance (₹)
1	7,36,000	1,00,000	44,160	6,80,160
2	6,80,160	1,00,000	40,810	6,20,970
3	6,20,970	1,00,000	37,258	5,58,228
4	5,58,228	1,00,000	33,494	4,91,722
5	4,91,722	1,00,000	29,503	4,21,225
6	4,21,225	1,00,000	25,274	3,46,499

Alternatively, the closing balance of liability can be computed by considering PV of 1,00,000 for 4 years.

Particulars	Amount (₹)
Remaining lease term	4 years
PVAF (6%, 4 years)	3.465
PV of remaining payments	3,46,500

[Rounding off difference exists due to rounding off)

This is a case of lease modification with increase in lease term.



Calculation of modified lease liability:

Particulars	Amount (₹)
Annual lease payment	1,00,000
Revised lease term	8 years
Revised discount rate	7%
PVAF (7%, 8 years)	5.971
Modified lease liability	**5,97,100**

Lessee recognises the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (i.e., ₹ 2,50,745) as an adjustment to the ROU Asset.

Adjustment to ROU asset:

Modified Lease liability	5,97,100
Original Lease liability as at modification date	(3,46,499)
Adjustment to ROU asset	2,50,604

The ROU asset will be increased by ₹ 2,50,604 on the date of modification.

ROU Asset Dr. 2,50,604

To Lease Liability 2,50,604

33. Illustration – Reduction in Scope (ROU Asset)

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?

Answer:

Note: First we reduce the ROU asset and Lease liability proportionately in ratio of reduction in area and then remeasure liability.

Step 1: Initial Lease Liability and ROU Asset Calculation

Entity **Lessee enters into a 10-year lease** for **5,000 sq. metres** of office space, with **annual lease payments of ₹ 50,000** payable **at year-end**. Since the **implicit rate is not available**, the **incremental borrowing rate of 6%** is used.

Calculation of Lease Liability and ROU Asset at Commencement

Particulars	Details
Annual Lease Payment	₹ 50,000
Discount Rate	6%
Lease Term	10 years
PVAF (6%, 10 years)	7.3600
Present Value of Lease Payments	₹ 50,000 × 7.3600 = **₹ 3,68,000**
Initial Lease Liability & ROU	**₹ 3,68,000**

Step 2: Pre-Modification Lease Liability and ROU Asset Balances

At the **beginning of Year 6**, before modification, the lease liability and ROU asset balances are:



ROU Asset Balance Calculation

Particulars	Calculation	Amount (₹)
ROU Asset at commencement	Given	3,68,000
Depreciation (Straight-line for 5 years)	3,68,000 ÷ 10 × 5	1,84,000
ROU Asset at beginning of Year 6	3,68,000 – 1,84,000	1,84,000
50% of remaining ROU Asset	1,84,000 × 50%	**92,000**

Lease Liability Amortization Schedule (Years 1-5)

Year	Opening Balance (₹)	Interest @ 6% (₹)	Lease Payment (₹)	Closing Balance (₹)
1	3,68,000.00	22,080.00	(50,000.00)	3,40,080.00
2	3,40,080.00	20,404.80	(50,000.00)	3,10,484.80
3	3,10,484.80	18,629.09	(50,000.00)	2,79,113.89
4	2,79,113.89	16,746.83	(50,000.00)	2,45,860.72
5	2,45,860.72	14,751.64	(50,000.00)	2,10,612.36

Calculation of Lease Liability for Remaining 5 Years using PVAF

PV of ₹ 50,000 for 5 years @ 6% = ₹ 2,10,600 [50,000 x 4.212]

Step 3: Lease Modification Adjustment

At the beginning of **Year 6**, the lease is **modified** to **reduce office space to 2,500 sq. metres**, reducing the **annual lease payment to ₹ 30,000** for the remaining **5 years**. The new **incremental borrowing rate is 5%**.

Proportionate Reduction

Particulars	Calculation	Amount (₹)
ROU Asset reduction	50% of ₹ 1,84,000	92,000
Lease liability reduction	50% of ₹ 2,10,600	1,05,300
Gain on lease modification	1,05,308 – 92,000	**13,300**

Journal Entry for Lease Reduction

Particulars	Debit (₹)	Credit (₹)
Lease Liability A/c	1,05,300	
ROU Asset A/c		92,000
Profit & Loss A/c		13,300

Step 4: Reassessment of Lease Liability Post-Modification [Consider new rent with new rate – like change in Consideration]

Since the **remaining lease liability (₹ 1,05,300) is lower** than the **new lease liability (₹ 1,29,870)**, the difference of **₹ 24,570** is adjusted in the ROU Asset.

Revised Lease Liability Calculation (5 Years, 5% Discount Rate)

Year	Lease Payment (₹)	Discount Factor @ 5%	Present Value (₹)
6	30,000	0.952	28,560
7	30,000	0.907	27,210
8	30,000	0.864	25,920
9	30,000	0.823	24,690
10	30,000	0.784	23,520
Total	**1,50,000**		**1,29,870**

Thus, **new lease liability after modification = ₹ 1,29,870**.



Journal Entry for Lease Adjustment
ROU Asset A/c Dr. ₹ 24,570
To Lease Liability A/c ₹ 24,570

(To adjust ROU Asset for revised lease liability)

34. Illustration – Change in Consideration

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?

Answer:

Step 1: Initial Lease Liability and ROU Asset Calculation at Lease Commencement

Calculation of Lease Liability and ROU Asset at commencement

Particulars	Amount
PVAF (6%, 10 years)	7.36
Annual lease payment (₹)	1,00,000
Present value of lease payments	1,00,000 × 7.36 = **7,36,000**
Initial Lease Liability	**7,36,000**
Initial ROU Asset	**7,36,000**

Step 2: Lease Liability Before Modification (Years 1-5)

Year	Opening Balance (₹)	Interest @ 6% (₹)	Lease Payment (₹)	Closing Balance (₹)
1	7,36,000	44,160	(1,00,000)	**6,80,160**
2	6,80,160	40,810	(1,00,000)	**6,20,970**
3	6,20,970	37,258	(1,00,000)	**5,58,228**
4	5,58,228	33,494	(1,00,000)	**4,91,722**
5	4,91,722	29,503	(1,00,000)	**4,21,225**

You can compute using PV factor for remaining 5 years as well.
1,00,000 x 4.2123 = 4,21,230

Step 3: Remeasuring Lease Liability After Modification (using new rate)

At the **beginning of Year 6**, the lease is modified with the changes:

Particulars	Details
Remaining lease term	5 years
Revised annual lease payment	₹ 95,000
Revised incremental borrowing rate	7%
PVAF (7%, 5 years)	4.100
Modified Lease liability	3,89,500

Step 4: Adjustment to ROU Asset

Particulars	Amount (₹)
Lease liability before modification (from Step 2)	4,21,225
Lease liability after modification	(3,89,500)
Reduction in lease liability / ROU asset	**31,725**



Lease Liability A/c Dr. ₹ 31,725
To ROU Asset A/c ₹ 31,725

(To adjust ROU Asset for revised lease liability due to lease modification)

35. Illustration – Increase in Scope & Reduction in Term

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?

Answer:

Step 1: Initial Lease Liability and ROU Asset at Lease Commencement

Particulars	Amount
PVAF (6%, 10 years)	7.36
Annual lease payment (₹)	1,00,000
Present value of lease payments (₹ 1,00,000 × 7.36)	**7,36,000**
Initial Lease Liability	**7,36,000**
Initial ROU Asset	**7,36,000**

Step 2: Lease Liability Before Modification (Years 1–5)

Year	Opening Balance (₹)	Interest @ 6% (₹)	Lease Payment (₹)	Closing Balance (₹)
1	7,36,000	44,160	(1,00,000)	6,80,160
2	6,80,160	40,810	(1,00,000)	6,20,970
3	6,20,970	37,258	(1,00,000)	5,58,228
4	5,58,228	33,494	(1,00,000)	4,91,721
5	4,91,721	29,503	(1,00,000)	**4,21,225**

Step 3: Lease Modification Adjustments (Reduction in term)

Lease liability for original 2000 Sq meters as at beg of Y6 for 3 years

Lease Payments	1,00,000
PVAF (6%, 3 Years)	2.6730
Lease Liability for 2000 Sq meters at beg of Y6.	2,67,300

Particulars	Lease Liability	ROU Asset



Carrying amount at end of Y5 (for 5 years)	421,225	368,000 [7,36,000 x 5/10]
Recomputed for 3 Years*	2,67,300	220,800 [368000 x 3/5]
Difference	153,925	147200

*How much should be the balance for remaining 3 years.

Journal Entry

Lease Liability Dr. Rs. 153,925

To ROU Asset Rs. 147,200

To P&L Rs. 6,725

Step 4: Lease Modification Adjustments (increase in scope/area)

Lease Payments	1,50,000
PVAF (7%, 3 Years)	2.624
Lease Liability for 2000 Sq meters at beg of Y6.	393,600
Lease Liability recomputed above	2,67,300
Difference (Adjust to ROU)	1,26,300

ROU Asset A/c Dr. Rs. 1,26,300

To Lease Liability Rs. 1,26,300

Break up of change in Liability

A. Impact on Existing Lease Payments (Change in Discount Rate) – Remeasurement

Particulars	Amount
Existing annual lease payment (₹)	1,00,000
PVAF @ 6% for 3 years	2.673
Present value @ 6% (₹ 1,00,000 × 2.6730)	2,67,300
PVAF @ 7% for 3 years	2.624
Present value @ 7% (₹ 1,00,000 × 2.6243)	2,62,400
Reduction in lease liability	**4,900**

Lease Liability Dr. 4,900

To ROU Asset 4,900

B. Increase in Lease Liability due to Increase in Space

Particulars	Amount
Additional annual lease payment (₹)	50,000
PVAF @ 7% for 3 years	2.624
Increase in lease liability (₹ 50,000 × 2.6243)	**1,31,200**

ROU Asset A/c Dr. Rs. 1,31,200

To Lease Liability Rs. 1,31,200

C. Net Impact of Lease Modification

Particulars	Amount (₹)
Increase due to additional space	1,31,200
Less: Reduction due to rate change	(4,900)
Net increase in lease liability	**1,26,300**

36. Illustration

Calculate of Lease liability and ROU Asset at commencement when,



- **Lease Term is 2 years**
- **Date of commencement is 1st April 20X9**
- **Lease payment at end of every quarter is Rs.1,00,000**
- **Discount factor per annum is 8%**

Answer:

Calculation of lease liability

= Annual payment * PVF (2%,8 periods)

= ₹ 1,00,000 * 7.3250 = ₹ 7,32,500

Calculation of ROU Asset at commencement:

Quarter	Opening balance	Interest @ 2%	Payment	Closing balance	Date
1	732500.00	14650.00	100000.00	647150.00	30-06-2019
2	647150.00	12943.00	100000.00	560093.00	30-09-2019
3	560093.00	11201.86	100000.00	471294.86	31-12-2019
4	471294.86	9425.90	100000.00	380720.76	31-03-2020
5	380720.76	7614.42	100000.00	288335.17	30-06-2020
6	288335.17	5766.70	100000.00	194101.88	30-09-2020
7	194101.88	3882.04	100000.00	97983.91	31-12-2020
8	97983.91	2016.09	100000.00	0.00	31-03-2021

37. 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**

Answer:

Year	Payment	Expense	Difference
1	2,000.00	2,200.00	(200.00)
2	2,500.00	2,200.00	300.00
3	2,100.00	2,200.00	(100.00)

JOURNAL ENTRY

Year 1	Lease expenses	Dr.	2,200	
	To Bank A/c			2,000
	To Lease equalisation Reserve A/c			200
Year 2	Lease expenses	Dr.	2,200	
	Lease equalisation Reserve A/c	Dr.	300	
	To Bank A/c			2,500
Year 3	Lease expenses	Dr.	2,200	
	To Bank A/c			2,100
	To Lease equalisation reserve A/c			100

38. 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?

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?

Answer:

Scenario:
Entity X (lessee) enters into a **10-year lease contract** with Entity Y (lessor) for a **non-specialised machine** used in manufacturing phone handsets. The lease can be **terminated annually without penalty** by both parties. Entity X expects to use the machine only until its upgraded phone model A2 is developed, which is anticipated within **one year**.

Application of Ind AS 116:

Under **Ind AS 116**, a lease qualifies as a **short-term lease** if its **lease term is 12 months or less** and **does not contain a purchase option**. According to **Paragraph B34**, a lease is no longer enforceable when **both** parties have the right to terminate without more than an insignificant penalty.

Since both Entity X and Y can **terminate the lease annually without a penalty**, the **non-cancellable lease period** is **only one year**, making the lease eligible for the **short-term lease exemption** under **Ind AS 116**.

Alternative Scenario (Upgrade Takes Three Years):

Even if Entity X takes **three years** to develop the new model, the lease **still qualifies for the short-term lease exemption** because both parties **retain the annual termination right** and the machine can be easily replaced at an **insignificant cost**.

Thus, in both cases, **Entity X can elect the short-term lease exemption** under **Ind AS 116**.

39. 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?

Answer:
Application of Ind AS 116:

Ind AS 116 requires **separation of lease and non-lease components**. The **office building and HVAC system** form **one lease component** because the HVAC system is **integrated** into the building and cannot be used independently.



The **office furniture** is **a separate lease component** since it can be used independently.

The **CAM services** are **non-lease components** because they **do not provide the right to use an asset** but rather constitute a service.

Component	Lease/Non-Lease	Reason
Office Building + HVAC	Lease Component	HVAC is integral to the building
Office Furniture	Lease Component	Can function independently
Common Area Maintenance	Non-Lease Component	Service provided by the lessor

Thus, **Entity L must allocate consideration between lease and non-lease components accordingly**.

40. 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?

Answer:

Scenario A

The **lease of equipment** is a lease component, while **maintenance is a non-lease component**. The **administrative fee is not a separate component** since it does not provide an identifiable good/service.

Scenario B: Additional Restoration Obligation

The lessee is required to restore the equipment to its **original condition at lease-end**. However, **restoration does not provide a good or service** during the lease period, so it is **not a separate lease component**.

Component	Lease/Non-Lease	Allocation Consideration
Equipment Rent	Lease Component	₹ 8,000
Maintenance	Non-Lease Component	₹ 1,500
Admin Fees	Not a Separate Component	₹ 500
Restoration	Not a Separate Component	Not allocated

Thus, **only the ₹ 8,000 and ₹ 1,500 will be considered in the allocation**.

41. 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?

Answer:

The lease component represents **85%** of the total estimated value, and the maintenance represents **15%**.

Component	Estimated Standalone Price	% of Total Standalone Price	Allocation of ₹ 90,000
Lease	₹ 85,000	85%	₹ 76,500
Maintenance	₹ 15,000	15%	₹ 13,500
Total	**₹ 1,00,000**	**100%**	**₹ 90,000**

Thus, **₹ 76,500 is allocated to the lease, and ₹ 13,500 to maintenance**.

42. Illustration

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?

Answer:

Since **maintenance has an observable price, ₹ 2,000 is allocated to maintenance**.
The **remaining ₹ 8,000** is allocated to the lease.
Insurance does not provide a service to the lessee, so it is **not considered a separate lease component**.

Component	Allocation
Lease	₹ 8,000
Maintenance	₹ 2,000
Insurance	Not allocated

43. 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?

Answer:

As Entity X has not elected to apply the practical expedient as provided in paragraph 15, it will separate the lease and non-lease components and allocate the total consideration of ₹ 1,70,000 to the lease and non-lease components in the ratio of their relative stand-alone selling prices as follows:

Particulars	Stand-alone Prices	% of total Standalone Price	Allocation of Consideration
	₹		₹
Building rent	1,20,000	60%	1,02,000
Service charge	80,000	40%	68,000
Total	2,00,000	100%	1,70,000

As Entity X's incremental borrowing rate is 10%, it discounts lease payments using this rate and the lease liability at the commencement date is calculated as follows:

PV of Lease payments = Lease Payments x PVAF (10%,9 years)
= 1,02,000 x 5.7590 = 5,87,418

Further, ₹ 68,000 allocated to the non-lease component of facility used will be recognised in profit or loss as and when incurred.

44. 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?

Answer:
On initial measurement, Entity X will measure the lease liability and ROU asset as under:

Calculation of Lease Liability and ROU Asset at commencement			
PV factor (5%, 5 Years)		4.3290	
Lease payments		10,000.00	
PV of lease payments		43,290.00	USD



Exchange Rate		68.00	
PV of lease payments		29,43,720	INR

As per **Ind AS 21**, lease liability (a monetary item) is **remeasured at the year-end exchange rate. However, non-monetary items (ROU Asset) are not remeasured.**

The lease schedule is presented below

Year	Opening bal	Int @ 5%	Payment	Closing bal	Closing rate	INR Closing
1	43,290.00	2,164.50	10,000.00	35,454.50	70	24,81,815
2	35,454.50	1,772.73	10,000.00	27,227.23		
3	27,227.23	1,361.36	10,000.00	18,588.59		
4	18,588.59	929.43	10,000.00	9,518.02		
5	9,518.02	481.98	10,000.00	0.00		

Lease payment schedule			**INR**		
Year	Opening bal	Interest	Payment	Closing bal	
1	29,43,720.00	1,49,350.50	7,00,000.00	23,93,071	
		[2164.5 x 69]			
		Exchange diff		88,744.50	dr. P&L

The exchange difference of Rs. 88,744.50 will be debited to P&L as per Ind AS 23.

Particulars		Dr. (₹)	Cr. (₹)
Interest Expense	Dr.	1,49,350	
To Lease liability			149350

Lease payment would be accounted for at the reporting date exchange rate, i.e. ₹ 70 at the end of year 1

Particulars		Dr. (₹)	Cr. (₹)
Lease liability	Dr.	7,00,000	
To Cash			7,00,000

At the end of year 1, the ROU asset will be measured as under:

Year	Opening Balance (₹)	Depreciation (₹)	Closing Balance (₹)
1	29,44,400	5,88,880	23,55,520

45. 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.**
- **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?

Answer:

Lessor shall classify the lease as a FINANCE LEASE because the sum of the present value of lease payments amounts to substantially all of the fair value of the underlying asset.

At lease commencement, Lessor accounts for the finance lease, as follows:

Net investment in the lease	₹ 1,11,000(a)	
Cost of goods sold	₹ 92,340(b)	
Revenue		₹ 1,03,340(c)
Property held for lease		₹ 1,00,000(d)

To record the net investment in the finance lease and derecognise the underlying asset.

i. The net investment in the lease consists of:
   (i) the present value of 10 annual payments of ₹ 15,000 plus the guaranteed residual value of ₹ 30,000, both discounted at the interest rate implicit in the lease, which equals ₹ 1,03,340 (i.e., the lease payment) (Refer note 1) AND
   (ii) the present value of unguaranteed residual asset of ₹ 20,000, which equals ₹ 7,660 (Refer note 2).

ii. Cost of goods sold is the carrying amount of the equipment of ₹ 1,00,000 (less) the present value of the unguaranteed residual asset of ₹ 7,660.

iii. Revenue equals the lease receivable

iv. The carrying amount of the underlying asset.

Computation of selling profit

Lease Payment	1,03,340
Cost of Goods Sold	1,00,000 – 7,660 = 92,340
Profit	11,000

Year 1 [Journal entry for a finance lease]

Cash	Dr.	₹ 15,000(e)	
Net investment in the lease			₹ 3,813(f)
Interest income			₹ 11,187(g)

v. Receipt of annual lease payments at the end of the year

vi. Reduction of the net investment in the lease for lease payments received of ₹ 15,000, net of interest income of ₹ 11,187

vii. Interest income is the amount that produces a constant periodic discount rate on the remaining balance of the net investment in the lease. Please refer the computation below:

The following table summarises the interest income from this lease and the related amortisation of the net investment over the lease term:

Year	Annual Rental Payment	Annual Interest Income (h)	Net investment at the end of the year
Initial net investment	-	-	1,11,000
1	15,000	11,187	1,07,187
2	15,000	10,802	1,02,989
3	15,000	10,379	98,368
4	15,000	9,914	93,282
5	15,000	9,401	87,683
6	15,000	8,837	81,520
7	15,000	8,216	74,736
8	15,000	7,532	67,268
9	15,000	6,779	59,047
10	15,000	5,953	50,000(i)

viii. Interest income equals 10.078% of the net investment in the lease at the beginning of each year. For e.g., Year 1 annual interest income is calculated as ₹ 1,11,000 (initial net investment) x 10.078%.

ix. The estimated residual value of the equipment at the end of the lease term.

Working Notes:

1 Calculation of net investment in lease:

Year	Lease Payment (A)	Present value factor @ 10.078% (B)	Present value of lease payments (A x B = C)
1	15,000	0.908	13,620
2	15,000	0.825	12,375
3	15,000	0.750	11,250
4	15,000	0.681	10,215
5	15,000	0.619	9,285
6	15,000	0.562	8,430
7	15,000	0.511	7,665
8	15,000	0.464	6,960
9	15,000	0.421	6,315
10	15,000	0.383	5,745
10	30,000	0.383	11,480*
			1,03,340

* Figure has been rounded off for equalization of journal entry

2 Calculation of present value of unguaranteed residual asset

Year	Lease Payment (A)	Present value factor @ 10.078% (B)	Present value of lease payments (A x B = C)
10	20,000	0.383	7,660

Self practice

A company manufactures specialised machinery. The company offers customers the choice of either buying leasing the machinery. A customer chooses to lease the machinery. Details of the arrangement are as follows:

(i) **The lease commences on 1st April, 20X1 and lasts for three years.**
(ii) **The lessee is required to make three annual rentals payable in arrears of ₹ 57,500.**
(iii) **The leased machinery is returned to the lessor at the end of the lease.**
(iv) **The fair value of the machinery is ₹ 1,50,000, which is equivalent to the selling price of the machinery**
(v) **The machinery cost ₹ 1,00,000 to manufacture. The lessor incurred costs of₹ 2,500 to negotiate and arrange the lease.**
(vi) **The expected useful life of the machinery is 3 years. The machinery has an expected residual value of ₹ 10,000 at the end of year three. The estimated residual value does not change over the term of the lease.**
(vii) **The interest rate implicit in the lease is 10.19%. The lessor classifies the lease as a finance lease. How should the Lessor account for the same in its books of accounts? Pass necessary journal entries.**

Solution

A **finance lease** is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee. In this case, the lease meets the **finance lease criteria** because:

1. The **useful life of the machinery (3 years) matches the lease term (3 years)**.
2. The **fair value of the machinery (₹1,50,000) equals the selling price**.
3. The **lessor earns interest income on the lease** at 10.19% implicit rate.

Step 1: Calculation of Cost of Sales

The cost to the lessor consists of:



Particulars	Amount (₹)
Book Value of Machinery	1,00,000
Initial Direct Costs	2,500
Less: Present Value of Unguaranteed Residual Value (₹10,000 discounted at 10.19%)	(7,470)
Total Cost of Sales	**95,030**

Step 2: Journal Entries at Lease Commencement

At the commencement of the lease, the lessor derecognizes the machinery and recognizes the finance lease:

Journal Entry	Debit (₹)	Credit (₹)
Lease Receivable A/c Dr.	1,50,000	
Cost of Sales A/c Dr.	95,030	
To Inventory A/c		1,00,000
To Revenue A/c		1,42,530
To Creditors/Cash (Initial Direct Cost)		2,500

- **Revenue recognized** = Lease Receivable (₹1,50,000) – PV of Residual Value (₹7,470) = ₹1,42,530. [Lease Receivable = PV of MLP + PV of UGRV ie PV of MLP = Lease Receivable – PV of UGRV]
- **Profit Recognized** = ₹1,42,530 – ₹95,030 = ₹47,500.

Step 3: Lease Receivable Schedule

Year	Opening Lease Receivable (₹)	Lease Payment (₹)	Interest Income (10.19%) (₹)	Reduction in Lease Receivable (₹)	Closing Lease Receivable (₹)
1	1,50,000	57,500	15,285	42,215	1,07,785
2	1,07,785	57,500	10,983	46,517	61,268
3	61,268	57,500	6,232*(Bal)	51,268	10,000

	Year 1		Year 2		Year 3	
Journal Entry	**Debit (₹)**	**Credit (₹)**	**Debit (₹)**	**Credit (₹)**	**Debit (₹)**	**Credit (₹)**
Cash/Bank A/c Dr.	57,500		57,500		57,500	
To Lease Receivable A/c		42,215		46,517		51,268
To Interest Income A/c		15,285		10,983		6,232

Year 3

Journal Entry	Debit (₹)	Credit (₹)
Cash/Bank A/c Dr.	57,500	
To Lease Receivable A/c		51,268
To Interest Income A/c		6,232

At the end of the lease term, the machinery is returned to the lessor at its residual value:

Journal Entry	Debit (₹)	Credit (₹)
Inventory A/c Dr.	10,000	
To Lease Receivable A/c		10,000

46. 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.

Answer:

Computation of implicit interest rate:

Year	Fixed lease	GRV	UGRV	Total
0				(10,00,000)
1	2,00,000			2,00,000
2	2,00,000			2,00,000
3	2,00,000			2,00,000
4	2,00,000			2,00,000
5	2,00,000	2,00,000	50,000	4,50,000

IRR=6.9435% [Students should compute this as a practice using interpolation method/formula method. In exams this rate will be provided]

Lease schedule:

Year	Opening balance	Interest	Payments	Closing balance
1	10,00,000	69,435	2,00,000	8,69,435
2	8,69,435	60,369	2,00,000	7,29,804
3	7,29,804	50,674	2,00,000	5,80,478
4	5,80,478	40,306	2,00,000	4,20,784
5	4,20,784	29,217	2,00,000	2,50,001

Calculation of revised present value:

Year	**Lease payment**	**PVF @ 6.9435%**	**PV**	**Note**
1	2,00,000	0.9351	1,87,015	End of Year 3
2	2,00,000	0.8744	1,74,872	End of Year 4
3	4,00,000	0.8176	3,27,037	End of Year 5
	NPV		6,88,924	

Computation of loss due to revised residual value:

Particulars	₹
Closing balance at the end of year 2 (As per Lease schedule)	7,29,804
Less: Revised closing balance	6,88,924
Loss	40,880

47. 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**
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%**

Answer:

Lease schedule – Lessor					
Year	Opening bal	Payment	Bal for Int	Interest 5%	Closing bal
1	12,00,000	1,95,000	10,05,000	50,250	10,55,250

Paragraph 79 of Ind AS 116 states as follows:

"A lessor shall account for a modification to a finance lease as a separate lease if both:

(a) the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
(b) the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

Further, paragraph 80 of Ind AS 116 states as follows:

"For a modification to a finance lease that is not accounted for as a separate lease, a lessor shall account for the modification as follows:

(a) if the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:

(i) account for the lease modification as a new lease from the effective date of the modification; and



(ii) measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.

(b) otherwise, the lessor shall apply the requirements of Ind AS 109.

In accordance with above, Entity Y accounts for the lease modification as below:

(i) Determine if the lease modification is to be accounted for as a separate new lease

Since there is no increase in scope of lease, Entity Y would not account for the modification as a new lease, separate from the original five-year lease. Entity Y would account for a single, modified lease as at the beginning of year 2.

(ii) Reassess lease classification based on the terms of the modified lease

Entity Y would classify the modified lease as an operating lease because it does not transfer substantially all the risks and rewards incidental to ownership of the underlying asset.

PV of lease payments			
		PV @ 5.43%	PV
Fixed LP	1,95,000.00	1.9484	3,70,196.00
GRV (End of Y3)	3,50,000.00	0.8996	3,14,860.00
			6,85,056.00
FV of Asset			10,00,000
	PV/FV		68.5%

(iii) Account for the modified lease

Entity Y would account for the modified lease by derecognising the net investment in the lease of INR 10,55,201 and recognising the equipment at the same amount.

Dr. PPE 10,55,201

Cr. Net Investment lease 10,55,201

If collectability of the lease payments is probable, Entity Y would recognise the remaining lease payments on a straight-line basis over the two-year modified lease team and record depreciation on the equipment.

48. Illustration – Lease modification (Operating Lease)

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?

Answer:

In case of modification of an operating lease for lessor, it is accounted as termination of existing lease. Lessor accounts for a new operating lease based on modified terms.



Step 1: Lease rental to be recognised based on original terms.

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Lease payment schedule				
Year	Fixed Lease	Income	Balance	Cumulative
1	1,00,000.00	1,25,779	25,779	25,779
2	1,05,000.00	1,25,779	20,779	46,558
3	1,10,250.00	1,25,779	15,529	62,087
4	1,15,762.50	1,25,779	10,016	72,103
5	1,21,550.63	1,25,779	4,228	76,332
6	1,27,628.16	1,25,779	-1,849	74,482
7	1,34,009.56	1,25,779	-8,231	66,252
8	1,40,710.04	1,25,779	-14,931	51,321
9	1,47,745.54	1,25,779	-21,967	29,354
10	1,55,132.82	1,25,779	-29,354	0

As at end of year 5, there is an amount of Rs. 76,332 outstanding from the lessee. This amount is adjusted against future lease payments to be made by the lessee. i.e. out of the total lease payments in future, Rs. 76,332 is for past dues.

Step 2: Accounting post modification

Years	Original Pmt	Addn Pmt	Total	Income	Diff
6	1,27,628	1,50,000	2,77,628	2,75,779	(1,849)
7	1,34,010	1,50,000	2,84,010	2,75,779	(8,231)
8	1,40,710	1,50,000	2,90,710	2,75,779	(14,931)
9	1,47,746	1,50,000	2,97,746	2,75,779	(21,967)
10	1,55,133	1,50,000	3,05,133	2,75,779	(29,354)
	Total receivable		14,55,226		(76,332)
	Less: Lease receivable Y5 (accrued already)		(76,332)		
	Balance		13,78,895		
	Income on SLM basis over 5 years.		2,75,779		

49. Illustration – Sale and Leaseback

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?

Answer:

This is a **sale and leaseback** transaction covered by **Ind AS 116**.

- Sale satisfies **Ind AS 115** → transfer qualifies as a **sale**
- Sale consideration ≠ fair value → **off-market transaction**
- Excess of sale price over fair value is treated as **additional financing**
- Buyer-lessor classifies lease as **operating lease**

Key Facts

Particulars	Amount (₹)	Note
Carrying amount of building	15,00,000	
Fair value of building	27,00,000	
Sale consideration	30,00,000	
Excess over fair value (Additional Financing)	3,00,000	This is the opening balance of liability
Gain on sale	12,00,000	27,00,000 – 15,00,000
Annual lease payment	2,00,000	
Lease term	20 years	
Discount rate	12% p.a.	
PVAF (12%, 20 years)	7.4700	
PV of payments	14,94,000	
Lease Liability (PV of Lease payments)	11,94,000	PV of Payments – Finance Liability (Loan)

Annual payment of ₹2,00,000 is split **proportionately** between:

- Lease component
- Financing component

Particulars	Total	Retained (ROU Portion)	Transferred Portion
Fair Value of Asset (₹)	27,00,000	11,94,000	15,06,000
Proportion (%)	100%	44.22% (11.94/27)	55.78% (15.06/27)
Carrying Amount (₹)	15,00,000	6,63,333 [15,00,000 x 44.22%]	8,36,667 [15,00,000 x 55.78%]
Total Gain (₹)	12,00,000	5,30,667	6,69,333

ROU Asset = (PV of lease payments / FV) × Carrying amount
= (11,94,000 / 27,00,000) × 15,00,000
= 6,63,333

Gain to be recognised – 6,69,333

Bank A/c Dr.	**30,00,000**	
Right of Use Asset A/c Dr.	**6,63,333**	
To Lease Liability A/c		**11,94,000**
To Financial Liability A/c		**3,00,000**
To Building A/c		**15,00,000**



To Profit on Sale of Asset A/c **6,69,333**

Accounting by Buyer-Lessor

- Building recognised at **fair value**
- Excess treated as **financial asset**
- Lease classified as **operating lease**

Building A/c Dr. **27,00,000**
Financial Asset A/c Dr. **3,00,000**
To Bank A/c **30,00,000**

Subsequent Measurement			
Financial Asset			
Opening balance	3,00,000		
Interest	36,000	Income	
Receipt	40,161		
Closing balance	2,95,839		

50. 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**

Answer:

Key facts

Transition		
Commencement	01-Apr-17	
Lease Term	3 years	
Lease payments - Fixed	2,00,000	end of year
Initial Application Ind AS 116	01-Apr-19	
Ind AS 17	Operating	
Discount rate	12%	01-Apr-17
Discount rate - Incremental Borrowing	10%	01-Apr-19
Financial Statements as on	31-Mar-20	
Comparative	31-Mar-19	
Restated Balance Sheet	01-Apr-18	

Under the full retrospective approach, the lease liability and the ROU asset are measured on the commencement date (i.e., 1 April 2017 in this case) using the incremental borrowing rate at lease commencement date (i.e., 12% p.a. in this case). The lease liability is



accounted for by the interest method subsequently and the ROU asset is subject to depreciation on the straight-line basis over the lease term of three years.

Full Retrospective Approach					
Lease Payements			2,00,000		
Discount rate			12%		
Term			3 years		
PVAF at 12% for 3 years			2.402		
Lease Liability (As on 1-Apr-2017)			4,80,400		
ROU Asset			4,80,400		
Lease payment schedule					
Dates	**Op. bal**	**Int @ 12%**	**Payment**	**Closing Bal**	
01-Apr-17	4,80,400	57,648	2,00,000	3,38,048	31-Mar-18
01-Apr-18	3,38,048	40,566	2,00,000	1,78,614	31-Mar-19
01-Apr-19	1,78,614	21,386	2,00,000	0	31-Mar-20
ROU Asset Balance as on 1-Apr-18					
Dates	Op. Bal	Depreciation	Closing Bal		
01-Apr-17	4,80,400	1,60,133	3,20,267.00		
01-Apr-18	3,20,267	1,60,133	1,60,134.00		
01-Apr-19	1,60,134	1,60,134	0.00		

Entry to account for ROU Asset & Lease liability

ROU Asset Dr.		3,20,267	
Retained Earnings Dr		17,781	
To Lease Liability			3,38,048

The following journal entries would be recorded during 2018-19:

Interest expense	Dr	40,566	
To Lease Liability			40,566
To record interest expense and accrete the lease liability using the interest method.			
Depreciation expense	Dr	1,60,133	
To ROU Asset			1,60,133
To record depreciation expense on the ROU asset.			
Lease Liability	Dr	2,00,000	
To Cash			2,00,000
To record lease payment.			

Modified Retrospective Approach (Alternative 1):

Under the modified retrospective approach (Alternative 1), the lease liability is measured based on the remaining lease payments (i.e., from the date of transition to the lease end



date, viz., 01 April 2019 to 31 March 2020 in this case) discounted using the incremental borrowing rate as of the date of initial application being 01 April 2019 (i.e. 10% p.a. in this case). The ROU asset is at its carrying amount as if Ind AS 116 had been applied since the commencement date (i.e., 01 April 2017 in this case) by using incremental borrowing rate as at transition date.

Lease Liability

Year	Payments	Present value Factor @ 12%	Discounted cash flows
31.3.2020	2,00,000	0.909	1,81,800

Lease Liability Schedule:

Year	Opening	Interest expenses @ 12%	Payments	Closing
31.3.2020	1,81,800	18,200	(2,00,000)	-

ROU Asset Schedule:

Year	Opening	Depreciation	Closing
31.3.2020	1,65,800	(165,800)	-

PV of Lease payments considering 10% for 3 years		
PVAF (10%, 3 Years)	2.4870	
PV of Lease payments	4,97,400	Lease Liab.
ROU Asset as on 1st April 2017	4,97,400	
Depreciation 2 Years	3,31,600	
Balance on 1-Apr-19	1,65,800	
ROU Asset Dr.	1,65,800	
Retained Earnings Dr.	16,000	
To Lease Liability		1,81,800

Modified Retrospective Approach (Alternative 2):

Under the modified retrospective approach (Alternative 2), the lease liability is also measured based on the remaining lease payments (i.e., from the date of transition to the lease end date, viz., 01 April 2019 to 31 March 2020 in this case) discounted using the incremental borrowing rate as of the date of initial application being 01 April 2019 (i.e. 10% p.a. in this case). The carrying amount of the ROU asset is an amount equal to the carrying amount of the lease liability on the date of initial application as there are no prepayments or accrual items and hence, no impact on retained earnings as on the transition date. Let us first calculate the Lease Liability and ROU Asset as follows:

ROU Asset	Dr.	1,81,800	
To Lease Liability			1,81,800
To initially recognise the lease-related asset and liability as of 1 April 2019.			

A summary of the lease contract's accounting (assuming there are no changes due to reassessments) is, as follows:

Particulars	**Full Retrospective Approach**	**Modified Retrospective Approach (Alternative 1)**	**Modified Retrospective Approach (Alternative 2)**
Opening balance sheet impact as on 1 April 2019:			
ROU Asset	1,60,126	1,65,787	1,81,820
Lease Liability	1,78,589	1,81,806	1,81,820
Period ended 31 March 2020			



activity:			
Cash lease payments	2,00,000	2,00,000	2,00,000
Lease payments recognised:			
Interest expense	21,411	18,194	18,182
Depreciation expense	1,60,127	1,65,787	1,81,820
Total periodic expense	1,81,538	1,83,981	2,00,002

51. Illustration

The Company has entered into a lease agreement for its retail store as on 1st April, 20X1 for a period of 10 years. A lease rental of ₹ 56,000 per annum is payable in arrears. The Company recognized a lease liability of ₹ 3,51,613 at inception using an incremental borrowing rate of 9.5% p.a. as at 1st April 20X1. As per the terms of lease agreement, the lease rental shall be adjusted every 2 years to give effect of inflation. Inflation cost index as notified by the Income tax department shall be used to derive the lease payments. Inflation cost index was 280 for financial year 20X1-20X2 and 301 for financial year 20X3-20X4. The current incremental borrowing rate is 8% p.

a.
Show the Journal entry at the beginning of year 3, to account for change in lease.

Solution
Scenario:

- **Company leases retail store** on **1st April 20X1** for **10 years**.
- **Annual lease rental**: ₹ 56,000 **(payable in arrears).**
- **Incremental borrowing rate at inception**: **9.5% p.a.**
- **Lease liability recognized at inception**: ₹ **3,51,613**
- **Lease rental adjusted every 2 years for inflation**, using the **Income Tax Inflation Index**.
- **Inflation index**:
  - **Base Year (FY 20X1-20X2):** 280
  - **New Index (FY 20X3-20X4):** 301
- **Revised lease rental from Year 3:** New Lease Rental=(56,000×301/280)=₹60,200
- **New incremental borrowing rate at Year 3: 8% p.a.** (Not applicable for remeasurement as per Ind AS 116)

Step 1: Re-measuring the Lease Liability at Year 3

- As per **Para 27(b) of Ind AS 116**, **variable lease payments linked to an index** are initially measured using the index at the commencement date.
- As per **Para 43**, the lease liability is **remeasured at the present value of remaining 8 lease payments of ₹ 60,200** discounted at the **original discount rate of 9.5% p.a.**

Year	Revised Lease Rental (₹)	Discount Factor @ 9.5%	Present Value (₹)
3	60,200	0.913	54,963
4	60,200	0.834	50,207
5	60,200	0.762	45,872
6	60,200	0.696	41,899
7	60,200	0.635	38,277
8	60,200	0.580	34,916
9	60,200	0.530	31,906
10	60,200	0.484	29,137
Total			**₹ 3,27,127**

Step 2: Compute Lease Liability Before Modification

Year	Opening Balance (₹)	Interest @ 9.5% (₹)	Lease Payment (₹)	Closing Balance (₹)
1	3,51,613	33,403	(56,000)	3,29,016

2	3,29,016	31,257	(56,000)	3,04,273

- **Closing lease liability before modification**: ₹ **3,04,273**
- **Revised Lease Liability after modification**: ₹ **3,27,127**
- **Increase in Lease Liability** = ₹ **22,854 (3,27,127 – 3,04,273)**

Journal Entry for Lease Remeasurement (Year 3)
Right-of-Use Asset A/c Dr. ₹ 22,854
To Lease Liability A/c ₹ 22,854

(Adjusting the increase in lease liability due to inflation-based rental adjustment.)

52. Illustration

How will Entity Y account for the incentive in the following scenarios:
Scenario A: Entity Y (lessor) enters into an operating lease of property with Entity X (lessee) for a five-year term at a monthly rental of ₹ 1,10,000. In order to induce Entity X to enter into the lease, Entity Y provides ₹ 6,00,000 to Entity X at lease commencement for lessee improvements (i.e., lessee's assets).
Scenario B: Entity Y (lessor) enters into an operating lease of property with Entity X (lessee) for a five-year term at a monthly rental of ₹ 1,10,000. At lease commencement, Entity Y provides ₹ 6,00,000 to Entity X for leasehold improvements which will be owned by Entity Y (i.e., lessor's assets). The estimated useful life of leasehold improvements is 5 years.

Solution

Lease incentives are **payments made by the lessor to the lessee** to encourage the lessee to enter into a lease agreement. As per **Ind AS 116, Para 70**, lease incentives **reduce the total lease income** recognized by the lessor over the lease term. The treatment of lease incentives varies depending on whether the incentives relate to **lessee-owned assets** or **lessor-owned assets**.

Scenario A: Lease Incentive for Lessee-Owned Assets

- Entity Y (lessor) provides ₹6,00,000 to Entity X (lessee) for **lessee improvements**, which means **the lessee owns the improvements**.
- As per **Ind AS 116**, this amount is treated as a **lease incentive** and is **amortized over the lease term**.

Journal Entries at Lease Commencement

Particulars	Debit (₹)	Credit (₹)
Deferred Lease Incentive A/c Dr.	6,00,000	
To Cash A/c		6,00,000

Recurring Monthly Journal Entries (Years 1 – 5)

Particulars	Debit (₹)	Credit (₹)
Cash A/c Dr.	1,10,000	
To Lease Income A/c		1,00,000
To Deferred Lease Incentive A/c		10,000

Amortization of lease incentive = ₹6,00,000 ÷ 60 months = ₹10,000 per month

- **Lease rental income is recognized at ₹1,00,000 per month** instead of ₹1,10,000.
- **Lease incentive is amortized equally over the lease term**.



Scenario B: Lease Incentive for Lessor-Owned Assets

- Entity Y provides ₹6,00,000 to Entity X **for leasehold improvements, but these remain lessor's property**.
- In this case, the amount is **not a lease incentive** but is **capitalized as Property, Plant & Equipment (PPE)** in the books of Entity Y.
- The cost is **depreciated over the useful life of the leasehold improvements (5 years).**

Journal Entries at Lease Commencement

Particulars	Debit (₹)	Credit (₹)
Property, Plant & Equipment A/c Dr.	6,00,000	
To Cash A/c		6,00,000

Recurring Monthly Journal Entries (Years 1 – 5)

1. Recording Lease Income

Particulars	Debit (₹)	Credit (₹)
Cash A/c Dr.	1,10,000	
To Lease Income A/c		1,10,000

2. Recording Depreciation on Leasehold Improvements

Particulars	Debit (₹)	Credit (₹)
Depreciation A/c Dr.	10,000*	
To Accumulated Depreciation A/c		10,000

Depreciation = ₹6,00,000 ÷ 60 months = ₹10,000 per month

Differences Between Scenario A & B

Aspect	Scenario A (Lessee-Owned Asset)	Scenario B (Lessor-Owned Asset)
Nature of Incentive	Lease incentive	Capitalized as PPE
Accounting Treatment	Deferred lease incentive, amortized over lease term	Recorded as **PPE** and depreciated
Impact on Lease Income	Reduces lease income to ₹1,00,000 per month	No impact, full ₹1,10,000 lease income is recognized
Depreciation	Not applicable	Depreciation of ₹10,000 per month

53. Illustration

Wealth Ltd. has entered into lease agreement with a lessor for a period of 5 years at the annual lease rental of Rs. 8 lakhs. There is an option at the end of the said period that lease can be owned by lessee. Other factors to be noted are discount rate of 8% per annum and interest rate implicit in the lease of 10% per annum.

Wealth Ltd. is reasonably certain to exercise the option to purchase the leased asset at the end of lease term and Rs. 56,00,000 is the exercise price agreed in the lease term for purchasing of land at the end of the 5th year. Therefore, the same has been considered in computing the present value of the lease liability.

At the end of the year 3, Wealth Ltd. exercised the option to purchase the land at value of Rs. 56 lakhs, whereas the market value on that date was Rs. 75 lakhs.
For revised discount rate, consider the interest rate implicit in the lease.

Required



(i) **Calculate the lease liability and right of use asset for the lease with the lessor. RoU is depreciated on SLM basis.**

(ii) **Provide the amounts reflecting in the balance sheet, profit and loss and statement of cash flows at the end of year 1.**

(iii) **What are the accounting entries if Wealth Ltd. decides to purchase the leased property at the end of year 3?**

Solution:

i. Calculation of ROU Asset and Lease Liability:

Year	Lease Payments / Purchase Price	PVF @ 10%	PV of Lease payments
1	8,00,000	0.909	7,27,200
2	8,00,000	0.826	6,60,800
3	8,00,000	0.751	6,00,800
4	8,00,000	0.683	5,46,400
5	64,00,000 (8,00,000 + 56,00,000)	0.621	39,74,400
			65,09,600

Entity would amortise the right-of-use asset over the useful life of the underlying asset (5 years). Annual amortisation expense would be Rs. 13,01,920 (Rs. 65,09,600 / 5 years). Accordingly, ROU Asset balance at the end of Year 1 is Rs. 52,07,680 (Rs. 65,09,600 – Rs. 13,01,920).

1. Presentation at the end of Year 1:

In Balance Sheet	In Profit and Loss	In Statement of Cash Flows
ROU Asset: Rs. 52,07,680 (W.N.2)	Depreciation = Rs. 13,01,920 (W.N.2)	Cash flow from financing activities: Lease payment = Rs. 8,00,000
Lease Liability: Rs. 63,60,560 (W.N.1)	Interest expense (Finance cost) = Rs. 6,50,960 (W.N.1)	

2. In the above part (i), it was considered that lessee was reasonably certain that he will exercise the option at the end of 5th year that's why the same has been considered in determination of lease payment. Now, lessee is exercising the option at the end of 3rd year which implies that there is change in the assessment of an option to purchase the underlying asset. Hence, paras 39 and 40(b) of IFRS 16 will come into the picture which are as follows (only relevant part have been reproduced here):

3. After the commencement date, a lessee shall apply paragraphs 40–43 to remeasure the lease liability to reflect changes to the lease payments. A lessee shall recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

4. A lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate,
if either:
(a)
(b) there is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraphs 20–21 in the context of a purchase option. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.

Therefore, the lease liability has to be remeasured on change in the assessment of exercising the option.

/Original lease liability is Rs. 60,16,278 (Working Note 1). Since at the end of the 3rd year, the lease has been terminated due to exercise of option to purchase the asset, the revised lease liability is the amount paid on exercising the option i.e. Rs. 56,00,000. The difference



of original lease liability and revised lease liability will decrease the carrying amount of the right-of-use asset.

Accordingly, the adjustment to ROU Asset would be
= Rs. 60,16,278–Rs. 56,00,000 = Rs. 4,16,278.

Journal Entry

Particulars		**(Rs.)**	**(Rs.)**
Lease liability	Dr.	4,16,278	
To ROU Asset			4,16,278
(Adjustment of difference in original lease liability and revised lease liability to ROU Asset)			
Particulars		**(Rs.)**	**(Rs.)**
Lease liability	Dr.	4,16,278	
To ROU Asset			4,16,278
(Adjustment of difference in original lease liability and revised lease liability to ROU Asset)			

Note: We have stopped till the entry to exercise the option to purchase the leased asset (as per the requirement of the question). Treatment for change in the value of PPE due to its fair value has not been considered here.

Working Notes:

1. Calculation of outstanding Lease Liability at the end of 3rd year

Year	**Opening balance (A)**	**Interest @ 10% (B)**	**Lease payments (C)**	**Closing balance (A) + (B) - (C)**
	Rs.	**Rs.**	**Rs.**	**Rs.**
1	65,09,600	6,50,960	8,00,000	63,60,560
2	63,60,560	6,36,056	8,00,000	61,96,616
3	61,96,616	6,19,662	8,00,000	60,16,278

2. Calculation of ROU Asset balance at the end of 3rd year

Year	**Opening balance (A)**	**Depreciation (B)**	**Closing balance (A-B)**
	Rs.	**Rs.**	**Rs.**
1	65,09,600	13,01,920	52,07,680
2	63,60,560	13,01,920	39,05,760
3	61,96,616	13,01,920	26,03,840



IND AS 37
Provisions, Contingent Liabilities & Contingent Assets
ILLUSTRATIONS

1. Illustration

X Ltd. is engaged in the manufacture of fertilisers. Effluents discharged in the manufacturing process have polluted the river near the manufacturing plant. The residents of the nearby locality launched a massive agitation against the pollution. X Ltd. agreed to their demands to reduce the water pollution by installing the necessary Effluent Treatment Plant. However, during the year no steps are taken to install the plant. No legislation requiring the company to reduce its pollution is in existence.

Sol:

Relevant Provisions

A **constructive obligation** arises when a company, through its past actions, policies, or statements, creates a reasonable expectation that it will fulfill certain responsibilities. If stakeholders believe the company will follow through on its commitments, a **valid expectation is created**, requiring the recognition of a provision.

Analysis

X Ltd. publicly committed to installing an **Effluent Treatment Plant** after protests from local residents. Even though there is **no legal requirement** to do so, its public promise has created a **constructive obligation**. Since the company has not acted on its commitment, there is an **unfulfilled obligation** that must be recognized.

Final Answer

X Ltd. **must recognize a provision** for the cost of installing the treatment plant as a constructive obligation has been created.

2. Illustration

ABC Limited is an automobile component manufacturer. The automobile manufacturer has specified a delivery schedule, non-adherence to which will entail a penalty. As on 31st March, 20X1, the reporting date, the manufacturer has a delivery scheduled for June 20X2. However, the manufacturer is aware that he will not be able to meet the delivery schedule in June 20X2. Determine whether the entity has a present obligation as at 31st March, 20X1, requiring recognition of provision.

Sol:

Relevant Provisions

A provision is recognized when:

1. A **present obligation** exists due to a past event.
2. It is **probable** that economic outflows will occur.
3. The obligation amount can be **reliably estimated**.

If the event triggering the liability has **not yet occurred**, no provision should be made.

Analysis



ABC Ltd. has a contract with a **delivery deadline in June 20X2** and penalties for non-compliance. As of **31st March 20X1**, the company expects to miss the deadline but has **not yet breached the contract**. Since the **penalty will only apply after the delivery failure**, no present obligation exists at the reporting date.

Final Answer

ABC Ltd. **should not recognize a provision** as no present obligation exists as of **31st March 20X1**.

3. Illustration

The government introduces a number of changes to the income tax system. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the end of the reporting period, no retraining of staff has taken place. It is assumed that a reliable estimate can be made of any outflows expected.
Should the provision be recognised?

Sol:

Relevant Provisions

Provisions are recognized **only if a past event** has created a present obligation. Future expenses, even if expected, do not qualify unless they are legally or constructively required.

Analysis

A financial services company is **required to retrain employees** due to regulatory changes, but as of the reporting date, **no retraining has been conducted**. Since the company **has not yet incurred any costs**, and training remains a **future activity**, there is **no present obligation**.

Final Answer

The company **should not recognize a provision** for retraining costs. Instead, the expenses should be recorded as and when they occur.

4. Illustration

Under new legislation, an entity is required to fit smoke filters to its factories by September 30, 20X1. The entity has not fitted the smoke filters till March 31, 20X2. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Answer:

Relevant Provisions

A provision should be recognised when:
(a) An entity has a present obligation (legal or constructive) as a result of a past event;
(b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) A reliable estimate can be made of the amount of the obligation.

A **legal obligation** exists when a company is bound by law to 2ulfil a responsibility. If a company fails to meet legal requirements by the deadline, it must recognize a provision for the expected penalties.

Analysis



A company is required to **install smoke filters by 30th September 20X1**, but it **fails to do so** by **31st March 20X2**. At **31st March 20X1**, no provision was needed as the deadline had not passed. However, by **31st March 20X2**, the company is **in violation of the law**, making it **liable for penalties**.

Final Answer

The company **must recognize a provision** for the expected fines or penalties but **should not recognize a provision for the installation cost**.

5. Illustration

A furnace has a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Answers:

- A provision should be recognised when:

(a) An entity has a present obligation (legal or constructive) as a result of a past event;
(b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) A reliable estimate can be made of the amount of the obligation.

Future maintenance or replacement costs do not qualify as provisions unless they are legally required or unavoidable. Instead, such costs should be accounted for through **depreciation**.

Analysis

A furnace lining must be **replaced every five years**, and as of the reporting date, it has been used for **three years**. However, since the company **controls the timing of the replacement**, and there is **no external obligation**, a provision is **not required**.

Final Answer

The company **should not recognize a provision** but should account for the cost through **depreciation over five years**.

6. Illustration

An airline is required by law to overhaul its aircraft once every three years. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Answers:

- A provision should be recognised when:

(a) An entity has a present obligation (legal or constructive) as a result of a past event;
(b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) A reliable estimate can be made of the amount of the obligation.

A company must recognize a provision **only if an unavoidable obligation exists**. If the company can **avoid the cost by discontinuing operations**, no provision is required.

Analysis



An airline must **overhaul its aircraft every three years**, but this obligation exists **only if it continues to use the aircraft**. If the company **sells the aircraft**, it can avoid the cost. Since the obligation depends on **future business decisions**, a provision **should not be recognized**.

Final Answer

The company **should not recognize a provision** for maintenance. Instead, it should account for the cost through **depreciation**.

7. Illustration

X Shipping Ltd. Is required by law to overhaul its shipping fleet once in every 3 years. The company's finance team was of the view that recognising the costs only when paid would prevent matching of revenue earned all the time with certain costs of large amounts which are incurred occasional. Thereby, it has formulated an accounting policy of providing in its books of account for the future cost of maintenance (overhauls, annual inspection etc.) by calculating a rate per hours sailed on sea and accumulating a provision over time. The provision is adjusted when the expenditure is actually incurred. Is the accounting policy of X Shipping Ltd. Correct?

Answer:

Relevant Provisions (Ind AS 37)

A **provision should be recognized** when:

1. There is a **present obligation (legal or constructive)** due to a past event.
2. It is **probable** that an **outflow of economic benefits** will be required to settle the obligation.
3. A **reliable estimate** can be made of the obligation.

An expense that will arise due to **future activities** is **not a liability** at the reporting date. Only **existing obligations** must be recognized. Future maintenance costs should not be treated as a provision unless they arise due to past events.

Analysis

X Shipping Ltd. is required by law to **overhaul its fleet every three years**. To manage costs, the company is **accumulating a provision over time** based on **hours sailed**, adjusting it when the expenditure is incurred. However, this approach does not comply with Ind AS 37. The cost of overhauling does **not arise from a past event**, and the company **could avoid** the overhaul by **selling the ships**, meaning there is **no present obligation**. The company is attempting to match expenses with revenue, but financial statements must **only recognize obligations that exist at the reporting date**, not anticipated future costs.

Conclusion

The accounting policy of X Shipping Ltd. is **incorrect** under Ind AS 37. Instead of accumulating provisions, the company should **use the component approach under Ind AS 16** (Property, Plant, and Equipment), where the overhaul cost is **capitalized and depreciated over time**.



8. Illustration

An entity in the oil industry (having 31st March year-end) causes contamination but cleans up only when required to do so under the laws of the particular country in which it operates. One country in which it operates has had no legislation requiring cleaning up, and the entity has been contaminating land in that country for several years. At March 31st 20x1, it is virtually certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year-end. It is assumed that a reliable estimate can be made of any outflows expected. Is the provision to be recognised?

Answer:

Relevant Provisions (Ind AS 37)

A **provision should be recognized** when:

1. A **present obligation** exists due to a **past event**.
2. An **outflow of economic benefits** is **probable**.
3. A **reliable estimate** of the obligation can be made.

A law that is **not yet enacted** does **not** create a present obligation unless it is **virtually certain** to be enacted.

Analysis

The entity has been **polluting land** in a country where there is **no current law** requiring cleanup. However, by **31st March 20X1**, it is **virtually certain** that a law requiring **cleanup of past contamination** will be enacted. Since the company has **already contaminated the land**, the **event has already occurred**, and the **future legislation will enforce a legal obligation**. Additionally, a **reliable estimate** of cleanup costs can be made.

Conclusion

A **provision must be recognized** as of **31st March 20X1** for the **best estimate of the cleanup costs**. The contamination is a **past event**, and the draft law makes it **virtually certain** that the company will have to clean up.

9. Illustration

An entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. 90% of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and 10% arise through the extraction of oil. At the end of the reporting period, the rig has been constructed but no oil has been extracted. It is assumed that a reliable estimate can be made of any outflows expected.

Answers:

Relevant Provisions (Ind AS 37)

A **provision should be recognized** when:

1. A **legal or constructive obligation** exists due to a **past event**.
2. An **outflow of resources** to settle the obligation is **probable**.
3. A **reliable estimate** of the cost can be made.

Analysis



The entity operates an **offshore oilfield**, and its licensing agreement requires it to **remove the oil rig** at the end of production.

- **90% of the eventual cost** relates to **removing the rig and restoring damage caused by construction**.
- **10% of the costs** will arise due to **damage from oil extraction**.

Since the rig has **already been constructed**, the company **already has a legal obligation** to remove it, meaning a **provision should be recognized**. However, costs related to **future oil extraction** should **not be recognized yet**, as they will arise in the future.

Conclusion

A **provision must be recognized for 90% of the costs** related to the **removal of the oil rig** and **restoration of construction damage**. The **remaining 10% should be recognized as a liability when oil extraction occurs**.

10. Illustration

After a wedding in 20X1-20X2, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of approval of the financial statements for the year to 31 March 20X2 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 March 20X3, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

Answer:
Recognition of provision:

Relevant Provisions (Ind AS 37)

A **provision is recognized** only if:

1. There is a **present obligation** from a **past event**.
2. An **outflow of resources** is **probable**.
3. A **reliable estimate** can be made.

If the outcome is **uncertain**, a **contingent liability should be disclosed** instead of a provision.

Analysis

- **31st March 20X2**: Legal proceedings have started, but the **company disputes liability**. The company's lawyers believe it is **probable that the company will not be found liable**, meaning there is **no present obligation**. The case should be treated as a **contingent liability** and disclosed in the financial statements.
- **31st March 20X3**: The legal team now believes it is **probable** that the company **will be found liable**. This means there is now a **present obligation**, and a **provision must be recognized**.

Conclusion



At **31st March 20X2**, **no provision is required**; instead, the case should be disclosed as a **contingent liability**. By **31st March 20X3**, a **provision must be recognized** for the **best estimate of settlement costs**, as it is now **probable** that the company will lose the case.

11. Illustration

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of ₹ 1 million would result. If major defects were detected in all products sold, repair costs of ₹ 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75% of the goods sold will have no defects, 20% of the goods sold will have minor defects and 5% of the goods sold will have major defects. In accordance with the standard, an entity assesses the probability of an outflow for the warranty obligations as a whole.

Answers:

Particulars	Probability	Repair cost (in Millions)	Expected Cost (in Millions)
No defects	75%	0	0
Minor defects	20%	1	0.2
Major defects	5%	4	0.2
Total expected cost			0.4

12. Illustration

An entity faces a single legal claim, with a 40 per cent likelihood of success with no cost and a 60 percent likelihood of failure with a cost of ₹ 1 million. Should entity use expected value method or most likely outcome method?

Answer:

- Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability.
- In this case, most likely outcome is likelihood of failure (60%) with a cost of ₹. 1 Million
- Therefore, A provision of ₹. 1 Million will be recognised.

13. Illustration

X Solar Power Ltd., a power company, has a present obligation to dismantle its plant after 35 years of useful life. X Solar Power Ltd. Cannot cancel this obligation or transfer to third party. X Solar Power Ltd. Has estimated the total cost of dismantling at ₹ 50,00,000, the present value of which is ₹ 30,00,000. Based on the facts and circumstances, X Solar Power Ltd. Considers the risk factor of 5% i.e., the risk that the actual outflows would be more from the expected present value. How should X Solar Power Ltd. Account for the obligation?

Answer:

Particulars	₹
Cost of dismantling	50,00,000
PV cost of dismantling (a)	30,00,000
Risk involved (b)	5%
Risk adjustment (c=a * b)	1,50,000
Provision to be recognised (a+c)	31,50,000

14. Illustration

ABC Ltd. has an obligation to restore the seabed for the damage it has caused in the past. It has to pay ₹ 10,00,000 cash on 31st March 20X3 relating to this liability. ABC Ltd.'s management considers that 5% is an appropriate discount rate.
Calculate the amount to be provided for at 31st March 20X1 for the costs of restoring the seabed.



Sol:

(a) Computation of Present Value as on 31.03.20x1:

- Discounting factor of 5% for 2nd year as on 31st March 20X1 = $(\frac{1}{1.05})^2$= 0.907
- The present value of the provision as on 31st March 20X1 is= ₹. 10,00,000 x 0.907 = ` 9,07,000
- The amount of increase in the provision resulting from unwinding of discounting to reflect the passage of time should be included as an element of borrowing cost in determining the profit or loss for the year.

15. Illustration

At the end of 20X1, an entity is demonstrably committed to the closure of some facilities, having drawn up a detailed plan and made appropriate announcements. The expected impact of the plan is as follows:

	20X2	20X3
Committed closure costs	₹ 10,00,000	
Gain from sale of property		₹ 2,00,000

Sol:

In this case, the entity has made a **detailed plan and public announcement** regarding the closure of certain facilities, which creates a **valid expectation** and results in a **constructive obligation**. The committed closure cost is ₹10,00,000, which must be recognized as a **provision at the reporting date**. The expected gain from the sale of the property (₹2,00,000) should **not be offset against the provision** but accounted for separately under **Ind AS 16** (Property, Plant, and Equipment).

Conclusion

The entity must recognize a **provision of ₹10,00,000** at the reporting date, while the gain on the sale of the property is accounted for separately as per Ind AS 16.

16. Illustration

X Beauty Solutions Ltd. Is selling cosmetic products under its brand name 'B', but it is getting its product manufactured from Y Ltd. It has an understanding (enforceable agreement) with Y Ltd. That if the company becomes liable for any damage claims, due to any injury or harm to the customer of the cosmetic products, 30% will be reimbursed to it by Y Ltd. During the financial year 20X1-20X2, a claim of ₹ 30,00,000 becomes payable to customers by X Beauty Solutions Ltd. How should X Beauty Solutions Ltd. Account for the claim that becomes payable?

Sol:

For **reimbursements**, an entity must recognize an asset **only if recovery is virtually certain** under an **enforceable agreement**. However, the reimbursement right must be recorded separately from the provision.

Analysis

X Beauty Solutions Ltd. has an **agreement with Y Ltd.** that 30% of any customer damage claim will be reimbursed. During the year, a **claim of ₹30,00,000** is payable to customers, out of which **₹9,00,000 (30%) will be reimbursed**. Since the agreement is **legally enforceable**, the reimbursement right must be **recognized as a separate asset** and **not netted off** against the liability.

Conclusion



A **provision of ₹30,00,000** must be recognized for the claim, while a **reimbursement asset of ₹9,00,000** should be recorded separately. The net expense in the **statement of profit and loss** will be **₹21,00,000** after offsetting the reimbursement.

17. Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. The gas will be used to generate electricity, which will be sold at a profit. Is this an onerous contract?

Sol:

An **onerous contract** is a contract where the **unavoidable costs** of fulfilling the contract **exceed the expected economic benefits**. When an onerous contract is identified, the entity must recognize a **provision for the least net cost of exiting the contract**, which is:

1. **The cost of fulfilling the contract**, or
2. **The compensation for non-fulfillment**, whichever is lower.

Analysis

The entity has a contract to **purchase gas at 23p per unit** for a total cost of **₹2,30,000**, while the **market price has dropped to 16p per unit** (total price **₹1,60,000**).

- Since the gas will be **used to generate electricity at a profit**, the contract is **not onerous**, as the economic benefits will still exceed the costs.

Conclusion

Since electricity will be sold at a **profit**, no provision is required as the contract is **not onerous**.

18. Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. What if electricity sold at a loss?

Sol:

Here, the entity is now **selling electricity at a loss**, meaning the contract is **onerous** because the **costs exceed economic benefits**.

- Before recognizing a provision, the entity must **assess if assets used for electricity generation are impaired** under **Ind AS 36**.
- If the assets are already impaired and a loss still exists, a **provision for the onerous contract** must be recognized.

Conclusion

If electricity is sold at a **loss**, a provision should be recognized for the **least cost of fulfilling or exiting the contract**.



Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. Assume the entity sells the gas under contract, which it no longer needs, to a third party for 18p per unit. The entity determines that it would have to pay ₹ 55,000 to exit the purchase contract. What is the provision to be made?

Solution:

The entity **sells the gas** to a third party at **18p per unit** for **₹1,80,000** but has a **purchase obligation at 23p per unit** (total **₹2,30,000**). The entity also has the option to **exit the contract by paying a ₹55,000 penalty**.

- **Loss on fulfilling the contract:** ₹2,30,000 - ₹1,80,000 = **₹50,000**
- **Cost of contract termination (penalty):** ₹55,000

Since the **lower cost is ₹50,000**, this amount must be **recognized as a provision**.

Conclusion

The entity should recognize an **onerous contract provision of ₹50,000**, as it represents the least cost of fulfilling the contract.

19. Illustration

X Sugars Ltd. has entered into a sale contract of ₹ 3,00,00,000 with Y Chocolates Ltd. for the supply of sugar during 20X1-20X2. As per the contract the delivery is to be made within 2 months from the date of contract.
In case of failure to deliver within the schedule, X Sugars Ltd. has to pay a compensation of ₹ 30,00,000 to Y Chocolates Ltd.
During the transit, the vehicle carrying the sugar met accident and X Sugar Ltd. lost the entire consignment.
It is, however covered by an insurance policy.
According to the report of the surveyor, the amount is collectible, subject to the deductible clause [i.e., 15% of the claim] in the insurance policy.
The cost of goods lost was ₹ 2,50,00,000.
Before the financial year end, X Sugars Ltd. received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount. Meanwhile Y Chocolates Ltd. has made demand of ₹ 30,00,000 since the goods were not delivered on time.
What provision or disclosure would X Ltd. need to make at year end?

Sol:

X Sugars Ltd. had a **sale contract of ₹3,00,00,000** but lost the goods in transit. The goods were **insured**, and the insurance company **agreed to pay 85% of the claim** (after deducting 15% as per policy terms). However, the company still has to **pay a penalty of ₹30,00,000** to Y Chocolates Ltd. for non-delivery.

- **Cost of goods lost:** ₹2,50,00,000
- **Insurance reimbursement (85% of claim):** ₹2,12,50,000
- **Penalty payable to Y Chocolates Ltd.:** ₹30,00,000

Conclusion



- The company can disclose the insurance reimbursement for ₹2,12,50,000 since informal confirmation has been received. If the informal confirmation is considered to be virtually certain, the reimbursement can be recognised in financial statements.
- The company also needs to recognise the penalty payable to Y chocolates for ₹30,00,000s

20. Illustration

The annual reporting period of ABC Ltd. ends on March 31. As per the legislation of the State government, a levy is imposed on ABC Limited in full when it generates revenue in financial year 2016-17. The levy imposed by the government is calculated by reference to revenue generated by ABC Ltd. in previous financial year. ABC Ltd. had generated revenue of ₹ 200 crores in financial year 2015-16. For financial year 2016-17, it starts to generate revenue on April 5, 2016.
ABC Ltd. paid the levy on July 10, 2016. What is the obligatory event that gives rise to recognition of a liability to pay a levy in the present case?
What are the principles for recognising the levy in the annual financial statements and interim financial report?

Sol:
Appendix C to Ind AS 37 inter alia states that, a levy is an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (i.e. laws and/or regulations), other than:

(a) those outflows of resources that are within the scope of other Standards (such as income taxes that are within the scope of Ind AS 12, Income Taxes); and
(b) fines or other penalties that are imposed for breaches of the legislation

According to paragraph 10 of Ind AS 37, an obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

The obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation.

ABC Ltd. is subject to a **government levy** when it **generates revenue in 2016-17**, but the levy is **calculated based on revenue of 2015-16**. Since the **obligating event** is the **first generation of revenue in 2016-17**, the levy liability must be **recognized in full on April 5, 2016**.

- The **previous year's revenue** is only used for **calculation purposes**, not for recognition of liability.
- The **date of levy payment (July 10, 2016)** does not impact the liability recognition.

Conclusion

ABC Ltd. **must recognize the liability in full on April 5, 2016**, when it **first generates revenue in 2016-17**.

With regard to interim financial report, an entity shall apply the same recognition principles in the interim financial report that it applies in the annual financial statements.

In the given case, ABC Ltd. has a present obligation to pay the levy on April 5, 2016. In the first interim financial report for the quarter ending June 30, 2016, the liability should be recognised in full since the liability is recognised in full on April 5, 2016.



21. Illustration

X Ltd. is operating in the telecom industry. During the Financial Year 20X1-20X2, the Income Tax authorities sent a scrutiny assessment notice under Section 143(2) of the Income-tax Act, 1961, in respect to return filed under Section 139 of this Act for Previous Year 20X0-20X1 (Assessment Year 20X1-20X2) and initiated assessment proceedings on account of a deduction claimed by the company which in the view of the authorities was inadmissible.
During the financial year 20X1-20X2 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of ₹ 1,00,00,000 against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 20X1-20X2, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 20X1-20X2.

Sol:

X Ltd. has a **pending tax dispute** with a demand of **₹1,00,00,000**. The legal opinion suggests a **50% chance of winning the case** based on conflicting judgments.

- **If an outflow of resources is probable**, a **provision should be recognized**.
- If the outflow is **possible but not probable**, the amount should be **disclosed as a contingent liability**.

Since the **chance of winning is uncertain**, but an outflow is still **probable**, a **provision should be made**.

Conclusion

X Ltd. **must recognize a provision of ₹1,00,00,000**, as it is more likely than not that the obligation exists at the reporting date.

22. Illustration

Entity A is a dealer in washing machines. Entity A offers to its customers a scheme whereby it states that after a period of 3 years, the entity offers to buy back the washing machine at a fixed price which is expected to be less than the fair value of the machine at the end of three years. The credit emanating therefrom will be required to be used by the customer for buying a new washing machine, i.e., new washing machine will be sold at a discounted price. Past experience indicates that customers generally opt for this scheme. At the time of sale of the first washing machine should entity A recognise any provision in this regard?

Sol:

Entity A **offers a buyback scheme** where customers can return their washing machine after 3 years at a **fixed price** (below fair value) to purchase a new machine.

Since:

1. The scheme creates a **valid expectation** among customers.
2. Past experience shows that customers **opt for the scheme**.



3. The discount is **reliably estimable**.

A **provision for the expected buyback discount should be recognized** at the time of **sale of the first machine**.

Conclusion

Entity A **must recognize a provision** for the estimated cost of fulfilling the **discounted sale obligation** from the buyback offer.

23. Illustration

U Ltd. Is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 20X2 as per the notified Ind AS. The financial statements are due to be approved for issue on 15th May 20X2. Following are a few transactions that have taken place in some of its subsidiaries during the year:
G Ltd. Is a wholly-owned subsidiary of U Ltd. Engaged in management consultancy services. On 31st January 20X2, the board of directors of U Ltd. Decided to discontinue the business of G Ltd. From 30th April 20X2. They made a public announcement of their decision on 15th February 20X2.
G Ltd. Does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 20X2. U Ltd. Would collect any amounts still owed by G Ltd.'s customers after 31st May 20X2. They have offered the employees of G Ltd. Termination payments or alternative employment opportunities.
Following are some of the details relating to G Ltd.:
- On the date of public announcement, it is estimated by G Ltd. That it would have to pay ₹ 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be ₹ 60 lakhs. The actual termination payments totalling to ₹ 520 lakhs were made in full on 15th May 20X2. As per latest estimates made on 15th May 20X2, the total relocation cost is ₹ 63 lakhs.
- G Ltd. Had taken a property on operating lease, which was expiring on 31st March 20X6. The present value of the future lease rentals (using an appropriate discount rate) is ₹ 430 lakhs. On 15th May 20X2, G Ltd. Made a payment to the lessor of ₹ 410 lakhs in return for early termination of the lease.
The loss after tax of G Ltd. For the year ended 31st March 20X2 was ₹ 400 lakhs. G Ltd. Made further operating losses totalling ₹ 60 lakhs till 30th April 20X2.
What are the provisions that the Company is required to make as per Ind AS 37?

Sol:

Relevant Provisions (Ind AS 37)

A **provision for restructuring** is recognized when:

1. The company has a **detailed, formal plan** for restructuring.
2. The company has created a **valid expectation** by communicating the plan to those affected.
3. The restructuring costs **exclude future operating losses** and **only cover direct costs**.

Analysis

U Ltd. Is **closing its subsidiary G Ltd.** And made a **public announcement on 15th February 20X2**, creating a **constructive obligation**. The estimated costs include:

- **Termination payments:** ₹520 lakhs (actual)



- **Relocation costs:** ₹63 lakhs (future cost, not included in provision)
- **Operating lease penalty:** ₹410 lakhs (onerous contract)

Since the **termination payments** and **lease settlement** relate to the restructuring plan, they should be **provisioned immediately**. However, **relocation costs** are **future business costs** and should not be included.

Conclusion

A provision of **₹930 lakhs (₹520 lakhs + ₹410 lakhs)** should be **recognized for restructuring**, while **relocation costs should be accounted for separately**.

24. Illustration

A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and financial statements have been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information?

Sol:

Relevant Provisions (Ind AS 37)

A **contingent asset** should **only be recognized** when it becomes **virtually certain** to be received. Otherwise, it should be **disclosed, not recognized**.

Analysis

The company exceeded the **turnover threshold** and is **eligible for a duty drawback**. However, the **claim was filed late**, and approval is at the **discretion of the department**. Since approval was received **only after the financial year-end,** the approval by the Department **created the right after the reporting date**. The event was not existing on balance sheet date i.e. the claim was **not virtually certain at the reporting date** and should be **classified as a contingent asset**.

Conclusion

As of **31st March 20X2**, the duty drawback should be **disclosed as a contingent asset**, but recognition should occur only in **20X2-20X3**, once realization is **virtually certain**.

25. Illustration

Entity XYZ entered into a contract to supply 1000 television sets for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non- performance of the contract is expected to be ₹ 0.25 million. Is the contract onerous and how much provision in this regard is required?



Relevant Provisions (Ind AS 37)

An **onerous contract** is one where the **cost of fulfilling it exceeds economic benefits**. A provision must be made for the **least net cost of exiting**.

Analysis

XYZ Ltd. has a contract to **supply 1,000 televisions for ₹2 million**, but the **cost has risen to ₹2.5 million**. The company can either:

1. **Fulfill the contract and incur ₹0.5 million in losses**, or
2. **Cancel the contract and pay a ₹0.25 million penalty**.

Since the **penalty cost is lower**, the company would chose that and hence, the provision should be recognized for **₹0.25 million**.

Conclusion

XYZ Ltd. **must recognize a provision of ₹0.25 million** as the **minimum cost of fulfilling or exiting the contract**.

26. Illustration

Marico has an obligation to restore environmental damage in the area surrounding its factory. Expert advice indicates that the restoration will be carried out in two distinct phases; the first phase requiring expenditure of ₹ 2 million to remove the contaminated soil from the area and the second phase, commencing three years later from the end of first phase, to replant the area with suitable trees and vegetation. The estimated cost of replanting is ₹ 3.5 million. Marico uses a cost of capital (before taxation) of 10% and the expenditure, when incurred, will attract tax relief at the company's marginal tax rate of 30%. Marico has not recognised any provision for such costs in the past and today's date is 31 March 20X2. The first phase of the clean up will commence in a few months time and will be completed on 31 March 20X3 when the first payment of ₹ 2 million will be made. Phase 2 costs will be paid three years later from the end of first phase. Calculate the amount to be provided at 31 March 20X2 for the restoration costs.

Sol:

Year	Cash flow	PVF (10%)	PV
20x2-20x3	20,00,000	0.909	18,18,000
20x5-20x6	35,00,000	0.683	23,90,500
Provision required at 31 March 20X2			42,08,500

The provision is calculated using the pre-tax costs and a pre-tax cost of capital. The fact that the eventual payment will attract tax relief will be reflected in the recognition of a deferred tax asset for the deductible temporary difference (assuming that the recognition criteria for deferred tax assets are met.)

27. Illustration

Sun Limited has entered into a binding agreement with Moon Limited to buy a custom-made machine for ₹ 4,00,000. At the end of 2017-18, before delivery of the machine, Sun Limited had to change its method of production. The new method will not require the machine ordered which is to be scrapped after delivery. The expected scrap value is nil. Given that the asset is yet to be delivered, should any liability be recognized for the potential loss? If so, give reasons for the same, the amount of liability as well as the accounting entry.



An **executory contract** is a contract in which **neither party has performed their obligations** or **both parties have partially performed their obligations to an equal extent**. Ind AS 37 applies to **executory contracts only if they are onerous**.

A contract is **onerous** when the **unavoidable costs** of fulfilling the contract **exceed the expected economic benefits**. In such cases, a **provision must be recognized** for the least net cost of fulfilling or exiting the contract.

Analysis

Sun Ltd. entered into a **binding agreement** with Moon Ltd. to purchase a **custom-made machine** for ₹4,00,000. However, before delivery, Sun Ltd. changed its production method, rendering the machine **useless**. Since the **machine has not been delivered yet**, the contract remains **executory**.

- Sun Ltd. **cannot cancel the contract** and must **accept delivery**.
- The machine **must be scrapped immediately** upon receipt, with **zero scrap value**.
- This means that the company **incurs a full loss of ₹4,00,000** without any future benefit.

Since the **cost of fulfilling the contract exceeds the economic benefits (which are nil)**, the contract qualifies as **onerous**, and a **provision of ₹4,00,000 must be recognized**.

Conclusion

Sun Ltd. must **recognize an onerous contract provision** of ₹4,00,000 for the **full purchase cost** of the machine. The accounting entry is:

		₹	₹
Onerous Contract Provision Expense A/c	Dr.	4,00,000	
To Provision for Onerous Contract Liability A/c			4,00,000
(Being asset to be received due to binding agreement recognized)			
Profit and Loss Account	Dr.	4,00,000	
To Onerous Contract Provision Expense A/c			4,00,000
(Being loss due to onerous contract recognized and asset derecognsied)			

28. Illustration

Vishnu Company has at its financial year ended 31st March, 2017, fifteen law suits outstanding none of which has been settled by the time the accounts are approved by the directors.
The directors have estimated the possible outcomes as below:

Result	Probability	Amount of loss
For first ten cases		
Win	**0.6**	
Loss-low damages	**0.3**	**90,000**
Loss-High damages	**0.1**	**1,60,000**
For remaining five cases		
Win	**0.5**	
Loss-low damages	**0.3**	**60,000**
Loss-High damages	**0.2**	**95,000**



The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

Sol:

- Calculation of expected loss in first ten cases:

Amount of loss	Probability	Expected loss (in ₹)
0	0.6	0
90,000	0.3	27,000
1,60,000	0.1	16,000
Total		43,000

Expected loss for 10 cases =43,000*10=4,30,000

- Calculation of expected loss in remaining five cases:

Amount of loss	Probability	Expected loss (in ₹)
0	0.5	0
60,000	0.3	18,000
95,000	0.1	19,000
Total		37,000

Expected loss for 5 cases =37,000*5=1,85,000

- Total contingent liability to be disclosed is ₹. 6,15,000.

29. Illustration

XYZ Ltd. offers a six-month warranty on its small to medium sized equipment, which can be put to use by the customer with no installation support. The warranty comes with the equipment and the customer cannot purchase it separately. This equipment is typically sold at a gross margin of 40%. XYZ Ltd. has made a provision of ₹ 30,000 during the year ended 31st March, 20X2, which is approximately 1% of its gross margin on the sale of these equipment. Based on past experience, it is expected that 1% of equipment sold have been returned as faulty within the warranty period. Faulty equipment returned to XYZ Ltd. during the warranty period are scrapped and the sale value is fully refunded to the customer.

Assuming that sales occurred evenly during the year, how should XYZ Ltd. evaluate whether any additional warranty provision is required on equipment sold in the past as at 31st March, 20X2? Had the warranty period been 2 years instead of six months, what additional criteria would XYZ Ltd. need to consider?

Solution

Ind AS 37 states that a **provision for warranty should be recognized** when:

1. **A present obligation exists** due to past sales.
2. **It is probable** that an outflow of economic resources will be required to settle the warranty claims.
3. **A reliable estimate** of the warranty obligation can be made.

The provision should be based on **historical data, expected failure rates, and refund policies**. If the warranty period extends beyond one year, **discounting should be applied**.

Analysis



XYZ Ltd. provides a **six-month warranty** with a **refund policy** for faulty equipment, meaning customers receive **a full refund** for defective products. The company **scraps returned goods**, meaning **no recovery from suppliers** is expected.

Given that **sales occur evenly throughout the year**, equipment sold in the **last six months of the year** is still **under warranty at year-end**.

- The company has already **recognized ₹30,000** as a warranty provision, which is **1% of its annual gross margin**.
- The **actual exposure** is higher, as the provision should be based on **the total sales price** rather than the gross margin.
- The provision should be adjusted for the **remaining equipment under warranty**.

Computation of Additional Warranty Provision

Particulars	% of Sales	Amount (₹)	Product under Warranty at 31st March 20X2 (₹)	% Expected to be Returned	Required Provision (₹)
Gross Margin	40%	30,00,000	-	-	-
Selling Price	100%	75,00,000	37,50,000 (6 months)	1%	37,500

Thus, the **required provision** is **₹37,500**, but XYZ Ltd. has already recognized **₹30,000**, so the **additional provision required is ₹7,500**.

Since the provision is expected to be **utilized within six months**, **no discounting is required**.

If the Warranty Period is 2 Years

In the case of a **2-year warranty**, the company must account for:

- **Time value of money** (discounting is required).
- **Extended coverage period**, increasing the probability of claims.

Revised Warranty Provision Calculation for 2-Year Warranty

Particulars	% of Sales	Amount (₹)	Product under Warranty at 31st March 20X2 (₹)	% Expected to be Returned	Required Provision (₹)
Gross Margin	40%	30,00,000	-	-	-
Selling Price	100%	75,00,000	75,00,000	1%	75,000

Since the **provision required is ₹75,000** and **₹30,000 has already been recognized**, an **additional provision of ₹45,000** must be made.

Additionally, **discounting must be applied** as per **Para 45 and 47 of Ind AS 37**, using a **pre-tax discount rate** that reflects **current market assessments**.

Conclusion

- For a **6-month warranty**, XYZ Ltd. should **increase the provision by ₹7,500**.
- For a **2-year warranty**, XYZ Ltd. should **increase the provision by ₹45,000 and apply discounting** to reflect the time value of money.



30. Illustration

HVCL manufactures heavy equipment for construction industry. An order for supply of 90 equipment was received from ABIL. The unit price of the equipment was agreed at ₹ 190 lakhs each. 64 equipment was supplied during the year 20X1-20X2 and balance quantity remaining to be supplied as on 31.3.20X2. HVCL has 5 equipment in its inventory as on 31.3.20X2. HVCL considered that the contract was an onerous contract and therefore, the net realisable value of inventory has been taken as value of inventory as on 31.3.20X2.

The management of HVCL contends that costs incurred towards administrative overheads, finance charges, R & D expenses, sales overhead, head quarter expenditure etc., are considered as period cost and hence not considered for creation of provision. Hence, the same have not been included in the computation of unavoidable cost.

The management of HVCL has submitted the details of costs that have been considered for creation of provision towards onerous contract:

- **Material cost - includes cost of material procured, cost of freight & insurance incurred for material procurement and handling, loading and unloading charges incurred.**
- **Labour cost/ Factory Overheads - includes salaries and other expenses of direct production department, and also expenses allocated from indirect departments to direct department.**
- **Material Overheads - Includes salaries and other expenses (including expenses allocated from other departments) booked under departments linked with materials like purchases, stores and quality control.**

Accordingly, provision has been made considering the above costs only. The value of provision created for 21 remaining equipment to be produced is as per the working shown below:

Particulars	Value (₹ in lakh)
(i) Cost of production (which includes material cost, labour cost/factory overhead and material overhead)	199.00
(ii) Selling price	(190.00)
(iii) Differential cost per equipment	9.00
(iv) Differential cost of ₹ 9 Lakh per equipment for 21 equipment	189.00

Whether the company's accounting treatment of cost for creation of provision towards onerous contracts is in line with the provisions of Ind AS 37?

Solution

Provisions (Ind AS 37)

As per **Ind AS 37**, an **onerous contract** is a contract in which the **unavoidable costs of fulfilling the obligations exceed the economic benefits** expected to be received. The unavoidable cost of a contract is the **least net cost of exiting from the contract**, which is the **lower of**:

- The **cost of fulfilling the contract**, or
- Any **compensation or penalties arising from failure to fulfill the contract**.

As per Ind AS 37, the **cost of fulfilling a contract** includes:

1. **Incremental costs directly related to fulfilling the contract**, such as:
   - Direct labour
   - Direct materials
2. **Allocation of other directly attributable costs**, such as:
   - Depreciation on assets used for contract execution



- Overheads that are linked directly to production

Costs that are **not directly linked to fulfilling the contract**, such as **administrative expenses, finance charges, research & development (R&D) costs, and sales overheads**, **should not be included** in the computation of an onerous contract provision.

Analysis

HVCL received an order from ABIL for **90 equipment** at a **unit price of ₹ 190 lakhs each**. Out of these, **64 units were supplied**, leaving **21 equipment pending production** as of **31st March 20X2**. The company considered the contract as **onerous** and has included **only relevant costs** (materials, direct labour, and material overheads) while creating the provision.

Computation of Onerous Contract Provision

Particulars	Amount (₹ in lakh)
Cost of production per unit (Material, Direct Labour & Overheads)	199.00
Selling price per unit	(190.00)
Loss per unit	9.00
Total loss for 21 pending units (9.00 × 21)	189.00

HVCL **excluded** the following **period costs**, which are **not directly related to the contract**:

- **Administrative overheads**
- **Finance costs**
- **R&D costs**
- **Sales overheads**
- **Headquarter expenses**

Conclusion

HVCL's **accounting treatment is correct** as per **Ind AS 37** because:

- **Only directly attributable costs** related to fulfilling the contract are included.
- **Period costs** (administrative, finance, R&D, etc.) are correctly **excluded**, as they are not directly incremental to the contract.
- The **provision of ₹ 189 lakhs** is based on the **net unavoidable loss** for the remaining 21 units.

Thus, HVCL has **correctly applied the provisions of Ind AS 37** in **recognizing and measuring** the provision for **onerous contracts**.



IND AS 19
Employee Benefits
ILLUSTRATIONS

1. Illustration

Mr. Rajan is working for Infotech Ltd. Consider the following particulars:

Annual salary of Mr. Rajan = ₹ 30,00,000

Total working days in 20X0-X1 = 300 days

Leaves allowed in 20X0-X1 as per policy = 10 days

Leaves utilized by Mr. Rajan in 20X0-X1 = 8 days

The unutilized leaves are settled by way of payment and accordingly, carry forward of such leaves to the subsequent period is not allowed.

Compute the total employee benefit expense for Infotech Ltd. in respect of 20X0-X1.

Solution:

Mr. Rajan is an employee of Infotech Ltd. The company follows a policy where unused leaves are encashed at the end of the financial year. According to Ind AS 19 (Employee Benefits), such payments are classified as short-term compensated absences, requiring recognition as an expense in the period in which the employee renders service.

Computation of Employee Benefit Expense:

Particulars	Amount (INR)
Annual Salary	30,00,000
Total Working Days	300
Per Day Salary (30,00,000 / 300)	10,000
Unutilized Leave (10 - 8)	2 Days
Additional Expense for Unutilized Leave (2 x 10,000)	20,000
Total Employee Benefit Expense for 20X0-X1	30,20,000

Thus, the total employee benefit expense recognized for the year 20X0-X1 will be INR 30,20,000.

2. Illustration

Mr. Niranjan is working for Infotech Ltd. Consider the following particulars:

	20X0-X1	20X1-X2
Annual salary	30,00,000	30,00,000
Working days	300 days	300 days
Leave allowed	10 days	10 days
Leave taken	7 days	13 days
Leave unutilized carried forward to next year	3 days	NIL

Scenario I

Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 3 days of 20X0-20X1 in 20X1-20X2.

Infotech Ltd. contends that it will record Rs. 30,00,000 as employee benefits expense in each of the years 20X0-20X1 and 20X1-20X2, stating that the leaves will, in any case, be utilized by 20X1-20X2.

Comment on the accounting treatment proposed to be followed by Infotech Ltd. Also pass journal entries for both the years.

Scenario II



Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 2 days of 20X0-20X1 subsequently. However, in 20X1-20X2, Mr. Niranjan availed in actual all 3 days of brought forward leave.
Compute the expense to be recognised in 20X0-20X1 and 20X1-20X2. Also pass journal entries for both the years.

Answer:

Scenario - I

Infotech Ltd. assumes that unutilized leaves from **20X0-X1 (3 days)** will be used in **20X1-X2**. Under **Ind AS 19**, **expense should be recognized in the period in which the benefit accrues**, rather than when the leave is taken.

The expenditure to be recognized will be as under:

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

Journal Entry for 20X0-20X1

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

Journal Entry for 20X1-20X2

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

Scenario-II

The expenditure to be recognized will be as under:

Particulars	Year 20X0-20X1	Year 20X1-20X2
Annual salary (A)	₹. 30,00,000	₹. 30,00,000
No. of working days (B)	300 days	300 days
Salary cost per day (A ÷ B)	₹. 10,000 per day	₹. 10,000 per day
Expense to be recognised: **In 20X0-20X1:** ₹ 30,00,000 + [₹ 10,000 per day x 2 days (leaves unutilized expected to be utilized subsequently)]	₹ 30,20,000	
In 20X1-20X2: ₹ 30,00,000 – [₹ 10,000 per day x 3 days (excess leave utilized in 20X1- 20X2)] + ₹ 10,000 (additional expense due to change in accounting estimate)		₹ 29,80,000

The additional ₹. 10,000 booked as an expense in 20X1-20X2 represents a change in accounting estimate (i.e. as against the entity's estimation that 2 days of unutilized leave would be utilized subsequently, actually 3 days were utilized subsequently), for which a prospective effect needs to be given, in line with Para 36 of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Journal Entry for 20X0-20X1

Employee Benefits Expense Account Dr.	30,20,000	
To Bank Account		30,00,000
To Provision for Leave Encashment		30,000



Journal Entry for 20X1-20X2

Employee Benefits Expense Account	Dr.	29,80,000	
Provision for Leave Encashment Account	Dr.	20,000	
To Bank Account			30,00,000

3. Illustration

Sundaram Ltd. has a headcount of 100 employees in 20X0-20X1. As per the employee policy, the employees are entitled to:

- **30 casual leaves out of which 10 casual leaves may be carried forward to the next year; and**
- **10 sick leaves out of which 2 sick leaves may be carried forward as paid leave.**

At 31st March, 20X1, the average unused entitlement is 5 days per employee for casual leaves and 1 day per employee for sick leave. On an average, it is found that the number of such employees who would be claiming casual leaves would be 30 and 10 employees who would claim sick leaves.

Compute the liability to be recognised in respect of sick leaves and casual leaves by the entity at the end of the financial year 20X0-20X1.

Answer:

Type of leave (A)	Leave Entitlement (B)	Leaves c/f permissible (C)	Average leaves Unutilized (D)	No. of Employees (E)	Liability (F = D x E)
Casual Leave	30 days	10 days	5 days	30	150 days salary
Sick Leave	10 days	2 days	1 day	10	10 days salary

The entity will recognise liability in the books equal to 150 (30 x 5) days of paid casual leaves and 10 (10 x 1) days of paid sick leaves.

4. Illustration

An entity has 100 employees, who are each entitled to ten working days of paid sick leave for each year. Unused sick leave may be carried forward for one financial year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis).
At 31 March 20X1, the average unused entitlement is two days per employee. Based on past experience, the management expects that only 20% of the employees will use 1 day from their carried forward leave. Salary per day is Rs. 2,500.
Compute the expenses in respect of the short-term compensated absences, if they are assumed to be
(a) vested short-term compensated absences, and
(b) non-vested short-term compensated absences.

Solution:

Vested short-term compensated absences:

Employee Benefit Expense = 100 Employees x 2 Days x ₹ 2,500 = ₹ 5,00,000

Non-vested short-term compensated absences:
Employee Benefit Expense = 100 Employees x 20% x 1 Day x ₹ 2,500 = ₹ 50,000



5. Illustration

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates observed during past 10 years represents 6% per annum. Acer Ltd. provides the following benefits to all its employees:
Paid vacation - 10 days per year regardless of date of hiring. Compensation for paid vacation is 100% of employee's salary and unused vacation can be carried forward for 1 year.
As of 31st March, 20X1, unused vacation carried forward was 3 days per employee, average salary was Rs. 15,000 per day and accrued expense for unused vacation in 20X0-20X1 was Rs. 65,00,000. During 20X1-20X2, employees took 9 days of vacation in average. Salary increase in 20X1-20X2 was 10%.
How would Acer Ltd. recognize liabilities and expenses for these benefits as of 31st March, 20X2?. Pass the journal entry to show the accounting treatment.

Answer:

Paid Vacation:

Step 1: Calculation of Unused Vacation in man-days as on 31st March, 20X2:

A. No. of Employees in service for the whole year (94%):

Particulars	Man-days
Unused vacation as on 31st March, 20X1	3 days per employee
Entitlement to vacation for 20X1-20X2	10 days per employee
Average vacation availed in 20X1-20X2	(9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	4 days per employee
Total Unused vacation as on 31st March, 20X2 - (A) (350 employees x 94% x 4 days per employee)	1,316 man-days

B. Newcomers (6%):

Particulars	Man-days
Entitlement to vacation for 20X1-20X2	10 days per employee
Average vacation availed in 20X1-20X2	(9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	1 day per employee
Total Unused vacation as on 31st March, 20X2 - (B) (350 employees x 6% x 1 day per employee)	21 man-days
Total unused vacation as on 31st March, 20X2 (A + B)	1,337 man-days

Step 2: Calculation of average salary per day:

Particulars	₹
Average salary per day as on 31st March, 20X1	15,000
Salary increase in 20X1-20X2	10%
Average salary per day as on 31st March, 20X2	16,500

Step 3: Calculation of provision for unused paid vacation:

Particulars	₹
Calculation of provision for unused paid vacation 20X1-20X2: (1,337 man-days x ₹ 16,500)	2,20,60,500
Provision for unused paid vacation 20X0-20X1	65,00,000

Step 4: Accounting treatment

Provision for 20X1-20X2

Employee Benefits Expenses A/c	Dr.	2,20,60,500	
To Provision for Leave Encashment			2,20,60,500

Settlement of Liability of 20X0-20X1

Provision for Leave Encashment A/c Dr.	65,00,000	
To Cash / Bank		65,00,000



6. Illustration

An entity has 100 employees, who are each entitled to five working days of paid sick leaves for each year. Unused sick leave may be carried forward for one calendar year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (LIFO basis).
At 31st March, 20X1, the average unused entitlement is two days per employee. The entity expects, on the basis of experience that is expected to continue, that 92 employees will take no more than five days of paid sick leaves in 20X1-20X2 and that the remaining eight employees will take an average of six and a half days each.

The entity expects that it will pay an additional twelve days of sick pay as a result of the unused entitlement that has accumulated at 31st March, 20X1 (one and a half days each, for eight employees).
Would the entity require to recognize any liability in respect of leaves?

Solution:

At **31st March 20X1**, the average unused entitlement is **2 days per employee**.
Management estimates that:

- **92 employees will take 5 days or less**. [They will not use previous years balance)
- **8 employees will take an average of 6.5 days**. [5 days used from current year and 1.5 days from previous year]

Since the additional leave taken due to carried forward balance is **1.5 days per employee for 8 employees**, the entity must recognize **12 days of additional sick pay** as a liability.

Liability to be recognized=12 days of sick pay.

7. Illustration

Laxmi Mills is a profit-making entity and has reported profit of Rs.200 crore in the financial year 20X1-20X2.
According to its profit–sharing plan, it distributes and pays 5% as its portion of profit to its employees if they complete 1 year with the organisation.
Under this plan, an entity is under an obligation to pay if the employees complete a specified period with the organisation. Laxmi Mills has estimated that due to staff turnover in the organisation, the estimated pay-out would be around 4.5%.
Compute the liability and expense of the company under this plan.
Solution:
The company shall recognize a liability and an expense of an amount of ₹ 9 crores for the financial year 20X1-20X2 (i.e. 4.5% of ₹ 200 crores).

8. Illustration

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates as observed during past 10 years represents 6% per annum. Acer provides the following benefits to all its employees:
Annual bonus - during past 10 years.
Acer paid bonus to all employees who were in service during the entire financial year. Bonus was paid in June following the financial year-end. Amount of bonus for 20X1-20X2 paid in June 20X2 represented Rs. 1,25,000 per employee. Acer Ltd. used to increase amount of bonus based on official inflation rate which is 8.5% for 20X2-20X3, although there was no legal obligation to increase the bonus by such inflation rate.
How would Acer Ltd. recognize liabilities and expenses for these employee benefits as on 31st March, 20X3? Pass the journal entry to show the accounting treatment.

Solution:

Particulars	₹



Bonus paid for 20X1-20X2	1,25,000 per employee
Bonus for 20X2-20X3 - increased by inflation of 8.5%[1,25,000 x (100% + 8.5%)]	1,35,625 per employee
No. of employees in staff during the whole year [350 x (100-6%)]	329 employees
Provision for Bonus for 20X2-20X3	4,46,20,625

Accounting Treatment:

Provision for Bonus for 20X2-20X3

Employee Benefits Expenses A/c Dr.	4,46,20,625	
To Provision for Bonus 20X2-20X3		4,46,20,625

Note:

It is given that the company is under no legal obligation to increase the bonus by the official inflation rate. However, the company has been increasing the bonus by the inflation rate over the past years. This has given rise to a constructive obligation for Acer Ltd. Informal practices, such as these, give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. Accordingly, provision is made for the amount considering the inflation rate.

9. Illustration

A company pays each employee a lump-sum one-time benefit upon retirement. This benefit is computed based on the employee's years in service in the company and the final salary prior to retirement. To cover its liabilities from this remuneration, the company contributes 3% of annual gross salaries to the fund. Would this obligation represent a defined contribution plan or a defined benefit plan and why?

Solution:

This obligation represent defined benefit plan.

Reason:

A company pays each employee a **lump-sum one-time benefit upon retirement**, which is based on:

- The **employee's years of service**.
- The **final salary prior to retirement**.

To fund this benefit, the company **contributes 3% of annual gross salaries** to a fund.

This is a **Defined Benefit Plan**, because:

- The benefit amount is predetermined based on service and salary.
- The company bears the risk **if fund assets are insufficient** to cover employee remuneration.

10. Illustration

In accordance with applicable legislation, company contributes 12% and employees 12% of annual gross salaries to the provident and pension fund. Upon retirement, the employees will get the accumulated balance that is calculated based on employee's years of service and his average salary for past 15 years before retirement. The pension will be paid out of the state fund assets and the company has no further obligation except to make contributions. Would this obligation represent a defined contribution plan or a defined benefit plan?

Solution:

A company contributes **12% of salaries** (with an additional **12% from employees**) to a **provident and pension fund**.

Upon **retirement**, employees receive a pension based on:



- **Years of service**.
- **Average salary for the last 15 years**.

The **pension is paid out of state fund assets**, and the **company has no further obligation** beyond contributions.

This is a **Defined Contribution Plan**, because:

- The company's **liability is limited** to fixed contributions.
- The **state fund bears the actuarial and investment risk**.

11. Illustration

Acer Ltd. provides lump-sum remuneration upon retirement to its employees. Remuneration is paid out of the fund to which Acer Ltd. contributes 12% of annual gross salaries. Contributions are made twice a year i.e., in November of the related financial year and in June after the financial year- end. Total annual gross salaries for 20X0-X1 amounted to Rs. 50 crores. Contribution made by Acer Ltd. in November 20X0 was Rs. 2.8 crores. Remuneration depends on the number of employee's service and amount of cash in the fund at retirement date (Acer Ltd. has no further obligations except for contributions).

How should this transaction appear in the financial statements of Acer Ltd. as of 31 March 20X1?

Solution:

1. Calculation of accrual for contributions in 20X0-20X1:

	₹
Annual gross salaries in 20X0-20X1	50.00 crores
Amount of total contributions for 20X0-20X1 (12%):	6.00 crores
Contributions already made in November 20X0	2.80 crores
Accrual (6 crores - 2.8 crores)	3.20 crores

2. Accounting treatment

Employee Benefits Expenses Account	Dr.	6.00 crores	
To Bank Account			2.80 crores
To Contribution Payable			3.20 crores

The contribution of ₹ 6 crores will be debited to the statement profit and loss. The contribution payable of ₹ 3.20 crores will appear as a liability as at 31st March, 20X1.

12. Illustration

In 2017-18, Diana Ltd. has 3,000 employees in the company.
As per the company policy, the employees are given 30 days of Privilege Leave (PL), 12 days of Sick Leave (SL) and 12 days of Casual Leave. Out of the total PL and SL, 10 PL and 5 SL can be carried forward to next year. On the basis of past trends, it has been noted that 1,000 employees will take 5 days of PL and 2 days of SL and 2,000 employees will avail 10 as PL and 5 as SL in the next year.
Also, the company has been incurring profits since incorporation. It has been decided in 2017-18 to distribute profits to its employees @ 8% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Diana Ltd. is to be around 7%. The profits earned during 2017-18 is Rs. 12,000 lakh.
Diana Ltd. also has a post-employment benefit plan available which is in the nature of defined contribution plan where contribution to this fund amounts to Rs. 500 lakh which will fall due within 12 months from the end of accounting period. The company has paid Rs. 120 lakh to its employees in 2017-18. What is the treatment for the short-term compensating absences, profit-sharing plan and the defined contribution plan by Diana Ltd. as per the provisions of relevant Ind AS? [May 19 (N), 5 marks]



Solution:

(i) For short term compensating expenses:

Diana. Ltd. will recognise a liability in its books to the extent of 5 days of PL for 1,000 employees and 10 days of PL for remaining 2,000 employees and 2 days of SL for 1,000 employees and 5 days of SL for remaining 2,000 employees in its books as an unused entitlement that has accumulated in 2017-2018.

(ii) For profit sharing plan:

Diana. Ltd. will recognise ₹ 840 lakh (12,000 x 7%) as a liability and expense it in books of accounts.

(iii) For defined contribution plan:

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

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

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

13. Illustration

A company has an employee benefit plan which involves a lump sum payment to employee on termination of service and that is equal to 1 per cent of final salary for each year of service. Consider the salary in year 1 is Rs. 10,000 and is assumed to increase at 7 per cent (compound) each year.

Taking a discount rate at 10 per cent per year, you are required to show

(a) benefits attributed (year on year) and

(b) the obligation in respect of this benefit (year on year)

for an employee who is expected to leave at the end of year 5.

Solution:

Salary at Year 1		**10,000**
Annual Increment		**7%**
Salary at Year 5	**10000 x $(1.07)^4$**	**13,108**
Benefit payable 1% for every year		**131**
Total benefit payable		**655**

Benefits attributed year on year

Years	Benefit	Cumulative	PVF 10%	PV
1 (End)	131	131	0.6830	89.47
2	131	262	0.7513	98.42
3	131	393	0.8264	108.26
4	131	524	0.9091	119.09
5 (End)	131	655	1	131.00

Computation of interest cost and obligation

Years	Opening	Int @ 10%	Service Cost	Closing
1 (End)	0	0.00	89.47	89.47
2	89.47	8.95	98.42	196.84
3	196.84	19.68	108.26	324.79
4	324.79	32.48	119.09	476.36



5 (End)	476.36	47.64	131.00	655.00

14. Illustration

AKJ Ltd is a listed company engaged in the business of manufacturing of electronic equipment. The company has various branch offices spread out across India and has 1,000 employees.
As per the statutory requirements, gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years –
(a) on his superannuation, or
(b) on his retirement or resignation, or
(c) on his death or disablement due to accident or disease.
The completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement.
The amount payable is determined by a formula linked to number of years of service and last drawn salary. The amount payable to an employee shall not exceed Rs.10,00,000.
How should the amount of employee benefit, if any, be attributed to each year of service?

Solution:

AKJ Ltd., a listed company, must account for gratuity as a **defined benefit plan** under **Ind AS 19 (Employee Benefits)**. The gratuity liability arises upon an employee's **superannuation, resignation, retirement, or death/disablement**, provided they have completed **five years of continuous service**, except in cases of death or disablement. The amount payable is linked to **years of service and last drawn salary**, with a statutory cap of **₹ 10,00,000 per employee**.

As per **Ind AS 19**, the **Projected Unit Credit (PUC) method** should be used to determine the gratuity liability. Employees who are unlikely to meet the **minimum five-year service condition** are excluded. Other employees are categorized based on their **expected tenure**, considering **mortality rates, resignation trends, and disability probabilities**. The gratuity amount is calculated using the prescribed formula, factoring in **salary increments and promotions**. For employees expected to receive **₹ 10,00,000 or less**, the gratuity cost is **spread evenly over their service period**. However, for employees where the **gratuity exceeds ₹ 10,00,000**, the allocation is limited to the period until the cap is reached. Beyond this, no further cost is recognized.

15. Illustration

OPQ Ltd is a listed company having its corporate office at Nagpur. The company has a branch office at Chennai. The company has been operating in Indian market for the last 10 years.
The company operates a pension plan that provides a pension of 2.5% of the final salary for each year of service. The benefits become vested after seven years of service.
On 1st April, 20X8, the company increased the pension to 3% of the final salary for each year of service starting from 1st April, 20X1. On the date of the improvement, the present value of the additional benefits for service from 1st April, 20X1 to 1 April 20X8 was as follows:
- **Employees with more than seven years' service on 1 January 20X8 – Rs. 2,75,000**
- **Employees with less than 7 years of service – Rs. 2,21,000 (average 4 years to go)**

What would be the accounting treatment in this case?

Solution:

OPQ Ltd. operates a **defined benefit pension plan**, initially providing **2.5% of the final salary per service year**, with benefits vesting after **seven years of service**. On **1st April 20X8**, the pension rate was retrospectively increased to **3% per year of service**, effective **from 1st April 20X1**. As per **Ind AS 19**, past service cost arises when an amendment to a defined benefit plan affects prior periods. If benefits are **already vested**, the past service cost is **recognized immediately in profit and loss**. If they are **not yet vested**, it is amortized over the remaining vesting period.



The company recognizes a **total liability of ₹ 4,96,000**, consisting of **₹ 2,75,000 for vested employees** and **₹ 2,21,000 for employees with an average of four years left for vesting** since these benefits is for the period of service already completed.

16. Illustration

RKA Private Ltd is an old company established in 19XX. The company started with a very small capital base and today it is one of the leading companies in India in its industry. The company has an annual turnover of Rs.11,000 crores and planning to get listed in the next year.
The company has a large employee base. The company provided a defined benefit plan to its employees. Following is the information relating to the balances of the fund's assets and liabilities as on 1st April X1 and 31st March X2 (Rs. Lacs)

Particulars	1st April	31st March
Present Value of benefit obligation	1,400	1,580
Fair Value of plans assets	1,140	1,275

For the financial year ended 31st March, 20X2, service cost was Rs. 55 lacs. The company made a contribution of an amount of Rs. 111 lacs to the plan. No benefits were paid during the year. Consider a discount rate of 8%.
You are required to –

(a) Compute the balance(s) of the company to be included its balance sheet as on 31st March, 20X2 and amounts to be recognized in the statement of profit and loss and other comprehensive income for the year ended 31st March, 20X2.
(b) Give the journal entries in respect of amount(s) to be recognized.

Solution:

(a) Extract of the Balance Sheet of RKA Private Ltd as at 31st March, 20X2:
Closing net defined liability [(1,580 – 1,275) lacs] = ₹. 305 lacs
Extract of the Statement of Profit or Loss of RKA Private Ltd for the year ended 31st March, 20X2

Particulars	₹ in lacs
Service cost	55
Net interest (Refer W.N.1)	21
Profit or loss	96
Other comprehensive income:	
Remeasurements (Refer W.N.2)	80
Total	156

(b) Journal entries in the books of RKA Private Ltd

		₹ in lacs	₹ in lacs
Profit & Loss	Dr	76	
Other comprehensive income	Dr	80	
To Cash (Contribution)			111
To Net defined benefit liability (Refer WN 3)			45

Working Notes:

1. Computation of Net interest taken to the Statement of Profit or Loss
= Discount rate x Opening net defined benefit liability
= 8% x (1,400 – 1,140) lacs
= 8% x 260 lacs
=₹ 21 lacs (Rounded off to nearest lacs)
2. Computation of Remeasurements

Defined Benefit Obligation Account

Particulars	₹	Particulars	₹
To Balance c/d (given)	1,580	By Balance b/d (given)	1,400
		By Current Service Cost	55
		By Interest on Opening Liability (1,400 x 8%)	112
		By Actuarial loss (bal. figure)	13
	1580		1580



Plan Assets Account

Particulars	₹	Particulars	₹
To Balance b/d (given)	1,140	By Balance c/d	1,275
To Bank Account (contribution for the year)	111	By OCI (Loss on remeasurement)	67.2
To P&L (Expected Return)	91.2		
	1,342.2		1,342.2

Net interest on opening balance of plan asset = ₹ 91 lacs (i.e. ₹ 1,140 lacs x 8%) (Rounded off to nearest lacs)
Hence there is a decrease in plan assets due to remeasurement for which computation is as follows:
=Actual Return – Net interest on opening plan asset
= ₹ 24 lacs – ₹ 91 lacs = ₹ 67 lacs.
Net remeasurement would be computed as follows:
Actuarial loss on liability + Loss on return = 13 lacs + 67 lacs = 80 lacs.

3. Computation of increase/ decrease in net defined benefit liability:

Particulars	₹ in lacs
Opening net liability (₹ 1,400 lacs – ₹ 1,140 lacs)	260
Closing net liability (₹ 1,580 lacs – ₹ 1,275 lacs)	305
Increase in liability	45

Alternate working note

Particulars	Obligation	Plan Assets	Net
Opening balance 1st April	1,400.00	1,140.00	260.00
Add: Interest cost/ Exp. Return @ 8%	112.00	91.20	20.80
Add: Service Cost	55.00		55.00
Add: Contribution		111.00	(111.00)
Expected closing bal on 31st Mar	1,567.00	1,342.20	224.80
Actual Closing bal on 31st Mar	1,580.00	1,275.00	305.00
Actuarial Gains/(Losses)	(13.00)		(13.00)
Loss on Remeasurement of PA		(67.20)	
Total Loss to be debited to OCI			(80.20)

Illustration

SA Pvt Ltd is engaged in the business of retail having 100 retail outlets across Northern and Southern India. The company's head office is located at Chennai.
SA Pvt Ltd is a subsidiary of SAG Ltd. SAG Ltd is listed on the National Stock Exchange in India.
Following information is available for SA Pvt Ltd:

Plan Assets
On 1st April, 20X1, the fair value of plan assets was ₹ 10,000.
Contribution to the plan assets done on 31st March, 20X2 – ₹ 3,000
Amount paid on 31st March, 20X2 – ₹ 300
On 31st March, 20X2, the fair value of plan assets was ₹ 14,700
Actual return on plan assets – ₹ 2,000



Defined Benefit Obligation

On 1st April, 20X1, present value of the defined benefit obligation was ₹ 12,000.
On 31st March, 20X2, present value of the defined benefit obligation was ₹ 15,500.
Actuarial losses on the obligation for the year ended 31st March, 20X2 were ₹ 100.
Current Service Cost – ₹ 2,500
Benefit paid – ₹ 300
Discount rate used to calculate defined benefit liability - 10%.

As per Ind AS 19, please suggest if there is any amount based on the above-mentioned information that would be taken to other comprehensive income (with workings). Also compute net interest on the net defined benefit liability (asset).

Solution:
As per Ind AS 19, net remeasurement of ₹. 900 would be recognized in other comprehensive income.
Computation of Net remeasurement:
= Remeasurement – Actuarial loss
=1000 (Refer WN - 1) – 100 (Given in the question) = 900
Computation of net interest expense

Particulars	₹
Defined benefit liability as at 1st April 20X1 (A) (Given in the question)	12,000
Fair value of plan asset as at 1st April 20X1 (B) (Given in the question)	(10,000)
Net defined benefit liability (A - B)	2,000
Net interest expense (as it is net liability) (Refer note given below)	200

Note:
Net interest expense would be computed on net defined benefit liability using discount rate of 10% given in the question-
=Net defined benefit liability x Discount rate
= 2,000 x 10% = ₹. 200.
Working Note:
Computation of amount of remeasurement

Particulars	₹
Actual return on plan asset for the year ended 31st March 20X2 (C) (Given in the question)	2,000
Less: Interest income on 10,000 held for 12 months at 10% (D)	(1,000)
Remeasurement (E = C - D)	1,000

17. Illustration [May-25 8 Marks]

A Ltd. prepares its financial statements to 31st March each year. It operates a defined benefit retirement benefits plan on behalf of current and former employees. A Ltd. receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1st April, 20X1, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,00,00,000. On the same date, the fair value of the assets of the defined benefit plan was ₹ 5,20,00,000. On 1st April, 20X1, the annual market yield on government bonds was 5%. During the year ended 31st March, 20X2, A Ltd. made contributions of ₹ 70,00,000 into the plan and the plan paid out benefits of ₹ 42,00,000 to retired members. Both these payments were made on 31st March, 20X2.
The actuaries advised that the current service cost for the year ended 31st March, 20X2 was ₹ 62,00,000. On 28th February, 20X2, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by ₹ 15,00,000 from that date.

During the year ended 31st March, 20X2, A Ltd. was in negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by ₹ 80,00,000. Before 31st March, 20X2, A Ltd. made payments of ₹ 75,00,000 to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.



On 31st March, 20X2, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,80,00,000. On the same date, the fair value of the assets of the defined benefit plan were ₹ 5,60,00,000.
Examine and present how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 20X2 as per Ind AS. Finance cost is to be computed on the opening balances.

Solution:

During the year, A Ltd. **incurred a current service cost of ₹ 62,00,000**, which is recognized as an expense in the **profit and loss statement**. Additionally, the company amended the plan retrospectively on **28th February 20X2**, leading to a **past service cost of ₹ 15,00,000**, which is also recognized in **profit and loss**. The redundancy program reduced the **DBO by ₹ 80,00,000**, with **settlement payments of ₹ 75,00,000** made out of the plan's assets. The net gain on settlement was **₹ 5,00,000**, which is recorded in **profit and loss**.

The **finance cost** for the year is based on the opening net liability of **₹ 80,00,000**, at a discount rate of **5%**, resulting in **₹ 4,00,000** being charged to **profit and loss**. The company contributed **₹ 70,00,000** to the plan during the year, and **benefits paid to retired employees amounted to ₹ 42,00,000**.

On **31st March 20X2**, the **DBO increased to ₹ 6,80,00,000**, while the **fair value of plan assets rose to ₹ 5,60,00,000**, leading to a closing **net liability of ₹ 1,20,00,000**. The difference between the expected and actual values results in a **remeasurement loss of ₹ 34,00,000**, which is recognized in **other comprehensive income (OCI)**.

For the year ended 31st March, 20X2, the remeasurement loss will be 3,400,000 (Refer W. N.).

Working Note:

Remeasurement of gain or loss

	₹ in '000
Liability at the start of the year (60,000 – 52,000)	8,000
Current service cost	6,200
Past service cost	1,500
Net finance cost	400
Gain on settlement	(500)
Contributions to plan	(7,000)
Remeasurement loss (balancing figure)	3,400
Liability at the end of the year (68,000 – 56,000)	12,000

18. Illustration

On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at ₹ 20,40,000 and the present value of the defined obligation was ₹ 21,25,000. On 31st March,20X2 the plan received contributions from XYZ Ltd amounting to ₹ 4,25,000 and paid out benefits of ₹ 2,55,000. The current service cost for the financial year ending 31 March 20X2 is ₹ 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was ₹ 23,80,000, and the present value of the defined benefit obligation was ₹ 27,20,000.
Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehensive income and balance sheet?

Solution:

Reconciliation of Plan assets and Defined benefit obligation

	Plan Assets (₹)	Defined benefit Obligation (₹)
Fair value/present value as at 1st April 20X1	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250



Current service cost	-	5,10,000
Contributions received	4,25,000	-
Benefits paid	(2,55,000)	(2,55,000)
Return on plan assets (gain) (assets) (balancing figure)	68,000	-
Actuarial Loss (balancing figure)	-	2,33,750
Closing balance as at 31st March, 20X2	23,80,000	27,20,000

	₹
In the Statement of Profit and loss, the following will be recognised:	
Current service cost	5,10,000
Net interest on net defined liability (₹ 1,06,250 – ₹ 1,02,000)	4,250
Defined benefit re-measurements recognised in Other Comprehensive Income:	
Loss on defined benefit obligation	(2,33,750)
Gain on plan assets	68,000
	(1,65,750)
In the Balance sheet, the following will be recognised:	
Net defined benefit liability (₹ 27,20,000 – ₹ 23,80,000)	3,40,000

19. Illustration

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

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

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

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

Solution:	
Computation of Expected Return on Plan Assets	
Particulars	**₹**
Return on ₹ 10,00,000 for 20X0-20X1 at 10.25%	1,02,500
Add: Return on ₹ 3,00,000 for 6 months at 10% Normal Rate = [3,00,000	
(Inflow ₹ 4,90,000 less Payments ₹ 1,90,000) x 10% x 6/12)]	15,000
Expected Return on Plan Assets	1,17,500
Computation of Actual Return on Plan Assets	
Particulars	**₹**
Fair Value of Plan Assets at the year-end – 31 March 20X1	15,00,000
Less: Fair Value of Plan Assets at the beginning – 1 April 20X0	(10,00,000)



Less: Contributions received during the year 20X0-20X1	(4,90,000)
Add: Benefits paid during the year 20X0-20X1	1,90,000
Actual Return on Plan Assets	2,00,000
Computation of Net Actuarial Gain	
Particulars	**₹**
Actual Return on Plan Assets	2,00,000
Less: Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
Less: Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	76,500

Alternatively,

Fair Value of Plan Assets at the beginning – 1 April 20X0	10,00,000
Add: Contributions received during the year 20X0-20X1	4,90,000
Less: Benefits paid during the year 20X0-20X1	(1,90,000)
Expected Closing Balance	13,00,000
Fair Value of Plan Assets at the year-end – 31 March 20X1	15,00,000
Actual Return on Plan Assets (FV – Expected)	2,00,000

20. Illustration

From the following particulars, compute the net defined benefit liability and expense to be recognized in Profit and Loss account. (₹ in lakhs)

Particulars	Defined benefit obligation		Plan Assets	
	31st Dec. 20X2	31st Dec. 20X1	31st Dec. 20X2	31st Dec. 20X1
Balance at the beginning of the year	63.25	47.08	21.80	14.65
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Changes in demographic assumptions	0.62	1.86	-	-
Changes in financial assumptions	3.58	1.93	-	-
Experience variance	(2.49)	4.46	-	-
Benefits paid	-	(0.61)	-	(0.61)
Investment income	-	-	1.47	1.12
Employers' contribution	-	-	8.00	7.00
Return on plan assets	-	-	2.12	(0.35)

Solution

Computation of defined benefit liability and expenses to be charged to Statement of Profit and Loss:

	Defined benefit obligation (₹in lakhs)		Plan Assets (₹in lakhs)	
	31st Dec 20X2	31st Dec 20X1	31st Dec 20X2	31st Dec 20X1
Balance at the beginning of year	63.25	47.08	21.80*	14.65
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-



Changes in demographic assumptions	0.62	1.86	-	-
Changes in financial assumptions	3.58	1.93	-	-
Experience variance	(2.49)	4.46	-	-
Benefits paid	-	(0.61)	-	(0.61)
Investment income	-	-	1.47	1.12
Employers' contribution	-	-	8.00	7.00
Return on plan assets	-	-	2.12	(0.35)
Balance at the end of year	75.07	63.25	33.39	21.81*

*Difference is due to approximation.

In the BALANCE SHEET, the following will be recognised:

Net defined liability to be recognised for the period ending 31 st December, 20X1:
= ₹ 41.44 lakhs (₹ 63.25 lakhs - ₹ 21.81 lakhs)
Net defined liability to be recognised for the period ending 31 st December, 20X2:
= ₹ 41.68 lakhs (₹ 75.07 lakhs - ₹ 33.39 lakhs)

In the STATEMENT OF PROFIT AND LOSS, the following will be recognised:

	Defined benefit obligation(₹ in lakhs)		Plan Assets(₹ in lakhs)	
	31st Dec., 20X2	31st Dec., 20X1	31st Dec., 20X2	31st Dec., 20X1
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Investment income	-	-	(1.47)	(1.12)
Total	**10.11**	**8.53**	**(1.47)**	**(1.12)**

Expense to be recognised in the Statement of Profit and Loss for the period ending 31st December, 20X1
= ₹ 7.41 lakhs (₹ 8.53 lakhs - ₹ 1.12 lakhs)
Expense to be recognised in the Statement of Profit and Loss for the period ending 31st December, 20X2 = ₹
8.64 lakhs (₹ 10.11 lakhs - ₹ 1.47 lakhs).

21. Homework Question

Arunachalam Ltd. operates a Defined Retirement Benefits Plan for its current and former employees. Given the large size of the company, it engaged a firm of Actuaries for advice on the Contribution Levels and overall Liabilities of the Plan to pay benefits. Following details are given:

(a) On 1st April, 20X1, the actuarial valuation of the present value of the defined benefit obligation was ₹ 15 crores. On the same date, the fair value of the assets of the Defined Benefit Plan was ₹ 13 crores. On 1st April, 20X1, the annual market yield based on Government Bonds was 5%.

(b) During the year ended 31st March, 20X2, Arunachalam made contributions of ₹ 1.75 crore into the Plan and the Plan paid out benefits of ₹ 1.05 crore to retired members. Assume that both these payments were made on 31st March, 20X2.

(c) The Actuarial Firm estimated that the current service cost for the year ended 31st March, 20X2 would be ₹
1.55 crores. On 28th February, 20X2, the rules of the Plan were amended with retrospective effect which led to an increase in the present value of the defined benefit obligation by ₹ 37.5 lakhs from that date.

(d) During the year ended 31st March, 20X2, Arunachalam was in negotiation with employee representatives regarding planned redundancies. These negotiations were completed shortly before the year end and the redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by ₹ 2 crores. Before 31st March, 20X2,



Arunachalam made payments of ₹ 1.875 crores to the employees affected by the redundancies in compensation for a curtailment of their benefits. These payments were made out of the assets of the Retirement Benefits Plan.

(e) On 31st March, 20X2, the present value of the defined benefit obligation was ₹ 17 crores and the fair value of the assets of the Defined Benefit Plan was ₹ 14 crores.

Discuss how the above will be accounted in the books of Arunachalam Ltd. for the year 20X1-20X2. Also give the extracts of financial statements affected due to above transactions.



IND AS 1
PRESENTATION OF FINANCIAL STATEMENTS
Illustrations

1. Illustration

Entity XYZ is a large manufacturer of plastic products for the local market. On 1st April, 20X6 the newly elected government unexpectedly abolished all import tariffs, including the 40 per cent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency Rs. appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products.

Before 20X6 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ went into losses. As at 31st March, 20X7, entity XYZ's equity was Rs. 1,000. During the second quarter of financial year ended 31 March 20X7, the management restructured entity's operations. That restructuring helped reduce losses for the third and fourth quarters to Rs. 400 and Rs. 380, respectively. During the year ended 31st March, 20X7, entity XYZ reported a loss of Rs. 4,000. In January 20X7, the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15th March, 20X7, the government announced that it would reintroduce limited plastic import tariffs at 10 percent in 20X8. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term.
Management of the entity XYZ undertook a going concern assessment at 31st March, 20X7. Management projects / forecasts that imposition of a 10 per cent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31st March, 20X7 annual financial statements?
Hint: XYZ's liabilities could exceed its assets by the end of financial year 20X7-20X8. But entity XYZ is a going concern.

Solution:

Entity XYZ, a plastic product manufacturer, faced financial distress due to the removal of import tariffs and currency appreciation, leading to a **₹4,000 crore loss for the year ended 31st March 20X7**. Despite restructuring, net equity stood at ₹1,000 crores. The government later announced a **10% import tariff effective from 20X8**, which management believed would help restore profitability.

As per **Ind AS 1**, financial statements must be prepared on a **going concern basis** unless liquidation or closure is imminent. If **material uncertainties** exist that cast doubt on an entity's ability to continue, they must be disclosed. The assessment must cover at least **12 months from the reporting date**.

Disclosure in Financial Statements: XYZ's financials should state that the **going concern assumption is based on expected tariff benefits and stable exchange rates**. However, if these assumptions do not materialize, **XYZ's liabilities could exceed its assets in the next financial year**, and this uncertainty must be transparently disclosed

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

Note 1: Basis of preparation



On the basis of management's assessment at 31st March 20X7, the financial statements have been prepared on the going concern basis. However, management's assessment assumes that the government will reintroduce limited plastic import tariffs and that the currency exchange rate will remain constant. On 15th March 20X7, the government announced that limited import tariffs will be imposed in 20X8. However, the government emphasised that the tariff would not be as protective as the 40 percent tariff in effect before 20X7.

Management projects / forecasts that a 10 percent tariff on all plastic products would result in entity XYZ returning to profitability. As at 31st March, 20X7 entity XYZ had net assets of 1,000. If import tariffs are not imposed and currency exchange rates remain unchanged, entity XYZ's liabilities could exceed its assets by the end of financial year 20X7-20X8. On the basis of their assessment of these factors, management believes that entity XYZ is a going concern.

2. Illustration

In 20X8 entity 'Superb' was acquired by entity 'Happy Go Luck'. To align its reporting date with that of its parent, Superb changed the end of its annual reporting period from 31stJanuary to 31st March. Consequently, entity Superb's reporting period for the year ended 31st March, 20X8 is 14 months.

On the basis of these facts, what disclosure would be appropriate?

Hint: Comparative amounts for the statement of comprehensive income, statement of changes in equity, statement of cash flows and related notes are not entirely comparable.

Solution:

Entity Superb, acquired by Happy Go Luck in 20X8, changed its reporting date from **31st January to 31st March**, making the current reporting period **14 months** while the prior period is **12 months**.

As per **Ind AS 1**, when an entity changes its reporting period, it must:

- **Disclose the reason for the change**.
- **State that comparative figures are not entirely comparable**.

Note 1

Basis of preparation and accounting policies

Reporting period

To align the entity's reporting period with that of its parent (Happy Go Luck), the entity changed the end of its reporting period from 31st January to 31st March. Amounts presented for the period ended 31st March, 20X8 are for 14 months. Comparative figures are for a 12 months period. Consequently, comparative amounts for the statement of comprehensive income, statement of changes in equity, statement of cash flows and related notes are not entirely comparable.

3. Illustration

An entity produces whisky from barley, water, and yeast in a 24-month distillation process. At the end of the reporting period the entity has one month's supply of barley and yeast raw materials, 800 barrels of partly distilled whisky and 200 barrels of distilled whisky. Determine whether they are current assets.

Hint: Current Assets

Solution:



An entity producing whisky undergoes a **24-month distillation process** and holds raw materials, work-in-progress, and finished goods.

As per **Ind AS 1**, inventory is a **current asset if it is part of the entity's normal operating cycle**, regardless of whether the cycle extends beyond **12 months**. Since whisky production is part of the entity's cycle, all inventories, including **raw materials, work-in-progress, and finished whisky**, are classified as **current assets**.

4. Illustration

An entity owns a machine with which it manufactures goods for sale. It also owns the building in which it carries out its commercial activities. Determine whether they are current assets.

Hint: Non-Current Assets

Solution:

The machine and the building are non-current assets because:

- they are not cash or cash equivalents;
- they are not expected to be realised or consumed in the entity's normal operating cycle;
- they are not held for the purpose of trading; and
- they are not expected to be realised within twelve months of the end of the reporting period.

5. Illustration

On 31 December 20X2, an entity replaced a machine in its production line. The replaced machine was sold to a competitor for Rs,3,00,000. Payment is due 15 months after the end of the reporting period. Determine the nature of payment due.

Hint: Receivable is a non-current asset

Solution:

An entity sold a replaced machine for **₹3,00,000**, with **payment due 15 months after the reporting date**.

As per **Ind AS 1**, an asset is **non-current** if it is:

- **Not cash or cash equivalent**.
- **Not expected to be realized within 12 months**.
- **Not held for trading purposes**.

Since the receivable is **due beyond 12 months**, it is classified as a **non-current asset**. If payment were due **within 12 months**, it would be a **current asset**.

6. Illustration

On 1st April, 20X2, XYZ Ltd invested Rs.15,00,000 surplus funds in corporate bonds that bear interest at 8 percent per year. Interest is payable on the corporate bonds on 1st April, of each year. The principal is repayable in three annual instalments of Rs.5,00,000 starting from 1st April, 20X3. Determine if it is a current liability?



Hint: Rs.5,00,000 (repayable on 31/3/20X3)– Current assets & remaining Rs.10 lakhs non-current assets

Solution:

XYZ Ltd invested **₹15,00,000** in corporate bonds at **8% interest**, payable annually. The **principal is repayable in three instalments of ₹5,00,000 each**, starting from **1st April 20X3**.

As per **Ind AS 1**, the **₹5,00,000** instalment due within 12 months is classified as a **current asset**, while the **remaining ₹10,00,000** is a **non-current asset**. Similarly, **₹1,20,000 accrued interest** is classified as a **current asset**, as it is expected to be received within 12 months.

7. Illustration

On 1st April, 20X3, Charming Ltd issued 100,000 Rs. 10 bonds for Rs. 1,000,000. On 1st April, each year interest at the fixed rate of 8 percent per year is payable on outstanding capital amount of the bonds (ie the first payment will be made on 1st April, 20X4). On 1st April each year (i.e from 1st April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at Rs. 10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements?

Hint: Rs.9,00,000 non-current liability & Rs.1,80,000 current liabilities

Solution:

Charming Ltd issued **100,000 bonds of ₹10 each** (total **₹10,00,000**) on **1st April, 20X3**, with **8% annual interest** payable each year. The company is obligated to **redeem 10,000 bonds annually** from **1st April, 20X4**.

As per **Ind AS 1**, in the financial statements for **31st March, 20X4**:

- **₹80,000 accrued interest** and **₹1,00,000 current portion of bonds** (due on **1st April, 20X4**) are classified as **current liabilities**.
- The **remaining ₹9,00,000 bonds** due after **12 months** are classified as **non-current liabilities**.

8. Illustration

X Ltd provides you the following information:

- Raw material stock holding period: 3 months
- Work-in-progress holding period: 1 month
- Finished goods holding period: 5 months
- Debtor's collection period : 5 months

The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?

Hint: Trade payables – Current Liabilities

Solution:

X Ltd has an **operating cycle of 14 months** and settles trade payables within **12.5 months**.

As per **Ind AS 1**, trade payables are classified as **current liabilities** if they are settled **within the entity's normal operating cycle**, even if it exceeds **12 months**. Since X Ltd's payables are due **within the cycle**, they are **classified as current liabilities**.

9. Illustration

Entity A has two different businesses, real estate and manufacturing of passenger vehicles. With respect to the real estate business, the entity constructs residential apartments for customers



and the normal operating cycle is three to four years. With respect to the business of manufacture of passenger vehicles, normal operating cycle is 15 months. Under such circumstance where an entity has different operating cycles for different types of businesses, how classification into current and non-current be made?

Hint: Classification should be based the normal operating cycle that is relevant to that particular asset / liability.

Solution:

Entity A has two businesses:

1. **Real estate (operating cycle: 3–4 years)**
2. **Passenger vehicle manufacturing (operating cycle: 15 months)**

As per **Ind AS 1**, an **asset/liability should be classified based on the operating cycle of the specific business it relates to**. Since the operating cycles are different for each business, classification should be done separately for each segment, and **disclosures should be made accordingly**.

It is advisable to disclose the normal operating cycles relevant to different types of businesses for better understanding.

10. Illustration

An entity has placed certain deposits with various parties. How the following deposits should be classified, i.e., current or non-current?

(a) Electricity Deposit

(b) Tender Deposit/Earnest Money Deposit [EMD]

(c) GST Deposit paid under dispute or GST payment under dispute.

Hint: (a) Non-Current (b) EMD based on terms of deposit (c) GST Deposit depends on facts of case

Solution:

Type of Deposit	Key Facts	Expectation of Realisation	Classification
Electricity Deposit	Refundable on demand when connection is surrendered. However, electricity connection is required as long as the entity continues its operations.	Entity does **not expect** to realise the deposit within 12 months due to commercial reality.	**Non-Current Asset**
Tender Deposit / Earnest Money Deposit (EMD)	Paid for participation in bids. Refundable if the bid is not successful. Bid outcome date is known, but success is uncertain till that date.	Depends on **terms of tender** and **expected timeline** of bid outcome.	**Current Asset** if expected within 12 months; otherwise **Non-Current Asset**
GST Deposit / GST Paid under Dispute	Amount paid under protest during legal dispute with tax authorities. Refund depends on outcome of dispute.	Based on management's **reasonable expectation** of recovery period.	**Current Asset** if expected within 12 months; otherwise **Non-Current Asset**



11. Illustration

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

Hint: Current Liability

Solution:

An entity develops **custom tools** for customers with an **operating cycle of 2 years**. The entity receives **upfront payments**, recorded as **Income Received in Advance**.

As per **Ind AS 1**, trade payables and other operating liabilities **are classified as current liabilities even if settled beyond 12 months**, provided they are part of **working capital**. Since **Income Received in Advance is part of the working capital cycle**, it is classified as a **current liability**.

12. Illustration

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

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

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

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

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

Hint: (a)Non-Current (b) Current (c) Current Liability (d) Current

Solution:

Scenario	Facts at End of Reporting Period	Ind AS 1 Principle Applied	Classification
(a) Roll-over agreed before reporting date with same bank (5 years)	Loan repayable in 9 months, but roll-over into 5-year facility agreed **before** reporting date and is **unconditional**	Entity has an **unconditional right to defer settlement** for at least 12 months	**Non-Current Liability**
(b) Roll-over agreed after reporting date	No roll-over arrangement exists **as at** reporting date	Classification based on **existing terms** at reporting date	**Current Liability**
(c) Existing loan with one bank, new facility from another bank	Old loan must be **settled**; refinancing is not automatic	Refinancing with another bank is **not equivalent to roll-over**	**Current Liability**
(d) No arrangement, only potential to refinance	Entity only has **potential / intention** to refinance	Para 73 of Ind AS 1 – potential to refinance is **ignored**	**Current Liability**



13. Illustration

In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 20X5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 20X2, failing which the loan becomes payable on demand. As on March 24, 20X2, the entity has not been able to get the promoter's contribution.

On March 25, 20X2, the entity approached the bank and obtained a grace period up to June 30, 20X2 to get the promoter's contribution.
The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 20X2.
(a) As on March 31, 20X2, how should the entity classify the loan?
(b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 20X2, the entity approached the bank and got the compliance date extended up to June 30, 20X2 for getting promoter's contribution. In this case will the loan classification as on March 31, 20X2 be different from (a) above?

Hint: (a) Current (b) Non-Current

Solution:

a) An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment." In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on 31st March 20X2, the loan will be classified as current.

b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on 30th June 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on 31st March 20X2, the loan will retain its classification as non-current.

14. Illustration

OMN Ltd has a subsidiary MN Ltd. OMN Ltd provides a loan to MN Ltd at 8% interest to be paid annually. The loan is required to be paid whenever demanded back by OMN Ltd.
How should the loan be classified in the financial statements of OMN Ltd? Will it be any different for MN Ltd?

Hint: Current

Solution:

The demand feature might be primarily a form of protection or a tax-driven feature of the loan. Both parties might expect and intend that the loan will remain outstanding for the foreseeable future. If so, the instrument is, in substance, long-term in nature, and accordingly, OMN Ltd would classify the loan as a non-current asset.
However, OMN Ltd would classify the loan as a current asset if both the parties intend that it will be repaid within 12 months of the reporting period.
MN Ltd would classify the loan as current because it does not have the right to defer repayment for more than 12 months, regardless of the intentions of both the parties.
The classification of the instrument could affect initial recognition and subsequent measurement. This might require the entity's management to exercise judgement, which could require disclosure under judgements and estimates.



15. Illustration

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

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

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

Hint: (a) Current if realisable within normal operating cycle (b) No

Solution:

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

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

b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and its realisation into cash is 28 months [15 months + 13 months]. Both inventory and debtors would be classified as current if the entity expects to realise these assets in the normal operating cycle.

16. Illustration

Company A has taken a long term loan from Company B. In the month of December 20X1, there has been a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on March 31, 20X2. In the month of May 20X2, the Company started negotiation with the Company B for not to demand payment as a consequence of the breach. The financial statements were approved for the issue in the month of June 20X2. In the month of July 20X2, both the companies agreed that the payment will not be demanded immediately as a consequence of breach of material provision.

Advise on the classification of the liability as current / non-current.

Hint: Liability to be classified as current as at March 31, 20X2.

Solution:

Where there is a **breach of a material provision of a long-term loan arrangement on or before the end of the reporting period**, as a result of which the liability becomes **payable on demand**, the liability **cannot be classified as non-current** merely because the lender **agreed after the reporting period**, but before approval of the financial statements, **not to demand payment**. For a liability to be classified as **non-current**, the lender must have agreed **by the end of the reporting period** to provide a **period of grace** that **extends at least twelve months after the reporting period**, during which the entity can **rectify the breach** and the lender **cannot demand immediate repayment**.

In the given case, Company B (the lender) agreed **not to demand payment only after the reporting date**. The financial statements were approved for issue in **June 20X2**, while the final agreement not to demand payment was reached only in **July 20X2**. Although negotiations had commenced in **May 20X2**, no binding agreement existed either **by the end of the reporting period** or **before the approval of the financial statements**. Accordingly, as at **31 March 20X2**, the entity did **not have an unconditional right to defer settlement** of the liability for at least twelve months. **Hence, the liability should be classified as current**.



17. Illustration

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

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

Hint: Items impacting (a) P&L – Service cost, translation gains/losses on forex, income tax, share based payments cost (b) OCI – Remeasurement, changes in surplus, translation gains / losses from foreign operations, gains / losses from investments.

Solution:

Items impacting the Statement of Profit and Loss for the year ended 31st March, 20X1 (₹)

Current service cost	1,75,000
Gains and losses arising from translating the monetary assets in foreign	75,000
currency	
Income tax expense	35,000
Share based payments cost	3,35,000

Items impacting the other comprehensive income for the year ended 31st March, 20X1 (₹)

Remeasurement of defined benefit plans	2,57,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the financial statements of a foreign	
operation	65,000
Gains and losses from investments in equity instruments designated at fair	
value through other comprehensive income	1,00,000

18. Illustration

XYZ Limited (the 'Company') is into the manufacturing of tractor parts and mainly supplying components to the Original Equipment Manufacturers (OEMs). The Company does not have any subsidiary, joint venture or associate company. During the preparation of financial statements for the year ended March 31, 20X1, the accounts department is not sure about the



treatment/presentation of below mentioned matters. Accounts department approached you to advice on the following matters.

S. No.	Matters
(i)	There are qualifications in the audit report of the Company with reference to two Ind AS.
(ii)	Is it mandatory to add the word "standalone" before each of the components of financial statements?
(iii)	The Company is Indian Company and preparing and presenting its financial statements in Rs. Is it necessary to write in the financial statements that the financial statements has been presented in Rs.
(iv)	The Company had sales transactions with 10 related party parties during previous year. However, during current year, there are no transactions with 4 related parties out of aforesaid 10 related parties. Hence, Company is of the view that it need not disclose sales transactions with these 4 parties in related party disclosures because with these parties there are no transactions during current year.

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

Hint: (i) Yes (ii) No (iii) Yes (iv) No

Solution:

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

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

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

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

19. Illustration

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

With reference to above background, answer the following:

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

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

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



Hint: (i) Yes (ii) Yes (iii) Yes

Solution:

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

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

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

20. Illustration

A Company while preparing the financial statements for Financial Year (FY) 20X1-20X2, erroneously booked excess revenue of Rs. 10 Crore. The total revenue reported in FY 20X1-20X2 was Rs. 80 Crore. However, while preparing the financial statements for 20X2- 20X3, it discovered that excess revenue was booked in FY 20X1-20X2 which it now wants to correct in the financial statements. However, management of the Company is not sure whether it need to present the third balance sheet as additional comparative.
With regard to the above background, answer the following:
(i) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?
(ii) The Company wants to correct the error during FY 20X2-20X3 by giving impact in the figures of current year only. Is the contention of management correct?

Hint: (i) No (ii) No
Solution:

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

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

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

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



21. Illustration

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

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

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

Considering the above items/transactions answer the following:

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

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

(iii) Can the security deposit of Rs. 5 Crore made by the Company with the customers be presented as current?

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

Hint: (i) Yes (ii) No (iii) No (iv) No

Solution:

i. Yes, but additionally the Company also need to disclose amounts that are receivable within a period of 12 months and after 12 months from the reporting date.

ii. No, the Company cannot disclose these payables as non-current and the Company also need to disclose amounts that are payable within a period of 12 months and after 12 months from the reporting date.

iii. No, because the amount will be receive d after the operating cycle of the Company.

iv. No, because the amount may be required to be paid before completion of the contract in case the contract is cancelled.



22. Illustration

Is offsetting permitted under the following circumstances?

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

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

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

Hint: (a) Yes, if in substance is in nature of reimbursement (b) Yes unless material (c) Yes if entity has legal right

Solution:

Offsetting is permitted only when the offsetting reflects the substance of the transaction.

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

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

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

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

23. Illustration

As per the statutory requirements, exceptional items are required to be disclosed whereas Ind AS 1 requires separate disclosures of material items and how these are to be presented in the financial statements. Does that imply that 'exceptional' means 'material'? Give examples. How should these be presented in the financial statements?

Solution

Exceptional items are not specifically defined under **Indian Accounting Standards (Ind AS)**. However, as per **paragraph 97 of Ind AS 1**, when items of income or expense are **material**, their nature and amount must be disclosed separately in the financial statements.

Materiality under **Ind AS 1** is assessed based on whether omitting, misstating, or obscuring information could influence the **economic decisions of primary users**. It considers both **size (quantitative aspect)** and **nature (qualitative aspect)** of the item.



*While all **exceptional items** are **material**, not all **material items** qualify as **exceptional**. Exceptional items are those that not only meet the **test of materiality** but also possess **unusual size, nature, or incidence**, requiring separate disclosure to explain the entity's performance.*

Examples of Exceptional Items (If Material & Unusual in Incidence):

1. **Write-downs** of inventories to **net realizable value** or impairments of **property, plant, and equipment** (PPE), and subsequent **reversals**.
2. **Restructuring costs** and reversals of provisions related to restructuring.
3. **Disposal of PPE or investments**.
4. **Discontinued operations**.
5. **Litigation settlements** with significant financial impact.
6. **Other reversals of provisions**, if substantial.

Presentation in Financial Statements:

- **Ind AS 1 does not mandate a specific format** for presenting exceptional items.
- Entities must **separately disclose such items in the Statement of Profit & Loss** under the relevant category, ensuring clarity for users.
- The **notes to financial statements** should explain the **nature, amount, and reason** for classification as an exceptional item.

Thus, **exceptional items are material, but not all material items are exceptional**. The distinction lies in their **nature, size, and impact on financial performance**, ensuring that users of financial statements receive **transparent and relevant information**.



Ind AS 7
Cash Flow Statement
ILLUSTRATIONS

1. Illustration

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

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

Solution

#	Name of the Security	Decision
1.	Fixed deposit with SBI	Not to be considered – long term
2.	Fixed deposit with HDFC	Exclude as original maturity is not less than 90 days from the date of acquisition
3.	Redeemable Preference shares in ABC Ltd.	Include as due within 90 days from the date of acquisition
4.	Cash balances at various banks	Include
5.	Cash balances at various banks	Include
6.	Cash balances at various banks	Include
7.	Bank overdraft of SBI Fort branch	Include (Assumed as integral part of an entity's cash management)
8.	Treasury Bills	Include

2. Illustration

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

Sr. No.	Nature of Transaction
1	Receipt from sale of mobile phones
2	Purchases of mobile phones from various companies
3	Employees expenses paid
4	Advertisement expenses paid
5	Credit sales of mobile
6	Miscellaneous charges received from customers for repairs of mobiles
7	Loss due to decrease in market value of the closing stock of old mobile phones
8	Payment to suppliers of mobile phones
9	Depreciation on furniture of sales showrooms
10	Interest paid on cash credit facility of the bank



11	Profit on sale of old computers and printers, in exchange of new laptop and printer
12	Advance received from customers
13	Sales Tax and excise duty paid

Solution:

#	Nature of Transaction	Included / Excluded with reason
1	Receipt from sale of mobile phones	Include – main revenue generating activity
2	Purchases of mobile phones from various companies	Include – expenses related to main operations of business
3	Employees expenses paid	Include – expenses related to main operations of business
4	Advertisement expenses paid	Include – expenses related to main operations of business
5	Credit sales of mobile	Do not include – Credit transaction will not be included in cash flow (receipts from customers will be included)
6	Misc. charges received from customers for repairs of mobiles	Include – supplementary revenue generating activity
7	Loss due to decrease in market value of the closing stock of old mobile phones	Do not include - Non cash transaction
8	Payment to suppliers of mobile phones	Include – cash outflow related to main operations of business
9	Depreciation on furniture of sales showrooms	Do not include – non cash item
10	Interest paid on cash credit facility of the bank	Do not include – cost of finance
11	Profit on sale of old computers and printers, in exchange of new laptop and printer	Do not include – non cash item
12	Advance received from customers	Include – Related to operations of business
13	Sales tax and excise duty paid	Include – related to operations of business

3. Illustration

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

S. No.	Nature of transaction paid
1	Interest received on loans
2	Interest paid on Deposits
3	Deposits accepted
4	Loans given to customers
5	Loans repaid by the customers
6	Deposits repaid
7	Commission received
8	Lease rentals paid for various branches
9	Service tax paid
10	Furniture purchased for new branches
11	Implementation of upgraded banking software



12	Purchase of shares in 100% subsidiary for opening a branch in Abu Dhabi
13	New cars purchased from Honda dealer, in exchange of old cars and remaining amount paid in cash
14	Provident fund paid for the employees
15	Issued employee stock options

Solution:

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

4. Illustration

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

S. No	Nature of Transaction
1	Issued preference shares
2	Purchased the shares of 100 % subsidiary company
3	Dividend received from shares of subsidiaries
4	Dividend received from other companies
5	Bonus shares issued
6	Purchased license for manufacturing of special drugs
7	Royalty received from the goods patented by the company
8	Rent received from let out of building (letting out is not main business)
9	Interest received from loans or advances given
10	Dividend paid
11	Interest paid on security deposits
12	Purchased Goodwill



13	**Acquired assets by issuing equity shares**
14	**Interim dividends paid**
15	**Dissolved the 100% subsidiary and received the amount in final settlement**

Solution:

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

5. Illustration

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

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

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

Balance Sheet as on 31st March

	20X2	20X1
Assets		
Non-current Assets		
Property, Plant and Equipment	75,000.00	65,000.00
Investment	12,000.00	10,000.00



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

Solution:

Cash flow from operations - Direct Method		
Particulars	**Amt**	**Amt**
Cash collected from Customers/Sales	WN 1	4,97,000
Amounts paid to suppliers	WN 2	(3,45,000)
Amounts paid for SGA OH	WN 3	(52,000)
Cash generated from operations		**1,00,000**
Less: Taxes Paid		**(30,000)**
Net Cash generated from Operations		70,000
Cash flow from operations - Indirect Method		
Net Profit before taxes		83,000
Add/(Less)		
+ Depreciation	7,000	
+ Interest	3,000	
+ Loss on sale of assets	2,000	12,000
Cash flow from operations before WC changes		**95,000**
Adjustment for WC Changes		
(-) Increase in Debtors	(3,000)	
+ Decrease in Inventories	1,000	
+ Increase in Trade Payables	4,000	
+ Increase in Payables for expenses	3,000	5,000
Cash flow from operations		**1,00,000**
Less: Taxes Paid		**(30,000)**
Net cash generated from operations		**70,000**
W.N.1 - Cash collected from customers		
Sales - Total	5,00,000	
Add: Opening Balance	7,000	
Less: Closing Balance	10,000	
Cash Collected	4,97,000	



Accounts Receivables - Ledger				
To Bal b/d	7,000		By Bank - bal fig	4,97,000
To Sales	5,00,000		By Bal c/d	10,000
WN 2				
COGS = OS + Pur - CS			Pur = COGS + CS - OS	
Opening Inventory			13,000	
COGS			3,50,000	
Closing Inventory			12,000	
	Purchases		3,49,000	
Amount paid to Trade Payables				
Purchases			3,49,000	
Add: Opening Balance			8,000	
Less: Closing balance			12,000	
	Amount paid to TP		3,45,000	
WN 3	**Selling & GA**			
Expense for the year			55,000	
Add: Opening bal			7,000	
Less: Closing bal			10,000	
	Cash paid for SGA		52,000	

6. Illustration

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

	20X2	20X1
Cash	4,000	14,000
Accounts Receivable	25,000	32,500
Prepaid Insurance	5,000	7,000
Inventory	37,000	34,000
Fixed Assets	3,16,000	2,70,000
Accumulated Depreciation	(45,000)	(30,000)
Total Assets	3,42,000	3,27,500
Accounts Payable	18,000	16,000
Wages Payable	4,000	7,000
Debentures	1,73,000	1,60,000
Equity Shares	88,000	84,000
Retained Earnings	59,000	60,500
Total Liabilities & Equity	3,42,000	3,27,500

Profit and Loss	20X2
Sales	2,00,000
Cost of Goods Sold	(1,23,000)
Depreciation	(15,000)
Insurance Expense	(11,000)
Wages	(50,000)
Net Profit	1,000

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



Solution:

Cash flow statement for Year 20X2 using Direct method		
Particulars	Amt	Amt
Cash flow from Operating Activities		
Cash collected from Customers	WN 1	2,07,500
Cash paid to suppliers	WN 2	(1,24,000)
Insurance Expenses	WN 3	(9,000)
Wages	WN 4	(53,000)
Net Cash generated from operations	**A**	**21,500**
Cash flow from Investing Activities		
Cash paid to acquire Fixed Assets		(46,000)
Cash used in Investing Activities	B	(46,000)
Cash flow from Financing Activities		
Cash received on issue of equity shares		4,000
Dividends Paid		(2,500)
Debentures issued		13,000
Cash generated from financing activities	**C**	**14,500**
Net Increase/(decrease)in cash & cash equivalents	**A+B+C**	**(10,000)**
Opening Cash and Cash equivalents		14,000
Closing cash and cash equivalents		4,000
WN 1 – Cash collected from customers		
Sales during the year	2,00,000	
Add: Opening balance	32,500	
Less: Closing balance	(25,000)	
	2,07,500	
WN 2 Cash paid to suppliers		
Purchases = COGS + CS – OS	123000+37000-34000	
	1,26,000	



Amount paid to suppliers			
Purchases		1,26,000	
Add: Opening balance		16,000	
Less: Closing Balance		(18,000)	
		1,24,000	
WN 3 Amount paid to insurance			
Expense as per P&L		11,000	
Less: Opening Prepaid		(7,000)	
Add: Closing Prepaid		5,000	
		9,000	
WN 4 Wages			
Expense as per P&L		50,000	
Add: Opening Payable		7,000	
Less: Closing balance		(4,000)	
Cash paid to employees		53,000	
Cash flow statement for Year 20X2 using indirect method			
Cash flow from Operating Activities			
Net profit			1,000
Add/Less			
Depreciation			15,000
Cash flow before WC changes			16,000
Add/Less - WC Changes			
Decrease in AR		7,500	
Decrease in Prepaid Ins.		2,000	
Increase in Inventory		(3,000)	
Increase in AP		2,000	
Increase in Wages Payable		(3,000)	5,500
Net Cash generated from Operations			21,500

7. Illustration

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

	20X2 ₹ in lakhs	20X1 ₹ in lakhs
Assets		
Non-Current assets		
Property, plant and equipment	**13,000**	**12,500**
Intangible assets	**50**	**30**
Other financial assets	**145**	**170**



Deferred Tax Asset (net)	855	750
Other non-current assets	800	770
Total non-current assets	14,850	14,220
Current assets		
Financial assets		
Investments	2,300	2,500
Cash and cash equivalents	220	460
Other current assets	195	85
Total current assets	2,715	3,045
Total assets	17,565	17,265
EQUITY AND LIABILITIES		
Equity		
Equity share capital	300	300
Other equity	12,000	8,000
Total equity	12,300	8,300
Liabilities		
Non-current liabilities		
Financial liabilities		
Long-term borrowings	2,000	5,000
Other non-current liabilities	2,740	3,615
Total non-current liabilities	4,740	8,615
Current liabilities		
Financial liabilities		
Trade payables	150	90
Bank overdraft	75	60
Other current liabilities	300	200
Total current liabilities	525	350
Total liabilities	5,265	8,965
Total equity and liabilities	17,565	17,265

Additional Information:

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

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

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

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

(b) Intangible Assets – ₹ 20 lacs

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

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

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

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

Solution:

Cash flow statement of Kuber Ltd for Y.E. 31st March of 20X2 – Indirect method		
	Amt in Lacs	Amt in Lacs
Cash flow from Operating Activities		
Net profit after taxes	4,450	
Add: Tax expense – Current	105	
Less: DTA Credited to P&L	(105)	
Profit before taxes		4,450
Add: Depreciation	500	
Add: Amortisation	20	



Less: Gain on sale of machinery			(10)	510
Cash flow from ops. Before changes in op assets/liabilities				**4,960**
Adj. for changes in Op. Assets/Liabilities				
Decrease in Fin. Assets			25	
Increase in other NCA			(30)	
Increase in OCA			(110)	
Decrease in Other NCL			(875)	
Increase in Trade payables			60	
Incrase in Other CL			100	(830)
Cash generated from operations				**4,130**
Less: Income Tax Paid				**(105)**
Net cash generated from Operations			**A**	**4,025**
Cash flow from Investing Activities				
Proceeds from sale of PPE - Machinery			70	
Purchase of PPE			(1,060)	
Purchase of IA			(40)	
Investments sold			200	
Net Cash used in Investing Activity			B	(830)
Cash flow from financing activity				
Dividends paid			(450)	
Repayment of LTB			(3,000)	
Net cash used in financing activity			C	(3,450)
Net increase in cash and cash equivalents				**(255)**
Opening cash and cash eq. [460-60]				**400**
Closing cash and cash eq.		**[220-75]**		**145**
Property, Plant and Equipment A/c				
To Bal b/d	12,500.00		By Disposal of PPE	60
To Bank	1,060.00		By Depreciation	500
			By Bal C/d	13,000
	13,560.00			13,560



8. Illustration

Z Ltd. has no foreign currency cash flow for the year 20X1. It holds some deposit in a bank in the USA. The balances as on 31.12.20X1 and 31.12.20X2 were US$ 100,000 and US$ 102,000 respectively. The exchange rate on December 31, 20X1 was US$1 = ₹ 45. The same on 31.12.20X2 was US$1 = ₹ 50. The increase in the balance was on account of interest credited on 31.12.20X2. Thus, the deposit was reported at ₹ 45,00,000 in the balance sheet as on December 31, 20X1. It was reported at ₹ 51,00,000 in the balance sheet as on 31.12.20X2. How these transactions should be presented in cash flow for the year ended 31.12.20X2 as per Ind AS 7?

Solution:

Particulars	20X1	20X2	
Cash and cash eq. (USD)	1,00,000	1,02,000	
Exchange rate	45	50	
Cash and cash eq (INR)	45,00,000	51,00,000	6,00,000.00
Profit and loss statement			
Other Income - Interest		1,00,000	
Unrealised gain on USD holdings/Currency		5,00,000	
Net profit for the period		6,00,000	
Cash flow from ops.			
Net Profit for the period		6,00,000	
Less: Unrealised gain on USD		(5,00,000)	
Net increase in cash and cash eq		1,00,000	
Add: Opening bal of cash and cash eq		45,00,000	
Add: Unreaslied gain on USD	Recon	5,00,000	
Closing cash and cash eq.		50,00,000	

9. Illustration

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

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

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

Solution:

- When a tax payment is directly linked to an investing or financing activity, it should be classified accordingly.
- Otherwise, income tax payments are classified as operating activities.

Accordingly, the transactions are analysed as follows:

Particulars	Amount (in crore)	Activity



Sale Consideration	100	Investing Activity
Capital Gain Tax	(20)	Investing Activity
Business profits	30	Operating Activity
Tax on Business profits	(3)	Operating Activity
Dividend Payment	(20)	Financing Activity
Dividend Distribution Tax	(2)	Financing Activity
Income Tax Refund	1.5	Operating Activity
Total Cash flow	86.5	

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

10. Illustration

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

Consolidated Statement of Profit and Loss

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

Consolidated Balance Sheet

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

Other information



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

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

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

Solution:

Consolidated Cashflow Statement Year 20X2			
		Rs	Rs
Cash flow from operating activities			
Net Profit before taxes			70,000.00
Add/Less			
Add: Depreciation	Non-Cash	30,000	
Add: Interest Cost	Financing	4,000	34,000.00
Cashflow before adj to assets/liabilities			**1,04,000.00**
Changes in operating assets/liabilities			
Accounts Receivable		4,000	
Inventories		9,000	
Trade payables		(24,000)	-11,000.00
Cash flow from ops. Before taxation			93,000.00
Less: Taxes Paid			
15000+11000-12000			**-14,000.00**
Net cash generated from ops			**79,000.00**
Cash flow from Investing activity			
Cash paid to acquire subsidiary	74000-2000		-72,000.00
Cash flow from Financing Activity			
Interest paid (as above)			(4,000.00)
Net Increase in cash and cash eq.			**3,000.00**
Opening cash and cash eq.			**5,000.00**
Closing cash and cash eq.			**8,000.00**
W.N - PPE			
Opening balance	80,000		
Less: Depreciation	30,000		
Add: PPE assumed	1,10,000		
	1,60,000		
Subsidiary			
Debtors balance	8,000		



Equity			8,000		
Holding			Year 2	Year 1	
Debtors			5,000	5,000	
Consolidated BS					
Debtors			13,000	5,000	
Closing Balance			13,000		
Less: Debtors acquired			(8,000)		
Less: Opening balance			(5,000)		
			Prov. For tax		
				By Bal b/d	11,000.00
To Bank		bal fig	14,000	By P&L	15,000.00
To Bal c/d			12,000		
			20X2	20X1	20X1
			A +B	A	B
Traded receivables			54,000	50,000	8,000.00

11. Illustration

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

Consolidated Statement of cash flows

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

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

Particulars	₹ in Lakhs
Revenue	**12,380**
Cost of goods sold	**(9,860)**
Gross Profit	**2,520**
Other Income	**300**
Operating Expenses	**(450)**
Other expenses	**(540)**



Interest expenses	(110)
Share of Profit of Associate	120
Profit before Tax	1,840

The below information is relevant for A Ltd Group.

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

Property, Plant and Equipment	140 Lakhs
Inventories	60 Lakhs
Trade receivables	30 Lakhs
Cash and cash equivalents	20 Lakhs
Total Assets	250 Lakhs
Less: Trade Payables	(50 Lakhs)
Net Assets on acquisition	200 Lakhs

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

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

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

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

4. A Ltd. purchased 30% interest in an Associate (G Ltd) for cash on 1st April 20X1. The associate reported profit after tax of ₹ 400 Lac and paid a dividend of ₹ 100 Lac for the year.
5. Impairment test was conducted on 31st March 20X2. The following were impaired as under:

Goodwill impairment loss	₹ 265 Lakhs
Intangible Assets impairment loss	₹ 900 Lakhs

The goodwill impairment relates to 100% subsidiaries.

Assume that interest cost is all paid in cash.

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

Solution:

Cash flow from operating activities - Consolidated				
Profit before taxes				1,920.00
Add/Less				
Share of profits from associate			(120)	
Depreciation for the year			290	
Gain on disposal of asset			(140)	
Interest cost		Financing	100	



Impairment losses				
Goodwill			265	
Intangible assets			900	1,295.00
Cash flow before adjustments to op assets/liab				3,215.00
Adjustments to op assets/liabilities				
Change in inventories		Decrease	410	
Change in Trade Receivables		Decrease	580	
Change in Trade Payables		Decrease	(2,110)	(1,120.00)
	Cash flow from operations			2,095.00
W.N 1 Profit before taxes				
As reported in P&L			1,840	
Add: Renovation expenses			30	
Add: Cost of qualifying asset			40	
Add: Borrowing cost to be capitalised			10	
Correct PBT			1,920	
WN 2				
Investment in Associates				
Investment at Cost			710	
Add: Share of Profit			120	
Less: Dividends received			(30)	
Closing balance			800	

12. Illustration

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

(a) Cash consideration of ₹ 15,00,000

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

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

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

Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7.



Solution:

The **aggregate cash flows** arising from obtaining control of a subsidiary should be **presented separately and classified under investing activities**. Additionally, the **net cash outflow or inflow** related to the acquisition or disposal of subsidiaries should be **reported net of cash and cash equivalents acquired or disposed of**.

> Transactions involving **changes in ownership interests that do not result in a loss of control** are considered **equity transactions** and are **classified under financing activities**. However, if the subsidiary is an **investment entity measured at fair value through profit or loss**, different accounting treatment applies.

Year Ended 31st March, 20X2:

- **Acquisition of 70% stake in Company B**
  - **Total consideration paid = ₹ 15,00,000 (cash) + ₹ 30,00,000 (equity shares)**
  - **Cash and cash equivalents acquired from Company B = ₹ 2,50,000**
  - The **net cash outflow** shall be reported under **investing activities** as:

    "Acquisition of subsidiary (net of cash acquired)" – ₹ 12,50,000 (₹ 15,00,000 - ₹ 2,50,000)

  - Since the issuance of **equity shares as consideration does not involve cash flow**, it will **not impact the cash flow statement**, but **appropriate disclosure** shall be made in the financial statements regarding the issuance of shares as non-cash consideration.

Year Ended 31st March, 20X3:

- **Acquisition of additional 10% stake in Company B**
  - **Consideration paid = ₹ 8,00,000 (cash)**
  - Since this is a **change in ownership interest without a loss of control**, the cash outflow shall be classified under **financing activities**.
  - It will be reported as:

    "Payment for acquisition of additional stake in subsidiary" – ₹ 8,00,000 (Financing Activity)

13. Illustration

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

	31.03.20X2 (amount in ₹)	31.03.20X1 (amount in ₹)
Current Assets:		
Inventory	1,20,000	1,65,000
Trade receivables	2,05,000	1,88,000
Cash & cash equivalents	35,000	20,500
Current Liabilities:		
Trade payable	1,95,000	2,15,000
Provision for tax	48,000	65,000

Summary of Statement of Profit and Loss Rs.	
Sales	85,50,000



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

Additional information:

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

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

Solution:

Cash flow from operations under direct method				
Cash collected from customers				85,33,000
Cash paid to suppliers				(55,75,000)
Cash paid for admin expenses				(15,40,000)
Cash flow from ops before exceptional item				14,18,000
Add: Cash inflow from insurance claim				1,10,000
Cash flow from ops before taxes				15,28,000
Less: Taxes paid				(1,12,000)
Cash flow from operations				14,16,000
W.N 1				
		Trade Receivable Account		
To Bal b/d	1,88,000	By Bank	Bal fig	85,33,000
To Sales	85,50,000	By Bal c/d		2,05,000
W.N 2 Purchases		CS = OS + Pur - Sales		
Purchase = Closing Stock + Cost of Sales - Opening Stock				55,55,000
WN 3 Trade Payable				
Opening bal				2,15,000
Add: Purchases				55,55,000
Less: Closing bal				(1,95,000)
Amount paid to trade payables				55,75,000



14. Illustration

The opening balance sheet at 1st April, 20X6 of an Indian company (which account for its transactions in INR (Rs.), which consists of cash of

Rs. 1,00,000 and share capital of Rs. 100,000. The Company borrows a long term loan on 30th September, 20X6 for US $ 2,200 when the rate of exchange is 1 US $= Rs. 87. There are no other transactions during the year. The exchange rate at the balance sheet date of 31st March, 20X7 is 1 US $ = Rs. 85.

The summarized balance sheet at 31st March, 20X7 is as follows:

	Rs.	Rs.
Assets		
Cash (1,00,000+1,91,400)		2,91,400
		2,91,400
Equity and liabilities		
Capital and reserves		
Share capital Other Equity	1,00,000	
Foreign Currency Translation Reserves	4,400	1,04,400
Non- current liabilities		
Long -term loan		1,87,000
Total equity and liabilities		2,91,400

Required:

How the foreign exchange difference arising from unsettled transactions will reflect in the Statement of Cash Flows?

Answer:

The foreign currency loan, having been translated at the rate ruling at the receipt date to Rs. 1,91,400 (US $ 2,200 x Rs. 87), is translated at the balance sheet date to Rs. 1,87,000 (US $ 2,200 x Rs. 85). The exchange gain of Rs. 4,400 is recognised in the Statement of profit and loss. The cash is made up of Rs. 1,00,000 (received from the share issue) and Rs. 1,91,400 (received on converting the currency loan immediately to Rs.).

Statement of Cash Flows

	Rs.
Cash flows from operating activities	
Profit	4,400
Less: Foreign exchange gain	(4,400)
Net cash flow from operating activities A	0
Cash flows from financing activities	
Receipts of foreign currency loan	1,91,400
Net cash flow from financing activities B	1,91,400
Net increase in cash and cash equivalent A+B	1,91,400
Cash and cash equivalents at the beginning of the reporting period	1,00,000
Cash and cash equivalents at the end of the reporing period*	2,91,400

The exchange gain of Rs. 4,400 does not have any cash flow effect and is related to financing activities. Therefore, it needs to be eliminated from profit. A similar adjustment would be necessary if the loan remains outstanding at 31st March, 20X8.



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?

Solution:

Company A has manufactured goods exclusively for Customer P, who is undergoing restructuring due to liquidity issues. P has informed Company A that it will secure a Letter of Credit from a nationalized bank, against which the goods can be dispatched. However, the Letter of Credit has not yet been arranged. The question is when Company A should recognize revenue.

As per Ind AS 115, revenue should be recognized only when it is **probable that the entity will collect the consideration** in exchange for the goods or services transferred. In this case, given that Customer P is facing liquidity issues, the **probability of collection is uncertain**. Since the **Letter of Credit has not yet been arranged**, Company A **should not recognize revenue** until it has sufficient evidence that collectability is probable.

If, however, Company A can demonstrate through other means that it will receive the consideration (such as a third-party guarantee), revenue recognition may be appropriate, assuming all other conditions under Ind AS 115 are met. Additionally, the entity must **continuously reassess the contract** to determine if the criteria for revenue recognition as per para 9 are subsequently met.

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?

Solution:

G Ltd. enters into a contract with P Ltd. for the sale of a machinery unit for **₹20,00,000**. P Ltd. pays a **non-refundable deposit of ₹1,00,000** and enters into a **long-term financing agreement** for the remaining amount, to be repaid primarily from the income of its new business venture. The financing is provided on a **non-recourse basis**, meaning that G Ltd. can only repossess the machinery in case of default, without further recourse to P Ltd.

P Ltd.'s ability to pay may be uncertain due to the following reasons:
(a) P Ltd. intends to pay the remaining consideration (which has a significant balance) primarily from income derived from its food processing unit (which is a business involving



significant risk because of high competition in the said industry and P Ltd.'s little experience);
(b) P Ltd. lacks sources of other income or assets that could be used to repay the balance consideration; and
(c) P Ltd.'s liability is limited because the financing arrangement is provided on a non - recourse basis.

Ind AS 115 requires that revenue should be recognized when **collectability is probable**. In this case, the **customer's ability to pay is uncertain** as the repayment is contingent on the success of its business venture. Furthermore, **the financing arrangement is non-recourse**, limiting G Ltd.'s ability to recover outstanding amounts. As a result, revenue should not be recognized until it is probable that the entity will collect the consideration. The **₹1,00,000 deposit should be recorded as a liability**, not as revenue, until G Ltd. determines that collectability is probable or one of the revenue recognition criteria is met under 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?
Solution:

Assessment of Contract Under Ind AS 115

Under **Ind AS 115**, a contract with a customer is recognized only when the following conditions are met:

1. **Approval and Commitment** – The contract must be approved (in writing, orally, or through customary business practices), and both parties must be committed to fulfilling their obligations.
2. **Identification of Rights** – The entity must be able to identify each party's rights concerning the goods or services to be transferred.
3. **Payment Terms** – The terms of payment for the goods or services must be clearly defined.
4. **Commercial Substance** – The contract must impact the entity's future cash flows in terms of risk, timing, or amount.
5. **Probability of Collection** – It must be probable that the entity will collect the consideration in exchange for the goods or services provided. If consideration is variable, price concessions must be evaluated.

Application to the Given Case

- The contract has been **orally approved**, and X Ltd. is committed to resolving the customer's issue in exchange for a fee.
- Both parties' **rights are clearly defined**—the customer is entitled to receive IT support, and X Ltd. is entitled to payment upon successful resolution.
- **Payment terms are established**, as the customer is aware of the required amount and online payment method.
- The contract has **commercial substance**, as it involves time and effort from X Ltd.'s support team, directly impacting the entity's cash flows.
- **Collection is probable**, as X Ltd. has assessed the customer's ability and intention to pay.



Enforceability of the Contract

Ind AS 115 recognizes that a contract can be **written, oral, or implied by business practices**, depending on jurisdictional and industry norms. In this case, as the **oral contract is legally enforceable**, all criteria under Ind AS 115 are met. Therefore, the entity should recognize the contract accordingly.

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?

Solution:

Ind AS 115 states that **two or more contracts entered into at or near the same time with the same customer (or related parties) should be combined** if they meet any of the following conditions:

1. **Single Commercial Objective** – The contracts are negotiated together as part of a single business arrangement.
2. **Interdependent Consideration** – The consideration in one contract is dependent on the price or performance of the other.
3. **Single Performance Obligation** – The goods or services in both contracts represent a single performance obligation.

In this case, **Company A enters into two contracts with the same customer within two days**. The contracts must be assessed to determine whether they should be **combined for revenue recognition**.

- The contracts were **negotiated as a package**, fulfilling the **single commercial objective criterion** under Ind AS 115.
- The **consideration for the boom lift (₹95,000) implicitly includes a component for the tyres**, avoiding a loss that would have been incurred if the tyre contract was accounted for separately.
- If treated independently, Company A would incur a **loss of ₹400** [(₹900 – ₹800) × 4] on the tyre contract. However, the pricing structure suggests **interdependence between the contracts**.

Given these factors, the two contracts should be **combined and accounted for as a single contract** for revenue recognition under **Ind AS 115**, ensuring that the allocation of consideration accurately reflects the economic substance of the transaction.

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?
Solution:

A manufacturer negotiates two contracts simultaneously:

1. **Design and manufacture of new fighter planes for a Kashmir air base.**
2. **Supply of parts for existing planes at other bases.**



Under **Ind AS 115**, contracts should be **combined** if they meet any of the following conditions:

- They are **negotiated as a package** with a **single commercial objective**.
- The **consideration in one contract** depends on the **performance or pricing of the other contract**.
- The goods or services in both contracts form a **single performance obligation**.

Analysis of the Given Case

Although both contracts were **negotiated at the same time**, they serve **distinct commercial objectives**:

- The **fighter plane contract** pertains to the **development of new aircraft**, which involves **design, manufacturing, and specialized engineering work**.
- The **spare parts contract** is a **routine supply agreement** for **existing planes at different locations**.

Additionally, the **pricing and performance of one contract do not impact the other**, and the **planes and spare parts are separate deliverables with independent obligations**.

Conclusion

Since the contracts do not satisfy the criteria for combination under **Ind AS 115**, they should be **accounted for separately** as independent contracts.

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?

Solution

The two contracts should be **combined** because they were entered into at nearly the same time with the same customer, and the goods or services in both contracts form a **single performance obligation**. The consulting services significantly modify the software, making it highly interdependent and inseparable. Since **B** cannot derive benefit from the software without customisation, the licensing and consulting services together represent **one distinct obligation**. Therefore, the contracts should be accounted for as a **single contract** under Ind AS 115.

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?
Solution

Manufacturer **M** enters into a contract to manufacture and sell a **cybersecurity system** to **Government-related Entity P**. One week later, **M** enters into another contract to sell the **same system** to **Government-related Entity Q**. Both entities are **controlled by the same government**. During negotiations, **M** agrees to provide a **deep discount** if both **P** and **Q** purchase the system.



The contracts should be **combined** because they were entered into **at nearly the same time**, and the pricing structure demonstrates that they were negotiated as a **single commercial package**. The deep discount was contingent upon both P and Q purchasing the system, meaning that the **consideration in one contract was dependent on the other**. Furthermore, since both customers are **related parties** (being controlled by the same government), the contracts should be treated as a **single contract** for accounting purposes under Ind AS 115.

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?
Solution

An entity agrees to sell **120 products** for ₹ **1,000 per product**, with control transferring at a **point in time** over **six months**. After delivering **60 products**, the contract is **modified** to include **30 additional products** at ₹ **950 per product**, which is their **stand-alone selling price** at the time of modification.

Since the **30 additional products are distinct and priced at their stand-alone selling price**, the contract modification is treated as a **separate contract**. The original contract for **120 products remains unaffected**, and the additional 30 products are accounted for separately at ₹ **950 per unit**. This approach ensures that revenue recognition reflects the **fair value of goods at the time of modification**, in accordance with Ind AS 115.

9. Illustration (SM) Contract Modification

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?

Solution:
Considering that the remaining goods or services are not distinct, the modification will be accounted for on a cumulative catch up basis, as given below:

Particulars	Hours	Rate (₹)	Amount (₹)
Initial contract amount	200	150	30,000
Modification in contract	50	100	5000
Contract amount after modification	250	140*	35,000
Revenue to be recognized	100	140	14,000
Revenue already booked	100	150	15,000
Adjustment in revenue			(1,000)

*35,000 / 250 = 140

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.

Solution:

To determine the transaction price, XYZ Limited needs to estimate the variable consideration using appropriate methods as per **Ind AS 115**.

1. **Variable Consideration for Early/Late Completion**:
   - The contract specifies that the promised consideration of **₹ 2.5 crore** will be adjusted by **₹ 1 lakh per day** depending on the completion date.
   - Since there are multiple possible outcomes (early completion, timely completion, or delay), the entity applies the **expected value method** to estimate this component.
2. **Incentive Bonus Based on Asset Rating**:
   - The entity may receive an additional incentive of **₹ 15 lakh** if the asset meets the required rating upon inspection.
   - Since there are only **two possible outcomes** (either the entity receives ₹ 15 lakh or receives nothing), the entity applies the **most likely amount method** to estimate this component.

11. Illustration (SM) – Variable Consideration

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

- **15 percent bonus of the contract price if completed by the 30th month (25% likelihood)**
- **10 percent bonus if completed by the 32nd month (40% likelihood)**
- **5 percent bonus if completed by the 34th month (15% likelihood)**

In addition to the potential performance bonus for early completion, AST Limited is entitled to a quality bonus of ₹ 2 crore if a health and safety inspector assigns the facility a gold star rating as defined by the agency in the terms of the contract. AST Limited concludes that it is 60% likely that it will receive the quality bonus.
Determine the transaction price.

Solution:

To determine the **transaction price**, AST Limited estimates the **variable consideration** separately for each element of variability:

1. **Early Completion Bonus**:
   - The contract provides performance bonuses for early completion, ranging from **5% to 15%** of the contract price.
   - Since there are multiple possible outcomes and AST Limited has experience with similar contracts, the **expected value method** is applied to estimate this component.
   - The expected early completion bonus is calculated as follows:

table:

Bonus %	Amount of bonus (₹ in crore)	Probability	Probability-weighted amount (₹ in crore)
15%	3.75	25%	0.9375
10%	2.50	40%	1.00



5%	1.25	15%	0.1875
0%	-	20%	-
			2,125

2. **Quality Bonus**:
   - AST Limited is eligible for an additional **₹ 2 crore** if the facility receives a **gold star rating**.
   - Since there are only **two possible outcomes** (₹ 2 crore or **nil**), the **most likely amount method** is used.
   - The entity concludes that it is **60% likely** to receive this quality bonus, making ₹ 2 crore the most likely estimate for this component.

Final Transaction Price Calculation:

Component	Amount (₹ in Crore)
Fixed Consideration	25.00
Expected Early Completion Bonus	2.125
Most Likely Quality Bonus	2.00
Total Transaction Price	**₹ 29.125 crore**

Thus, the **transaction price** for the contract is **₹ 29.125 crore**, considering the estimated variable considerations.

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?

Solution:

Ind AS 115 requires that the transaction price be determined based on the consideration an entity expects to receive in exchange for transferring goods or services. The transaction price must account for any variable consideration, such as discounts, rebates, and price concessions.

An entity should assess whether there is a valid expectation from the customer, based on past business practices, policies, or other circumstances, that a discount or rebate will be provided. Additionally, revenue should only be recognized to the extent that it is highly probable that there will be no significant reversal when the uncertainty is resolved.

Analysis of the Case:

- The TV manufacturer sells TV sets at a list price of ₹10,000 per unit.
- If a dealer purchases more than 8,000 units during the contract period (June to May), a **retrospective** discount of **5% on all units purchased** applies.
- By **March 31, 2018**, the dealer has purchased **5,000 sets**.
- Based on past trends, it is **expected** that the dealer's total purchases by May 2018 will exceed **8,000 units**, making the dealer eligible for the discount.

Conclusion:

Since it is probable that the dealer will cross the 8,000-unit threshold, **the revenue recognized should be adjusted for the expected 5% discount** on all sales made up to March 31, 2018. This adjustment ensures that the reported revenue reflects the actual amount expected to be received, in line with Ind AS 115 requirements.



Additionally, as per Ind AS 10 (Events after the Reporting Period), any relevant events occurring between the reporting date and the approval of financial statements should be considered while estimating the probable discount.

Thus, revenue should be reduced by the probable discount amount to reflect the economic reality of the transaction.

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 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.

Solution:

For the quarter ended **June 30, 20X1**, since the 100-unit threshold was not expected to be breached at that time, revenue is recognized at **₹1,000 per unit**, amounting to **₹10,000 (10 × ₹1,000)**.

For the quarter ended **September 30, 20X1**, the revenue needs to be adjusted due to the revised estimate. Revenue for the **50 units sold in this quarter** is recognized at **₹900 per unit**, totaling **₹45,000 (50 × ₹900)**. Additionally, since the **previous 10 units** should also have been recognized at **₹900 per unit**, the previously recognized revenue is adjusted by reducing **₹100 per unit (₹1,000 – ₹900)**, leading to a **downward adjustment of ₹1,000 (10 × ₹100)**.

Thus, for the quarter ended **September 30, 20X1**, the total revenue recognized is **₹44,000 (₹45,000 – ₹1,000 adjustment for past revenue)**.

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.

Solution:

Ind AS 115 requires that an entity recognize revenue based on the transaction price, which includes any variable consideration. Variable consideration should only be included in revenue if it is highly probable that a significant reversal will not occur when the uncertainty is resolved. If the consideration depends on market conditions or other factors



outside the entity's control, it may not meet this criterion. The entity must reassess estimates at each reporting date and update revenue recognition accordingly.

Analysis of the Case:

The entity enters into a five-year asset management contract where it receives a ***2% quarterly management fee*** *based on the client's assets under management and an* ***additional 20% performance-based incentive fee*** *if returns exceed a market index. The* ***management fee is variable****, as it depends on the asset value at the end of each quarter, while the* ***performance-based incentive fee*** *is also variable but depends on market conditions over five years.*

At the contract's inception, the entity determines that the incentive fee is ***highly uncertain*** *due to its dependency on market performance. Since the entity cannot conclude that it is highly probable that revenue recognized for the incentive fee will not be reversed, it does* ***not*** *include this fee in the transaction price. However, at each quarter-end, the* ***quarterly management fee is known*** *and can be included in revenue since the uncertainty is resolved.*

Conclusion:

On ***March 31, 20X2****, the client's assets under management are* ***₹100 crore****, meaning the* ***quarterly management fee is ₹2 crore (2% of ₹100 crore)****. This fee is* ***recognized as revenue*** *for the quarter, as it relates specifically to the services provided during that period.*

However, the ***performance-based incentive fee is not recognized as revenue*** *because its variability depends on future market conditions, and a significant reversal could occur. The entity will reassess this at each reporting date and recognize it only when it meets the revenue recognition criteria under Ind AS 115.*

15. Illustration (SM) 0 Sale with a right to return

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.

Solution

Provision under Ind AS 115:

Ind AS 115 requires that if a contract includes a right of return, the consideration received from the customer is considered ***variable****. The entity should estimate the amount of revenue to be recognized based on expected returns, applying the* ***expected value method*** *when it provides the best prediction of the consideration to be received. Additionally, the*



*entity must recognize a **refund liability** for the expected returns and an **asset** for the right to recover products expected to be returned.*

Analysis of the Case:

*The entity enters into **1,000 contracts**, selling **one product per contract** at **₹50 per unit**, resulting in **₹50,000 total consideration**. Customers are allowed to return unused products within **30 days** for a full refund. The entity estimates that **970 products will not be returned**, and **30 products will be returned**. The cost per product is **₹30**, and returned products can be **resold at a profit**.*

*Since returns introduce **variability in consideration**, the entity applies the **expected value method** to estimate revenue. Given its past experience and the **short return window of 30 days**, the entity concludes that it is highly probable that a **significant reversal** of recognized revenue will not occur.*

Conclusion:

*Upon transferring control of the **1,000 products**, the entity recognizes:*

1. ***Revenue** = ₹48,500 (**₹50 × 970 products not expected to be returned**)*
2. ***Refund Liability** = ₹1,500 (**₹50 × 30 products expected to be returned**)*
3. ***Asset for Right to Recover Products** = ₹900 (**₹30 × 30 products expected to be returned**)*

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.
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?

Solution:

*Ind AS 115 requires that the transaction price be determined based on the **amount of consideration an entity expects to receive**. If an entity is likely to offer a **price concession**, the consideration is treated as **variable**. The entity should estimate the expected amount using either the **expected value method** or the **most likely amount method** and recognize revenue only to the extent that it is **highly probable** that a significant reversal will not occur when the uncertainty is resolved.*

Analysis of the Case:

*Entity I sells machinery for **₹2 million**, but at contract inception, it is aware that the customer may **not pay the full price**. Based on past experience and similar contracts, Entity I estimates that the customer will **at least pay ₹1.75 million**, which is sufficient to cover its **cost of sales of ₹1.5 million**. Since the entity has granted **similar price concessions** in comparable contracts and wants to grow its presence in this market, it determines that it will **likely accept ₹1.75 million** as the final price.*

*Since the entity expects to provide a **price concession**, the consideration is **variable**. However, because it is **highly probable** that Entity I will collect at least ₹1.75 million and this amount is **not subject to significant reversal**, it meets the revenue recognition criteria.*



Conclusion:

The **transaction price** in this arrangement is **₹1.75 million**, as this is the amount Entity I expects to receive after considering the price concession. Since this amount is **not constrained under the variable consideration guidance**, it is recognized as revenue.

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?

Solution:

1.9.9.1 Provision under Ind AS 115:

Ind AS 115 requires that revenue be recognized based on the **transaction price**, which includes variable consideration if it is highly probable that a significant revenue reversal will not occur when the uncertainty is resolved. If a contract includes **tiered pricing** based on cumulative sales volume, the entity must estimate total expected sales and determine the most probable transaction price. Any excess amounts received before reaching the price adjustment threshold must be recognized as a **liability** until the final pricing tier is determined.

Analysis of the Case:

Entity J enters into a one-year contract to sell **water treatment chemicals** with a **retroactive price adjustment** based on cumulative sales volume. The price per container varies as follows:

- ₹100 per container for **1 to 1,000,000 containers**
- ₹90 per container for **1,000,001 to 3,000,000 containers**
- ₹85 per container for **above 3,000,000 containers**

Entity J estimates that total sales for the year will be **2.8 million containers**, meaning the applicable price per container will be **₹90**. During the **first quarter ended 31st March 20X8**, **700,000 containers** are sold at an invoiced price of **₹100 per container**.

Since it is **highly probable** that the estimated total sales will reach **2.8 million containers**, Entity J determines that the expected price per container should be **₹90**. The extra ₹10 per container collected initially will be treated as a **liability**, as it is expected to be refunded or adjusted once the threshold is crossed.

Conclusion:

For the **quarter ended 31st March 20X8**, Entity J recognizes:

1. **Revenue** = ₹63 million (**700,000 containers × ₹90**)
2. **Liability (for excess cash received)** = ₹7 million (**700,000 containers × (₹100 – ₹90)**)



Entity J will continue to **update its estimate** of total sales volume at each reporting date until the uncertainty is resolved. If the expected volume changes, the transaction price may need to be adjusted accordingly.

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.

Solution:

Ind AS 115 requires an entity to **adjust the transaction price** if a contract includes a **significant financing component**. A financing component exists if the timing of payments provides either a **financing benefit to the customer (deferred payment)** or a **financing benefit to the entity (advance payment)**. The significance of the financing component is assessed based on factors such as the period between payment and delivery and the prevailing market interest rates.

A commercial airplane component supplier enters into a contract for a total **consideration of ₹70,00,000**. The supplier receives an **advance payment**, and based on an assessment of the facts, the entity determines that **₹1,40,000** represents an **insignificant financing component**. Since this amount is just **2% of the contract price**, it is **not considered material**, and the entity **does not need to adjust the transaction price**.

However, in an alternate scenario, where the advance payment is **larger and received much earlier**, the entity concludes that **₹14,00,000** represents a financing component. This amount is **20% of the contract price**, which is considered **significant** under Ind AS 115. As a result, the entity must **adjust the promised consideration** to reflect the impact of the financing component, typically by discounting future cash flows using a relevant discount rate.

The assessment of whether a financing component is **significant** is a **matter of judgment** and depends on the **facts and circumstances of the contract**.

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.

Solution:

Ind AS 115 requires that an entity adjust the **transaction price** when a **significant financing component** exists in a contract. A financing component exists when the timing of payments provides a **benefit to either the customer (deferred payment)** or the **entity (advance payment)**. If the payment terms extend significantly beyond the delivery of goods, the consideration should be adjusted to reflect the time value of money. The interest rate used should be reflective of a **market rate** for similar financing arrangements.



Analysis of the Case:

NKT Limited sells a product for **₹1,21,000**, payable **24 months after delivery**, while the customer **obtains control of the product at contract inception**. The **cash selling price** of the product is **₹1,00,000**, indicating that the difference of **₹21,000** represents a **financing component**. The **implicit interest rate** embedded in the contract is **10%**, which discounts the future consideration to its present value. Since the **financing component is significant**, Ind AS 115 requires that revenue be recognized at the **cash selling price (₹1,00,000)** at contract inception.

The **remaining ₹21,000** is recognized as **interest income over the 24-month period** in accordance with **Ind AS 109**, using the **effective interest rate method**.

Conclusion:

- **Revenue recognized at contract inception** = ₹1,00,000 (cash selling price).
- **Interest income** of **₹21,000** is recognized over **24 months** as per **Ind AS 109**.
- The entity will continue to accrue interest revenue on the outstanding receivable until payment is received from the customer

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
Case B—Contractual discount rate does not reflect the rate in a separate financing transaction ie 14%.
Solution:

Ind AS 115 requires that when a contract includes a significant financing component**, the entity must determine the transaction price by discounting the promised consideration using a discount rate that reflects the customer's credit characteristics. If the contractual interest rate does not reflect a** market-based rate**, the entity must adjust the transaction price using the appropriate discount rate. The entity must also account for the financing element separately under** Ind **AS 109 (Financial Instruments).**

Case A – Contractual Discount Rate Reflects Market Rate (10%)

Since the **contractual interest rate (10%)** reflects the rate that would be used in a **separate financing transaction**, the transaction price remains **₹1 crore**.

- The equipment's **cash selling price is ₹1 crore**, which is recognized as **revenue** at contract inception.
- The **receivable** is also recorded at ₹1 crore.
- The contractual **monthly installment of ₹2,12,470** continues as per the agreed **10% interest rate**.
- Interest income is subsequently recognized over time in accordance with **Ind AS 109**.

Case B – Contractual Discount Rate Does Not Reflect Market Rate (14%)

Since the **contractual interest rate (10%)** is lower than the **market rate (14%)**, the transaction price must be adjusted by discounting the promised payments at **14%**, which better reflects the financing component.

- The **monthly installment of ₹2,12,470** is discounted at **14%**, giving a **transaction price of ₹91,31,346**.



- This adjusted **₹91,31,346 is recognized as revenue** when control of the equipment transfers to the customer.
- **receivable of ₹91,31,346** is recorded, and the entity will recognize **interest income** over time as per **Ind AS 109**.

21. Illustration (SM) – financing component

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

Solution:

Journal Entries showing accounting for the significant financing component

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

Cash	Dr.	₹. 4,00,000	
To Contract liability			₹. 4,00,000

(b) During the two years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration and accretes the contract liability by recognizing interest on ₹. 4,000 at 6% for two years:

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

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

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

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

Solution:

Ind AS 115 requires an entity to assess whether a contract includes a **significant financing component**. A financing component exists if the timing of payments provides a **financing benefit** to either the **customer (deferred payment)** or the **entity (advance payment)**. However, if the payment terms are structured for reasons **other than financing**, such as ensuring performance under the contract, no significant financing component is deemed to exist.

ABC Limited enters into a **three-year construction contract** for a power plant, where milestone payments are scheduled based on **progress completion**. A portion of each



milestone payment is **retained as retention money** and is only paid after the entire construction is complete.

Since the milestone payments are **aligned with the entity's performance**, and the **retention money is held to ensure contract fulfillment** rather than for financing purposes, it does **not constitute a significant financing component** under Ind AS 115. The retention serves as a protection mechanism for the customer, ensuring that ABC Limited properly completes its contractual obligations.

The contract **does not contain a significant financing component**, as the milestone payments **coincide with performance**, and the **retention money is withheld for risk management purposes rather than financing**. Therefore, **no adjustment to the transaction price is required** under Ind AS 115.

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.

Solution:

Ind AS 115 requires an entity to assess whether a contract includes a **significant financing component** by evaluating whether the timing of payments provides a **financing benefit** to either the **customer (deferred payment)** or the **entity (advance payment)**. However, if the **payment terms are structured for reasons other than financing**, such as risk management or cost efficiency, the contract does **not** contain a significant financing component.

Analysis of the Case:

XYZ Limited sells **PC support and repair coverage for three years** for an **upfront payment of ₹3,000**, with **no option for monthly payments**. The **upfront payment structure** is not designed to provide **financing to XYZ Limited**, but rather to:

- **Maximize profitability** by ensuring full commitment from customers.
- **Manage risks**, as customers who pay monthly are less likely to renew, leading to a concentrated group of high-usage customers, increasing costs.
- **Reduce administrative costs**, such as managing renewals and monthly collections.

Since the **payment terms are structured for operational and risk-management reasons**, rather than for providing financing to the entity, Ind AS 115 does **not** consider this as a **significant financing component**.

XYZ Limited **does not need to adjust the transaction price** as the contract **does not** contain a **significant financing component**. The upfront payment is driven by **business considerations**, not financing. Therefore, revenue is recognized **over the service period of three years** as the performance obligation is satisfied over time.

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.



Solution

Ind AS 115 requires an entity to assess whether a contract includes a **significant financing component**. A financing component exists if the timing of payments provides a **financing benefit** to either the **customer (deferred payment)** or the **entity (advance payment)**. However, if the **payment terms are structured primarily to mitigate credit risk**, rather than to provide financing, the contract does **not** contain a significant financing component.

A computer hardware vendor enters into a **three-year support service arrangement**. Customers with **low credit ratings** are required to **pay in advance**, while other customers are allowed to **pay over time**. The upfront payment is required **to mitigate the risk of non-payment** rather than to provide financing. Additionally, there is **no difference between the amount of consideration and the cash selling price**, meaning the customer does **not receive a discount for prepayment**.

Since the **primary purpose of advance payment is credit risk management**, and **not financing**, the contract does **not** contain a significant financing component.

The **advance payment requirement is a risk mitigation measure** rather than a financing benefit. Therefore, **no adjustment to the transaction price is required**, and the contract **does not contain a significant financing component** under Ind AS 115. Revenue will be recognized **over the three-year period** as the support services are provided.

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?
Solution

Ind AS 115 states that if **non-cash consideration** (such as equity shares) is received in exchange for goods or services, the **transaction price** should be measured at the **fair value of the non-cash consideration** at the time the performance obligation is satisfied. If the fair value cannot be reliably measured, it should be based on the **standalone selling price** of the services provided. Any **subsequent changes in the fair value** of the shares after recognition should **not** be reflected in revenue but may be accounted for under relevant financial instruments standards.

The entity enters into a **one-year contract** to provide **weekly services**, starting from **April 1, 20X1**. The contract specifies that the customer will provide **100 equity shares per week** as consideration, totaling **5,200 shares for the contract**. The entity concludes that the services constitute a **single performance obligation** satisfied **over time**, with revenue recognized on a **weekly basis** as each service is completed.

To determine the **transaction price**, the entity must **measure the fair value** of the **100 shares received per week** on the date the performance obligation for that week is satisfied. The revenue recognized for each week will be based on the **fair value of 100 shares at that time**. However, **any changes in the fair value of the shares after recognition** will **not** affect the revenue recorded.

The entity will recognize revenue **weekly** based on the **fair value of 100 shares** at the time each service is completed. The total revenue for the year will be the **sum of weekly fair**



values of the shares. Any **subsequent fluctuations in share price** after recognition will **not** be adjusted in revenue but will be accounted for separately under **Ind AS 109 (Financial Instruments)**.

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.

Solution

RT Limited enters into a contract with AT Limited to construct an office building over **18 months** for a **fixed consideration of ₹350 crore**. The contract also includes a **performance-based bonus** of **10 lakh equity shares**, provided the project is **completed within one year**. At **contract inception**, the fair value per share is **₹100**, making the **potential bonus worth ₹10 crore**.

As per **Ind AS 115**, when a contract includes **variable consideration**, such as a performance bonus, an entity must assess whether it is **highly probable** that there will be **no significant reversal of revenue** when the uncertainty is resolved. If the bonus is likely to be earned, it should be included in the **transaction price**. Additionally, **non-cash consideration**, such as equity shares, must be measured at **fair value at the contract inception**, and any **subsequent changes in share price** should **not** affect revenue recognition.

Applying these principles, the transaction price consists of the **fixed consideration of ₹350 crore** and the **bonus consideration of ₹10 crore (10 lakh shares × ₹100 per share)**. If RT Limited is expected to **meet the one-year deadline**, the total **transaction price will be ₹360 crore**. However, any **changes in the share price after contract inception will not impact revenue recognition** under Ind AS 115.

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.
Solution

Production Company Y sells a **television show** to **Television Company X** for a **fixed consideration of ₹1,000** and **100 advertising slots**. Y determines that the **stand-alone selling price** of the television show is **₹1,500**, and the **fair value of the advertising slots** is **₹600**.

As per **Ind AS 115**, when a contract includes **non-cash consideration** (such as advertising slots), the entity must measure it at **fair value** at the time of revenue recognition. If the **fair value cannot be reliably estimated**, the entity should use the **stand-alone selling price** of the goods or services provided.

Applying these principles, if the **fair value of the advertising slots can be reasonably estimated**, the **transaction price is ₹1,600** (₹1,000 fixed amount + ₹600 fair value of advertising slots). However, if the **fair value of the advertising slots cannot be determined**, the transaction price would be **₹1,500**, based on the **stand-alone selling price** of the television show.

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?
Solution

MS Limited, a **car manufacturer**, places an order for **10,000 steering systems** from its supplier, **SK Limited**, at a price of **₹25,000 per unit**. Additionally, **MS Limited provides tooling** to SK Limited, which has a **fair value of ₹2 crore** at contract inception. SK Limited determines that each **steering system is a separate performance obligation**, and **control transfers upon delivery**. Furthermore, since **SK Limited obtains control of the tooling and can use it for other projects**, it should be included in the **transaction price**.

As per **Ind AS 115**, when **non-cash consideration** (such as tooling) is provided, it must be **measured at fair value** and included in the **transaction price**. The total transaction price consists of both **monetary and non-monetary consideration**.

Applying these principles, the total **transaction price** is **₹27 crore**, which includes **₹25 crore for the 10,000 steering systems (₹25,000 × 10,000 units)** and **₹2 crore for the tooling**.

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.

Solution

A **producer entity** sells **energy drinks** to a **retailer** and agrees to pay the retailer a **slotting fee** for prominent shelf placement to increase product visibility and sales. This fee is **negotiated as part of the sales contract** for the energy drinks.

As per **Ind AS 115**, when an entity makes a payment to a customer (or a customer's customer), it must assess whether it is receiving a **distinct good or service** in exchange. If the payment is **not in exchange for a distinct good or service**, it must be treated as a **reduction of the transaction price**.

In this case, the **producer does not receive a distinct good or service** in return for the **slotting fee**. The payment is made purely to **increase product visibility**, which is not a separately identifiable benefit. Therefore, the **slotting fee should be deducted from the transaction price** of the energy drinks.

Thus, the **revenue recognized by the producer entity should be net of the slotting fee paid to the 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



Solution

An entity that manufactures **consumer goods** enters into a **one-year contract** with a **large global retail chain** to sell products worth **at least ₹15 crore**. The contract also requires the entity to make a **non-refundable payment of ₹1.5 crore** to the customer at contract inception to compensate for **shelving modifications** needed to accommodate the entity's products. The entity **does not obtain control** over any rights to the customer's shelves.

As per **Ind AS 115**, when an entity makes a **payment to a customer**, it must assess whether the payment is in exchange for a **distinct good or service**. If the entity **does not receive a distinct good or service in return**, the payment is treated as a **reduction of the transaction price** rather than a separate expense. Since the entity **does not gain control** over the customer's shelves, the **₹1.5 crore payment is a reduction of the transaction price**.

The total transaction price is therefore **₹13.5 crore** (₹15 crore - ₹1.5 crore). As per Ind AS 115, this reduction should be allocated across the contract period **proportionately to each sale**. The reduction percentage is **10% (₹1.5 crore ÷ ₹15 crore × 100)**.

In the first month, if the **invoiced amount is ₹1.25 crore**, then the **recognized revenue is ₹1.125 crore** after adjusting for the **10% reduction** (₹1.25 crore - ₹0.125 crore). The entity will continue applying this **10% reduction** to all future sales under the contract.

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.

Solution

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

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

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.

Solution

The contract includes a **₹20,000 discount** on the overall transaction price of **₹100,000**. Using the **relative stand-alone selling price method**, this discount would typically be **proportionately allocated** to all three products (X, Y, and Z). However, since the entity **regularly sells Products Y and Z together for ₹50,000**, it has evidence that the **entire discount of ₹20,000 should be allocated to Products Y and Z**.

- If **Products Y and Z are transferred at the same time**, the entity can account for them as a **single performance obligation**, allocating **₹50,000 to Product X** and recognizing revenue of **₹50,000 when Products Y and Z are delivered**.
- If **Products Y and Z are transferred separately**, the **₹50,000 allocated to them** is further split based on their **relative stand-alone selling prices**:

Product	Allocated Transaction Price (₹)	Calculation
Product Y	**₹17,857**	(₹25,000 ÷ ₹70,000) × ₹50,000
Product Z	**₹32,143**	(₹45,000 ÷ ₹70,000) × ₹50,000
Total	**₹50,000**	

Case B – Residual Approach is Appropriate

The contract now includes **Product Alpha**, and the **total consideration is ₹130,000**. The **stand-alone selling price of Product Alpha is highly variable**, ranging from **₹15,000 to ₹45,000**.

Since **Products X, Y, and Z have observable selling prices** (₹50,000 for Product X and ₹50,000 for Products Y and Z after discount), the residual approach is used to allocate the remaining transaction price to **Product Alpha**.

Product	Stand-alone Selling Price (₹)	Method Used
Product X	**₹50,000**	Directly Observable
Products Y & Z	**₹50,000**	Directly Observable (with Discount)
Product Alpha	**₹30,000**	**Residual Approach (₹130,000 – ₹100,000)**
Total	**₹130,000**	

Since **₹30,000 falls within the expected range (₹15,000 – ₹45,000)**, the residual approach is **appropriate** for allocating the price to Product Alpha.



Case C – Residual Approach is Inappropriate

The transaction price is now **₹105,000**, and applying the residual approach would allocate **₹5,000 to Product Alpha** (₹105,000 - ₹100,000 for Products X, Y, and Z). However, this **does not faithfully depict the expected consideration**, as **₹5,000 is significantly lower** than the observed selling range (₹15,000 – ₹45,000).

Since the residual approach **produces an unrealistic allocation**, the entity **cannot use it**. Instead, the entity must use **another method, such as the relative stand-alone selling price method**, to allocate the **₹105,000 transaction price** across all products **X, Y, Z, and Alpha**.

Thus, in this case, the **transaction price must be allocated based on relative stand-alone selling prices** following **Ind AS 115 guidelines (Paragraphs 73-80)** instead of the residual approach.

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.

Case A – Variable Consideration Allocated Entirely to One Performance Obligation

The contract involves two intellectual property licenses, **Licence A** (₹16,00,000) and **Licence B** (₹20,00,000). The consideration for **Licence A is fixed at ₹16,00,000**, while for **Licence B, it is a 3% sales-based royalty**, estimated to be **₹20,00,000**.

As per **Ind AS 115**, variable consideration should be allocated to a **specific performance obligation** if:
(a) The variable payment **relates specifically** to the obligation (here, Licence B is linked to the customer's future sales).
(b) The allocation is **consistent with the stand-alone selling price** of the licenses.

Since the estimated royalty of **₹20,00,000 aligns with Licence B's selling price**, the entity **allocates the entire royalty to Licence B** and **₹16,00,000 to Licence A**.

- **Upon transferring Licence B**, no revenue is recognized initially because it is based on **future sales-based royalties**. Revenue will be recognized when actual sales occur.
- **Upon transferring Licence A (one month later), revenue of ₹16,00,000 is recognized immediately**.



Case B – Variable Consideration Allocated on the Basis of Stand-Alone Selling Prices

In this case, **Licence A has a fixed price of ₹6,00,000**, and **Licence B has a 5% sales-based royalty**, estimated at **₹30,00,000**. Since **Licence A is transferred three months later**, the allocation must reflect stand-alone selling prices.

Applying **Ind AS 115**, variable consideration should only be allocated entirely to one obligation if it reflects the stand-alone price. Here, allocating **₹6,00,000 to Licence A and ₹30,00,000 to Licence B does not match their relative stand-alone prices (₹16,00,000 and ₹20,00,000, respectively)**. Thus, allocation is done using **relative stand-alone selling price**.

Product	Stand-alone Price (₹)	Allocation Basis (%)	Allocated Fixed Price (₹6,00,000)
Licence A	16,00,000	(16,00,000 ÷ 36,00,000)	**₹2,66,667**
Licence B	20,00,000	(20,00,000 ÷ 36,00,000)	**₹3,33,333**
Total	36,00,000	100%	6,00,000

- **When Licence B is transferred**, the entity **recognizes revenue of ₹3,33,333**.
- **When Licence A is transferred three months later, revenue of ₹2,66,667 is recognized**.

For **royalty recognition**, the **first month's royalty payment is ₹4,00,000**. The allocation is based on **stand-alone selling price**:

Product	Royalty Allocation (%)	Royalty Revenue Recognized (₹)
Licence B (Transferred)	(20,00,000 ÷ 36,00,000)	**₹2,22,222**
Licence A (Not Yet Transferred)	(16,00,000 ÷ 36,00,000)	**₹1,77,778 (Contract Liability)**

Since **Licence A is not yet transferred**, the **₹1,77,778 royalty is recorded as a contract liability** and recognized only when Licence A is delivered.

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**
- **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.

Solution



Since **each service is distinct**, the consultant initially **allocates the transaction price** based on the **relative stand-alone selling price method** as follows:

- **Due diligence – ₹80 lakh**
- **Valuation – ₹20 lakh**
- **Software implementation – ₹1 crore**

At contract inception, the consultant expects completion by **30th January, 20X1** and, given its **lack of prior experience**, it **does not include the early completion bonus** in the transaction price due to the risk of a **significant revenue reversal** as per **Ind AS 115**.

On **1st July, 20X0**, based on **better-than-expected project progress**, the consultant **revises its forecast** and now expects to complete the software implementation by **30th September, 20X0**, making the **₹20 lakh bonus probable**. As a result, the transaction price is **updated to ₹2.2 crore** and the **software implementation price is revised to ₹1.2 crore** (₹1 crore + ₹20 lakh bonus).

As of **1st July, 20X0**, the **completion status** of the performance obligations is:

- **Due diligence – 100% complete**
- **Valuation – 100% complete**
- **Software implementation – 60% complete**

Since the **bonus is allocated entirely to the software implementation service**, the **revised cumulative revenue** for software implementation is calculated as **60% of ₹1.2 crore = ₹72 lakh**.

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?
Solution

Telco G Ltd. grants a **one-time credit of ₹50** to a customer in **Month 14** of a **two-year contract** as a **commercial gesture**, unrelated to prior service issues. The contract includes a **subsidized handset and a voice and data plan**. Since G Ltd. **does not regularly provide such credits**, customers do **not expect** them to be granted.

As per **Ind AS 115**, this **is not variable consideration** but a **change in the transaction price**. Since the credit does **not relate to a satisfied performance obligation**, it is accounted for as a **contract modification** and is **recognized over the remaining contract term**.

If instead of a **one-time credit**, G Ltd. had granted a **₹5 discount per month for the remaining term**, this too would be considered a **change in the transaction price** and treated as a **contract modification**, with the discount **allocated over the remaining contract period**.

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.?
Solution:

As per **Ind AS 115 (Paragraphs 70-72), consideration payable to a customer** should be treated as a **reduction in the transaction price** unless it is in exchange for a **distinct good or service** that the customer provides to the entity. Since **Moon Ltd. does not obtain control over the storage facility**, the **₹4,00,000 payment is not for a distinct good or service** but rather a **cost incurred to facilitate the contract**. Therefore, the **transaction price is reduced to ₹16,00,000 (₹20,00,000 - ₹4,00,000)**.

As per **Ind AS 115**, this reduction should be **recognized as a reduction in revenue** when the **related goods are transferred**. The reduction is **allocated proportionately** across the contract. The **reduction percentage is 20% (₹4,00,000 ÷ ₹20,00,000)**.

If, in the **first month, components worth ₹5,00,000 are delivered**, the revenue recognized will be **₹4,00,000** after adjusting for the **20% reduction** (₹5,00,000 - ₹1,00,000). The **same proportionate adjustment** will apply to future deliveries.

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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.

(a) How will the transaction price be allocated to performance obligations?
(b) What will be the accounting treatment for the incentive amount?

Solution

(a) Allocation of Transaction Price to Performance Obligations

Entity Y enters into a contract to sell **hardware, professional services, and maintenance services** for **₹2,00,000**. Each component is a **separate performance obligation**, as professional and maintenance services are **regularly sold separately**. The **stand-alone selling prices** are:

- **Hardware** – ₹1,85,000 (estimated using the expected cost plus margin approach).
- **Professional Services** – ₹25,000 (directly observable).
- **Maintenance Services** – ₹15,000 (directly observable).

As per **Ind AS 115**, the transaction price is allocated **proportionately based on stand-alone selling prices**.

Performance Obligation	Stand-Alone Selling Price (₹)	Allocation Ratio	Allocated Transaction Price (₹)
Hardware	1,85,000	(1,85,000 / 2,25,000)	**₹1,64,444**
Professional Services	25,000	(25,000 / 2,25,000)	**₹22,222**



Maintenance Services	15,000	(15,000 / 2,25,000)	**₹13,334**
Total	2,25,000	100%	₹2,00,000

Thus, the transaction price of **₹2,00,000** is allocated as **₹1,64,444 to Hardware, ₹22,222 to Professional Services, and ₹13,334 to Maintenance Services**.

(b) Accounting Treatment of Incentive Amount

The contract includes an **incentive of ₹10,000**, payable only if **professional services are provided within 7 days** of hardware delivery.

As per **Ind AS 115**, variable consideration should be **allocated entirely to a single performance obligation** if:

1. The **variable payment relates specifically** to an obligation (here, **professional services**).
2. Allocating the **variable amount entirely to that obligation** aligns with the **contract objectives**.

Since the incentive **depends entirely on the timely completion of professional services**, it should be **allocated entirely to the professional services obligation**.

Thus, if the performance condition is met, the total allocated price for **professional services** becomes:
₹22,222 (initial allocation) + ₹10,000 (incentive) = ₹32,222.

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?

Solution:

As per **Ind AS 115,** an entity recognizes revenue **over time** if the customer **simultaneously receives and consumes the benefits** of the service as it is performed.

Analysis:
Minitek Ltd. provides **monthly payroll processing services** to ABC Ltd. Since each month's service is **performed and consumed simultaneously**, it meets the **over-time revenue recognition** criterion. If the contract is **terminated early**, completed services do not need to be re-done by another entity.

Conclusion:
Since the customer **benefits each month**, revenue should be **recognized evenly over the contract period** as per **Ind AS 115**

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?

Solution

As per **Ind AS 115,** a performance obligation is satisfied **over time** if the customer **benefits progressively from the service performed**.



Analysis:
T&L Ltd. provides **sea transportation services** for Horizon Ltd. from **India to Sri Lanka** over **20 days**. The **customer benefits as the voyage progresses**, and if another entity takes over, it does not need to **re-perform** the service already completed.

Conclusion:
Since the service is performed progressively, the performance obligation is **met over time**, and revenue should be recognized **based on voyage completion percentage** as per **Ind AS 115.**

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?

Solution:

As per **Ind AS 115,** a performance obligation is satisfied **over time** if the entity's work is **specific to the customer** and has **no alternative use**, and the entity has a **right to payment** for work completed.

Analysis:
AFS Ltd. provides **audit services** to WBC Ltd. The **audit opinion is specific to the company** and has **no alternative use**. Additionally, the contract requires **compensation for costs incurred plus a margin** if terminated early, establishing a **right to payment**.

Conclusion:
Since the work is **customer-specific** and AFS Ltd. has a **right to enforce payment**, revenue should be **recognized over time** based on the progress of work, as per **Ind AS 115**

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.
Solution:

As per **Ind AS 115**, revenue is recognized **over time** if the asset is **highly customized** and has **no alternate use**, and the entity has a **right to enforce payment for work completed**.

Analysis:
Space Ltd. is building a **customized satellite** for a government agency. The satellite **cannot be repurposed** due to its unique specifications, and Space Ltd. has a **right to payment for work completed** in case of termination.

Conclusion:
Since the satellite is **customer-specific** and the company has **payment rights**, revenue should be **recognized as work progresses** based on cost incurred or percentage completion, as per **Ind AS 115.**

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.

Solution:

As per **Ind AS 115,** revenue can be **recognized over time** only if the entity has a **legally enforceable right to payment** for performance completed to date.

Analysis:
ABC Ltd. builds **equipment for a customer**, and the contract includes **non-refundable installment payments**. However, if the customer **terminates the contract**, ABC Ltd. does **not have a right to full compensation** for work completed.

Conclusion:
Since the **right to payment criterion is not met**, revenue cannot be recognized over time and should be **recognized at a point in time upon completion**.

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 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?
Solution:

- As per **Ind AS 115,** a service is recognized **over time** if the customer **simultaneously receives and consumes the benefits** as the entity performs.
- **Analysis:**
  A health club provides **unlimited access** for **one year** with a **fixed monthly fee of ₹100**. The customer **continuously benefits from access** and consumes the service **uniformly** throughout the period.

Conclusion:
Since the service is provided evenly, revenue should be **recognized over time** using the **straight-line method**, as per **Ind AS 115.**

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?



Solution

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

(a) The elevators are part of the overall construction project and are not a distinct performance obligation
(b) The cost of elevators is substantial to the overall project and are incurred well in advance.
(c) Upon delivery at site, the customer acquires control of such elevators.
(d) And there is no modification made to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method –

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

The revenue to be recognized is measured as follows:

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

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

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.

Solution

As per **Ind AS 115**, a contract includes a **significant financing component** if there is a **difference between the promised consideration and the cash selling price** that provides a **financing benefit** to either party.

Analysis:
The EPC contract involves **monthly progress payments** with a **25% holdback payment due at the end**. The **delay in payment does not provide financing benefits** but rather **ensures project completion**. There is **no premium charged** for deferred payment, and the structure is to **mitigate performance risk** rather than provide financing.



Conclusion:
Since the **holdback payment is a contractual safeguard** rather than a **financing arrangement**, the contract **does not contain a significant financing component**, and no adjustments are required to the transaction price.

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.

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.

Solution

As per **Ind AS 115**, a contract does **not include a financing component** if deferred payment is **intended to align incentives** rather than **provide financing benefits**.

Analysis:
Company Z enters a **cost-plus-award fee contract** for **specialized missile development**. The **₹100 crore award fee is contingent** on achieving **technical specifications** after a **16-month test fire**. While the **award fee is paid later**, its purpose is to **incentivize performance**, not to provide financing.

Conclusion:
Since the **award fee structure is based on performance metrics** rather than **timing of payments**, the contract **does not contain a significant financing component**, and no adjustment to the transaction price is required.

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

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

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

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



by the ratio of cumulative cost incurred to total estimated costs to complete, less revenue recognized to date.

Calculation of cumulative catch-up adjustment:			
Updated variable consideration	L		250,000
Percent complete in Year 4: (rounded off)	M=N/O		95%
Cumulative costs through Year 4	N	900,000	
Estimated costs to complete	O	950,000	
Cumulative variable revenue through Year 4:	P		138,157
Cumulative catch-up adjustment	F=L x M–P		99,343

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.

Solution:

The entity will record the following journal entries:

Particulars		₹	₹
Cash/Trade Receivable	**Dr**	36,000	
Warranty Expense	**Dr**	2,000	
To Accrued warranty costs (assurance-type warranty)			2,000
To Revenue			32,000
To Contract Liability (Service-type warranty)			4,000
(To record revenue and contract liabilities related to warranties)			
Cost of Goods Sold	**Dr.**	14,000	
To Inventory			14,000
(To derecognize inventory and recognize cost of goods sold)			

The entity derecognizes the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer.

The entity recognizes the contract liability associated with the service type warranty as revenue during the contract warranty period and recognizes the costs associated with providing the service-type warranty as they are incurred.

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

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.
Solution

The entity will record the following journal entries:
Upon delivery of the batteries, the entity records the following entry:

Cash/ Receivable	**Dr.**	**Rs. 2,00,000**	
To Revenue			**Rs. 1,70,000**
To Contract Liability (Service-type warranty)			**Rs. 30,000**
Warranty	**Expense**	Rs. 10,000	
Dr.			Rs. 10,000
To Accrued Warranty Costs			

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

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.
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.

Solution
Relevant Provisions of Ind AS 115

- As per **Ind AS 115**, an entity is a **principal** if it **controls the goods or services before transfer to the customer.**
- The **indicators** for being a principal include **inventory risk, pricing discretion, and primary responsibility for fulfillment.**

Analysis

The entity purchases tickets from airlines at a **negotiated reduced rate** and commits to buy a specific quantity regardless of resale. The entity also **determines the resale price** and is exposed to inventory risk, as it must pay for unsold tickets. Although airlines are responsible for service fulfillment, the entity provides **customer service for complaints.**

Conclusion

Since the entity **controls the tickets before selling them** and bears **inventory risk**, it is acting as a **principal** and should **recognize revenue on a gross basis.**

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?
Solution

Relevant Provisions of Ind AS 115

- The entity is a **principal** if it **controls the service before transferring it to the customer** and is responsible for ensuring the service is performed as agreed.

Analysis

Company **D Ltd.** collaborates directly with customers, determines advertising needs, and ensures **advertisements meet customer requirements** after placement. Even though the actual placement is done by **F Ltd.,** D Ltd. **directs** F Ltd. and ensures performance. However, it **does not bear inventory risk** and does not set the pricing.

Conclusion

Despite the lack of inventory risk, **D Ltd. controls the advertising services before customer transfer,** making it a **principal.** It should **recognize revenue at gross amount.**

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?

Solution

In this scenario, an entity enters into a contract with a customer for the sale of a **machine and spare parts**, with the manufacturing process spanning two years. The entity satisfies two **distinct performance obligations** at a **point in time**. Upon completion of manufacturing, the customer **takes possession of the machine** but **requests the spare parts to be stored** at the entity's warehouse due to its proximity to the customer's factory. The legal title and



identification of spare parts are transferred to the customer, but physical possession remains with the entity.

Performance Obligations and Revenue Recognition

The total transaction price will be allocated to three **performance obligations**:

1. **Sale of Machinery** – Since the customer has taken physical possession and legal title of the machine, revenue for the sale of the machine shall be recognized **on 31st March, 20X3**.
2. **Sale of Spare Parts (Bill-and-Hold Arrangement)** – The entity needs to evaluate whether it meets the criteria for recognizing revenue for spare parts under a **bill-and-hold arrangement**.
3. **Custodial Services for Storing Spare Parts** – The obligation to store spare parts for **2 to 4 years** is a **separate performance obligation** and should be recognized as revenue **over time**.

Evaluation of Bill-and-Hold Criteria for Spare Parts

According to **Ind AS 115**, revenue for the **sale of spare parts** can be recognized under the **bill-and-hold arrangement** if the following conditions are met:

- **Substantive Reason for Bill-and-Hold** – The **customer requested** the storage arrangement due to the warehouse's proximity to their factory.
- **Product Identification** – The spare parts are **identified separately** as belonging to the customer and have been **inspected** by them.
- **Readiness for Transfer** – The spare parts are **ready for shipment** at the customer's request.
- **Entity Has No Further Control** – The entity **cannot redirect** or use the spare parts for another customer.

Since **all criteria** are satisfied, revenue for spare parts will be recognized **on 31st March, 20X3**.

Recognition of Custodial Services

The **storage of spare parts** is a **distinct obligation** that benefits the customer over time. The revenue for this service shall be recognized **on a straight-line basis** over the storage period.

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?
Solution

An entity, a **music record label**, grants a **license** to a customer, a **consumer products company**, allowing the use of a **1975 symphony recording** in advertisements for **two years** in a specific country. The contract provides **fixed consideration** of ₹50,000 per month and is **non-cancellable**.

Assessment of the Performance Obligation

Under **Ind AS 115**, the entity must determine whether the **license is distinct** and whether its obligation is satisfied **at a point in time or over time**. The entity concludes the following:



- The **only performance obligation** is to **grant the license** for use of the recording.
- The entity does **not have any ongoing obligation** to modify or enhance the recording.
- The recording has **stand-alone functionality**, meaning the **customer can derive benefits independently**.
- The contract does **not require any ongoing activities** that would affect the functionality of the licensed IP.

Since the license provides a **right to use the intellectual property (IP) as it exists** at the time of transfer, the revenue is recognized **at a point in time** when the customer **obtains control of the license**.

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
Solution

A **software company** licenses its **software application** to a **customer** with an agreement to provide **updates or upgrades on an if-and-when-available basis**. The customer **can choose** whether to install updates, and no other contractual obligations exist.

Assessment of License Type

Under **Ind AS 115**, the entity must determine if the **license provides a right to access or a right to use** the software. The key points are:

- The updates **are not guaranteed** and do not **significantly change** the functionality of the software.
- The entity has **no contractual obligation** to enhance or modify the software.
- The customer can **use the software as-is** without additional intervention from the entity.

Since the **updates are optional** and not **integral** to the software, the license provides a **right to use** the software 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
Solution

A **film studio** grants a **license** to a **customer** to **distribute a completed film**. The film studio also undertakes **marketing activities** that could impact **box office performance**.

Assessment of License Type

The entity needs to evaluate whether the license is for a **right to access** or a **right to use** intellectual property. The key factors are:

- The **marketing activities do not change the film's functionality**.
- The film has **stand-alone functionality**, meaning the customer **derives value independently**.
- The entity's activities **do not affect the availability or utility** of the licensed content.



Since the film is **ready for use** and **not modified over time**, the license provides a **right to use** and revenue is recognized **at a point in time**.

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?

Solution

A **sports team** licenses its **team name and logo** to an **apparel manufacturer** for **three years**. The **apparel maker** can use the logo on products and marketing materials.

Assessment of License Type

The entity must determine if the license is for a **right to access** or **right to use** intellectual property:

- The **team plays ongoing games**, which directly **impact the brand value**.
- The **customer benefits** from the entity's **continuous activities** (i.e., games, media exposure).
- The license is **affected by the team's success and brand promotion**.

Since the team's ongoing activities **affect the value of the IP**, the license is classified as a **right to access** intellectual property, and revenue is recognized **over time**.

Modified Case: If the **team no longer plays games** and is simply a **historical brand**, then the **IP does not require active support**. In this case, the license provides a **right to use**, and revenue is recognized **at a point in time**.

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?

Solution

An entity **sells a tangible asset** for **₹1 million** with a **call option** allowing repurchase at **₹1.1 million** within a year.

Analysis of Control and Accounting Treatment

- Since the **entity has the right to repurchase**, control does **not transfer to the customer**.
- The **repurchase price exceeds the original selling price**, indicating a **financing arrangement**.
- The transaction should be accounted for as a **liability**, with the **difference recognized as interest expense**.

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?
Solution

An entity **sells an asset** for **₹1 million** with a **put option** allowing the customer to **sell it back for ₹900,000** (market price expected to be ₹750,000).

Analysis of Control and Accounting Treatment

- The **customer has a strong incentive to return** the asset since the **repurchase price is higher than market value**.
- Control **does not transfer** to the customer **until the option expires**.
- Until expiry, the entity **recognizes the transaction as a lease**, treating the **difference as lease income**.
- If the **customer does not exercise the put option**, revenue is recognized at the repurchase price of ₹900,000

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?

Solution:

According to **Ind AS 115**, since the voucher provides a **material right**, it must be treated as a **separate performance obligation**, and the transaction price must be allocated between Product A and the voucher based on their **relative standalone selling prices**.

The standalone selling price of Product A is **₹1,000**, and the voucher is valued at **₹500 × 30% × 80% = ₹120**. The total combined standalone price is **₹1,120**. The transaction price of **₹1,000** is then allocated proportionally.

Performance Obligation	Standalone Selling Price (₹)	Allocated Transaction Price (₹)
Product A	1,000	(₹1,000/₹1,120) × ₹1,000 = ₹890
Discount Voucher	120	(₹120/₹1,120) × ₹1,000 = ₹110

Revenue of **₹890** is recognized when Product A is delivered, while **₹110** is recognized when the voucher is either redeemed or expires.

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.
Solution

An entity sells **annual gym memberships** for **₹7,500 per year** to **100 customers**, with a **renewal option** in the second and third years at **₹6,000 per year**. The entity estimates a **50% annual attrition rate**, meaning **fewer members** renew each year.



Under **Ind AS 115**, the discounted renewal option provides a **material right**, requiring allocation of revenue to reflect the **expected future renewals**. The total estimated memberships over three years are calculated as:

Year	Members
Year 1	100
Year 2	50
Year 3	25
Total	**175**

The total consideration includes **₹7,500 for the first year's members** and **₹6,000 for renewals**, giving a total of:

(100×₹7,500)+(50×₹6,000)+(25×₹6,000)=₹12,00,000

The **allocated revenue per membership** is:

₹12,00,000/175=₹6,857

Since the entity **initially collects ₹7,500** but recognizes only **₹6,857**, the **remaining ₹643** is deferred as a **contract liability** and recognized when members renew at a discount.

61. Illustration (ICAI EM)

According to Ind AS 115, if a contract grants a customer an option to acquire additional goods or services at a discount that would not have been available otherwise, the option represents a separate performance obligation. Paragraph B40 of Ind AS 115 states that such options must be accounted for separately if they provide a material right. In this case, since the customer earns a ₹500 discount (100 points × ₹5) solely due to the stay, it is a separate performance obligation.

Revenue Allocation Based on Standalone Selling Prices

The total transaction price of ₹10,000 needs to be allocated between the stay and the loyalty points in proportion to their relative standalone selling prices:

Component	Standalone Selling Price (₹)	Allocated Revenue (₹)
Stay Revenue	10,000	(₹10,000/₹10,500) × ₹10,000 = ₹9,524
Loyalty Points	500	(₹500/₹10,500) × ₹10,000 = ₹476

Recognition of Revenue

- **Stay Revenue (₹9,524): Recognized immediately when the stay is completed.**
- **Loyalty Points (₹476): Deferred as a contract liability and recognized as revenue when the points are redeemed.**

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?

Solution:

Entities often provide **sales incentives** to customers to enhance sales and customer loyalty. These incentives can be **cash-based** or **non-cash-based**, each having different accounting implications under **Ind AS 115**.

1. Cash Incentives

Ind AS 115 states that **cash incentives** paid to customers are considered as a **reduction of the transaction price**, unless they are given in exchange for a distinct good or service. **Paragraph 70** clarifies that cash incentives include **direct cash payments, credits, or vouchers** that reduce the price the customer pays. Therefore, cash incentives **reduce revenue at the time of sale**.

2. Non-Cash Incentives

The accounting treatment of **non-cash incentives** depends on their nature and the entity's involvement.

Scenario 1: Loyalty Points for Future Purchases

Loyalty points represent a **separate performance obligation** if they provide a **material right** to the customer (i.e., a benefit they would not receive otherwise). According to **Paragraph B40**, the customer effectively prepays for future goods, and the entity recognizes revenue when the **loyalty points are redeemed** or **expire**.

Scenario 2: Coupons for Third-Party Products

When an entity provides a **coupon redeemable for third-party goods**, it must determine whether it acts as a **principal or an agent** (**Paragraph B34**).

- If the entity **controls the third-party good or service** before transfer, it acts as a **principal** and recognizes revenue for the full transaction price.
- If the entity **only facilitates the transaction**, it acts as an **agent** and recognizes only the **commission or fee earned**.

Scenario 3: Free Goods or Services Provided by the Seller

If the seller provides **free goods or services as part of a sale (e.g., Buy 2 Get 1 Free)**, the transaction price must be **allocated across all performance obligations** (**Paragraph 73**).

- The **total consideration** is distributed across the products based on **relative standalone selling prices**.
- The **free product does not generate additional revenue**, but rather **reduces revenue recognized for the paid products**.

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.

Solution:



Step 1: Allocation of Transaction Price

- The entity awards **10 points for every ₹100 of sales**.
- **Total sales = ₹1,00,000 → Total points awarded = (1,00,000 / 100) × 10 = 10,000 points**.
- Each point is worth **₹1**, but the entity expects **only 9,500 points to be redeemed**.
- **Total estimated liability for loyalty points = 9,500 × ₹1 = ₹9,500**.
- **Total Standalone Selling Price** = ₹1,09,500.
- The total transaction price (₹1,00,000) is allocated based on the standalone selling price:

Performance Obligation	Standalone Selling Price (₹)	% Allocation	Allocated Revenue (₹)
Sale of Product	1,00,000	91.32%	91,324.20
Loyalty Points	9,500	8.68%	8,675.80
Total	**1,09,500**	**100%**	**1,00,000**

At the time of sale, **₹91,324.20 is recognized as revenue** and **₹8,675.80 is deferred as a liability** for future redemption.

Step 2: Recognizing Revenue When Points Are Redeemed

Revenue is recognized for loyalty points **as and when they are redeemed**, based on the expected redemption rate.

At the End of Year 1

- **4,500 points redeemed**.
- Revenue recognized = **(4,500/9,500) × 8,675.80**.

Year	Points Redeemed	Total Expected Redemptions	Revenue Recognized for Points (₹)	Remaining Deferred Revenue (₹)
Year 1	4,500	9,500	**₹4,109.59**	₹8,675.80 - ₹4,109.59 = ₹4,566.21

At the End of Year 2

- **Additional 4,000 points redeemed**.
- Cumulative redemption = **8,500 points**.
- The entity revises its estimate and now expects **9,700 points to be redeemed**.
- **Revised revenue allocation = (8,500/9,700) × 8,675.80**.
- Revenue to be recognized in Year 2 = **₹7,602.50 - ₹4,109.59**.

Year	Cumulative Points Redeemed	Revised Expected Redemptions	Total Revenue Recognized for Points (₹)	Revenue Recognized in Current Year (₹)	Remaining Deferred Revenue (₹)
Year 2	8,500	9,700	₹7,602.50	₹3,492.92	₹8,675.80 - ₹7,602.50 = ₹1,073.30

Thus, **₹3,492.92 is recognized in Year 2**, leaving a balance deferred revenue of **₹1,073.30**, which will be recognized as remaining points are redeemed.

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

Solution:

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

65. Illustration [Solve along with class lectures]

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 [Solve along with Class lectures]

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.

(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.

Solution

(i) *Here the operator has a contractual right to receive cash from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, the operator recognizes a financial asset to the extent it has a contractual right to receive cash.*

(ii) *Here the operator has a contractual right to charge users of the public services. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service. Therefore, the operator shall recognize an intangible asset to the extent it receives the right (a licence) to charge users of the public service.*

(iii) Accounting treatment for preparation of financial statements

Bhilwara-Jabalpur Toll Project

Journal Entries

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

Kolhapur-Nagpur Expressway -Intangible asset

Journal Entries



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

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

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?

Solution:

Under **Ind AS 115**, revenue is recognized based on the **transaction price**, which represents the amount of consideration expected to be received in exchange for goods or services. **Non-monetary exchanges** involving **dissimilar goods or services** fall within the scope of Ind AS 115 and must be measured at **fair value**.

Analysis of the Given Transaction

- **A Ltd. (Telecommunication Company)** agrees to provide **1,00,000 minutes of talk time**.
- **B Ltd. (Power Supplier)** agrees to provide **20,000 power units**.
- The fair values of the services exchanged:
  - A Ltd. normally charges **₹0.50 per minute** for talk time.
  - B Ltd. normally charges **₹2.50 per unit** for electricity.

Since the exchange involves **dissimilar goods or services**, revenue is recognized at the **fair value of the goods or services received or given**, whichever is more reliably measurable.

Revenue Measurement for A Ltd.

A Ltd. provides talk time in exchange for power units. The fair value of the talk time given is:

Service Provided by A Ltd.	Units	Rate (₹/Unit)	Total Fair Value (₹)
Talk Time	1,00,000 minutes	0.50	50,000



Since A Ltd. receives **20,000 power units valued at ₹2.50 per unit**, the fair value of the power received is:

Service Received by A Ltd.	Units	Rate (₹/Unit)	Total Fair Value (₹)
Power	20,000 units	2.50	50,000

69. Illustration (May, 2023 RTP)

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?

Solution:

As per **Ind AS 115**, when revenue is recognized over time, only costs that reflect actual progress should be considered. **Company X is acting as a principal**, and it measures progress using an **input method based on costs incurred**.

Key Considerations

- **Total Contract Price** = ₹ 50,00,000
- **Total Expected Costs** = ₹ 40,00,000 (including ₹ 10,00,000 for air conditioners)
- **Performance Obligation** = Single obligation for **renovation and installation**
- **Air Conditioners' Role** = Purchased as is, without modification
- **Ind AS 115 Guidance** = **Procurement cost does not reflect progress**, hence excluded

Revenue Recognition Approach

Since **air conditioners do not contribute to progress**, their cost **(₹ 10,00,000)** is excluded from performance measurement. Instead, revenue for air conditioners is recognized separately **at zero margin** when delivered.

Computation of Revenue Recognition

Particulars	Amount (₹)
Total Contract Price	50,00,000
Less: Air Conditioner Cost (excluded from progress measurement)	(10,00,000)
Adjusted Revenue for Renovation Work	40,00,000
Cost Incurred (excluding ACs) till 31st March 20X1	6,00,000
Percentage of Completion	6,00,000 / 30,00,000 = 20%
Revenue Recognized from Renovation Work	20% × 40,00,000 = 8,00,000
Revenue for Air Conditioners (recognized separately at zero margin)	10,00,000
Total Revenue Recognized (March 31, 20X1)	18,00,000
Less: Total Cost Incurred (₹ 6,00,000 + ₹ 10,00,000)	(16,00,000)
Profit for the Year	



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?
Solution:

Entity K sells **electric razors** to retailers for ₹ 50 per unit and includes a **rebate coupon** worth ₹ 10 per unit, which can be redeemed by end consumers. Based on **past experience and industry trends**, Entity K estimates that **25% of eligible rebates** will be redeemed. Since this estimate ensures that a **significant reversal of revenue is not probable**, the transaction price must be adjusted accordingly.

As per **Ind AS 115**, when a seller provides a **sales incentive** like a rebate, it is considered a **variable consideration** that should be deducted from the **transaction price**. Therefore, Entity K **reduces the selling price per unit** by the expected redemption value of the rebate:

Particulars	Amount (₹)
Selling price per unit	50.00
Less: Expected rebate (₹ 10 x 25%)	(2.50)
Transaction price per unit	**47.50**

The difference of **₹ 2.50 per unit** is recognized as a **liability** for the estimated rebate **payable to customers** upon redemption. **Revenue is initially recognized at ₹ 47.50 per unit**, and the **liability is reassessed at each reporting date**. If the **actual redemption rate differs** from the initial estimate, Entity K will **adjust the transaction price and liability accordingly** to comply with **Ind AS 115's revenue recognition principles**.

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.
Solution:

To estimate the transaction price, **M applies the expected value method**, considering the probability-weighted price reductions:

Price Reduction (₹)	Probability	Adjusted Price (₹)
0	70%	₹ 5,000 x 70% = ₹ 3,500
500	20%	₹ 4,500 x 20% = ₹ 900
1,000	10%	₹ 4,000 x 10% = ₹ 400
Expected Price per unit		**₹ 4,800**

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.

Solution:

Extracts of Balance Sheet of Nivaan Ltd. as on 31st March, 2019

	₹. In lacs
Current Assets Contract Assets- Work-in-progress (Refer W.N. 3)	9.0
Current Liabilities Contract Liabilities (Advance from customers) (Refer W.N. 2)	4.5

Extracts of Statement of Profit and Loss of Nivaan Ltd. as on 31st March, 2019

	₹. In lacs
Revenue from contracts (Refer W.N. 1)	18
Cost of Revenue (Refer W.N. 1)	(15)
Net Profit on Contracts (Refer W.N. 1)	3

Working Notes:

1. Table showing calculation of total revenue, expenses and profit or loss on contract for the year (₹. In lacs)

	A & Co.	B & Co.	Total
Revenue from contracts	12 (40*30%)	6 (30*20%)	18
Expenses due for the year	10.2 (34*30%)	4.8 (24*20%)	15
Profit or loss on contract	1.8	1.2	3

2. Calculation of amount due from / (to) customers (₹. In lacs)

	A & Co.	B & Co.	Total
Billing based on revenue recognised in the books	12	6	18
Payments received from the customers	(13)	(9.5)	(22.5)
Advance received from the customers	1	3.5	4.5

3. Work in Progress recognised as part of contract asset at the end of the year (₹. In lacs)



	A & Co.	B & Co.	Total
Total actual cost incurred during the year	16	8	24
Less: Cost recognised in the books for the year 31.3.2019	(10.2)	(4.8)	(15)
Work-in-progress recognised at the end of the year	5.8	3.2	9.0

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

(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.

Solution:

Identification of Performance Obligations

As per **Ind AS 115**, a contract must be separated into distinct performance obligations if:

- The **customer can benefit** from each component separately.
- The company's promise to transfer goods or services is **separately identifiable**.

Based on this, the contract has **three distinct elements**:

1. **Sale of the machine (Model Pi)** – This is a separate obligation since the customer can purchase the machine without availing maintenance services.
2. **Rendering of after-sales services** – Maintenance services on **30th September 2018** and **1st April 2019** are independent from the machine sale.
3. **Financing component** – Since payment is deferred until **1st April 2019**, there is a **significant financing component**.

(i) Calculation and allocation of revenue to each component of the transaction

Date	Opening balance	Finance income	Goods	Services	Payment received	Closing balance



1 st April, 2018	-	-	2,51,927	-	-	2,51,927
30th September, 2018	2,51,927	12,596 (Note 1)	-	45,000	-	3,09,523
31st March 2019	3,09,523	15,477 (Note 2)	-	-	-	3,25,000
1 st April, 2019	3,25,000	-	-	75,000	(4,00,000)	

Notes:

1. Calculation of finance income as on 30th September, 2018 = 5% x 2,51,927 = ₹ 12,596

2. Calculation of finance income as on 31st March, 2019 = 5% x 3,09,523 = ₹ 15,477

(ii) Journal Entries

Date	Particulars		Dr.	Cr.
1 st April, 2018	Mr. Anik	Dr.	2,51,927	
	To Revenue - sale of goods (Profit or loss A/c)			2,51,927
	(Being revenue recognised from the sale of the machine on credit)			
	Cost of goods sold (Profit or loss)	Dr.	1,60,000	
	To Inventories			1,60,000
30th September 2018	Mr. Anik	Dr.	12,596	
	To Finance Income (Profit or loss)			12,596
	(Being finance income recognised)			
	Mr. Anik	Dr.	45,000	
	To Revenue- rendering of services (Profit or loss)			45,000
	(Being revenue from the rendering of maintenance services recognised)			
	Cost of services (Profit or loss)	Dr.	30,000	
	To Cash/Bank or payables			30,000
	(Being the cost of performing maintenance services recognised)			
31st March 2019	Mr. Anik	Dr.	15,477	
	To Finance Income (Profit or loss)			15,477
	(Being finance income recognised)			
1st April, 2019	Mr. Anik	Dr.	75,000	
	To Revenue- rendering of services (Profit or loss)			75,000
	(Being revenue from the rendering of maintenance services recognised)			
	Cost of services (Profit or loss)	Dr.	50,000	
	To Cash/Bank or payables			50,000
	(Being the cost of performing maintenance services recognised)			
	Cash/Bank	Dr.	4,00,000	
	To Mr. Anik			4,00,000
	(Being the receipt of cash from the customer recognised)			



(iii) Extract of Notes to the financial statements for the year ended 31st March, 2019 and 31st March, 2020

Note on Revenue

	2019-2020	2018-2019
Sale of goods	-	2,51,927
Rendering of machine - maintenance services	75,000	45,000
Finance income	-	28,073
	75,000	3,25,000

74. Illustration – Loyalty Programme

KK Ltd. runs a departmental store which awards 10 points for every purchase of ₹ 500, which can be redeemed by the customers for future shopping with the same merchant. Unutilized points will lapse on expiry of two years from the date of credit. The value of each point is ₹ 0.50.

During the accounting period 20X1-20X2, the entity awarded 1,00,00,000 points to various customers, of which 18,00,000 points remained undiscounted. The management expects that only 80% of the total award points will be redeemed, and normally 60% - 70% are redeemed during the next year.

KK Ltd. has approached your firm with the following queries and has asked you to suggest the accounting treatment (Journal Entries) under the applicable Ind AS for these award points:

1. **How should the recognition be done for the sale of goods worth ₹ 10,00,000 on a particular day?**
2. **How should the redemption transaction be recorded in the year 20X1-20X2? The Company has requested to present the sale of goods and redemption as independent transactions. Total sales of the entity is ₹ 5,000 lakhs.**
3. **How much of the deferred revenue should be recognized at the year-end (20X1-20X2) considering that only 80% of the outstanding points will be redeemed?**
4. **In the next year 20X2-20X3, 60% of the expected outstanding points were discounted. The balance 40% of the outstanding points of 20X1-20X2 still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 20X2-20X3, and what will be the amount of balance deferred revenue?**
5. **How much revenue will the merchant recognize in the year 20X3-20X4, if 3,00,000 points are redeemed in the year 20X3-20X4?**

Solution

Recognition of Revenue on Sale of Goods: When KK Ltd. makes a sale, customers earn **loyalty points**, which can be redeemed for discounts on future purchases. Since these points provide a **material right** to the customer, they are treated as a separate **performance obligation** under **Ind AS 115**. Revenue is allocated between the sale of goods and the estimated liability for future redemptions.

(a) Recognition for Sale of Goods Worth ₹ 10,00,000

Particulars	Amount
Purchase value	₹ 10,00,000
Points per ₹ 500	10 points
Total points earned	(10,00,000 ÷ 500) × 10 = **20,000 points**
Value per point	₹ 0.50
Expected redemption	80%
Stand-alone value of points	20,000 × 0.50 × 80% = **₹ 8,000**

Thus, revenue is allocated as:



Particulars	Standalone SP	Allocation of TP	Amount (₹)
Sale of Goods	10,00,000	[10,00,000 x (10,00,000/10,08,000)]	**9,92,063**
Points	8,000	[10,00,000 x (8,000/10,08,000)]	**7,937**
Total	10,08,000		

Journal Entry:

Particulars	Dr. (₹)	Cr. (₹)
Bank A/c	10,00,000	
To Sales A/c		9,92,063
To Liability under Customer Loyalty Programme		7,937

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b)

Particulars	Amount
Total sales	₹ 50,00,00,000
Total points awarded	(50,00,00,000 ÷ 500) x 10 = **1,00,00,000 points**
Expected redemption (80%)	80,00,000 points
Value per point	₹ 0.50
Value of points (stand-alone)	**₹ 40,00,000**

Particulars	Standalone SP	Allocation of TP	Amount (₹)
Sale of Goods	50,00,00,000	[50,00,00,000 x (500/504)]	**49,60,31,746**
Points	40,00,000	[50,00,00,000 x (4/504)]	**39,68,254**
Total	50,40,00,000		**50,00,00,000**

Journal Entry in the year 20X1

Particulars	Dr. (₹)	Cr. (₹)
Bank A/c	50,00,00,000	
To Sales A/c		49,60,31,746
To Liability under Customer Loyalty Programme		39,68,254

Liability under Customer Loyalty programme Dr. 32,53,968
To Sales A/c 32,53,968
(On redemption of [(100 lakhs -18 lakhs) x 80% points]

Revenue for points to be recognized – Expected redemption (80%)

Particulars	Points	Expected Redemption	Revenue
Total points issued	1,00,00,000	80,00,000	39,68,254
Points remaining undiscounted to be redeemed in future	18,00,000	14,40,000	39,68,254 x (1440 /8000) = 7,14,286
Current Year (20X1-X2) Redemption	82,00,000	65,60,000	39,68,254 x (6560 /8000) = 32,53,968

Particulars	Dr. (₹)	Cr. (₹)
Liability under Customer Loyalty Programme	32,53,968	
To Sales A/c		32,53,968



c) Revenue to be deferred with respect to undiscounted point in 20X1-20X2 = 39,68,254 – 32,53,968= 7,14,286

d) In 20X2-20X3, KK Ltd. would recognize revenue for discounting of 60% of expected outstanding points as follows:

Particulars	Points
Outstanding points	18,00,000
Expected redemption (80%)	14,40,000
Redeemed in 20X2–20X3 (60% of 14,40,000)	**8,64,000**
Add: Points Discounted in 20X1-X2	**65,60,000**
Total Points Discounted	**74,24,000**
Total Cumulative Revenue	39,68,254 x (74,24,000 / 80,00,000) =36,82,540
Less: Revenue Recognised	32,53,968
Balance to be recognised*	36,82,540 – 32,53,968 = 4,28,572
Closing Balance of Liability	₹ 7,14,286 – 4,28,572 = 2,85,714

*(Can also be done as 60% of 7,14,286). However, it is better to follow cumulative approach in case estimates change.

Particulars	Dr. (₹)	Cr. (₹)
Liability under Customer Loyalty Programme	4,28,572	
To Sales A/c		4,28,572

e) In the year 20X3-20X4, the merchant will recognized the balance revenue of ₹ 2,85,714 irrespective of the points redeemed as this is the last year for redeeming the points. Journal entry will be as follows:

Particulars	Dr. (₹)	Cr. (₹)
Liability under Customer Loyalty Programme	2,85,714	
To Sales A/c		2,85,714

Final Summary Reconciliation

Year	Revenue from Loyalty Points (₹)
20X1–20X2	32,53,968
20X2–20X3	4,28,572
20X3–20X4	2,85,714
Total	**39,68,254**

75. Illustration (Self practice)

A property sale contract includes the following:
(a) Common areas
(b) Construction services and building material
(c) Property management services
(d) Golf membership
(e) Car park
(f) Land entitlement

Analyse whether the above items can be considered as separate performance obligations as per the requirements of Ind AS 115. (RTP May 21)



Solution

As per **Ind AS 115**, at the inception of a contract, an entity must evaluate the promised goods or services to determine whether they are **distinct** and therefore qualify as separate **performance obligations (POs).**

A **performance obligation** is a promise in a contract to transfer to the customer either:

- A distinct **good** or **service**, or
- A **series** of distinct goods or services with a consistent pattern of transfer.

A **good or service** is distinct if:

1. The customer can benefit from it either **individually** or **in combination** with other available resources.
2. The promise to transfer is **separately identifiable** within the contract context.

Based on these principles, the **assessment** of whether each component in the property sale contract qualifies as a **separate performance obligation** is provided below:

Goods/Service	Separate PO?	Reasoning
Common Areas	**No**	Ownership of common areas is typically undivided and not separable from the property itself. If these areas were sold separately, they might qualify as separate POs.
Construction Services & Building Material	**No**	Though distinct, they form an integrated service that contributes to a complete deliverable (building).
Property Management Services & Golf Membership	**Yes**	These services can be used separately and are not highly interrelated with property ownership.
Car Park & Land Entitlement	**Analysis Required**	If sold separately or pledged as security, they may qualify as distinct. However, if tied to apartment ownership, they are **interdependent** and not distinct.

76. Illustration (Self practice)

Prime Ltd. is a technology company that sells Software S, Hardware H, and Accessory A. Their stand-alone selling prices are:

- **Software S – ₹ 50,000**
- **Hardware H – ₹ 1,00,000**
- **Accessory A – ₹ 20,000**

Since demand for Hardware H and Accessory A is low, they are bundled and sold together at ₹ 1,00,000. Prime Ltd. enters into a contract with Zeta Ltd. for all three items at ₹ 1,50,000.

How should the discount be allocated across these three performance obligations? What if Hardware H and Accessory A were transferred at the same time?

Solution

According to **Ind AS 115**, discounts in contracts should be **allocated proportionally** unless:

- The entity **regularly** sells a specific bundle at a discount.
- The discount **logically belongs** to only certain performance obligations.



Since **Prime Ltd.** regularly sells **Hardware H and Accessory A** together at ₹ 1,00,000 and Software S separately at ₹ 50,000, the **entire ₹ 20,000 discount** should be allocated to **Hardware H and Accessory A**.

Transaction Price Allocation:

Product	Standalone Price (₹)	Allocation Basis	Final Allocation (₹)
Hardware H	1,00,000	(1,00,000 / 1,20,000) × 1,00,000	83,333
Accessory A	20,000	(20,000 / 1,20,000) × 1,00,000	16,667
Total	1,20,000	-	1,00,000

If **Hardware H and Accessory A** were transferred at the **same time**, they could be considered **one single performance obligation**, and ₹ 1,00,000 would be allocated to them collectively.

77. Illustration (Self practice)

On 1st April, 20X1, S Limited enters into a contract with Corp Limited to construct heavy-duty equipment for a promised consideration of ₹ 20,00,000 with a bonus of ₹ 2,50,000 if the equipment is completed within 24 months.

At contract inception, S Limited:

- **Accounts for the promised bundle as a single performance obligation under Ind AS 115.**
- **Estimates total costs to be ₹ 11,00,000.**
- **Concludes that there is a high probability of a significant reversal in revenue recognition.**
- **Faces external uncertainties such as supply chain difficulties affecting completion.**

By 31st March, 20X2, S Limited has completed 65% of the performance obligation (based on costs incurred) but still constrains variable consideration under Ind AS 115.

On 4th June, 20X2, the contract is modified:

- **Fixed consideration increases by ₹ 1,50,000.**
- **Expected costs increase by ₹ 80,000.**
- **Bonus eligibility is extended by six months, making it highly probable that S Limited will achieve it.**
- **The contract remains a single performance obligation.**

S Limited seeks advice on the accounting treatment for the contract under Ind AS 115 for 20X1-20X2 and 20X2-20X3.

Solution

Under **Ind AS 115**, revenue from contracts is recognized **over time** if the performance obligation is satisfied progressively. Since S Limited is constructing heavy-duty equipment, the revenue is recognized based on **costs incurred** relative to the total estimated cost.

Accounting Treatment for 20X1-20X2

At contract inception, the **bonus is excluded** from the transaction price due to **uncertainty** and risk of **revenue reversal**. S Limited recognizes revenue based on **65% completion** of the performance obligation.

Computation for 20X1-20X2:

Particulars	Amount (₹)
Transaction Price	₹ 20,00,000
Expected Costs	₹ 11,00,000



Expected Profit (45%)	₹ 9,00,000
Costs Incurred to Date (65% of ₹ 11,00,000)	₹ 7,15,000
Revenue Recognized (65% of ₹ 20,00,000)	₹ 13,00,000
Gross Profit (Revenue - Cost Incurred)	₹ 5,85,000

Accounting Treatment for 20X2-20X3

On **4th June, 20X2**, the contract is **modified**, increasing both **consideration and costs**. Since the **bonus is now highly probable**, it is **included** in the revised transaction price.

Revised Computation for 20X2-20X3:

Particulars	Amount (₹)
Original Fixed Consideration	₹ 20,00,000
Increase in Consideration	₹ 1,50,000
Bonus Included	₹ 2,50,000
Total Revised Transaction Price	₹ 24,00,000
Total Expected Costs (Original ₹ 11,00,000 + Increase ₹ 80,000)	₹ 11,80,000

S Limited now measures **performance completion at 60.60%** (₹ 7,15,000 actual costs incurred compared to **total expected costs ₹ 11,80,000**).

Additional Revenue Recognized in 20X2-20X3:

Particulars	Amount (₹)
Revenue Recognized for 60.60% of ₹ 24,00,000	₹ 14,54,400
Less: Revenue Already Recognized in 20X1-20X2	₹ 13,00,000
Cumulative Catch-Up Revenue Adjustment (to be recognized on 4th June, 20X2)	₹ 1,54,400

78. Illustration (Self practice)

A Ltd. operates 20 resorts across India. Under its customer loyalty program, every customer who stays at any of the resorts earns 1 point for every ₹ 100 spent. These points can be redeemed for future stays.

Key details:

- **Likelihood of redemption: 100% (based on past experience).**
- **Standalone selling price of each point: ₹ 5.**
- **Customer X spends ₹ 10,000 on a stay at one of the resorts.**

How should A Ltd. account for the loyalty points under Ind AS 115?

Solution

Under **Ind AS 115**, customer loyalty points represent a **separate performance obligation** if they provide a **material right** to the customer that would not have been received without entering into the contract.

Since **each ₹ 100 spent earns 1 point**, Customer X earns 100 points. The **standalone price of 100 points** is:100×5=₹500

Since these points give a **discount on future purchases**, they are considered a **separate performance obligation**. The transaction price of ₹ 10,000 needs to be **allocated** between:

1. **Revenue for the stay** (main obligation)
2. **Revenue for loyalty points** (deferred revenue, recognized when points are redeemed)

The allocation is done on a **relative standalone selling price** basis:



Particulars	Amount (₹)
Standalone Selling Price of Stay	₹ 10,000
Standalone Selling Price of 100 Points	₹ 500
Total Value Considered	₹ 10,500

Now, we allocate the **transaction price of ₹ 10,000** proportionally:

Particulars	Calculation	Amount (₹)
Revenue for Stay	10,000/10,500×10,000	**₹ 9,524**
Deferred Revenue for Points	500/10,500×10,000	**₹ 476**

Since **A Ltd. acts as a principal**, the **₹ 476** will be recognized as **revenue when points are redeemed**.

79. Illustration

X Ltd. agrees to produce 2,000 customized engines for use by Customer A in its products. X Ltd. concludes that the engines will transfer to Customer A over time because:

- **they have no alternative use to X Ltd.; and**
- **Customer A is contractually obligated to pay X Ltd. for any finished or in-process engines, including a reasonable margin, if Customer A terminates the contract even when no fault of X Ltd.**

X Ltd. already has the process in place to produce the engines and is given the design by Customer A, such that X Ltd. does not expect to incur any significant learning curve or design and development costs.

X Ltd. uses a method of measuring progress toward complete satisfaction of its manufacturing contracts that takes into account work in progress and finished goods controlled by Customer A.

Require:

(i) State whether the 2000 engines are distinct in nature or not.
(ii) State whether 2000 engines is a single performance obligation or each engine is a separate performance obligation.

Solution

(i) X Ltd. concludes that each of the 2,000 engines is distinct, because:
- Customer A can use each engine on its own; and
- each engine is separately identifiable from the others because one does not significantly affect, modify or customize another.

(ii) Despite the fact that each engine is distinct, X Ltd. concludes that the 2,000 units are a single performance obligation because:
- each engine will transfer to Customer A over time; and
- X Ltd. uses the same method to measure progress toward complete satisfaction of the obligation to transfer each engine to Customer A.

Consequently, the transaction price for all 2,000 engines is recognized over time using an appropriate measure of progress. This outcome may be different from the outcome of allocating a fixed amount to each engine if each one was a performance obligation.

