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FINANCIAL REPORTING DIGEST

Edition 8

VOLUME-2

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FINANCIAL REPORTING

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IND AS 115
REVENUE FROM CONTRACTS WITH CUSTOMERS

1. SCOPE

☞ This Standard applies to all contracts with customers, EXCEPT the following:

a. Lease contracts within the scope of Ind AS 116;
b. Insurance contracts (Ind AS 104)
c. Financial instruments and other contractual rights or obligations within the scope of Ind AS 109, Ind AS 110, Ind AS 111, Ind AS 27 & Ind AS 28; and
d. Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.
(For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.)

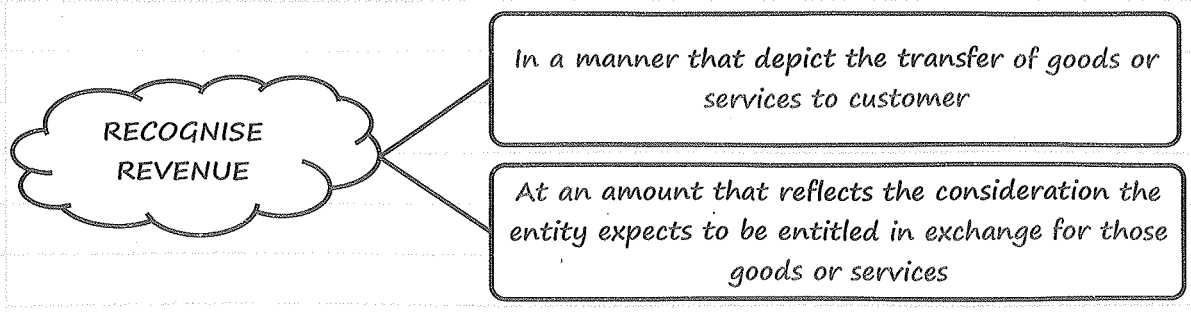
☞ This standard is applicable ONLY to contracts with CUSTOMER.

❖ CUSTOMER

A customer is a party that has contracted to obtain goods or services that are an output of entity's ordinary activities in exchange for consideration.

A counterparty would not be a customer if it has contracted with the entity for Developing an asset in a collaboration arrangement

2. CORE PRINCIPLE OF IND AS 115



3. FIVE STEP MODEL FOR REVENUE RECOGNITION

☞ To achieve the core principle, an entity should apply the following 5 step model:

Step 1: Identify the contract with the customer

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Step 2: Identify the performance obligations in the contract

↓

Step 3: Determine the transaction price

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Step 4: Allocate the transaction price to the performance obligations in the contract

↓

Step 5: Recognize revenue as and when the entity satisfies its performance obligations

4. STEP 1: IDENTIFYING THE CONTRACT

4.1 CRITERIA FOR RECOGNIZING A CONTRACT

☞ An accounting contract exists only when an arrangement with a customer meets ALL of the following five criteria:

a) Parties have approved the contract and are committed to perform their contractual obligations;

b) The entity can identify each party's rights regarding the goods or services to be transferred;

c) The entity can identify the payment terms for the goods or services to be transferred;

d) The contract has commercial substance;

e) It is probable that the entity will collect substantially all of the consideration to which it expects to be entitled.

☞ A contract may NOT pass all the 5 conditions of Step 1, but entity may still transfer goods or services to the customer and receive non-refundable consideration. In that circumstance, the entity cannot recognise revenue for the non-refundable consideration received i.e. the entity will recognise consideration received as a liability until either:

- Step 1 criteria are subsequently met, OR

- The contract has been terminated / or there are no remaining obligations, and consideration received from the customer is non-refundable.

4.3 CONTRACT TERM

☞ An entity shall apply this Standard to the duration of the contract (i.e. the contractual period) in which the parties have enforceable rights and obligations.

❖ TERMINATION PROVISIONS

☞ Some contracts can be terminated by either party or it may only be terminated by one party. An accounting contract DOES NOT exist if each party to a contract has the unilateral enforceable right to terminate a wholly unperformed contract without paying a substantive termination penalty.

4.4 COMBINING CONTRACTS

☞ Two or more contracts may need to be accounted for as a single contract if they are entered at or near same time, with the same customer and if ANY ONE of the following conditions exists:

a) The contracts are negotiated as a single package; OR

b) The amount of consideration paid in one contract depends on price or performance of other contract; OR

c) The goods or services promised in the contract are a single performance obligation.

4.5 CONTRACT MODIFICATIONS

A. IDENTIFYING A MODIFICATION

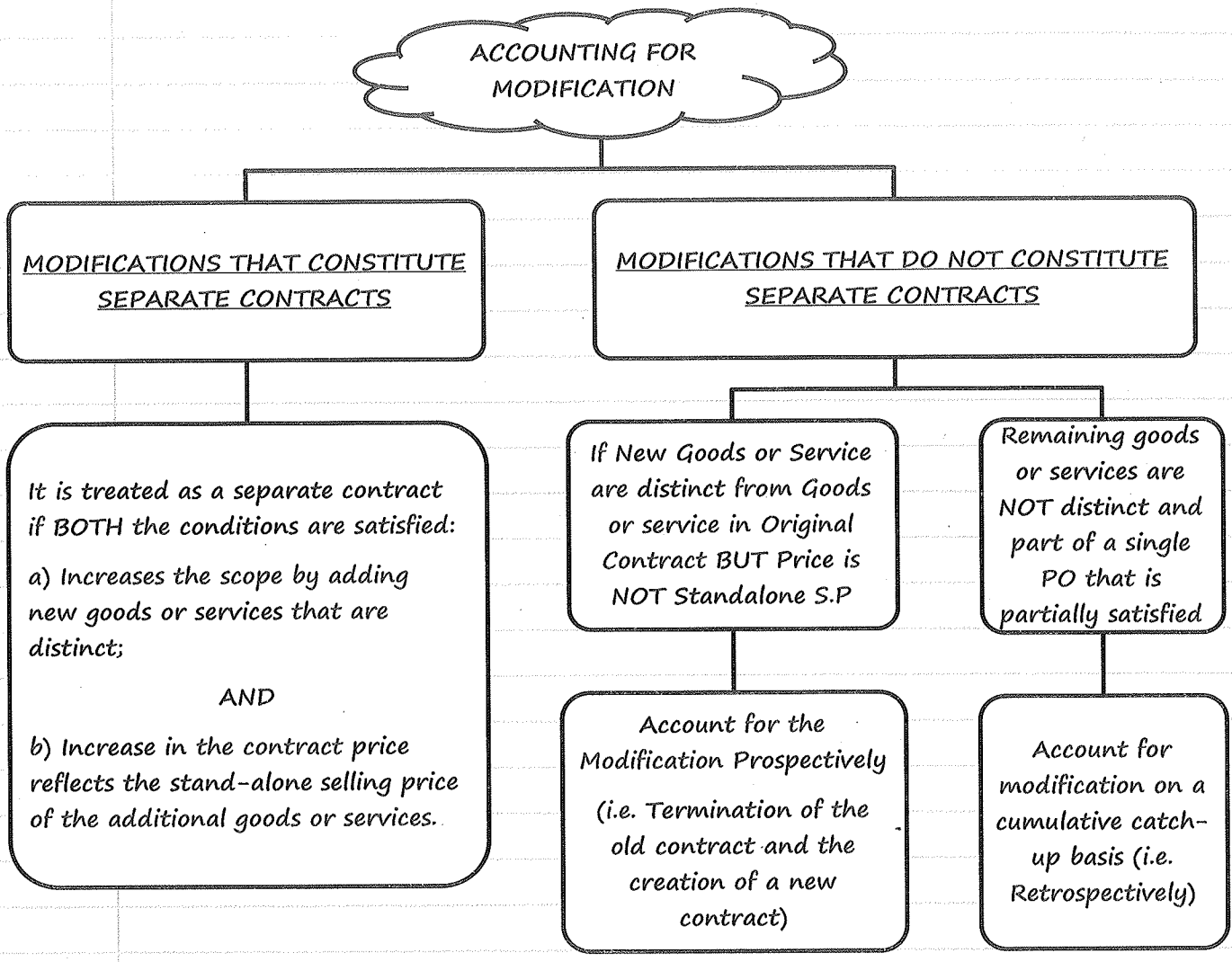
☞ A contract modification exists if three conditions are met:

i) There is a change in the scope, price, or both in a contract.

ii) That change is approved by both the entity and the customer.

iii) The change is enforceable.

B. ACCOUNTING FOR THE MODIFICATION



5. STEP 2: IDENTIFYING PERFORMANCE OBLIGATIONS

☞ Performance obligation is a promise to transfer to the customer either:

a) A good or service (or a bundle of goods or services) that is distinct; OR

b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer.

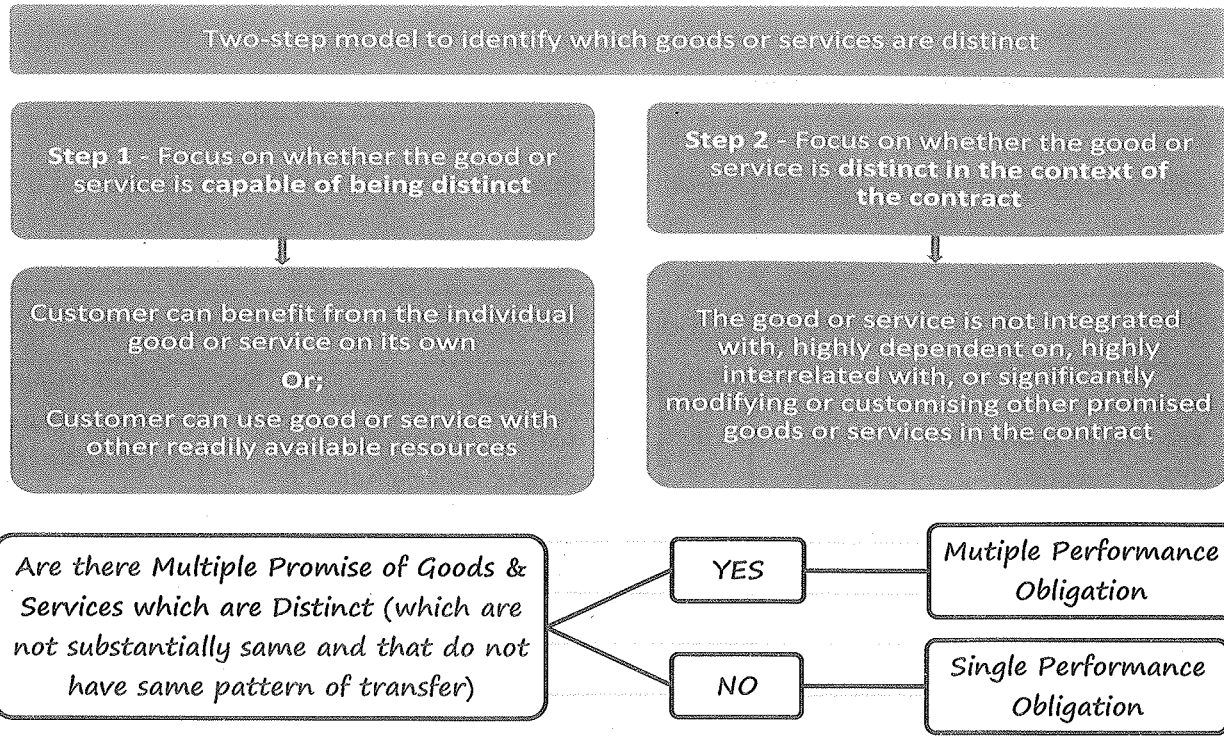
☞ At contract inception, an entity shall assess

a) The goods or services promised in a contract AND

b) Shall identify performance obligation under each promise.

A. DISTINCT PERFORMANCE OBLIGATIONS

☞ A good or service that is promised to a customer is distinct if BOTH of the following criteria are met:



B. Promise to transfer a series of distinct goods or services that are substantially the same and have the same pattern of transfer:

☞ An entity is required to treat that series as a single performance obligation (i.e. it is not optional). Examples: Cleaning services, transaction processing services and delivering electricity to customer.

❖ LONG TERM ARRANGEMENTS

☞ Should a three-year maintenance agreement be considered a single performance obligation or should it be broken into smaller periods (daily, monthly or yearly)?

☞ It may be appropriate to treat a three-year services contract as three separate one-year performance obligations, if the contract can be renewed or cancelled by either party at discrete points in time (that is, at the end of each service year).

☞ In long-term service agreements when the consideration is fixed, the accounting generally will not change regardless of whether a single performance obligation or multiple performance obligations are identified.

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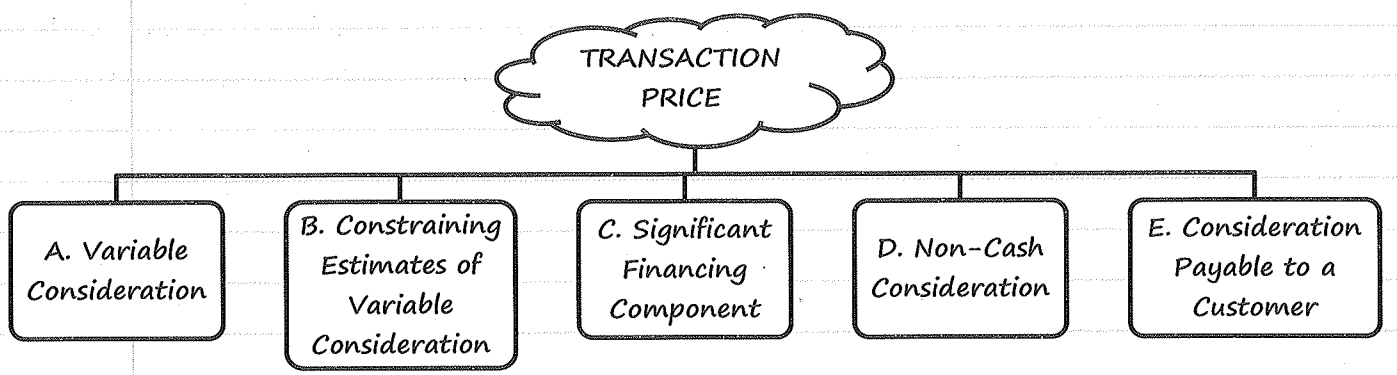
6. STEP 3: DETERMINING THE TRANSACTION PRICE

☞ Transaction Price is the amount of consideration which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, GST).

☞ The consideration promised may be FIXED or VARIABLE or both.



A. VARIABLE CONSIDERATION

☞ An amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.

☞ Variable consideration may be fixed in amount, but the entity's right to receive that consideration is contingent on a future outcome.

❖ Penalties

Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration.

❖ ESTIMATING THE AMOUNT OF VARIABLE CONSIDERATION

An entity shall estimate an amount of variable consideration by using either of the following methods:

1. THE EXPECTED VALUE	2. THE MOST LIKELY AMOUNT
◦The expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. This method may be appropriate if the contract has multiple outcomes possible.	◦It is the single most likely amount in a range of possible consideration amounts (i.e. the single most likely outcome). This method may be appropriate if the contract has only two possible outcomes.

B. CONSTRAINING ESTIMATES OF VARIABLE CONSIDERATION

☞ Variable Consideration shall be included in the transaction price only when it is highly probable that significant reversal will NOT occur.

☞ Factors that increase the likelihood or the magnitude of a revenue reversal include any of the following:

a) Amount of consideration is highly susceptible to factors outside entity's influence.

b) Uncertainty about the amount of consideration is not expected to be resolved for a long period of time.

c) Entity's experience or other evidence with similar types of contracts is limited, or has limited predictive value.

d) Entity has a practice of either offering a broad range of price concessions or changing payment terms & conditions of similar contracts in similar circumstances.

e) Contract has a large number and broad range of possible consideration amounts.

❖ REASSESSMENT OF VARIABLE CONSIDERATION

☞ At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained).

C. SIGNIFICANT FINANCING COMPONENT

☞ An entity shall adjust the Transaction Price for the effects of the time value of money if the timing of payments agreed (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing.

☞ Either party may benefit from financing i.e.,

- Customer may pay before the entity performs its obligation (a customer loan to the entity) OR
- Customer may pay after the entity performs its obligation (a loan by the entity to the customer).

☞ The financing component is recognised as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears). The interest income or expense is recognised over the financing period using the effective interest method described in Ind AS 109.

☞ Discount rate is the rate at which entity could have taken finance. If that rate is NOT available then the entity can compute IRR (i.e. EIR) which equates the promised consideration and the cash selling price.

❖ A CONTRACT WOULD NOT HAVE A SIGNIFICANT FINANCING COMPONENT IF ANY OF THE FOLLOWING FACTORS EXIST:

a) Customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.
(Example, consider a prepaid card for mobile phone services, wherein the customer has the discretion to avail mobile services within a certain band of time)

b) A substantial amount of consideration is variable based on future event that is not within the control of the customer or the entity.
(Example, if the consideration is a sales-based royalty)

c) Difference between promised consideration and cash selling price arises for reasons other than the provision of finance.
(Example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete its obligations under the contract)

D. NON-CASH CONSIDERATION

☞ Sometimes a customer promises to pay for a good or service in a form other than cash such as shares, advertising, or equipment.

☞ To determine the transaction price in such cases:

1st Preference	2nd Preference
•Fair Value of Non-Cash Consideration Received	•Standalone Selling Price of goods or services given

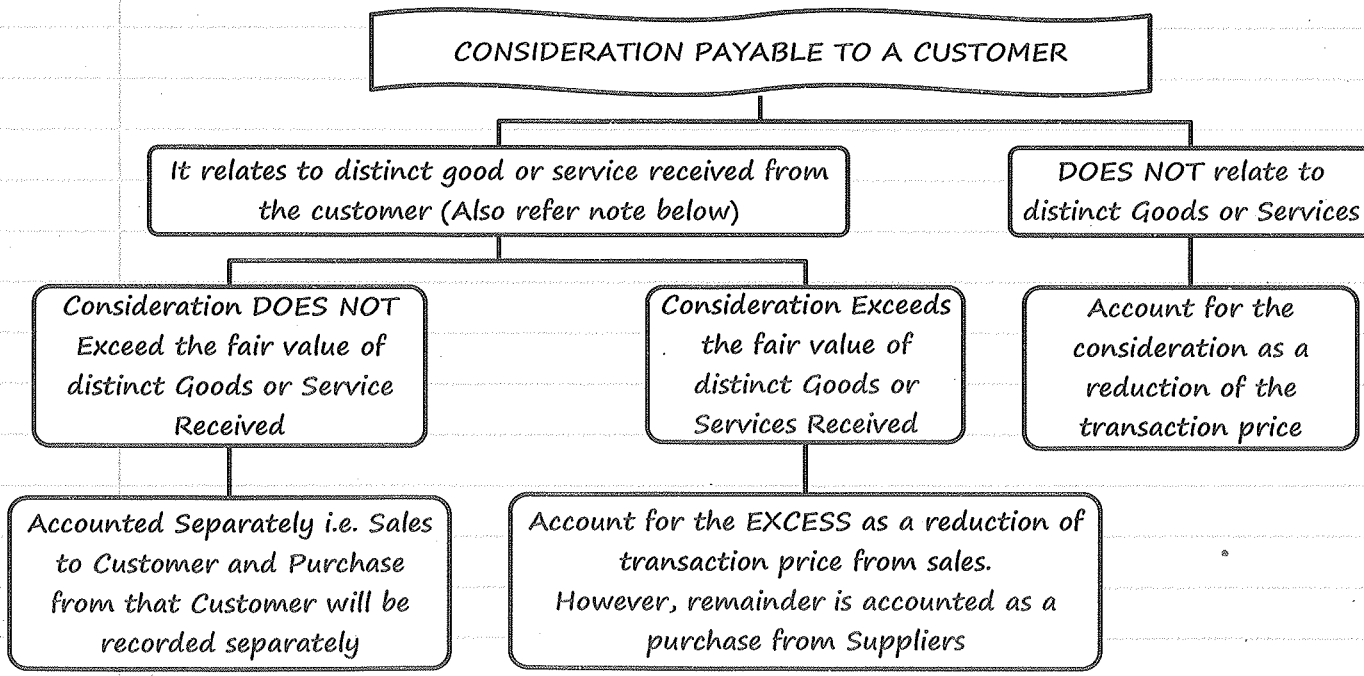
❖ CUSTOMER-PROVIDED GOODS OR SERVICES

☞ If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services.

If entity obtains Control	If entity DOES NOT obtain Control
•Fair Value of Goods or Services supplied by customer will be added to Transaction Price.	•Fair Value of Goods or Services supplied by customer will NOT be added to Transaction Price.

E. CONSIDERATION PAYABLE TO A CUSTOMER

☞ Consideration payable to a customer includes cash amounts, coupons, vouchers that an entity expects to pay or that can be applied against amounts owed to the entity.



❖ Consideration paid or payable to a customer can take many different forms. Some common examples of consideration paid to a customer are given below:

1) Slotting fees

Manufacturers of consumer products commonly pay retailers fees to have their goods displayed prominently on store shelves. Those shelves can be physical (i.e. in a building where the store is located) or virtual (i.e. they represent space in an internet reseller's online catalogue). Generally, such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction of the transaction price.

2) Co-operative advertising arrangements

In some arrangements, a vendor agrees to reimburse a reseller for a portion of costs incurred by the reseller to advertise the vendor's products. The determination of whether the payment from the vendor is in exchange for a distinct good or service at fair value will depend on a careful analysis of the facts and circumstances of the contract.

Example

Mobile-Co sells 1,000 phones to Retailer for ₹ 10,00,000. The contract includes an advertising arrangement that requires Mobile-Co to pay ₹ 1,00,000 toward a specific advertising promotion that Retailer will provide.

The payment from Mobile-Co to Retailer is consideration for a distinct service provided by Retailer and reflects fair value. The advertising is distinct because Mobile-Co could have engaged a third party who is not its customer to perform similar services. The transaction price is ₹ 10,00,000 and is not affected by the payment made by Retailer for the sale of the phones.

3) Price protection

A vendor may agree to reimburse a retailer up to a specified amount for shortfalls in the sales price received by the retailer for the vendor's products over a specified period of time. Normally such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction of the transaction price.

7. STEP 4: ALLOCATING THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

☞ Allocate the transaction price to each performance obligation (or distinct good or service) on

a relative stand-alone selling price basis EXCEPT for allocating discounts and for Variable consideration.

☞ There are two exceptions to the above principle of allocation transaction price based on standalone selling price:

- Allocating discounts (Refer Point B below), and
- Allocating variable consideration (Refer Point C below)

A. DETERMINING STANDALONE SELLING PRICE

☞ Standalone selling price is the price at which an entity would sell a promised good or service separately to a similar customer under similar circumstances.

☞ If a stand-alone selling price is not directly observable, an entity shall estimate the stand-alone selling price by apply estimation methods (discussed below). A combination of below methods may also be used:

ADJUSTED MARKET ASSESSMENT APPROACH	EXPECTED COST PLUS MARGIN APPROACH	RESIDUAL APPROACH
•Price of competitors similar goods or services and adjusting those prices to reflect the entity's costs and margins.	•Forecast its expected costs for each performance obligation and then add an appropriate margin for that good or service	•Total Transaction Price LESS sum of observable standalone selling prices of other goods or services in the contract (after allocating discount) •Also refer Note Below

❖ NOTE: RELATES TO RESIDUAL APPROACH

☞ An entity may use a residual approach to estimate the standalone selling price only if:

- Entity sells the same good or service to different customers for a broad range of amounts; OR
- Such good or service has not previously been sold on a stand-alone basis and its prices is not yet decided.

☞ An entity shall allocate the discount before using the residual approach to estimate the stand-alone selling price of a good or service where the discount is allocated entirely to one or more performance obligations in the contract.

B. ALLOCATION OF A DISCOUNT

☞ The entity shall allocate discount proportionately to all performance obligations on the basis of standalone selling prices of distinct goods or services EXCEPT when entity has evidence that entire discount relates to only one or more, but not all, performance obligations.

☞ When to allocate discount to 'less than all' performance obligations?

- The entity also regularly sells a smaller bundle of some of those distinct goods or services at a discount; AND
- Discount attributable to the smaller bundle of goods or services is substantially the same as the discount in the contract.

C. ALLOCATION OF VARIABLE CONSIDERATION

☞ Variable consideration may be attributable to (i) the entire contract or (ii) a specific part of the contract.

❖ CHANGES IN TRANSACTION PRICE

☞ After contract inception, the transaction price can change for various reasons.

☞ If the change in transaction price is the result of a contract modification, the entity should follow the contract modification guidance.

8. STEP 5: RECOGNIZE REVENUE AS AND WHEN ENTITY SATISFIES ITS PERFORMANCE OBLIGATIONS

☞ An entity shall recognise revenue as & when the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when the customer obtains control of that asset.

A. CONTROL

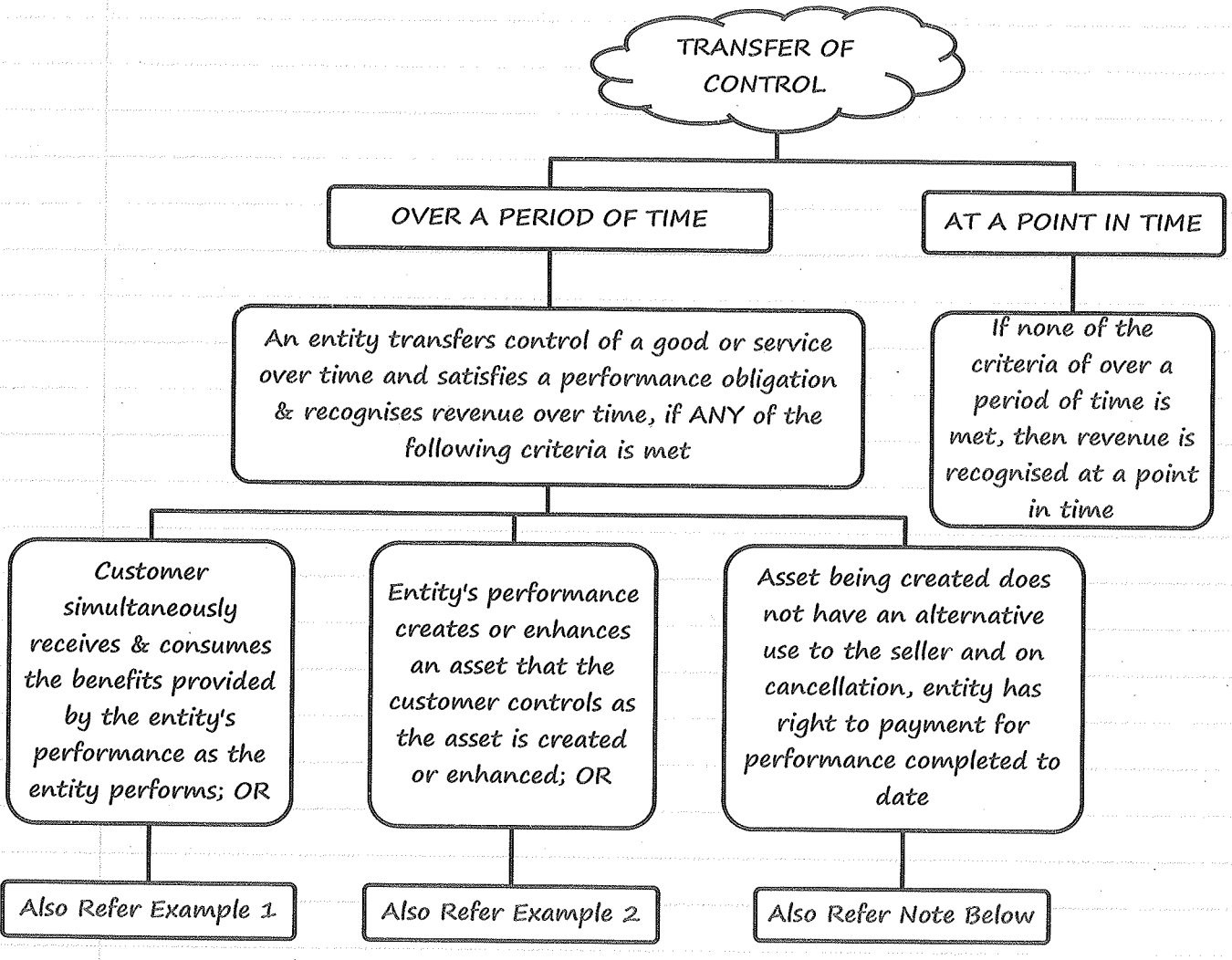
☞ Control of an asset refers to ability to direct the use & obtain substantially all the benefits from the asset OR ability to prevent others from directing the use of the asset.

☞ In addition, an entity shall consider indicators of the transfer of control, which include the following:

- The entity has a present right to payment for the asset;
- The customer has legal title to the asset;
- The entity has transferred physical possession of the asset;

- The customer has the significant risks and rewards of ownership of the asset;
- The customer has accepted the asset.

B. CONTROL MAY BE TRANSFERRED CONTROL OVER A PERIOD OF TIME OR AT A POINT IN TIME.



Example 1: Routine or recurring services – e.g. cleaning services, Routine transaction processing services, Hotel management services.

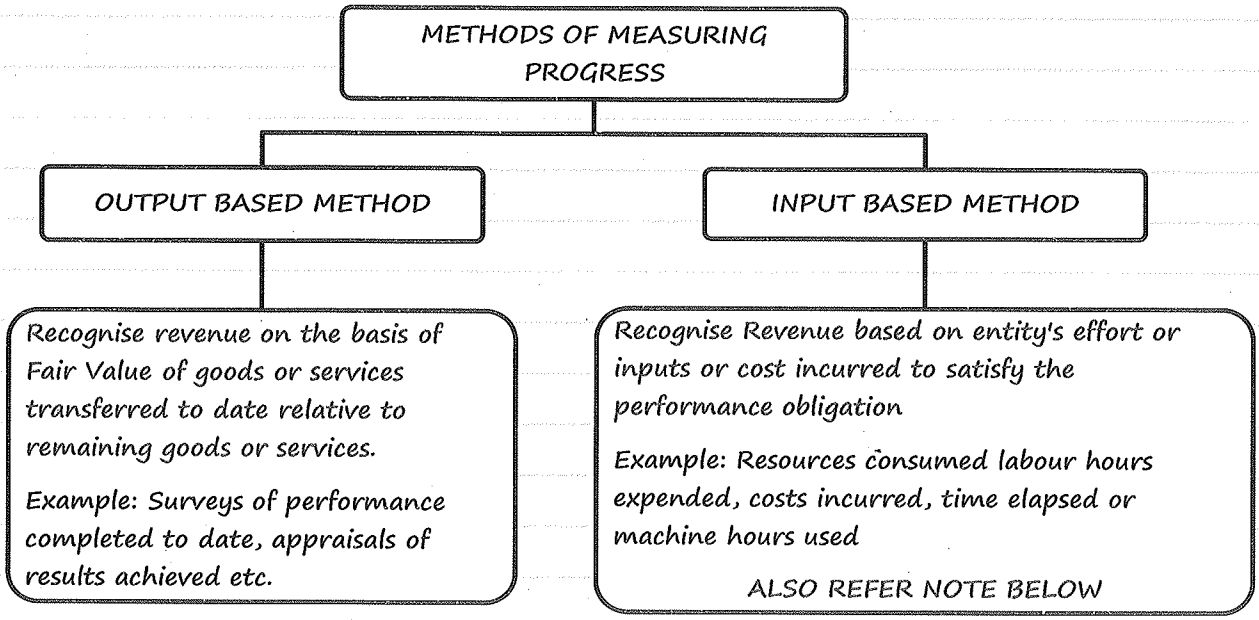
Example 2: Construction contracts, where contractor engages to construct a specific asset for the customer on customer's land

NOTE:

- Compensation should include costs incurred for work completed PLUS a reasonable profit margin.
- A small compensation / flat penalty on termination does not tantamount to legally enforceable right for work completed

C. METHODS OF MEASURING PROGRESS IF CONTROL IS TRANSFERRED OVER A PERIOD OF TIME

☞ The standard provides two methods for recognising revenue on contracts involving the transfer of goods and services over time: input methods and output methods



NOTE:

- Exclude abnormal losses and wastages from the cost incurred calculation as they do not contribute to satisfying performance obligation.
- In case of unused material, we would adjust the input method & calculate stage of completion based on used material only. The unused material should be recognised only to the extent of cost incurred.
- If the inputs/costs are incurred evenly, we can use the straight-line method

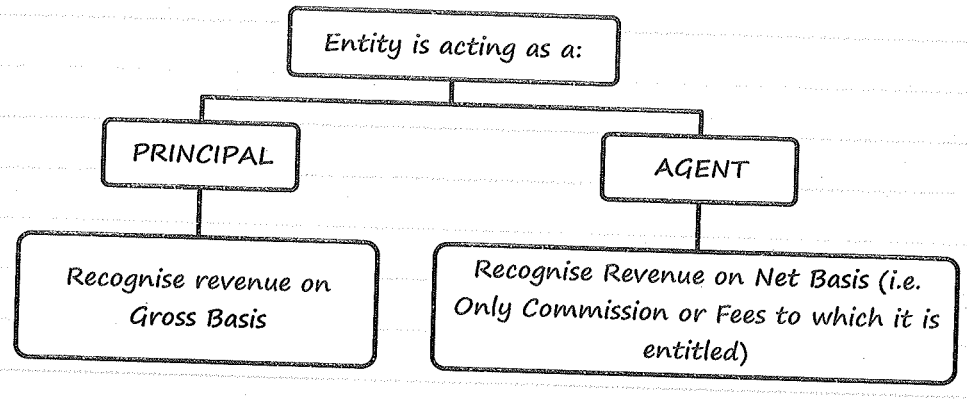
D. TRANSFER OF CONTROL AT A POINT IN TIME

☞ If none of the criteria of over a period of time is met, then performance obligation is

considered to be discharged at a point in time. In such case, revenue is recognised at a point in time.

9. SPECIAL CASES

I. PRINCIPAL VS AGENT



☞ INDICATORS THAT AN ENTITY IS A PRINCIPAL:

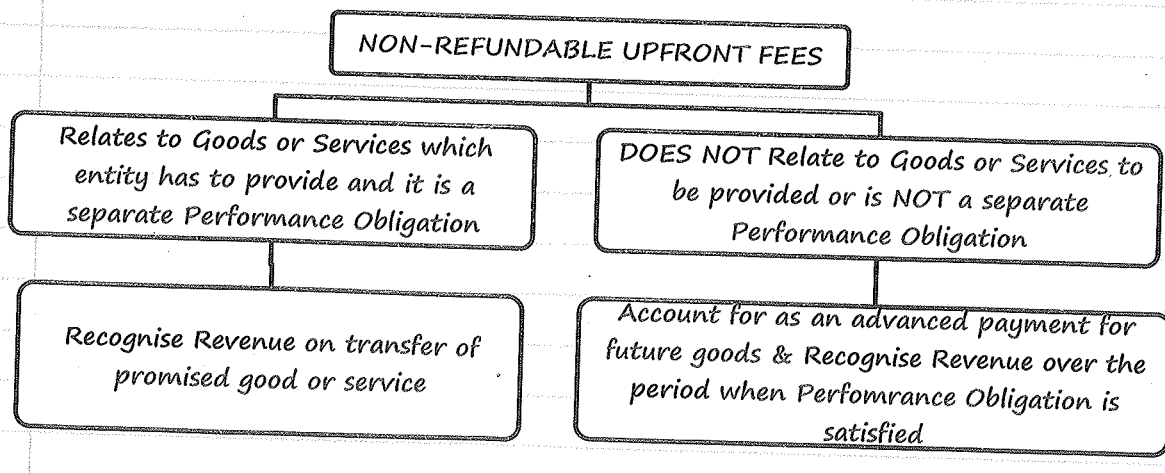
a) The entity is primarily responsible for fulfilling the contract;

b) The entity has inventory risk before goods or service has been transferred to a customer.

c) The entity has discretion in establishing prices for goods or services.

In some contracts in which the entity is the agent, control of the goods or services promised by the agent might transfer before the customer receives the goods or services from the principal.

II. NON-REFUNDABLE UPFRONT FEES



(Examples include: Joining fees in health club membership, activation fees for telecom services, setup fees in service contracts etc).

III. CUSTOMER OPTIONS FOR ADDITIONAL GOODS OR SERVICES

- In case an entity gives customers option to purchase additional goods or services by way of coupons, gift cards and customer award credits like loyalty or reward programs etc, then such option is treated as a separate performance obligation ONLY IF:
  - it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).
- If option provides a material right to the customer, entity recognises revenue when those future goods or services are transferred or when option expires.
- Entity has to allocate the transaction price to performance obligations on a relative stand-alone selling price basis.
- That estimate shall reflect the discount that customer would obtain when exercising option, adjusted for both of the following:
  - any discount that the customer could receive without exercising the option; and
  - the likelihood (Probability) that the option will be exercised.

IV. SALE WITH A RIGHT OF RETURN

- An entity shall:
  - Recognise Revenue for the transferred products only to the extent entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);
  - Recognise a Refund Liability (For consideration received on goods expected to be returned by customer); and
  - Recognise an Asset (and corresponding adjustment to cost of sales i.e. P&L) for its right to recover products from customers. (Asset will be recognised at: Carrying amount of the product LESS any expected costs to recover those products LESS potential decreases in the value of returned products)
- An entity shall present the asset separately from the refund liability.

☞ Exchanges of one product for another of same type, quality, condition and price (for example, one colour or size for another) are not considered returns as per this Standard.

V. ACCOUNTING FOR RESTOCKING FEES FOR GOODS THAT ARE EXPECTED TO BE RETURNED

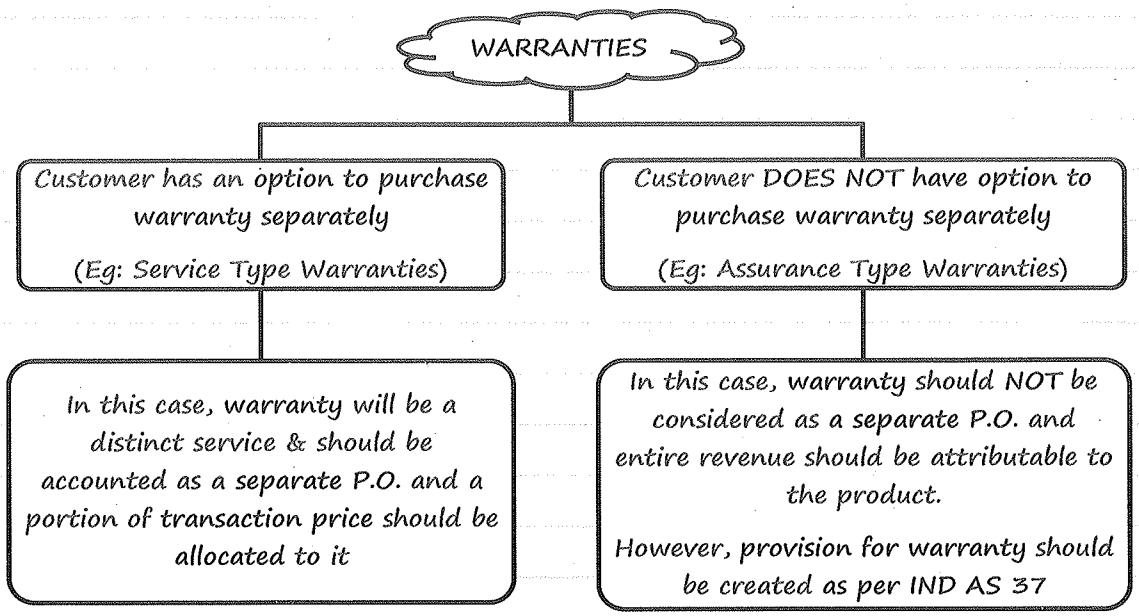
☞ Entities sometimes charge customers a restocking fee' when a product is returned. This fee may be levied by entities to compensate them for the costs of repackaging, shipping and/or reselling the item at a lower price to another customer.

☞ Restocking fees for goods that are expected to be returned would be included in the estimate of the transaction price at contract inception and recorded as revenue when control of good transfers.

EXAMPLE

An entity enters into a contract with a customer to sell 10 units of a product for ₹ 100 per unit. Customer has the right to return the product, but if it does so, it will be charged a 3% restocking fee (or ₹ 3 per returned unit). The entity estimates that 10% of the sold units will be returned. Upon transfer of control of the 10 units, the entity will recognise revenue of ₹ 903 [(9 units not expected to be returned x ₹ 100 selling price) + (1 unit expected to be returned x ₹ 3 restocking fee per unit)]. A refund liability of ₹ 97 will also be recorded [1 unit expected to be returned x (₹ 100 selling price – ₹ 3 restocking fee)].

VI. WARRANTIES



☞ In assessing whether a warranty is a separate P.O. or not, an entity shall consider factors such as:

a) Whether the warranty is required by law - If required by law, it indicates that the promised warranty is not a performance obligation.

b) Length of warranty coverage period - Longer the coverage period, the more likely it is that the promised warranty is a separate performance obligation.

VII. CONSIGNMENT ARRANGEMENTS

☞ A consignment agreement is an agreement between a consignee and consignor for the storage, transfer, sale or resale and use of the goods. Entities (Consignor) frequently deliver inventory on a consignment basis to other parties like distributor, dealer (Consignee).

☞ Indicators to evaluate whether it is a consignment arrangement:

a) Product is controlled by the entity (consignor) until a specified event occurs, such as sale of product to a customer of the dealer or until a specified period expires;

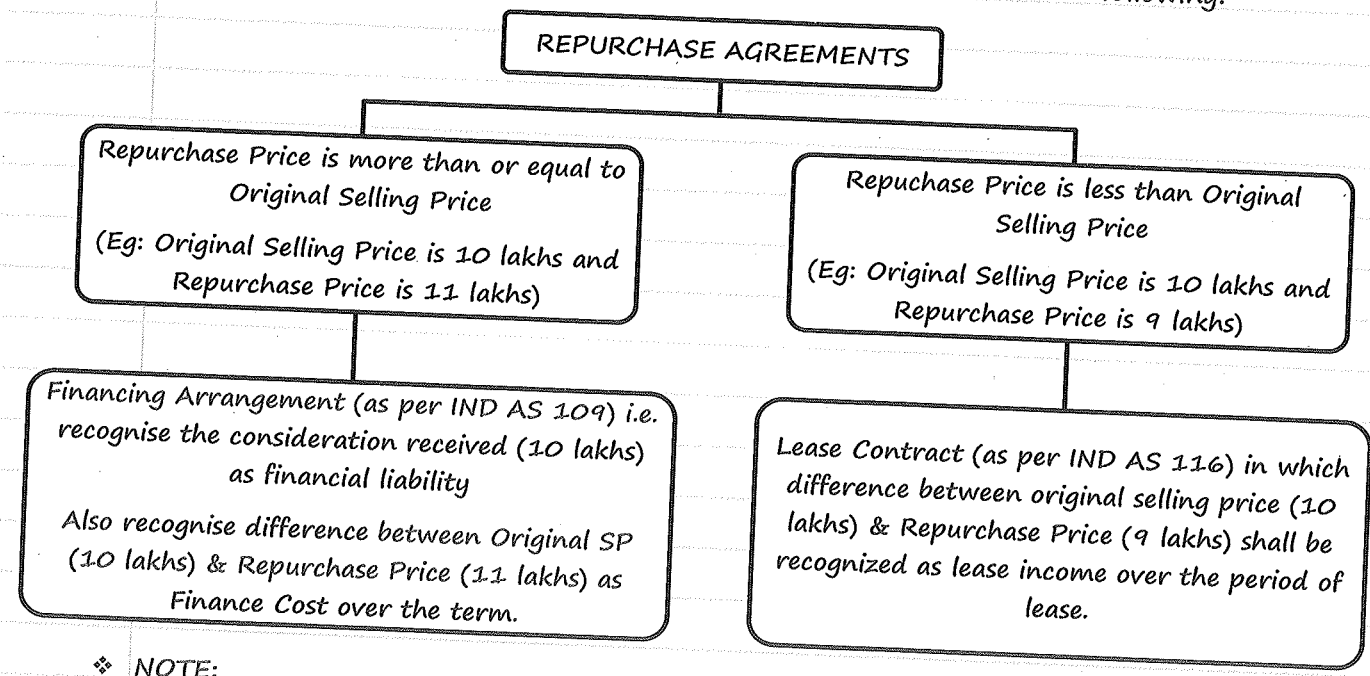
b) Consignor is able to require the return of the product or transfer the product to a third party (such as another dealer); and

c) Consignee does not have an unconditional obligation to pay for the product until the goods are sold to the ultimate or end customer (although it might be required to pay a deposit).

- In case of consignment arrangements, revenue would NOT be recognised when the goods are delivered to the consignee because control has not yet transferred. Revenue is recognized when the entity has transferred control of the goods to the consignor or the end consumer.
- A consignment sale differs from a sale with a right of return. The customer has control of the goods in a sale with right of return and can decide whether to put the goods back to the seller. In case of consignment sales, the consignee does not have the control over the goods.

VIII. SALE & REPURCHASE AGREEMENTS

- A repurchase agreement is a contract in which an entity sells goods and also promises or has the option to repurchase the goods.
- In case of repurchase agreements, revenue should not be recognised as the customer does not obtain control even though the customer may have physical possession of the asset.
- Consequently, the entity shall account for the contract as either of the following:



❖ NOTE:

- If the option lapses unexercised, an entity shall derecognise the liability and recognise revenue.
- The above treatment would be done for options only if, the entity estimates at the inception that there is a significant economic incentive for the option holder to exercise the option.

☞ If the customer does not have a significant economic incentive to exercise its right, the entity shall account for the agreement as sale of a product with a right of return.

IX. BILL AND HOLD

☞ A bill and hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product (at customers request because of customer's lack of available space or because of delays in customer's production schedules).

☞ In such arrangements, the entity shall recognise revenue at the point of time when control is transferred to the customer.

☞ For a customer to have obtained control of a product even though the product remains in an entity's physical possession (i.e. Bill and Hold Arrangement) ALL the following criteria must be met:

a) The reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
b) The product must be identified separately as belonging to the customer;
c) The product currently must be ready for physical transfer to the customer; and
d) The entity cannot have the ability to use the product or to direct it to another customer.

☞ Where an entity recognises revenue on bill & hold basis, the entity checks for additional performance obligations (for eg: custodial services for goods held) and allocate a portion of transaction price to each performance obligation.

X. LICENCES OF INTELLECTUAL PROPERTY

☞ Recognition of revenue for licences of intellectual property (Eg: software and technology, media and entertainment (e.g. motion pictures and music), franchises, patents, trademarks and copyrights) differs from the recognition model for other promised goods and services.

☞ A licence will either provide:

✓ A right to access the entity's intellectual property throughout the licence period, which results in revenue that is recognised over time; or
✓ A right to use the entity's intellectual property as it exists at the point in time in which the licence is granted, which results in revenue that is recognised at a point in

time.

A. RIGHT TO ACCESS IP (OVER TIME)

☞ All criteria must be met

a) The entity is required (by the contract) or reasonably expected (by the customer) to undertake activities that significantly affect the licensed IP

b) The licence exposes the customer to any effects of the entity's activities

c) The entity's activities are not a performance obligation under the contract

➢ Recognize revenue over time

Example

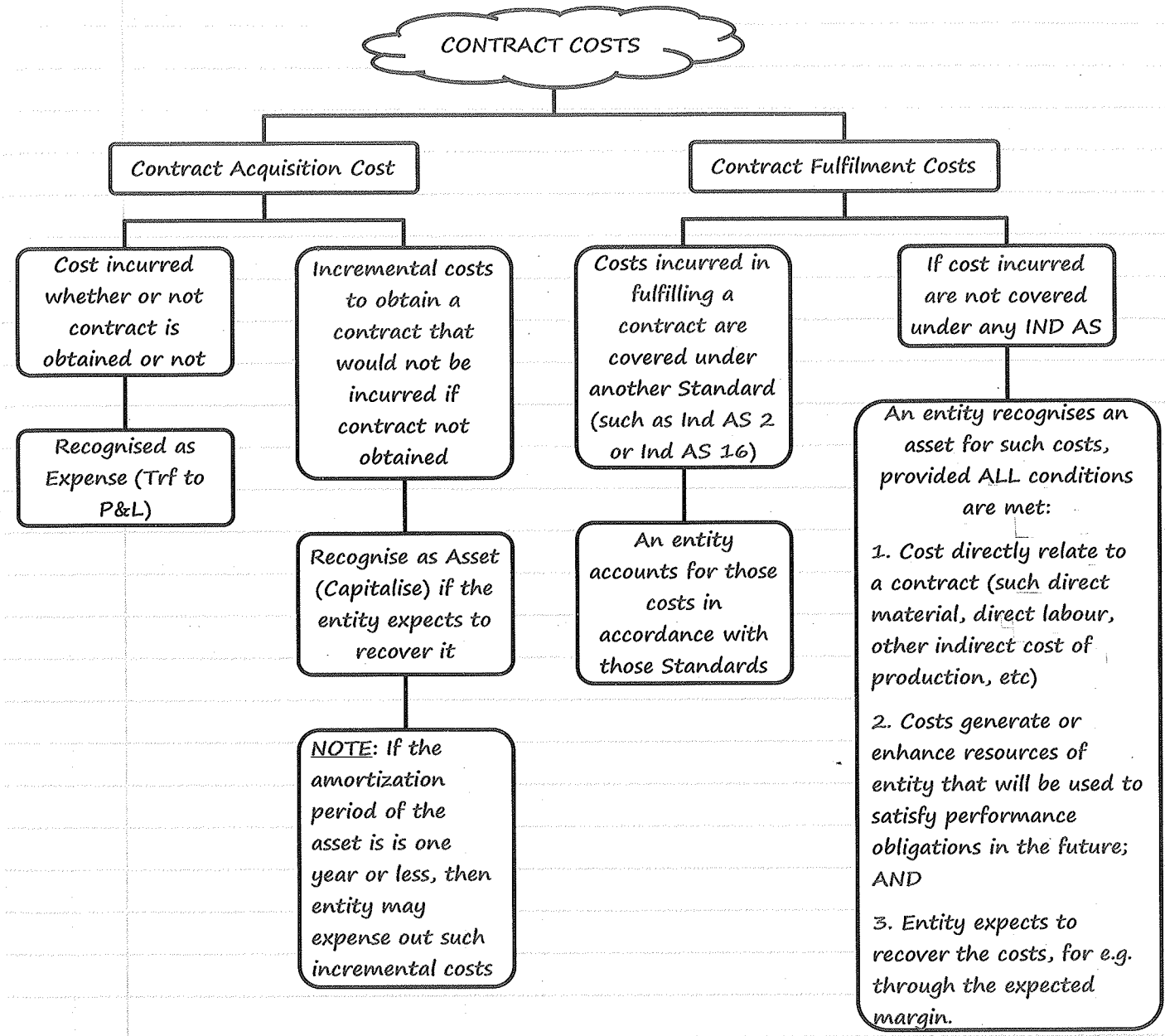
Pogo has created a popular television show called –Chhota Bheem. Pogo grants a three-year license to Toy Manufacturer for use of the character –Chhota Bheem on its toys. As per the contract, Pogo will continue to produce the show, popularize the character, carry out marketing activities. Toy Manufacturer produces and sells –Chhota Bheem toys. In this case, the license provides access to Pogo's Intellectual Property (IP). Pogo will undertake activities that significantly affect the IP by production and marketing of the show, development of the characters. Toy manufacturer is directly exposed to any positive or negative effects by Pogo's activities ie. how the show is received by kids and their parents. These activities are not separate performance obligations as they do not transfer a good or service to Toy Manufacturer separate from the license. Hence, Pogo will recognize revenue over time.

B. RIGHT TO USE

☞ If all 3 criteria for access (over time) are not met, the nature of the entity's promise is to provide a right to use the IP as it exists at a specific point in time, the customer gains control over that intellectual property at the beginning of the period for which it has the right to use the intellectual property.

☞ Recognize revenue at a point in time.

XI. CONTRACT COSTS



❖ NOTE: The following contract fulfilment costs should be expensed as incurred:

- General & administrative costs that are not explicitly chargeable to the customer;
- Costs of wasted materials, labour, or other resources that were not reflected in the contract price;
- Costs that relate to satisfied performance obligations; etc.

❖ EXAMPLE OF CONTRACT ACQUISITION COSTS (Refer Question 14 of Question Bank)

❖ AMORTISATION & IMPAIRMENT OF CONTRACT COST RECOGNISED AS ASSET

☞ Amortize capitalised contract costs consistent with pattern of transferring goods or services.

☞ Recognises an impairment loss if carrying amount of an asset exceeds remaining amount of consideration LESS directly related contract costs yet to be recognised.

☞ Before recognising an impairment loss under the revenue recognition guidance, an entity recognises impairment losses associated with assets related to Ind AS 2, Ind AS 16 and Ind AS 38.

☞ Reversal of impairment loss is permitted (Same as IND AS 36).

XII. SERVICE CONCESSION ARRANGEMENTS

ABOUT SERVICE CONCESSION ARRANGEMENTS	PARTIES
☞ Such types of arrangements involve the construction of infrastructure used to provide public services. It also involves operating and maintaining that infrastructure for a specified period of time. ☞ It is also called the "Build-operate-transfer" (B-O-T) or "Public-to-Private" service concession arrangement. ☞ It is of the public service nature because it has some involvement of infrastructure which is used by the general public. It can be bridges, roads, national highways, etc.	☞ Grantor – It is a Public Authority (Eg: Govt Body) that grants the operator contract to construct/upgrade & operate that infrastructure for a specified period of time. ☞ Operator - An entity constructing & operating the infrastructure. The operator is paid for its services over the period of the arrangement.

A. ACCOUNTING PRINCIPLES

i) Treatment of the operator's rights over the infrastructure

☞ Infrastructure under this arrangement shall not be recognized as PPE by the operator. It is because operator does not have right to control the use of public service infrastructure. But yes, operator has access to operate infrastructure to provide public service on behalf of grantor in accordance with terms specified in contract.

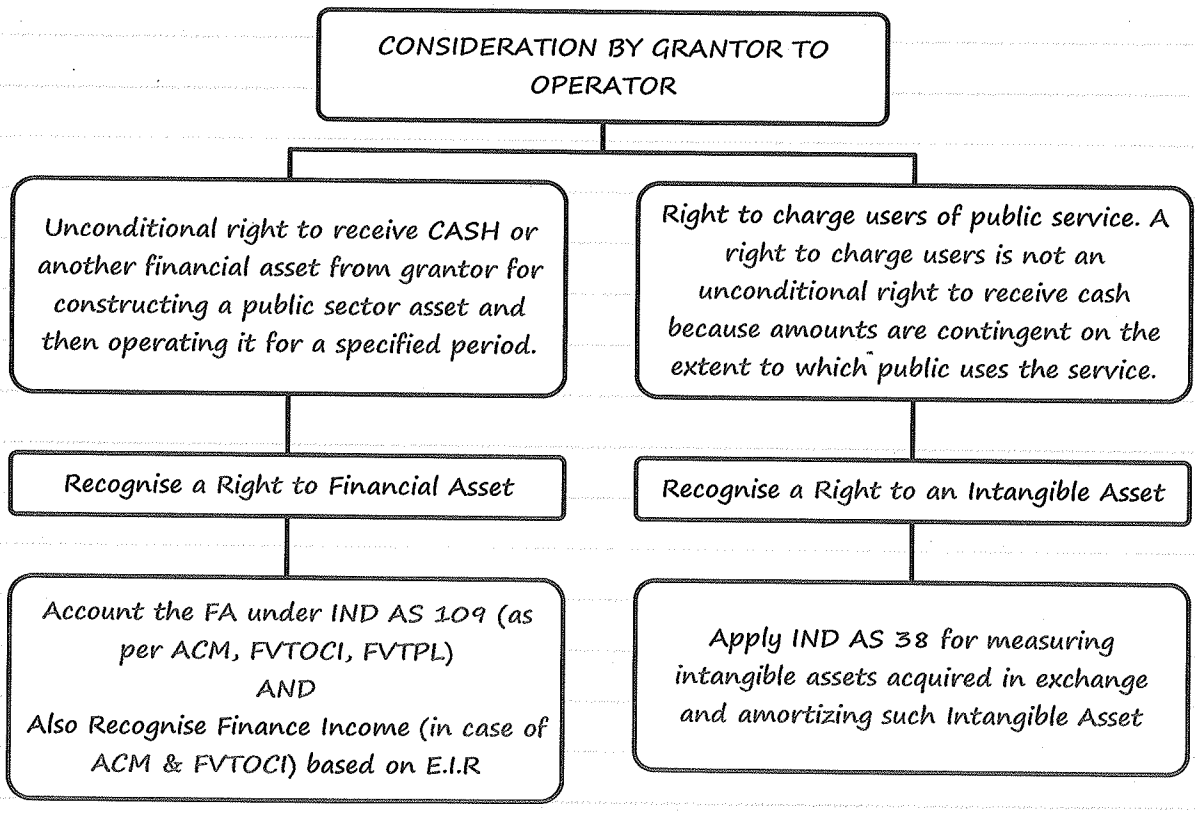
ii) Recognition and measurement

☞ Operator (acting as a service provider) shall recognize revenue in accordance with Ind AS 115.

☞ If the operator is performing more than one service (i.e. construction services and operating services) under a single contract, the consideration received or receivable shall be allocated based on the fair value of the services provided.

iii) Consideration given by the grantor to the operator

☞ The grantor can provide the operator with the consideration which shall be recognized at fair value.



❖ NOTE:

☞ If operator is paid for construction services partly by a financial asset & partly by an intangible asset, it is necessary to account separately for each component of the operator's consideration.

SIGNIFICANT DIFFERENCES IN IND AS 115 VIS-À-VIS AS 7 AND AS 9

S.No.	PARTICULARS	IND AS 115	AS 7 & AS 9
1.	Framework of Revenue Recognition	Ind AS 115 gives a framework of revenue recognition within a standard. It specifies the core principle for revenue recognition	AS 7 and AS 9 do not provide any such overarching principle.
2.	Guidance on Recognition & Measurement of Multiple Elements within a Contract	Ind AS 115 gives guidance on how to recognize &measure multiple elements within a contract with customer.	AS 7 and AS 9 do not provide guidance on this aspect.
3.	Coverage	Ind AS 115 comprehensively deals with all types of performance obligation contracts with customers. However, it does not deal with revenue from 'interest' and 'dividend' which are covered in financial instruments standard.	There is no emphasis on performance obligation under the contract with customer. AS 7 covers only revenue from construction contracts which is measured at consideration received / receivable. AS 9 deals only with recognition of revenue from sale of goods/services, interest, royalties & dividends.
4.	Measurement of Revenue	As per Ind AS 115, revenue is measured at transaction price	As per AS 9, Revenue is gross inflow of considerations arising in course of ordinary activities. Revenue is measured by charges made to customers for goods / services supplied. As per AS 7, revenue from construction contracts is measured at consideration received/receivable and recognized as revenue as construction progresses.
5.	Recognition of Revenue	As per Ind AS 115, revenue is recognized when the control is transferred to the customer. It introduces a 5-step model for revenue recognition.	As per AS 9, revenue is recognized when significant risks and rewards of ownership is transferred to buyer. As per AS 7, contract revenue should be recognized by reference to the stage of completion
6.	Multiple elements of performance obligations	Ind AS 115 gives guidance on how to recognize & measure multiple elements of performance obligations within a	AS 7 and AS 9 provide no specific guidance.

		contract.	
7.	Capitalisation of Costs	Ind AS 115 provides guidance on recognition of costs to obtain and fulfil a contract, as asset.	AS 7 and AS 9 do not deal with such capitalisation of costs.
8.	Guidance on combining contracts and variable & contingent consideration	Ind AS 115 provides guidance on combining contracts entered near same time with same customer, guidance on treatment of variable & contingent consideration.	AS 7 and AS 9 do not deal with such aspects.
9.	Guidance on Subsequent changes in transaction price	Ind AS 115 provides guidance on Subsequent changes in transaction price.	AS 7 and AS 9 do not deal with such aspects.
10.	Guidance on Service Concession Arrangements	Ind AS 115 gives guidance on service concession arrangements and disclosures thereof.	AS does not provide such guidance.
11.	Disclosure Requirements	Ind AS 115 contains detailed disclosure requirements.	Less disclosure requirements are prescribed in AS.

❖ **Comparison Between IND AS 115 with AS 7 & AS 9 (Certain Points which has impact on certain questions)**

1. <u>Warranties</u>

Ind AS 115 deals with warrantees in two specific ways. However, as per AS 9 only a general provision for warrantees is sufficient without revenue reversal or recognition of a contractual liability.

Illustration 35

Accounting point	Treatment under Ind AS 115	Treatment as per AS 9
How warranty is accounted	Expense and liability effect Created at the inception of contract with customer	Provision is made on past experience based on a certain percentage of total revenue to give effect to subsequent warranty costs, say 5% of Revenue

Accounting Treatment	Total Cash Inflow – 36,000 Warranty Expense – 2,000 Accrued Warranty Cost – 2,000 Contract liability (for future service cost) – 4000 Actual revenue – 32,000	Total cash inflow – 36,000 Provision for warranty (at 5% of transaction price) – 1800 Contract liability – None Actual revenue – 34,200

2. Significant financing component

As per Ind AS 115, transaction price is adjusted for the effect of time value of money when a significant financing component exists. As per AS 9, revenue is not adjusted for time value of money.

After Illustration 38

Point of accounting	Treatment under Ind AS 115	Treatment under AS 9
Cash selling price 1,00,000 Promised selling price of 1,21,000	Transaction price will be bifurcated as 1,00,000 and 21,000 1,00,000 will be recognised as revenue and 21,000 shall be treated as interest income being a price difference due to financing arrangement involved in the transaction	Transaction price of 1,21,000 shall be treated as revenue once the risk and rewards are transferred to the customer. Here, there is no requirement to dissect the transaction price to look for multiple element arrangement like financing component.
Revenue recognized	1,00,000	1,21,000
Other income (interest)	21,000 over 2 years as per Ind AS 109	No interest income is recognized.

3. Contract acquisition cost

It is not specifically dealt with in either in AS 7 or AS 9.:

Example

A software company has agreed to pay a special commission of 1% of the contract value to a sales consultant who has agreed to work based on the successful bidding of the proposal to a customer. In case the contract is not signed by the company and the customer, for whatever reason, then there is no commission to be paid to the sales consultant.

The contract value is 1 crore over 3 years and the company has signed the contract with the customer after successful bidding with the help of the sales consultant.

In this context, the accounting differences will be as follows:

Particulars	Treatment under Ind AS 115	Treatment under AS 9
1st year of operations – Contract acquisition cost of 1 crore	• Amortization as expense of the year 33.33 lakhs • Contract asset 66.67 lakhs	Expense of 1 crore as sales commission
2nd year of operations – Contract acquisition cost of 1 crore	• Amortization as expense of the year 33.33 lakhs • Contract asset 33.34 lakhs	No accounting treatment
3rd year of operations – Contract acquisition cost of 1 crore	• Amortization as expense of the year 33.34 lakhs • Contract asset of nil	No accounting treatment

IND AS 116
LEASES

1. SCOPE

Ind AS 116 shall be applied to ALL LEASES, including leases of Right-of-Use (ROU) assets in a sub-lease, EXCEPT for:

- Leases to explore for or use minerals, oil, natural gas within the scope of IND AS 106
- Leases of biological assets held by a lessee which are within the scope of IND AS 41
- Service Concession Arrangements which are within the scope of IND AS 115
- Licences of intellectual property granted by a lessor as per IND AS 115
- Rights held by a lessee under licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights as per IND AS 38.

NOTE: A lessee may, but is not required to, apply Ind AS 116 to leases of intangible assets other than those described herein.

2. EXEMPTIONS FROM APPLYING IND AS 116

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

- Short-term leases; and
- Leases for which the underlying asset is of low-value

A. SHORT-TERM LEASES

☞ It is a lease that at the commencement date has a lease term of 12 months or less and does not include an option to purchase / renewal (beyond 12 months) the underlying asset.

☞ In case there is an option of renewal (beyond 12 months) at the commencement date:

- Such Option is Reasonably Certain to be exercised – Not a Short-Term Lease
- Option is NOT Reasonably Certain to be exercised – Short Term Lease

☞ The short-term lease exemption can be made by class of underlying asset to which the right of use relates.

B. LEASES OF LOW-VALUE ASSETS

☞ Ind AS 116 does not explicitly define low-value assets, it provides the conditions based on

which an asset can be treated as of low-value:

It can be low value ONLY IF BOTH the following conditions are satisfied:

- The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; AND
- The underlying asset is not highly dependent on, or highly interrelated with, other assets

☞ The election for leases of low value can be made on a lease-by- lease basis.

(For example, an entity enters into a rental contract for a large number of laptops. Entity has considered that the value of individual laptop would be low, even though the contract for all the laptops is not. The conditions of Ind AS 116 are satisfied i.e., the entity can benefit from use of an individual laptop together with other resources that are already available. Consequently, each laptop qualifies as a low value asset)

☞ A lease of an underlying asset does not qualify as a lease of low value asset if the nature of the asset is such that, when new, the asset is typically not of low value. (For Example: leases of second hand / old cars would not qualify as leases of low-value assets because a new car would typically not be of low value.)

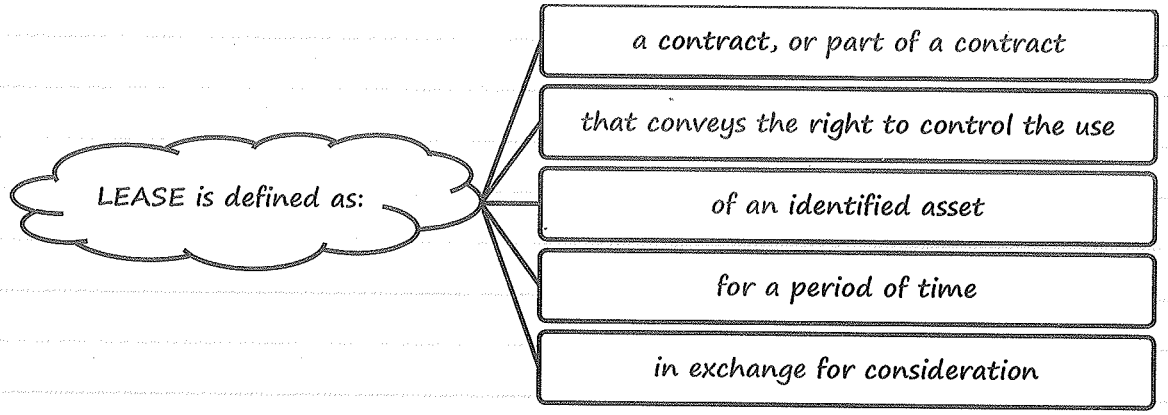
☞ Head leases do not qualify as low value assets:

If a lessee subleases or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset, i.e., an intermediate lessor who subleases or expects to sublease an asset, cannot account for the head lease as a lease of a low-value asset.

NOTE: If a lessee elects to apply the above recognition exemption, the lessee shall recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis.

3. WHAT IS A LEASE?

☞ IND AS 116 requires customers & suppliers to determine whether a contract is a lease at the INCEPTION of the contract.



4. KEY CONCEPTS RELATING TO THE DEFINITION OF LEASE

A. INCEPTION DATE

☞ The inception date is defined as the EARLIER of the following dates:

- Date of a lease agreement; OR
- Date of commitment by the parties to the principal terms & conditions of lease

B. COMMENCEMENT DATE

☞ It is the date on which a lessor makes an underlying asset available for use to the lessee.

☞ The timing of when lease payments begin under the contract does not affect the commencement date of the lease.

INCEPTION DATE	COMMENCEMENT DATE
•Date when an entity shall assess if the contract contains a lease or not.	•Date when a lessee initially recognises a lease liability and ROU Asset AND a lessor (for finance leases) initially recognises its net investment in the lease (i.e. Date when Accounting starts)

C. RIGHT TO CONTROL

☞ To assess whether a contract conveys the right to control the use of an identified asset an entity shall assess whether, the customer has both of the following:

a) The right to obtain substantially all of the economic benefits from use of the identified asset; and

b) The right to direct the use of the identified asset

a) RIGHT TO OBTAIN SUBSTANTIALLY ALL OF THE ECONOMIC BENEFITS:

☞ A customer can obtain economic benefits either directly or indirectly. Economic benefits from use of an asset include:

- the asset's primary outputs,
- any by-products (for e.g., renewable energy credits that are generated through the use of the asset),
- benefits from subleasing the aasset,

b) RIGHT TO DIRECT THE USE OF THE IDENTIFIED ASSET

☞ The customer (lessee) has the right to direct the use if substantial decisions about how and for what purpose an asset will be used is taken by the customer.

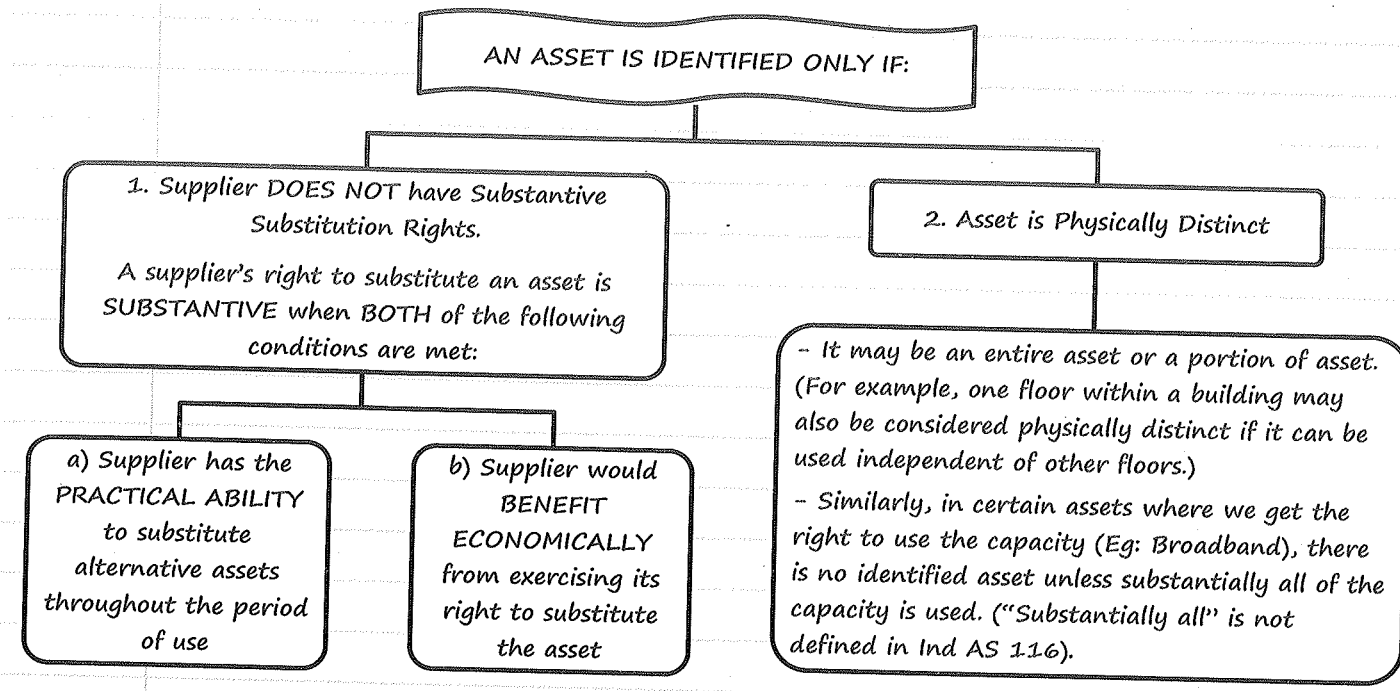
☞ In some arrangements, decisions related to how and for what purpose an asset is used, are already specified (pre-determined) in the contract before the lease term commences.

☞ A supplier's protective rights, DO NOT prevent the customer from having the right to direct the use of an identified asset. Protective rights are intended to protect a supplier's interests (for e.g., compliance with laws and regulations) and might take the form of a specified maximum amount of asset use, a restriction on where an asset may be used or a requirement to follow specific operating instructions.

D. IDENTIFIED ASSET

☞ An arrangement only contains a lease if there is an identified asset. An identified asset can be:

- Explicitly specified in a contract; OR
- Implicitly specified at the time that the asset is made available for use by the customer.



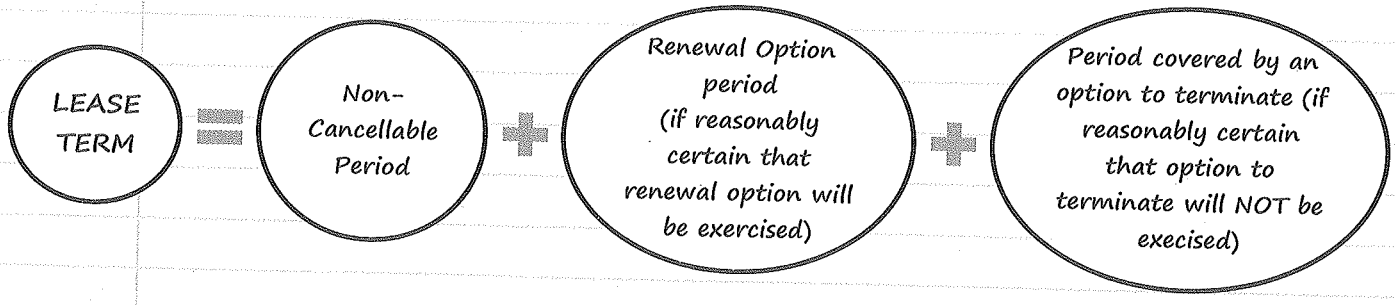
❖ NOTE:

☞ If supplier is required to substitute alternative assets only when the underlying asset is not operating properly (for e.g., a normal warranty provision) do not create a substantive substitution right.

☞ Ind AS 116 further clarifies that a customer should presume that a supplier's substitution right is not substantive when the customer cannot readily determine whether the supplier has a substantive substitution right.

E. LEASE TERM

☞ In simple terms, lease term is the summation of the following:



☞ The lease term begins at the lease commencement date and the assessment of whether a lessee will exercise an extension or termination option should be done on lease commencement date.

❖ CANCELLABLE LEASES:

☞ Any non-cancellable periods in contracts that meet the definition of a lease are considered part of the lease term.

☞ In case the contract of lease is cancellable at any time or after the end of the non-cancellable term, then:

If both lessee & lessor can terminate without any significant penalty	If only the lessor has the right to terminate a lease	If only the lessee has the right to terminate a lease
•Then there are no enforceable rights and obligations (i.e. no contract) beyond the non-cancellable term (i.e., the lease term is limited to the non-cancellable term)	•The period covered by the option to terminate the lease is included in the non-cancellable period of the lease (as lessee has an obligation to make the payments);	•The period covered by the option to terminate the lease is included if lessee has economic incentive to continue (i.e. not terminate) & exclude in case lessee has no economic incentive to continue.

EXAMPLE

Suppose the term of a contract is 10 years and the non-cancellable / lock-in period is 6 years. The lease term shall be as follows:

If the termination option is with 'Lessor'	If the termination option is with 'Lessee'	If the termination option is with 'Both' (i.e. any party can terminate)

The lease term shall be 10 years. Reason: Because even after 6th year, the lessee would be contractually bound to make the payment until 10th Year and also, has right to use the asset until 10th year, unless lessor terminates the contract.	The lease term shall be 10 years, assuming reasonable certainty. Reason: Because after the expiry of 6th year, though the lessee is not contractually bound till 10th year, but it is assumed that lessee is reasonably certain that it will not exercise this option to terminate. Lease term will be 6 years in case lessee has no economic incentive to continue	The lease term shall be 6 years. Reason: Because after 6th year either party can terminate the contract without consent of other party and hence contract is not enforceable after 6th year provided there is insignificant/no penalty for termination.

❖ LEASE TERM FOR NON-CONSECUTIVE PERIODS

☞ This is seen in when sports teams lease a sports stadium for particular non-consecutive days of the year. In these arrangements, the lease term is the aggregate of the non-consecutive periods.

❖ REASSESSMENT OF LEASE TERM AND PURCHASE OPTIONS

☞ An entity is required to reassess the lease term upon the occurrence of either a significant event OR a significant change in the circumstances.

F. LEASE PAYMENTS

☞ Lease payments are defined as payments made by a lessee to a lessor.

☞ They comprising the following:

1. Fixed payments (including in-substance fixed payments), LESS any lease incentives
2. Variable lease payments that depend on an index or a rate
3. Exercise price of a purchase option if the lessee is reasonably certain to exercise that option
4. Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease
5. For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees
6. For the lessors, lease rentals includes residual value guarantees provided by the lessee, a party related to the lessee or a third party unrelated to the lessor

☞ Exclusion of payments for calculating lease liability:

- Payments allocated to non-lease components (unless lessee opts for using Practical Expedient to not to separate non-lease component)
- Variable lease payments that do not depend on index or rate

i) Fixed lease payments

☞ They refer to a determinable amount to be paid which can be either be a equal each year (Example: 5 year equipment lease with annual payments of ₹ 20,000) or they can be payments that change over time (Example: lease payments of ₹ 20,000 per month at lease commencement that increase annually by ₹ 2,500 per month).

ii) In-substance fixed lease payments

☞ These are payments that may in form contain variability but, in substance, are unavoidable. Examples may include:

- If there is more than one set of payments, but only one of those sets of payments is realistic. In such a case, consider the realistic set to be lease payments.
- If there is more than one realistic set of payments, but it must make at least one of those sets of payments. In such a case, consider lowest set of payment to be lease payments.

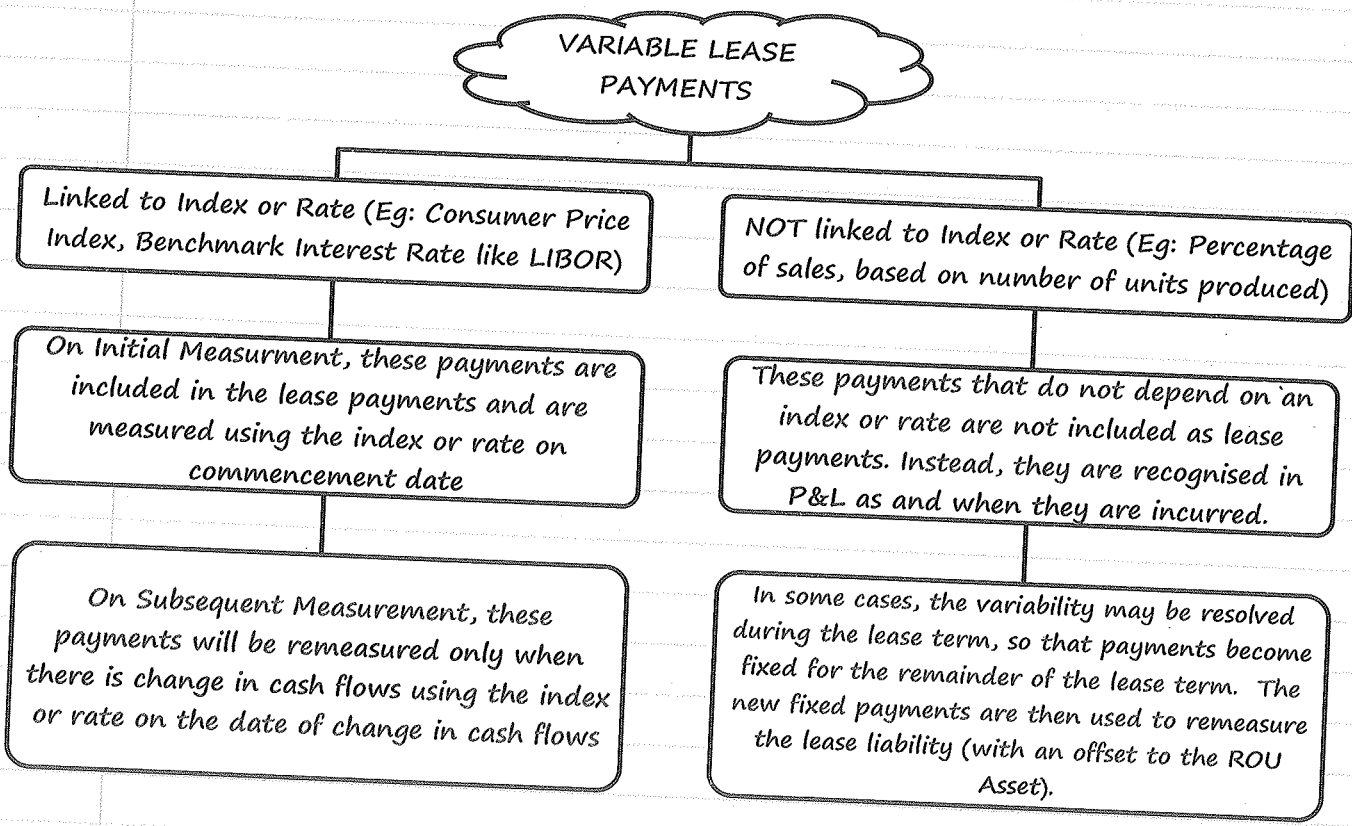
iii) Lease incentives

☞ These are payments made by lessor to a lessee
(Example: signing bonus, reimbursement of costs incurred by lessee such as moving, transportation expenses etc.)

☞ These payments reduce the cash outflow for the lessee, they are deductible from lease payments.

iv) Variable lease payments

☞ These payments that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.



v) Exercise price of a purchase option

☞ If the lessee is reasonably certain to exercise a purchase option, the exercise price is included as a lease payment.

vi) Penalties for terminating a lease

☞ If it is reasonably certain that lessee will not terminate a lease, any termination penalty is excluded from the lease payments. Otherwise, the lease termination penalty is included as a lease payment.

vii) Guaranteed Residual Value (GRV)

FOR LESSEE	FOR LESSOR
•A lessee may provide a guarantee to the lessor that the value of the underlying asset it returns to the lessor at the end of the lease will be at least of a specified amount. •For a lessee, lease payments include amounts expected to be payable by the lessee under GRV.	Ind AS 116 requires lessors to include in the lease payments any GRV provided to the lessor by: ▪the lessee, ▪a party related to the lessee; OR ▪a third party unrelated to the lessor.

G. INITIAL DIRECT COSTS

☞ 'Initial direct costs' are defined as the incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained.

H. DISCOUNT RATES

☞ Discount rates are used to determine the present value of the lease payments, which are used to determine Right of Use asset and Lease liability in case of a lessee and to measure a lessor's net investment in the lease

☞ For a Lessee

- 1st Priority – Interest Rate Implicit in the Lease (i.e. Lessor's IRR)
- 2nd Priority – Lessee's Incremental Borrowing Rate.

☞ For a Lessor

- Interest rate implicit in the lease (i.e. Lessor's IRR)

5. SEPARATION OF LEASE AND NON-LEASE COMPONENTS

A. Identifying and separating multiple lease components

☞ A contract might contain rights to use multiple assets (for e.g., a building and an equipment, multiple pieces of equipment, etc.). The right to use each such asset is considered as a 'separate' lease component ONLY IF BOTH the following conditions are satisfied:

a) The lessee can benefit from the use of the asset either on its own OR together with other resources that are readily available to the lessee; AND

b) The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract

☞ If one or both of these criteria are not met then, the right to use multiple assets is considered a 'single' lease component, i.e., not a 'separate' lease component.

B. Separating lease components from non-lease components

☞ There may be many contracts containing a lease coupled with an agreement to purchase or sell other goods or services. Such other goods or services may be non-lease components.

☞ The non-lease components are identified and accounted for separately from the lease component in accordance with other standards.

EXAMPLE

- A supplier may lease a truck and also provide a driver. Only the use of the truck is considered a lease component.

NOTE: Costs related to property taxes and insurance DO NOT involve the transfer of a good or service. Consequently, if these costs are fixed in the contract, they should be included in the overall contract consideration to be allocated to the lease and non-lease components.

❖ Optional exemption of using Practical Expedient to not to separate non-lease component

☞ Optional exemption of using Practical Expedient to not to separate non-lease component is available to the lessee. This expedient is not available for lessors.

☞ Lessees that make this policy election, will allocate ALL consideration to lease component.

NOTE: Practical expedient does not allow lessees to account for multiple lease components of a contract as a single lease component.

C. Allocating the consideration in the contract

☞ Allocate the consideration to the lease and non-lease components on a relative stand-alone price basis (provided in case of lessee if he does not opt for practical expedient)

6. CONTRACT COMBINATIONS

☞ Ind AS 116 requires that two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty) be considered a 'single' contract IF ANY ONE of the following criteria is met:

- The contracts are negotiated as a package; OR
- The amount of the consideration to be paid in one contract depends on the price or performance of the other contract; OR
- All or some of the Rights to use the assets in each of the contract are a single lease component.

7. LESSEE ACCOUNTING

☞ At the commencement date, a lessee shall recognise a ROU Asset and a Lease Liability (except for short-term leases and leases of low-value assets, if they choose to apply such exemptions).

Journal Entry:
ROU Asset A/c Dr.
To Lease Liability A/c

A. INITIAL RECOGNITION AND MEASUREMENT	
LEASE LIABILITY	ROU ASSET
▪ Lease Liability is measured at present value the remaining lease payments Note: Lease payments used in measuring the lease liability are amounts due to the lessor excluding any payments that a lessee makes before lease commencement.	▪ A lessee initially measures the ROU Asset at COST, which consists of ALL of the following: Initial Measurement of lease liability (+) Payments made before commencement Date (-) Lease Incentives received before commencement Date (+) Initial Direct Cost (IDC) incurred by lessee (+) PV of Decommissioning / site restoration = INITIAL COST OF ROU ASSET
B. SUBSEQUENT MEASUREMENT	

LEASE LIABILITY	ROU ASSET
▪ A Lease Liability should be accounted in a manner similar to other financial liabilities (i.e. on an amortised cost basis). ▪ Thus, after the commencement date, a lessee shall measure the lease liability by: a) increasing the carrying amount to reflect interest on the lease liability; b) reducing the carrying amount to reflect the lease payments made; and c) remeasuring the carrying amount to reflect any reassessment or lease modifications (Discussed Later)	▪ After the commencement date, ROU asset should be measured using a cost model, unless it applies the revaluation model as specified under Ind AS 16. ▪ <u>Cost model for ROU Assets:</u> Initial Measurement of ROU Asset (at cost) (-) Accumulated depreciation (-) Accumulated impairment losses and (+/-) Adjusted for re-measurements of the lease liability due to reassessment / lease modification (Discussed Later) <u>Depreciation for ROU assets</u> ROU Assets should be depreciated over the lease term. In case purchase option is expected to be exercised by lessee, then it should be depreciated over entire useful life. <u>Revaluation model for ROU assets:</u> A lessee may elect to apply revaluation model to all ROU assets that relate to that class of PPE. However, if ROU assets meet the definition of investment property, then, revaluation model cannot be applied.

C. <u>LEASES DENOMINATED IN A FOREIGN CURRENCY</u>

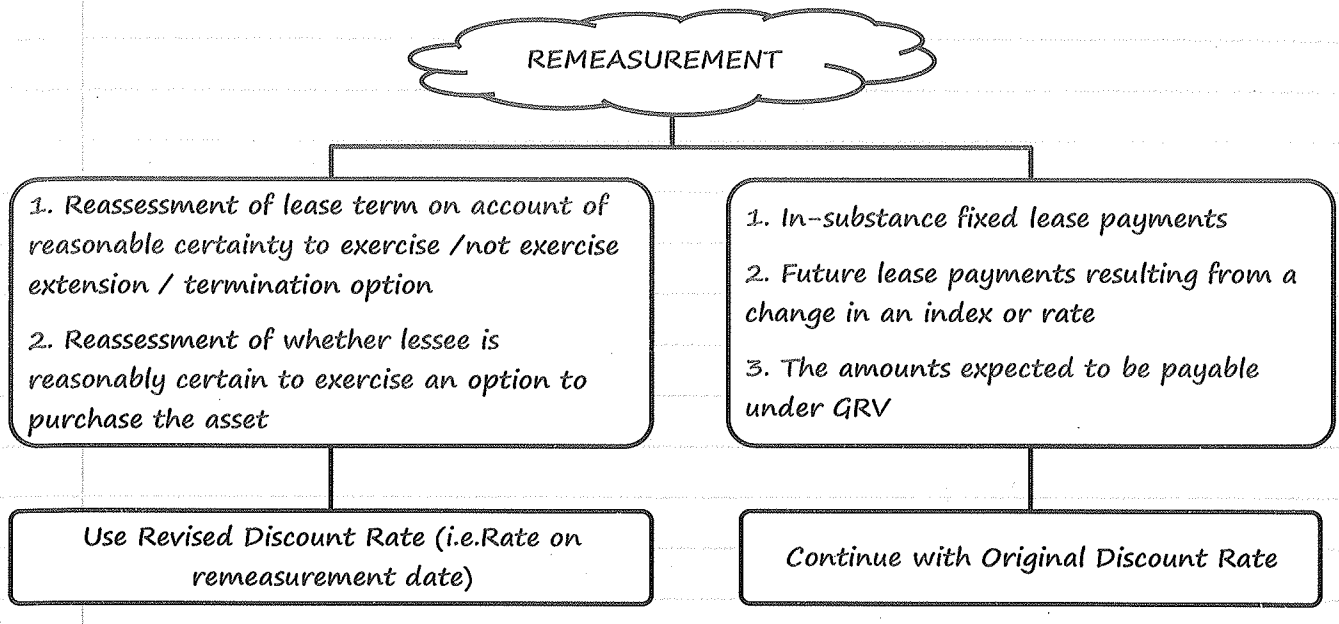
☞ Lessees apply Ind AS 21, to leases denominated in a foreign currency.

☞ Lease Liabilities – Lessees remeasure the foreign currency-denominated lease liability using Closing Rate, like monetary liabilities. Any changes due to exchange rate changes are recognised in P/L.

☞ ROU Assets – It is a non-monetary asset which is to be measured at historical cost, it is not affected by changes in the exchange rate.

D. <u>REMEASUREMENT</u>

☞ Ind AS 116 requires lessees to REMEASURE LEASE LIABILITIES upon a change in lease payments on account of ANY of the following (other than lease modification):



☞ Accounting Entry to give the effect of Remeasurement

i) If Remeasurement results in Increase in Lease Liability

ROU Asset A/c Dr.

To Lease Liability

ii) If Remeasurement results in Decrease in Lease Liability

Lease Liability A/c Dr.

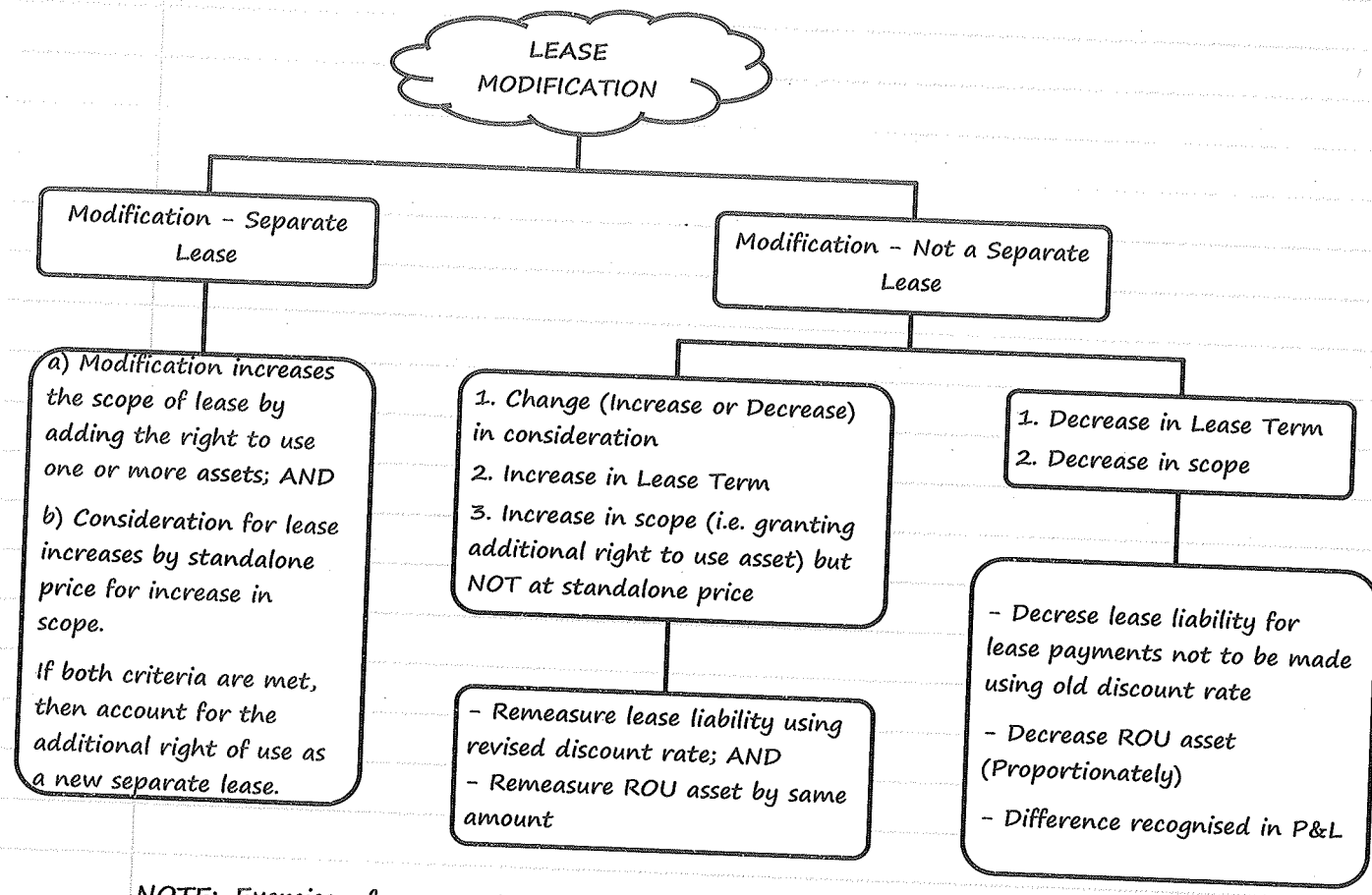
To ROU Asset A/c

NOTE: However, if the carrying amount of the ROU Asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee recognises any remaining amount of the remeasurement in profit or loss.

E. LEASE MODIFICATIONS ACCOUNTING FOR LESSEE

☞ A 'lease modification' is a change in scope or consideration for a lease, that was not part of original terms & conditions of lease (for e.g., adding or terminating the right to use one or more assets, leasing additional space in the same building, extending or shortening lease term, etc).

☞ Modification can involve: Change in Consideration, Change in Tenure, Change in Scope



NOTE: Exercise of an purchase or renewal option or a change in assessment of whether option is reasonably certain to be exercised are not lease modifications but can result in the remeasurement of Lease Liabilities and ROU Assets (Remeasurement – as discussed above).

8. LESSOR ACCOUNTING

☞ A 'lessor' is defined as an entity that provides the right to use an underlying asset for a period of time in exchange for consideration.

A. CLASSIFICATION

☞ At inception, lessors classify all leases as FINANCE LEASE or OPERATING LEASE.

FINANCE LEASE	OPERATING LEASE
•It is defined as a lease where substantially all the risks and rewards incidental to ownership of an underlying asset are transferred to the lessee.	•It is defined as a lease that DOES NOT transfer substantially all the risks and rewards incidental to ownership of an underlying asset. (i.e. Lease other than a Finance Lease)

❖ INDICATORS OF FINANCE LEASE

Ind AS 116 lists a number of indicators that individually, or in combination, would normally lead to a lease being classified as a FINANCE LEASE:

i) Ownership: Lease transfers ownership of asset to lessee by the end of lease term

ii) Purchase option: Lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date option becomes exercisable

iii) Lease term: The lease term is for major part of the economic life of the asset even if title is not transferred

iv) PV of Minimum Lease Payments: The present value of lease payments substantially covers fair value of the asset. (The term "substantially all" is not defined in Ind AS 116)

v) Specialised Nature: The asset is of such a specialised nature that only the lessee can use it without major modifications

NOTE: Lessors are required to reassess the lease classification ONLY IF there is a lease modification. If a lease modification results in a separate new lease, that new lease would be classified in the same manner as any new lease.

B. ACCOUNTING IN THE BOOKS OF LESSOR

PARTICULARS	OPERATING LEASE	FINANCE LEASE
1. Initial Measurement	No Entry	Lease Receivable A/c Dr. (Net Investment) To Asset A/c (At Carrying Amount) (Difference if any will be transferred to P&L)

2. Subsequent Measurement	<u>Recognise Depreciation</u> Depreciation A/c Dr. To Asset A/c <u>Recognise Lease Rent Income</u> Bank A/c Dr. Deferred Rent A/c Dr. To Rent Income A/c (Lease Rent are to be recognised on SLM Basis unless another basis is more representative)	<u>No Depreciation</u> <u>Recognise Finance Income</u> Lease Receivable A/c Dr. To Finance Income (P&L) A/c (using the interest rate implicit in the lease). <u>Receive Lease Payment</u> Bank A/c Dr. To Lease Receivable A/c
3. Initial Direct Cost	Initial direct costs are included in the carrying amount of underlying asset in an operating lease.	Initial direct costs are included in the initial measurement of the finance lease receivable which reduces the amount of income recognised over the lease term.
4. Variable Lease Payments that do not depend on an index or rate	Recognise income from variable lease payments that do not depend on an index or rate (e.g., performance- or usage- based payments) in the period in which that income is earned	Recognise income from variable lease payments that are not included in the net investment in the lease (e.g., performance- or usage-based variable payments) in the period in which they are earned.

❖ <u>KEY CONCEPTS APPLIED BY THE LESSOR:</u>

i) <u>GROSS INVESTMENT</u>

= Lease payments receivable + Unguaranteed residual value (UGRV)

ii) <u>UNGUARANTEED RESIDUAL VALUE</u> (UGRV)

= Expected Residual Value (-) Guaranteed Residual Value

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

iii) <u>NET INVESTMENT</u>

= Present Value of Gross Investment (i.e. PV of Lease Payments + PV of UGRV)

iv) <u>UNEARNED FINANCE INCOME</u>

= Gross Investment (-) Net Investment

NOTE:

- Discount rate used should be the interest rate implicit in the lease (IRR of Lessor) i.e. Rate at which PV of (LP + UGRV) should be equal to Fair Value at inception
- A lessor shall review regularly estimated UGRV. If there is reduction in UGRV, it shall be considered. Increase in UGRV from original estimate shall be ignored.

C. FINANCE LEASES WHERE LESSOR IS A MANUFACTURER OR DEALER

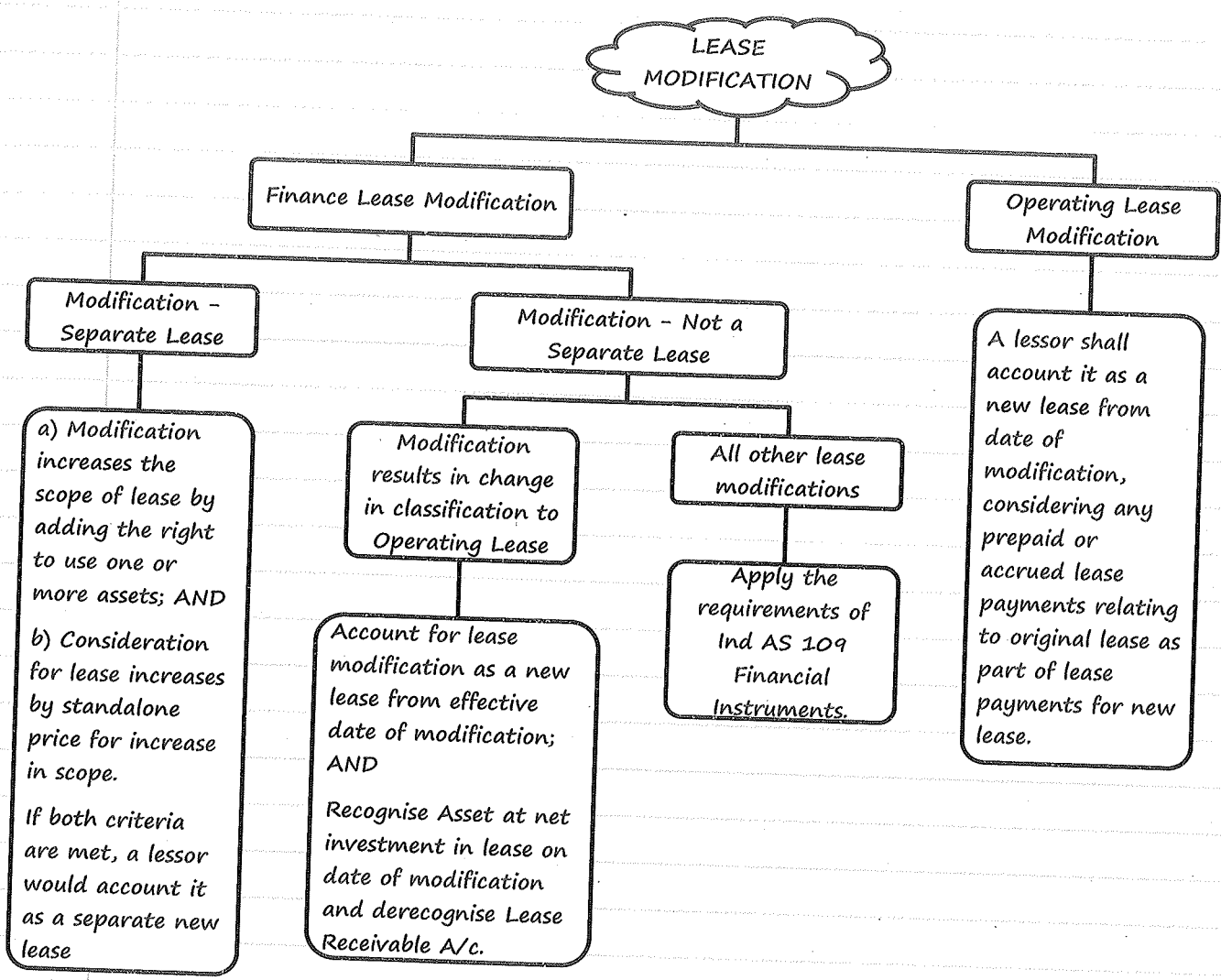
- At lease commencement (i.e. initial measurement), a manufacturer or dealer lessor recognises the following:

1. Revenue should be recorded based on the lower of fair value of the asset or the Present Value of Lease Payments (excluding UGRV).
2. The COGS will be calculated as (Cost (-) PV of UGRV)
3. The difference will be shown as selling profit (Gross Profit). The presentation of profit on sale of inventory is generally presented by showing the revenue & COGS separately & hence the above-mentioned numbers need to be calculated
4. Any Initial direct cost incurred by a manufacturer / dealer is to be expensed to P&L immediately as it attributable to sales

- Subsequent Measurement in case of Finance Lease where lessor is a manufacturer or dealer remains the same (as discussed above)

D. LEASE MODIFICATIONS ACCOUNTING FOR LESSOR

- A 'lease modification' is a change in scope or consideration for a lease, that was not part of original terms & conditions of lease (for e.g., adding or terminating the right to use one or more assets, or extending or shortening lease term).



E. LEASE CLASSIFICATION TEST FOR LAND AND BUILDINGS

- For a lease that includes both land & buildings, lessor separately assesses classification of each element as a finance lease or an operating lease, as land normally has an indefinite economic life.
- The lessor allocates lease payments between land & buildings in proportion to their relative fair values at inception date. If lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, UNLESS it is clear that both elements are operating leases, in which case, the entire lease is classified as an operating lease.

☞ If amount for land element is immaterialto lessee, the lessor may treat land & buildings as a single unit for purpose of lease classification and classify it as a finance lease or an operating lease. In such a case, the lessor regards the economic life of the buildings as the economic life of the entire underlying asset.

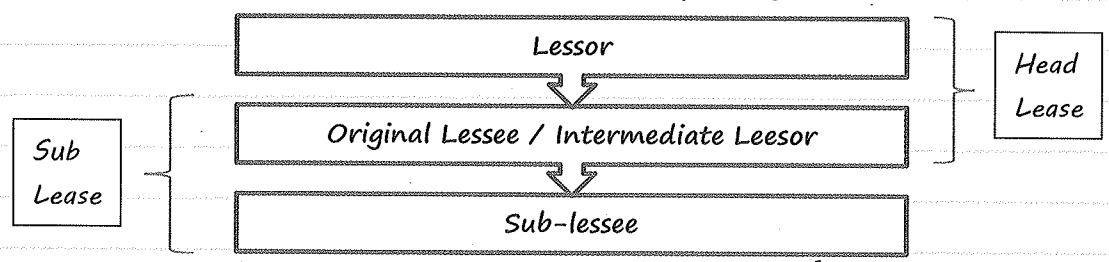
9. SUB-LEASES

A. MEANING

☞ A 'Sub-lease' is defined as a transaction for which an underlying asset is re-leased by a lessee to a third party.

☞ The original lease is often referred to as a 'head lease', the original lessee is often referred to as an 'intermediate lessor' or 'sub-lessor' and the ultimate lessee is often referred to as the 'sub-lessee'.

☞ It can be demonstrated with the help of a following simple diagram:



B. INTERMEDIATE LESSOR ACCOUNTING

☞ The intermediate lessor accounts for the sublease as follows:

If sublease is classified as a 'Finance Lease'	If sublease is classified as an 'Operating Lease'
•The original lessee (intermediate lessor) derecognises the ROU Asset on the head lease and recognises •Journal Entry Lease Receivable A/c Dr. To ROU Asset A/c To Gain (P&L) •Original lease liability is NOT derecognised.	•The original lessee continues to account for lease liability and ROU asset on the head lease (i.e. No entry at the time of sub-lease) •Recognise Sub Lease Rent on SLM Basis

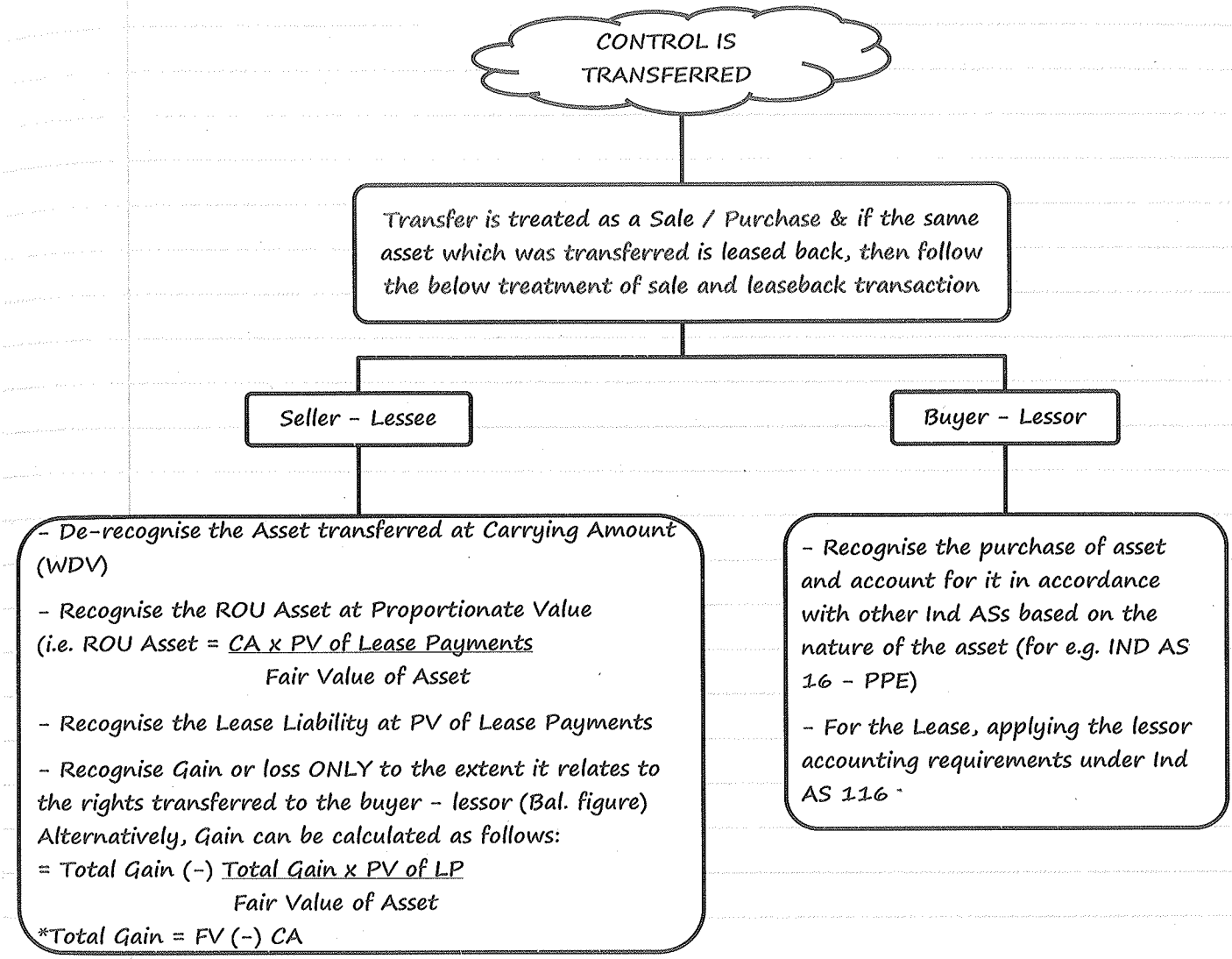
NOTE:

- While assessing the sub-lease as an operating of finance lease, we will compare the lease term with the life of the ROU Asset (Original Lease Term), and not with the life of the underlying asset.
- When the head lease is a short-term lease, the sublease is classified as an operating lease. This is because the Intermediate lessor has not recognised any ROU Asset and Lease Liability in its books under Head Lease. Therefore, intermediate Lessor can never show the sub-lease as Finance Lease.

10. SALE AND LEASEBACK TRANSACTIONS

- A sale and leaseback transaction involves the transfer of an asset and leaseback of the same asset. In this situation, a seller becomes a lessee and a buyer becomes a lessor.
- There are two transactions involved in this:
  - Sale of Asset by Seller Lessee to Buyer Lessor
  - Lease Transaction
- Thus, there are following two possibilities in this scenario:
  i) Control is transferred
  ii) Control is NOT transferred

i) TREATMENT OF SALE & LEASEBACK TRANSACTION WHEN CONTROL IS TRANSFERRED



❖ SALE & LEASEBACK AT OFF MARKET TERMS

☞ There may be cases where the transaction is not at market terms (i.e. Selling Price may be more than or less than Fair Value OR the Lease Payments are not at market rates. In such case an adjustment has to be made for:

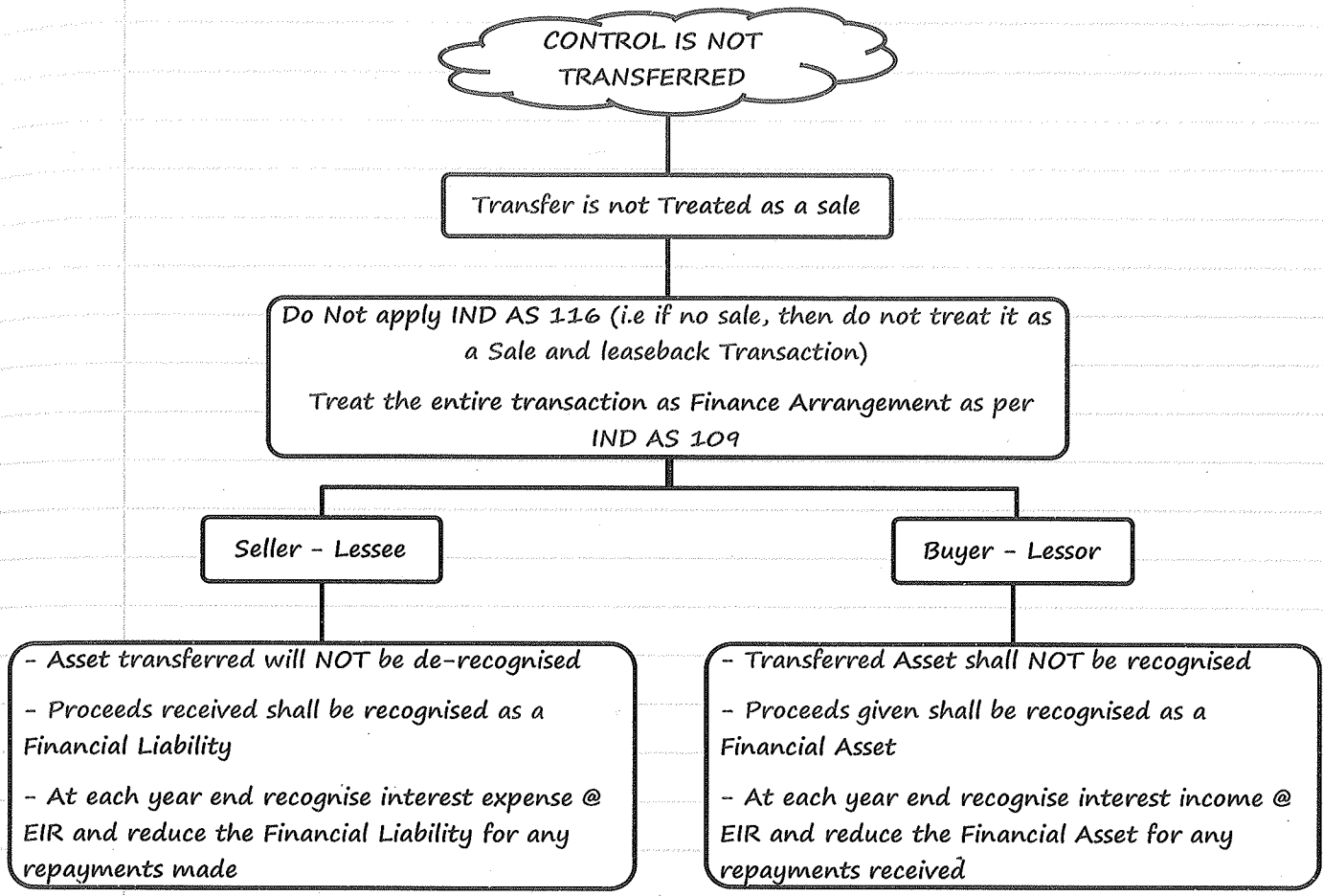
- The difference between selling price and fair value; OR
- The difference between present value of contractual lease payment and the present value of fair lease payments

} Whichever is more readily determinable

When Sale price or Present Value is LESS	When Sale price or Present Value is

	GREATER
▪ A seller-lessee recognises the difference as an increase to the sales price and increase the initial measurement of the ROU asset as a 'lease prepayment'. ▪ Buyer-lessors are required to increase the purchase price of asset and recognise a liability (in the nature of advance received) as 'lease prepayments' received from the seller-lessee.	▪ A seller-lessee recognises the difference as a reduction in the sales price and recognise an 'additional financing received' (a Financial liability) from the buyer-lessor. ▪ Buyer-lessors are required to reduce the purchase price of asset and recognise a financial asset in the nature of 'additional financing provided' to the seller-lessee. Note: The total annal lease payment to be made by lessee shall be bifurcated into two parts (as such lease payment are more than the market lease rent rates): 1. Real Lease Payments p.a. 2. Repayment of Excess funding by buyer lessor

ii) TREATMENT OF SALE & LEASEBACK TRANSACTION WHEN CONTROL IS NOT TRANSFERRED



11. TRANSITION APPROACH

☞ An entity shall apply Ind AS 116 for annual reporting periods beginning on or after 01 April 2019.

☞ Thus, Ind AS 116's transition provisions are applied at the beginning of the annual reporting period in which the entity first applies Ind AS 116 (i.e., the date of initial application). For e.g., an entity with a reporting date of 31 March 2020, applies the transition provisions on 01 April 2019.

NOTE: There is a practical expedient provided which permits lessees and lessors to make an election of not reassessing whether existing contracts contain a lease as defined under Ind AS 116. Further, if an entity chooses to apply the practical expedient, it must be applied to ALL contracts (i.e., an entity is NOT permitted to apply the option on a lease-by-lease

basis).

A. TRANSITION OPTIONS FOR LESSEES

☞ A lessee is required to apply Ind AS 116 to its leases in either of the following ways:

i) Full Retrospective Approach

ii) Modified Retrospective Approach

i) Full Retrospective Approach

☞ Apply Retrospectively to each prior reporting period presented, applying Ind AS 8, i.e., an entity applies Ind AS 116 as if it had been applied since the inception.

☞ A restated opening balance sheet at 01 April 2018 will also need to be disclosed as required by Ind AS 1. Hence, the balance sheets for 3 Period will be presented: As at 31 March 2020, 31 March 2019 & 1 April 2018.

ii) Modified Retrospective Approach

☞ When applying the modified retrospective approach, a lessee does not restate comparative figures.

☞ A lessee recognises the cumulative effect of initially applying Ind AS 116 as an adjustment to the opening balance of retained earnings at the date of initial application.

Particulars	Leases Previously Classified as Operating Leases under IND AS 17	Leases Previously Classified as Finance Leases under IND AS 17
Value of Lease Liability	A lessee recognises a lease liability measured at PV of remaining lease payments, discounted using the rate at the date of application of transition provision.	Carrying amount of Liability (under IND AS 17) shall be taken as the carrying amount of lease liability.
Value of ROU Asset	A lessee measures the ROU asset on a lease-by-lease basis, at either: ▪ Alternative 1: The carrying amount as if Ind AS 116 had always been applied since the commencement date, but using a discount rate	The carrying amount of the leased asset (under IND AS 17) shall be taken as the carrying amount of the ROU Asset

	at the date of application of transition provision OR ▪ Alternative 2: An amount equal to the lease liability	

B. TRANSITION PROVISION FOR LESSORS

☞ A lessor is not required to make any adjustments on transition for leases and shall account for those leases applying Ind AS 116 from the date of initial application except in case of an 'Intermediate Lessor' (i.e. in case of sub-leases).

SIGNIFICANT DIFFERENCES BETWEEN IND AS 116 AND AS 19

Sr No	Particulars	Ind AS 116	AS 19
1	Lease definition	Under Ind AS 116, definition of lease is similar to that in AS 19. But, in Ind AS 116, there is substantial change. The changes primarily relate to concept of 'control' used in identifying whether a contract contains a lease or not. Ind AS 116 provides guidance on whether an arrangement contains a lease, identified asset, substantive substitution rights etc.	Guidance part in AS 19 given therein is different. AS 19, in general, considers right to use an identified asset. Also under AS 19 even if a lessor has substantial substitution right, contract may still be accounted for as a lease.
3.	Separation of lease & non-lease components	Ind AS 116 provides detailed guidance on whether there are non-lease / service components.	AS 19 does not contain any guidance. AS 19 requires accounting for entire contract without separating non-lease components.
3	Scope of Land	No such scope exclusion	Excludes leases of land from its scope
4	Definition	Makes a distinction between 'inception of lease' & 'commencement of lease'	No such distinction
5	Classification	Eliminates classification of leases into operating leases or finance leases for a lessee and introduces a single lessee accounting model which requires to recognise ROU & Lease Liability for all leases unless it applies recognition exemption (for leases of low value assets or short-term leases)	AS 19 requires a lessee to classify leases as either finance leases or operating leases
6	Sale & Leaseback transactions	In Ind AS 116, the approach for computation of gain/loss for a completed sale is different. The amount of gain/loss should reflect the amount that relates to the right transferred to the buyer-lessor.	As per AS 19, if a sale & leaseback transaction results in a finance lease, excess, if any, of sale proceeds over carrying amount shall be deferred and amortised by seller-- lessee over lease term in proportion to

			depreciation of leased asset.
		Also determine whether it is a sale as per IND AS 115. If not, then seller- lessee recognise a finance liability and buyer-lessor recognise a financial asset accounted as per Ind AS 109	AS 19 does not contain such specific requirement
7	Treatment of initial direct costs		
7A	Finance lease – Lessor accounting		
i)	Non- manufacturer/ non-dealer	Interest rate implicit in lease is defined in such a way that initial direct costs gets included automatically in finance lease receivable.	Either recognised as expense immediately or allocated against the finance income over lease term.
ii)	Manufacturer / dealer	Same as per AS 19	Recognised as expense immediately
7B	Operating Lease – Lessor accounting	Added to carrying amount of leased asset & recognised as expense over lease term on same basis as lease income.	Either deferred & allocated to income over lease term in proportion to recognition of rent income, or recognized as expense in the period in which incurred
8	Definition of Initial direct costs	Ind AS 116 define initial direct costs as 'Incremental costs' (eg: commissions, legal fees, incurred in negotiating & arranging a lease) that would not have been incurred if lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease.'	Different guidance given
9	Combining Contracts	IND AS 116 provides special guidance on combining contracts	AS 19 does not provide any guidance on combining contracts
10	Reassessment of Lease Term: .	IND AS 116 provides special guidance on Reassessment of Lease term	AS 19 does not contain any guidance on re-assessment or changes to lease term

11	Lease Modification from point of view of lessor	IND AS 116 provides special guidance on Lease Modification from point of view of lessor	AS 19 does not provide guidance on lease modifications
12	Presentation	As a consequence of single lease model for lessees, there are many changes in presentation in financial statements.	Different guidance given
13	Disclosure	There are a number of changes in the disclosure relating to qualitative aspects of leasing transactions. For eg. Entities are required to disclose nature & risks arising from leasing transactions.	Different guidance given

IND AS 102
SHARE BASED PAYMENTS

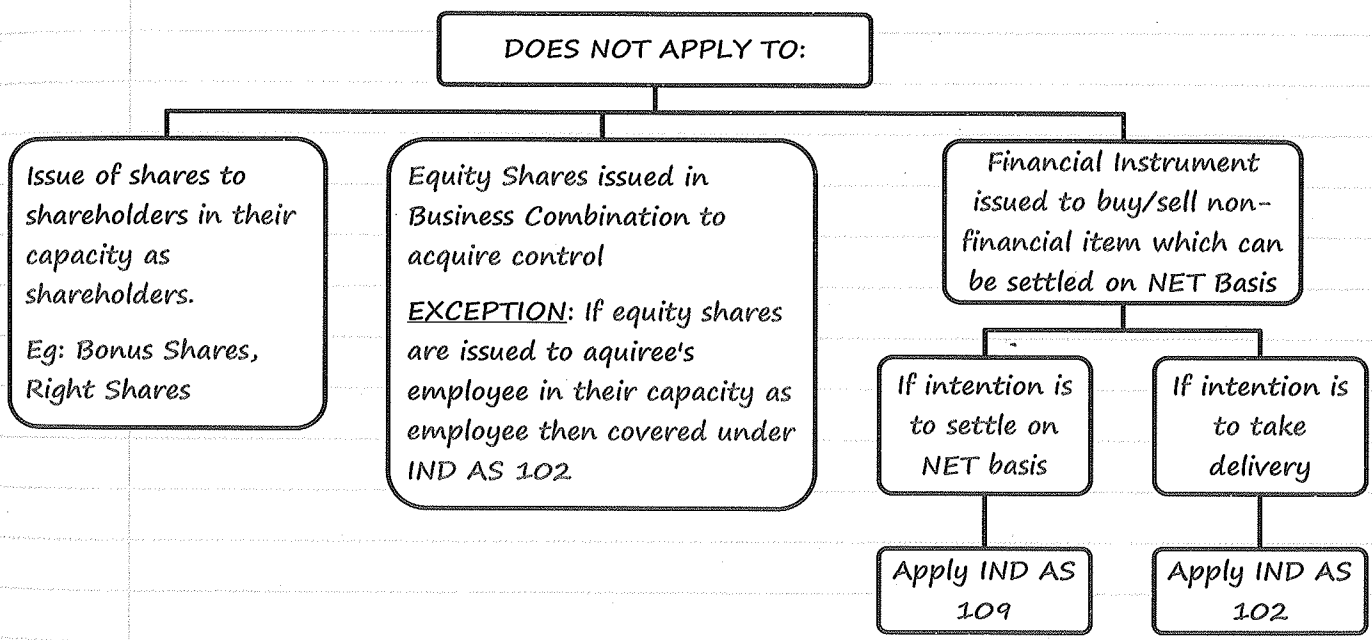
1. DEFINITION

☞ SBP is an agreement between the reporting entity and another party (including an employee) in which the entity is to receive goods or service against payment of:

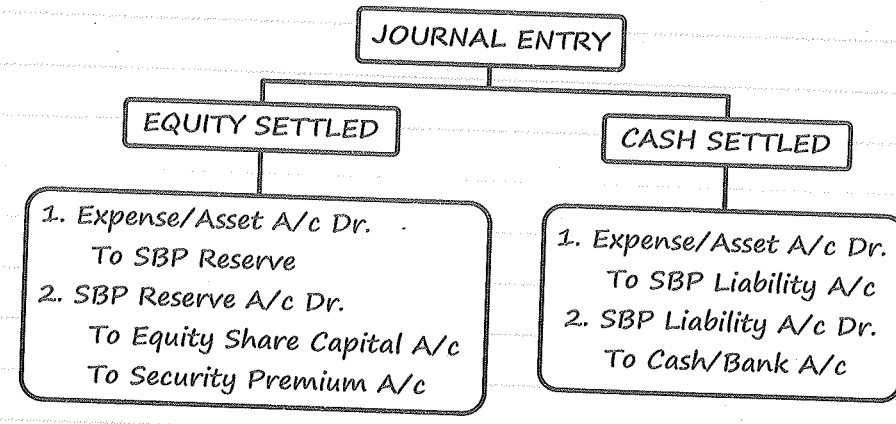
a) Shares of Reporting Entity – Equity Settled; OR

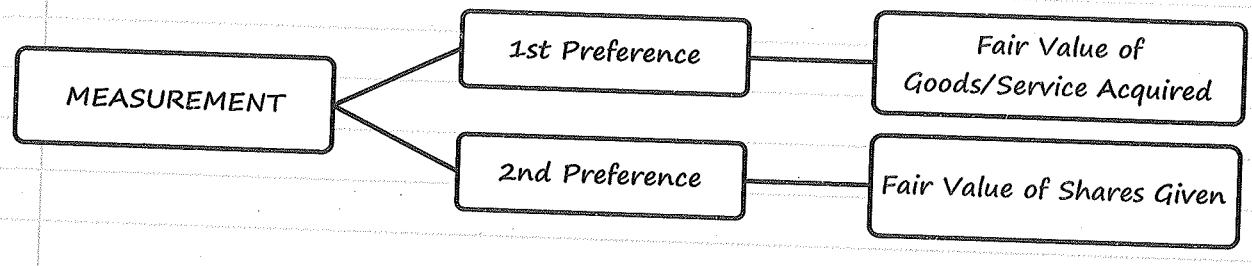
b) Cash that is based on the price of equity shares of the reporting entity – Cash Settled

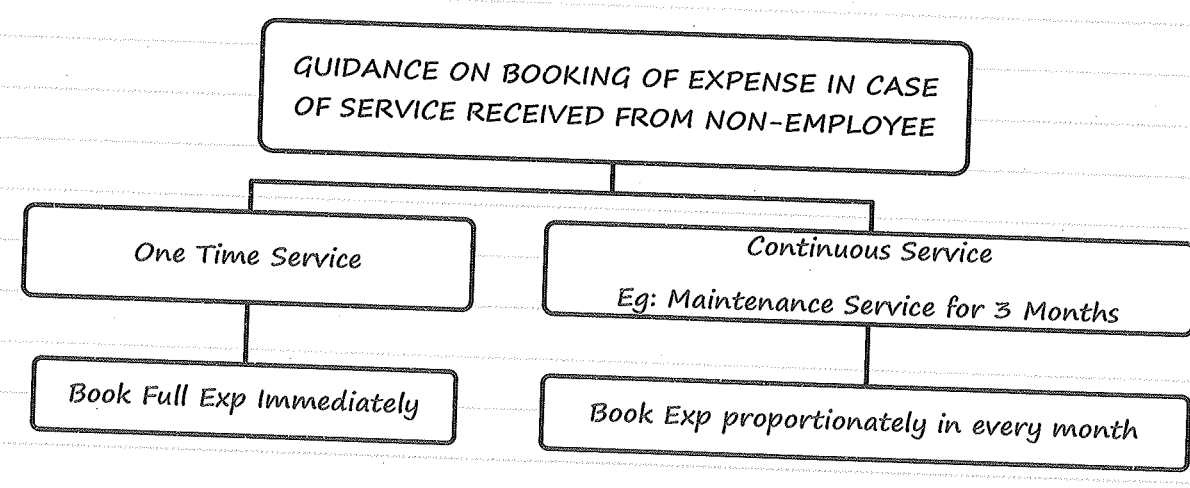
2. SCOPE



3. SHARE BASED PAYMENT WITH OTHER THAN EMPLOYEE / NON-EMPLOYEE







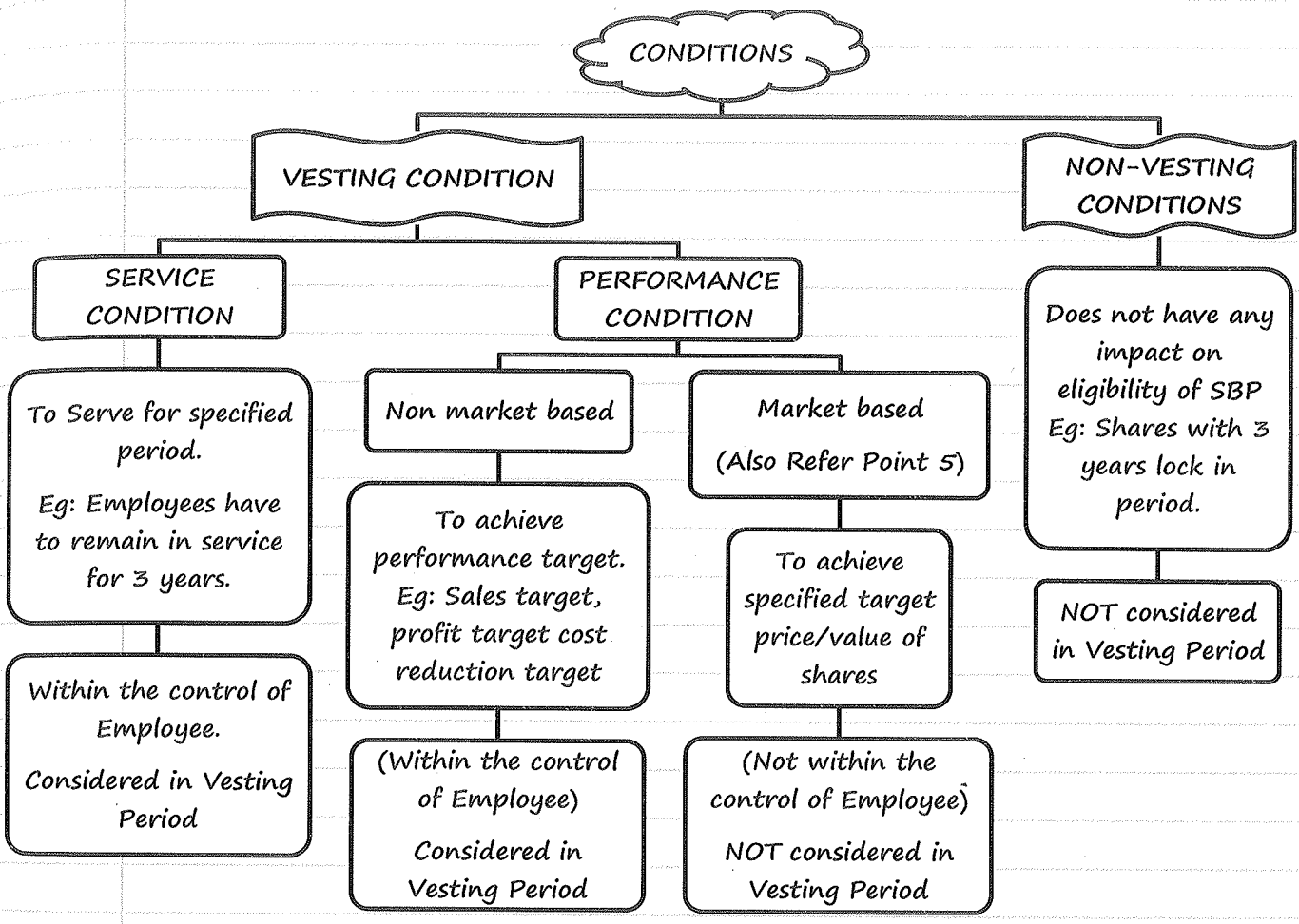
4. SHARE BASED PAYMENTS WITH EMPLOYEES (EQUITY SETTLED)

a) GRANT DATE

☞ Date on which the entity and another party (Including employee) agree to a share-based payment agreement. (i.e. date of such agreement)

NOTE: If agreement is subject to approval of appropriate authorities then grant date will be date of approval.

b) CONDITIONS



c) RECOGNITION & ALLOCATION OF EXPENSE

☞ SBP granted to employees are expense for the company which are to be recognised during the Vesting Period* Proportionately

*VESTING PERIOD - Period during which all specified vesting conditions are to be satisfied

☞ CALCULATION OF EXPENSE TO BE RECOGNISED EACH YEAR

$$\left\{\frac{\text{No. of employees expected to fulfil the conditions at each year end (x) No. of options (x) Fair Value of Options on GRANT DATE (x) Expired Period}}{\text{Total Vesting Period}}\right\}$$

(-) Expense Already recognised in Previous Years.

NOTE:

FAIR VALUE ON GRANT DATE is taken in case of Equity settled transactions

Fair Value changes post grant date are not considered (Only in case of Equity Settled Transactions)

JOURNAL ENTRIES

I. ON GRANT DATE

No Entry

II. AT THE END OF EACH YEAR DURING VESTING PERIOD

a) BOOKING OF EXPENSE

Employee Benefit Expense (P&L) A/c Dr.

To SBP Reserve (Other Equity) A/c

(Expense will be booked proportionately each year during the vesting period -Calculated as per the Above Formula)

b) REVERSAL OF EXPENSE (IF ANY) DURING THE VESTING PERIOD

SBP Reserve A/c

To Employee Benefit Expense A/c

(Also Refer Note 2 Given Below)

III. DURING EXERCISE PERIOD

a) ON EXERCISE OF OPTIONS BY EMPLOYEE

SBP Reserve A/c Dr.

To Equity Share Capital A/c

To Security Premium A/c (if any)

b) IF ANY OPTIONS LAPSE DURING EXERCISE PERIOD

SBP Reserve (Other Equity) A/c

To Retained Earnings (Other Equity) A/c

(Also Refer Note 2 Given Below)

NOTE:

IN CASE OF EQUITY SETTLED TRANSACTIONS:

1. Reversal of expense through P&L can be done only during the vesting period
2. Post vesting period, NO reversal of expense can be done through P&L. Only transfer

within equity can be done (i.e. transfer SBP Reserve to Retained Earnings)

5. MARKET BASED CONDITIONS

☞ Any change in market condition will have no effect on estimation of expense. We will Continue to record expense even if market conditions have failed i.e. expense cannot be reversed due to failure of Market conditions.

A. IF MARKET CONDITIONS ARE SATISFIED EARLIER THAN EXPECTED

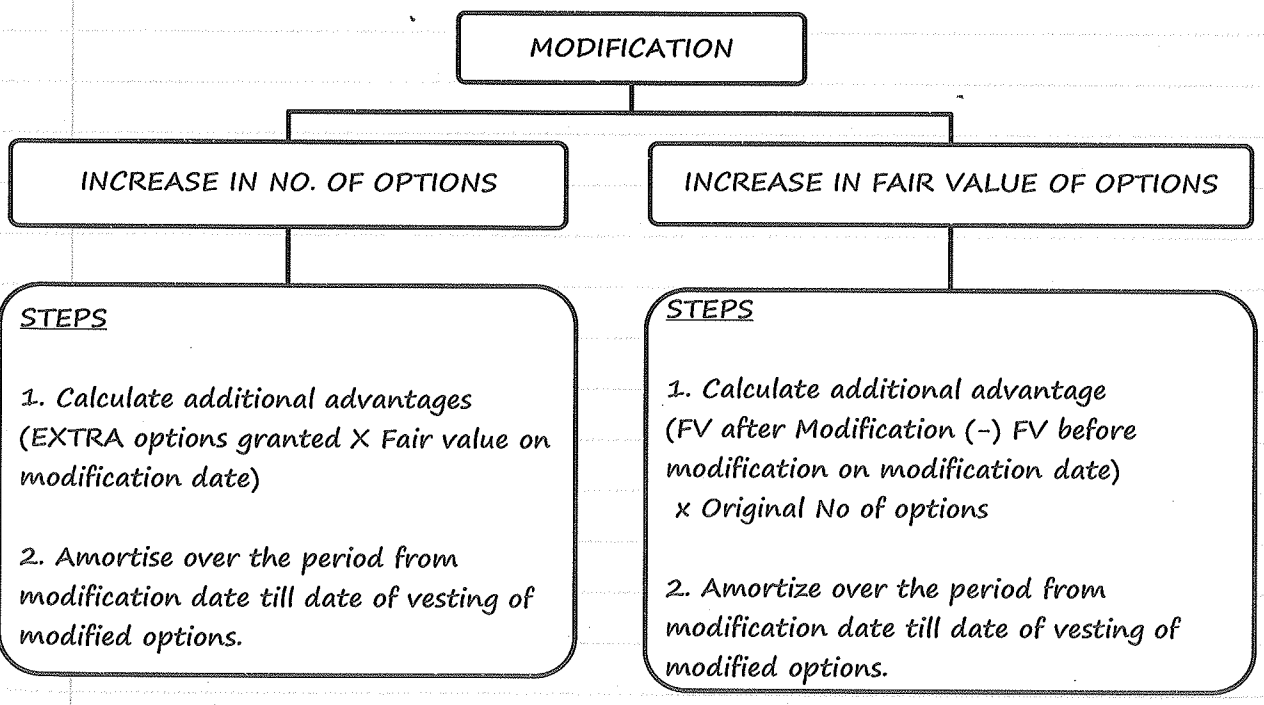
☞ Prospective expense of future years should be recognised in the year of vesting (Accelerated Expense)

B. IF MARKET CONDITIONS DELAY VESTING PERIOD.

☞ Recognition of expense should not be delayed i.e. expense should be recorded as planned.

NOTE: At the end if Market conditions is never fulfilled, then the balance in SBP reserve to will be transferred to Retained Earnings (i.e. transfer with in equity and not through P&L)

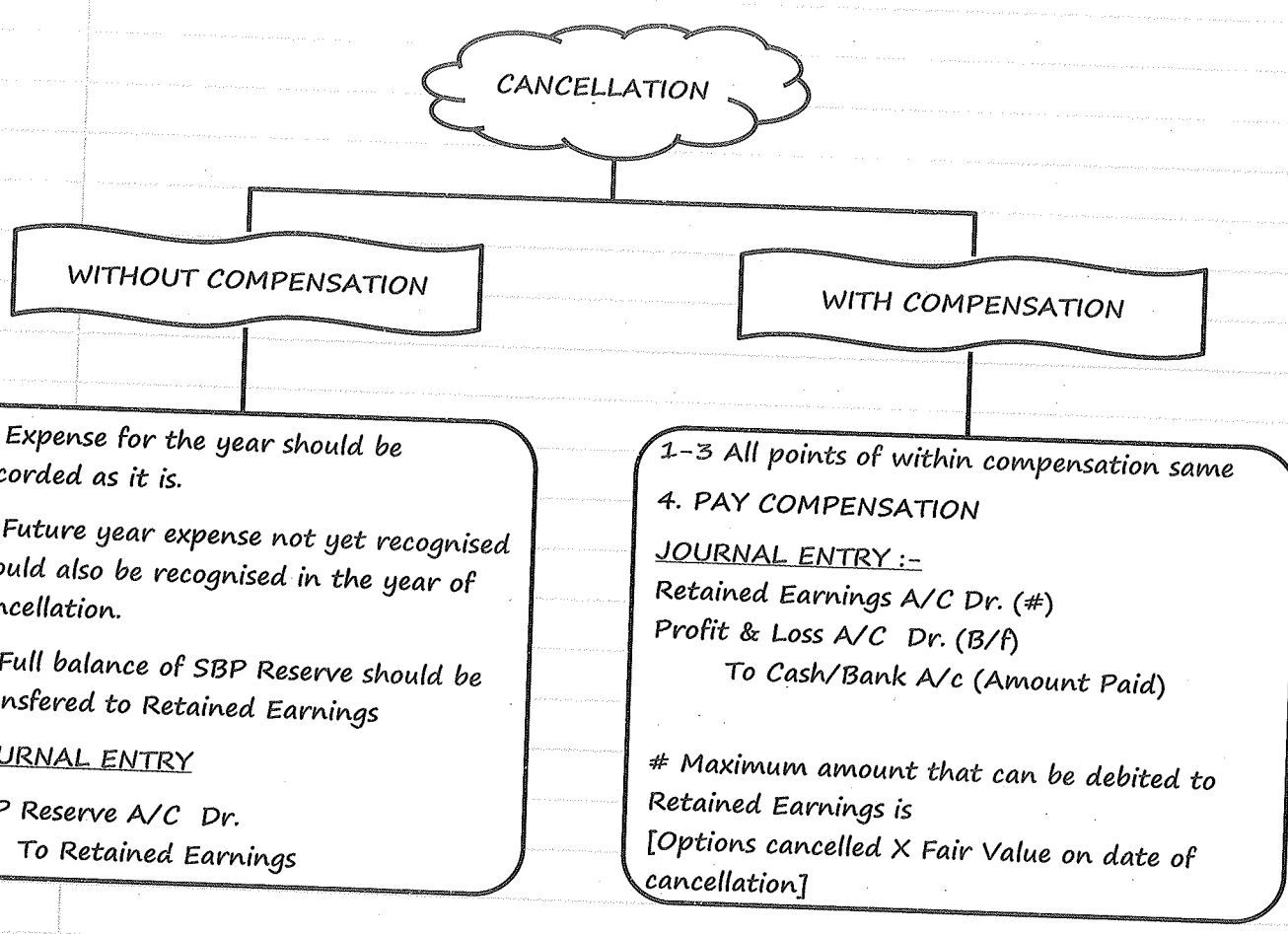
6. MODIFICATION



HINT: In case of modification, account for original SBP separately & Modification separately.

7. CANCELLATION (Other than by forfeiture due to vesting conditions not satisfied)

☞ Cancellation are done midway during the vesting period. Expense for future years is yet to be recognised



8. CASH SETTLED SBP FOR EMPLOYEES (Also known as Stock Appreciation Rights – SAR's)

☞ Similar to equity settled EXCEPT Fair value should be remeasured through P&L (EBE) at the end of each reporting Period during the vesting period and post vesting period till the options are exercised using the FV on each year end.

☞ CALCULATION OF EXPENSE TO BE RECOGNISED EACH YEAR

$$\left[\text{No. of employees expected to fulfil the conditions at each year end} \times \text{No. of options} \times \text{Fair Value of Options AT THE END OF REPORTING PERIOD} \times \frac{\text{Expired Period}}{\text{Total Vesting Period}}\right] - \text{(-) Expense Already recognised in Previous Years.}$$

JOURNAL ENTRIES

I. ON GRANT DATE

No Entry

II. AT THE END OF EACH YEAR DURING VESTING PERIOD

a) BOOKING OF EXPENSE

Employee Benefit Expense (P&L) A/c Dr.

To SBP Liability A/c

b) REVERSAL OF EXPENSE DURING VESTING PERIOD

SBP Liability A/c Dr.

To Employee Benefit Expense A/c

III. DURING EXERCISE PERIOD

a) BOOKING OF FAIR VALUE CHANGES (IF ANY) DURING EXERCISE PERIOD

IF FAIR VALUE INCREASES – Employee Benefit Expense A/c Dr.

To SBP Liability A/c

IF FAIR VALUE DECREASES – SBP Liability A/c Dr.

To Employee Benefit Expense A/c

b) ON PAYMENT OF CASH

SBP Liability A/c Dr.

To Cash / Bank A/c

❖ SAR's THAT VESTS IMMEDIATELY

☞ In some cases, SAR's issued vests immediately i.e. on grant date itself as NO vesting conditions are there.

☞ In such case employees are given exercise period to exercise the option which can be more than 1 year. In such cases FV of SAR's need to be remeasured at the end of each reporting period till the options are exercised.

JOURNAL ENTRIES

I. ON GRANT DATE

Employee Benefit Expense A/c Dr.

To SBP Liability

(Book full Expense Based on Fair Value on Grant Date as shares Vests Immediately)

II. DURING THE EXERCISE PERIOD

a) BOOKING OF FAIR VALUE CHANGES AT EACH YEAR END DURING EXERCISE PERIOD TILL THE OPTIONS ARE EXERCISED

IF FAIR VALUE INCREASES – Employee Benefit Expense A/c Dr.

To SBP Liability A/c

IF FAIR VALUE DECREASES – SBP Liability A/c Dr.

To Employee Benefit Expense A/c

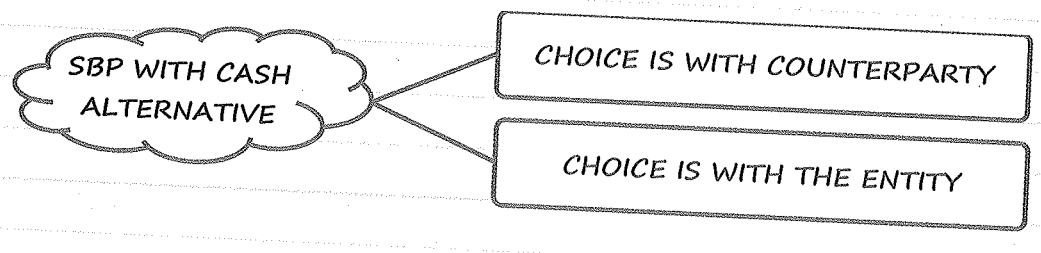
b) ON PAYMENT OF CASH

SBP Liability A/c Dr.

To Cash / Bank A/c

NOTE: In Cash Settled if any change occurs in FV during the exercise period, then SBP liability is remeasured through P&L (EBE), BUT in case of Equity settled we never remeasure during the exercise period.

9. SBP WITH CASH-ALTERNATIVE



A. CHOICE IS WITH COUNTERPARTY (EMPLOYEES) – Treat as Compound Financial Instrument

STEP 1 – Identify value of ESOP on grant date based on equity-based settlement.

No of shares/ options to be allotted (X) Fair Value of equity settled option on Grant date

STEP 2 – Identify value of cash settled option (debt component)

No of option in SAR (X) Fair value of cash settled SAR on grant date.

STEP 3 - Value of equity component = Equity settled ESOP (as per step 1) (-) Cash settled ESOP (as per step 2)

(If Value of Equity settled ESOP is less than or equal to cash settled ESOP then the value of equity component is zero.)

STEP 4 - Equity component (as per Step 3) is recognised in SBP Reserve proportionately during the vesting period

STEP 5 - Cash settled (debt component) is recognized in SBP liability during Vesting Period which requires Remeasurement each year (i.e. Expense is booked based on Fair Value at the End of Each Year).

JOURNAL ENTRIES

I. ON GRANT DATE

No Entry (Only Computations are done i.e. Step 1, Step 2, Step 3)

II. AT THE END OF EACH YEAR DURING VESTING PERIOD

a) BOOKING EXPENSE OF EQUITY COMPONENT & LIABILITY COMPONENT

Employee Benefit Expense A/c Dr.

To SBP Reserve A/c

(As per Step 4)

Employee Benefit Expense A/c Dr.

To SBP Liability A/c

(As per Step 5)

OR

Employee Benefit Expense A/c Dr.

To SBP Reserve A/c

To SBP Liability

III. UPON SETTLEMENT (i.e. Upon Exercise)

a) IF COUNTERPARTY (EMPLOYEE) CHOOSES CASH OPTION

i) ON PAYMENT OF CASH

SBP Liability A/c Dr.

To Cash/Bank A/c

ii) TRANSFER OF SBP RESERVE BALANCE TO RETAINED EARNINGS (I.E. TRANSFER WITHIN OTHER EQUITY)

SBP Reserve A/c Dr.

To Retained Earnings A/c

b) IF COUNTERPARTY (EMPLOYEE) CHOOSES EQUITY SETTLED OPTION

i) TRANSFER OF SBP LIABILITY TO SBP RESERVE

SBP Liability A/c Dr.

To SBP Reserve A/c

ii) ISSUE OF SHARES

SBP Reserve A/c Dr.

To Equity Share Capital A/c Dr.

To Securities Premium (if any) A/c Dr.

iii) TRANSFER BALANCE IN SBP RESERVE (IF ANY) TO RETAINED EARNINGS (I.E. TRANSFER WITHIN OTHER EQUITY)

SBP Reserve A/c Dr.

To Retained Earnings A/c

B. CHOICE IS WITH THE ENTITY

☞ Equity settled accounting treatment would be required when there is no obligation to settle in cash.

☞ Treat as cash settled only when it has present obligation to settle in cash. Present obligation can be identified in following situations

a) Entity cannot issue shares due to some restrictions
b) Stated policy to settle in case.
c) Past practice / history to settle such types of transaction in cash

☞ If equity settled accounting has been done but the settlement is required to be done in Cash:

JOURNAL ENTRY

SBP Reserve A/C

To Bank A/C

(If balance in SBP reserve is not sufficient, then balance will be debited to P&L)

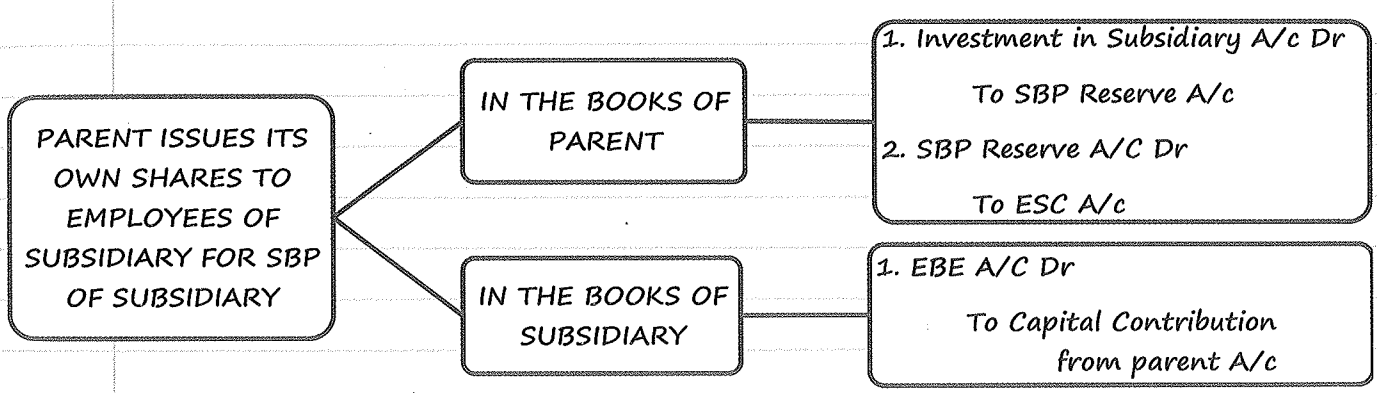
EXAMPLE

SBP reserve = 1 lakh as per equity settled

Settlement required in cash = Rs 120000

SBP Reserve	Dr	100000	
P&L A/C	Dr	20000	
To Bank			120000

10. GROUP SHARE BASED PAYMENT PLANS



"The only person you should try to be better than is the person you were yesterday"

IND AS 103
BUSINESS COMBINATION

1. DEFINITION OF BUSINESS COMBINATION

☞ A BUSINESS COMBINATION is a transaction in which acquirer obtains CONTROL of another business by acquiring its net assets OR acquiring its significant equity interest.

☞ As such, two elements are required for a transaction to be a business combination under Ind AS 103:

- Acquirer obtains CONTROL of an Acquiree ("control" as defined in Ind AS 110); and
- Acquiree is a BUSINESS

2. CONTROL (AS PER IND AS 110)

☞ Control exists if and only if all the following conditions are satisfied.

i) Power over the investee

ii) Exposure or rights to variable returns from its involvement with the investee.

iii) Ability to use its power over the investee to affect the amount of the investor return

NOTE: Control assessment has been discussed in detail in CFS (IND AS 110)

3. BUSINESS

☞ A business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business.

☞ The term 'business' is defined as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

3.1 ELEMENTS OF BUSINESS

A. INPUT

☞ Any economic resource that creates outputs, or has the ability to contribute to the creation of outputs, when one or more processes are applied to it.

Eg: Tangible asset, intangible asset.

B. PROCESS

☞ Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates output or has the ability to contribute to the creations of outputs.

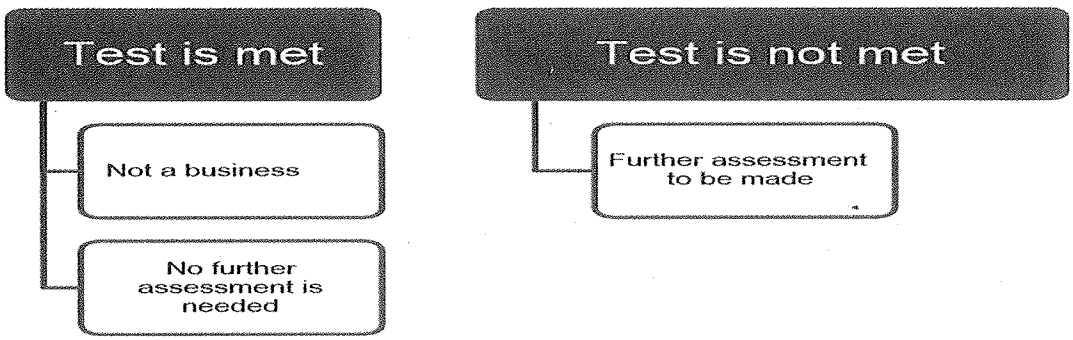
Eg: Strategic management processes, operational processes and resource management processes

C. OUTPUT

☞ The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.

3.2 CONCENTRATION TEST

☞ An optional test (the concentration test) has been introduced to permit a simplified assessment of whether an acquired set of activities and assets is not a business.



☞ The concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets.

☞ 3 Step process for concentration test:

i) Measure the Fair Value of Gross Assets acquired:

- Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held)
- (+) Fair value of liabilities assumed (Excluding DTL)
- (-) Cash and cash equivalent and deferred tax assets

ii) Identify the single identifiable assets or group of similar identifiable asset;

iii) Determine if substantially all of the value determined in point (a) is concentrated in the value determined in point (b). If yes, then it is an asset acquisition otherwise needs to assess

business definition as per Ind AS 103

EXAMPLE: ON CONCENTRATION TEST

Entity A holds 20% interest in Entity B. Subsequently Entity A, further acquires 50% share in Entity B by paying ₹ 300 Crores.

The fair value of assets acquired and Liabilities assumed are as follows: Building -₹ 1000 Crores

Cash and Cash Equivalent -₹ 200 Crores Financial Liabilities -₹ 800 Crores DTL -₹ 150 crores

Fair value of Entity B is ₹ 400 Crores and Fair value of NCI is ₹ 120 Crores (400 x 30%)

Fair value of Entity A's previously held interest is ₹ 80 Crores (400 x 20%)

Entity A needs to determine whether acquisition is an asset acquisition as per concentration test.

a. Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held) = 300 + 120 + 80 = ₹ 500 Crores
b. Fair value of liability assumed (excluding deferred tax) – ₹ 800 crores
c. Cash and cash equivalent – ₹ 200 crores.

Fair value of gross assets acquired - ₹ 1,100 Crores

In the above scenario, substantially all fair value of gross assets acquired is concentrated in a single identifiable asset i.e. building. Hence it should be asset acquisition. (1,000 / 1,100 = 91% of value of gross assets is concentrated into single identifiable asset i.e. building). A Judgement is required to conclude on the word substantially as the same is not defined in the standard.

In our view we have considered 91% of the value as substantial to conclude the above transaction as asset acquisition.

4. ASSET ACQUISITION

- Acquisition of asset or group of assets that does not constitute a business is asset acquisition
- All the assets acquired as a part of asset acquisition would be recognised & measured based on allocation of overall consideration paid in the ratio of their relative fair values.

NOTE:

- NO Goodwill / Gain on Bargain Purchase would be recognised
- DTA / DTL would not be calculated on initial recognition of asset acquisition.

☞ Any transaction cost incurred on asset acquisition will be capitalised with the value of asset.

5. ACCOUNTING FOR BUSINESS COMBINATION

❖ ACQUISITION METHOD (Also known as Purchase Method)

- STEP 1: Identifying the Acquirer
- STEP 2: Determining the Date of Acquisition
- STEP 3: Calculation of Purchase Consideration transferred
- STEP 4: Recognise & Measure Identifiable Assets & Liabilities
- STEP 5: Recognise & Measure Non-Controlling Interest
- STEP 6: Recognise & Measure Goodwill or Gain on Bargain Purchase

I. STEP 1 – IDENTIFYING THE ACQUIRER

☞ Acquirer is the entity who obtains control over the acquiree. It is usually the entity that issues consideration

EXCEPTION – REVERSE ACQUISITION (DEALT LATER IN THIS CHAPTER)

II. STEP 2 – DETERMINING THE DATE OF ACQUISITION

☞ It is the DATE ON WHICH ACQUIRER OBTAINS CONTROL of the acquiree.

☞ It is the date on which acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date.

☞ However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date.

☞ An acquirer shall consider all facts and circumstances in identifying the acquisition date.

NOTE: If any Govt. approval is required for acquisition, then date of acquisition will be date on which Govt. approval is obtained.

III. STEP 3 – CALCULATION OF PURCHASE CONSIDERATION TRANSFERRED

	Acquisition Date Fair Value of Cash/Asset Transferred		XX
(+)	Acquisition Date Fair Value of Shares/Debentures Transferred		XX
(+)	Acquisition Date Value of Deferred Consideration (@PV)	Refer Note 1	XX
(+)	Acquisition Date Fair Value of Contingent Consideration	Refer Note 2 & 3	XX
(+)	Pre-combination period SBP awards	Refer Note 4	XX
	TOTAL PURCHASE CONSIDERATION		XX

NOTE:

1. DEFERRED CONSIDERATION

☞ Deferred Consideration is consideration that is payable in future WITHOUT any condition. It will be valued at its Present Value in Calculation of Purchase Consideration.

☞ At every year end unwinding of discount is required to be done

JOURNAL ENTRY FOR UNWINDING OF DISCOUNT

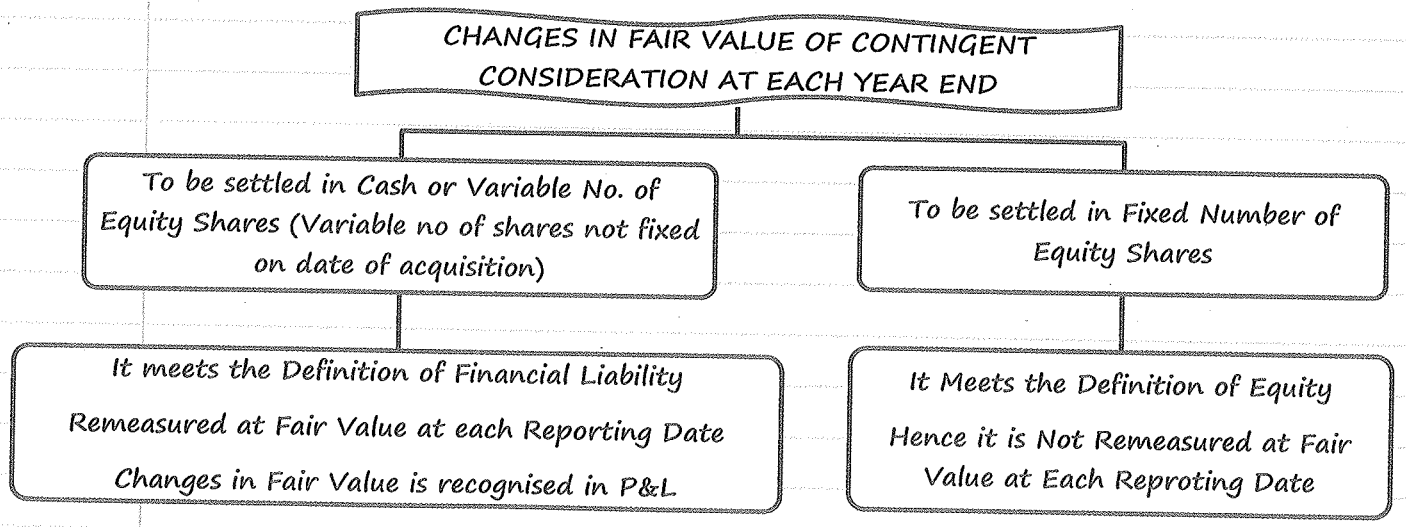
Finance Cost A/c Dr.

To Deferred consideration

2. CONTINGENT CONSIDERATION (CC)

☞ It is the amount paid by the acquirer only on occurrence of certain future events. In Calculation of P.C. recognise the contingent consideration at Acquisition Date Fair Value (Fair Value of CC on the date of Acquisition will be already given in the question)

☞ Contingent consideration may be settled in cash or shares



3. CONTINGENT PAYMENT TO EMPLOYEE SHAREHOLDERS

- A. If Contingent Consideration is paid for being in Employment
  - Will NOT form Part of PC
  - Will be treated as remuneration expense
- B. Other Contingent Consideration in the Capacity of Shareholders
  - Will form Part of PC
  - (For treatment Refer Note 2)

4. SHARE BASED PAYMENT AWARD (SBP Award)

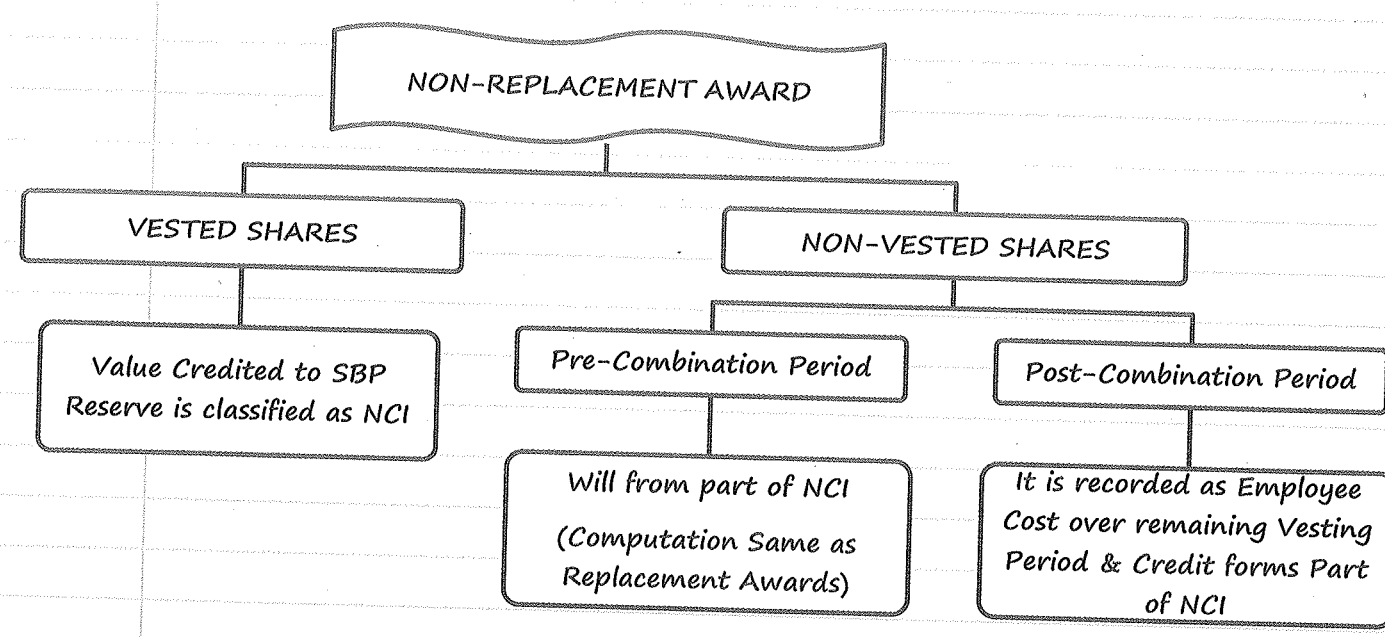
A. REPLACEMENT AWARDS

☞ An acquire may replace its SBP awards (Replacement Awards) for awards held by employees of the acquiree.

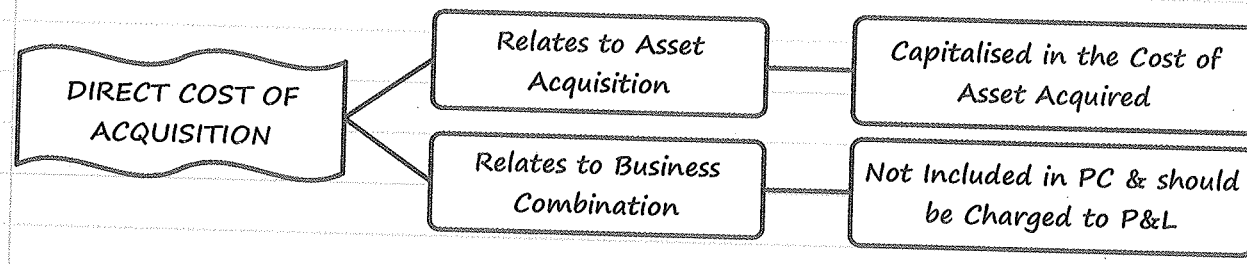
- REPLACEMENT AWARDS
  - PRE-COMBINATION PERIOD
    - Will from Part of PC
      - Fair Value of Original Award (X) Expired period / Original Vesting Period OR Revised Vesting Period (Whichever is Higher)
  - POST-COMBINATION PERIOD
    - Will NOT Form Part of PC. It will be allocated as a service cost over the remaining vesting period
      - Fair Value of Replaced Awards (-) Value Allocated to Pre-Combination Period

B. NON-REPLACEMENT AWARD

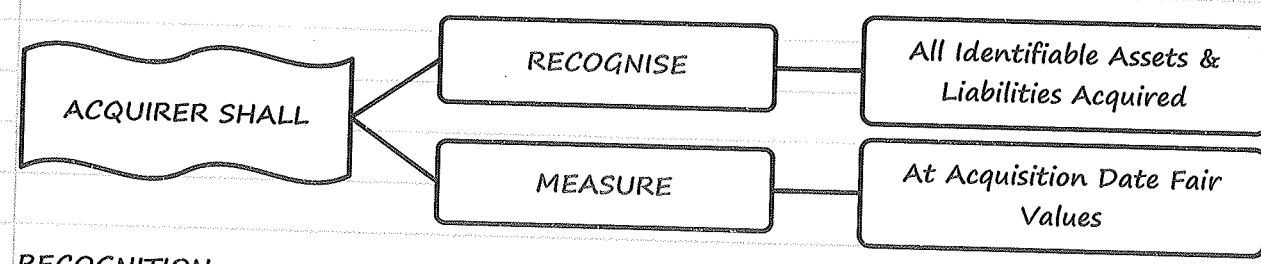
☞ These are outstanding SBP Awards of acquiree that the acquirer DOES NOT exchange for its own SBP Awards. (WILL NOT FORM PART OF PC)



5. DIRECT COST OF ACQUISITION (e.g. Stamp Duty Fees, Due Diligence Fees, legal fees, Investment banker fees etc.)



IV. STEP 4 - RECOGNISE & MEASURE IDENTIFIABLE ASSET & LIABILITIES



❖ RECOGNITION

☞ When the acquirer applies the recognition principle under business combination it may record certain assets and liabilities which the acquiree had not recorded earlier in their financial statements.

EXAMPLE

- Research & Development cost of acquiree – If such R&D cost meets the definition of intangible asset then recognise as intangible asset.
- Assembled work force – Not an intangible asset (Control & FEBs are not certain as employee can leave the organisation)

☞ Classification of Asset & liabilities acquired shall be on the basis of conditions existing on the acquisition date.

EXCEPTION TO CLASSIFICATION – In case of lease the classification as operating lease or finance lease which was done at inception of the lease. Cannot be changed on acquisition date.

❖ EXCEPTION TO THE RECOGNITION OR MEASUREMENT PRINCIPLE

EXCEPTION MAY RESULT IN TWO SCENARIOS:

- An asset or liability which otherwise would NOT have been recorded gets recorded;
- The Assets &liabilities are measured at a value other than the acquisition date Fair Values.

A. CONTINGENT LIABILITY

☞ Ind AS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise on acquisition date a contingent liability assumed in a business combination if it is a PRESENT OBLIGATION that arises from past events and its FAIR VALUE can be MEASURED RELIABLY even if it is not probable that an outflow of resources will be required to settle the obligation.

☞ SUMMARY

Outcome	Ind AS 37	Business Combination
Possible obligation	Not recognised	Not recognised
Present obligation – not probable that outflow of economic benefits will occur	Not recognised	Recognised if reliable measured
Present obligation – probable that outflow of economic benefits will occur, cannot be measured reliably	Not recognised	Not recognised

B. INCOME TAX

☞ The acquirer shall recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, Income Taxes.

C. EMPLOYEE BENEFITS

☞ The acquirer records the fair value of the obligations for any post retirement obligation as per the principles of Ind AS 19

D. NONCURRENT ASSET HELD FOR SALE

☞ The acquirer shall measure an acquired noncurrent asset that is classified as held for sale at the acquisition date at FVLCTS as per Ind AS 105.

E. INDEMNIFICATION ASSET

☞ The acquiree in a business combination may indemnify (Compensation for harm or loss) the acquirer against losses above a specified amount on a liability arising from a particular contingency.

☞ As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified liability measured on the same basis as the indemnified liability.

☞ If Contingent Liability Acquired & disclosed by Acquirer, then indemnification asset on such contingent liability will also be disclosed.

NOTE:

The amount of indemnification asset CANNOT exceed the amount of liability.

F. SHARE BASED PAYMENT AWARD / TRANSACTIONS

☞ The acquirer shall measure all the SBP transaction (replaced /non replaced) as per Ind AS 102. (Already discussed above)

G. REACQUIRED RIGHTS

☞ As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or unrecognised

assets. Examples of such rights include a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement.

☞ A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill.

H. OPERATING LEASE

i) ACQUIREE IS A LESSEE

☞ The acquirer shall recognise right-of-use assets and lease liabilities for leases identified in accordance with Ind AS 116.

☞ The acquirer shall measure the lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the acquisition date.

☞ The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.

ii) ACQUIREE IS A LESSOR

☞ In measuring the acquisition-date fair value of an asset, the acquirer shall take into account the terms of the lease.

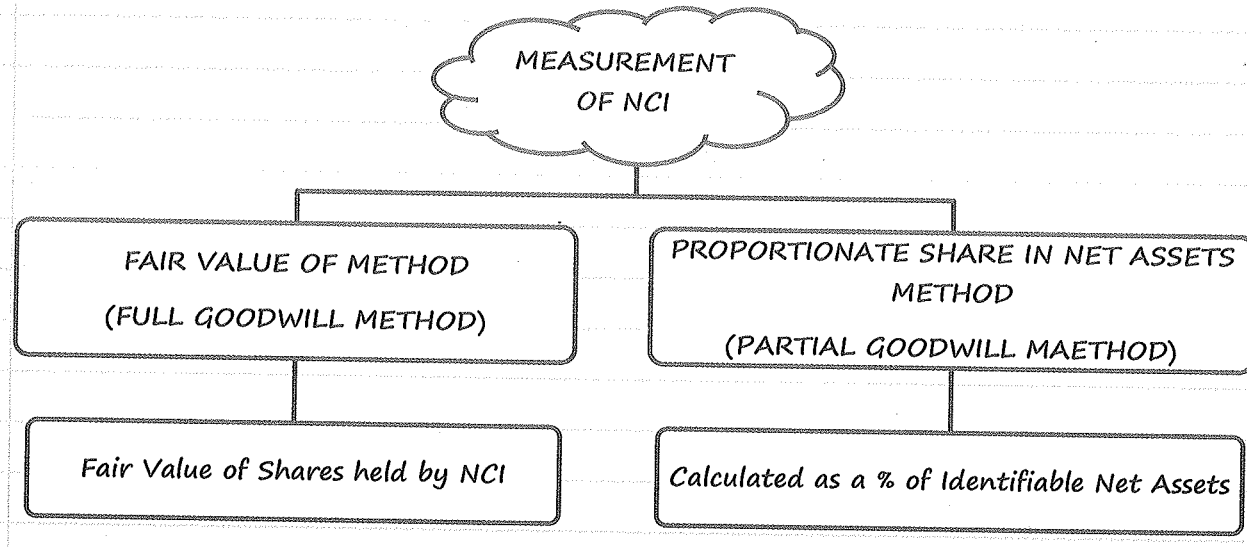
☞ The acquirer DOES NOT recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms.

Amendment:

- Contingent Liabilities: For a levy that would be within the scope of Appendix C Levies of Ind AS 37, the acquirer applies the requirements of Appendix C to determine if the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date
- Contingent Assets: Explicitly prohibits recognition of Contingent Assets

V. STEP 5 - RECOGNISE & MEASURE NON-CONTROLLING INTEREST (ON ACQUISITION DATE)

☞ Non-Controlling Interest (NCI) represents Net Assets not owned by the Acquirer (Parent).



VI. STEP 6 – RECOGNISE & MEASURE GOODWILL OR GAIN ON BARGAIN PURCHASE

	Purchase Consideration Transferred	(As per Step 3)	xx
(+)	Non – Controlling Interest	(As per Step 5)	xx
(+)	Acquisition Date Fair Value of Previously held Equity Interest in Acquiree	(Refer Note 1 Below)	xx
			xx
(-)	Identifiable Net Assets Acquired	(As per Step 4)	xx
	GOODWILL / (GAIN ON BARGAIN PURCHASE)		XX

NOTE:

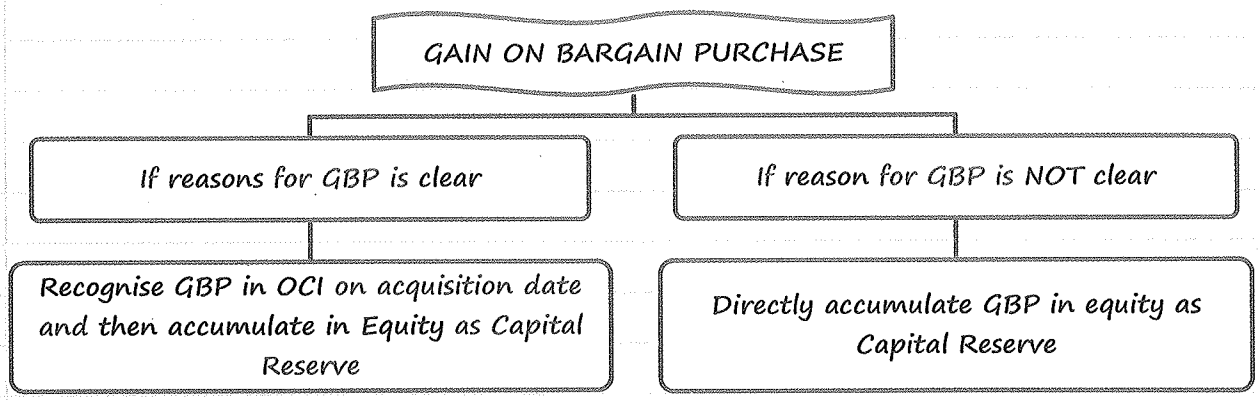
1. STEP ACQUISITION

☞ An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. This is known as Business Combination achieved in stages (Step Acquisition).

In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or OCI (as appropriate)

2. GAIN ON BARGAIN PURCHASE

☞ Ind AS itself acknowledges that it is very rare that a bargain purchase in a business combination will arise and accordingly the standard re-emphasises the above point by requiring the entities to reassess and identify the clear reason why it is a bargain purchase business combination.



☞ The gain shall be attributed to the acquirer and there will be no allocation to the noncontrolling shareholders.

6. COMMON CONTROL TRANSACTIONS [(CARVED OUT) TO IFRS 3 THIS IS NOT GIVEN BY IFRS 3, IT IS GIVEN BE APPENDIX C OF IND AS 103]

☞ Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination.

☞ HINT TO IDENTIFY COMMON CONTROL TRANSACTION: Before and After Business Combination, the entity should be controlled by same shareholder.

EXAMPLES

- Merger between fellow subsidiaries
- Acquisition of an entity from an entity within the same group etc.

❖ METHOD OF ACCOUNTING OF COMMON CONTROL BUSINESS COMBINATION

☞ It shall be accounted for using the POOLING OF INTEREST METHOD (& NOT Acquisition Method)

☞ The pooling of interest method is considered to involve the following:

i) Record all assets & liabilities of the acquiree at book value i.e. Carrying amounts.
(No adjustments are made to reflect fair values, or recognise any new assets or liabilities)

ii) The identity of the reserves shall be preserved and shall appear in the financial statements of the Acquirer in the same form in which they appeared in the financial statements of the acquiree.

iii) Purchase consideration payable to the acquiree for the business combination may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets transferred other than shares shall be considered at their fair values.

iv) Difference if any shall be transferred to CAPITAL RESERVE and should be presented separately from other reserves (Positive and negative balance both in go in capital reserve and no goodwill shall be created under any circumstance)

❖ JOURNAL ENTRY IN THE BOOK OF ACQUIRER

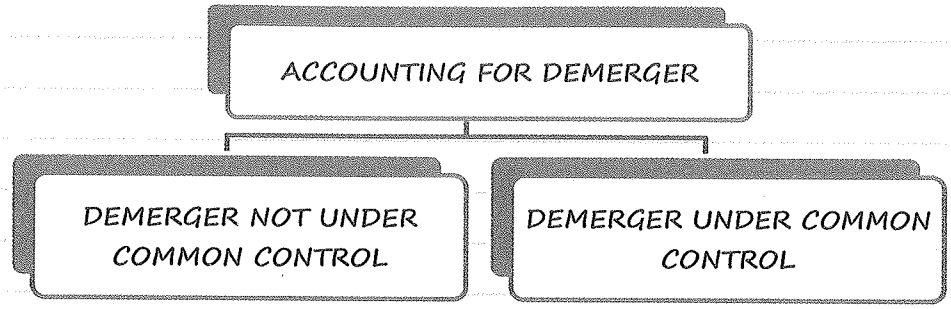
All Assets of acquiree A/c Dr (At book value)
Capital reserve A/C (Balance Figure) Dr
To All Liabilities A/c (At book value)
To All Reserves A/c (At book value)
To P.C Payable A/c
In Shares (At nominal value)
Cash & other Assets (At Fair Value)
To Capital Reserve A/c (Balance Figure)

7. DEMERGER

☞ Demerger is an arrangement whereby some part /undertaking of one company is transferred to another company which operates completely separate from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company

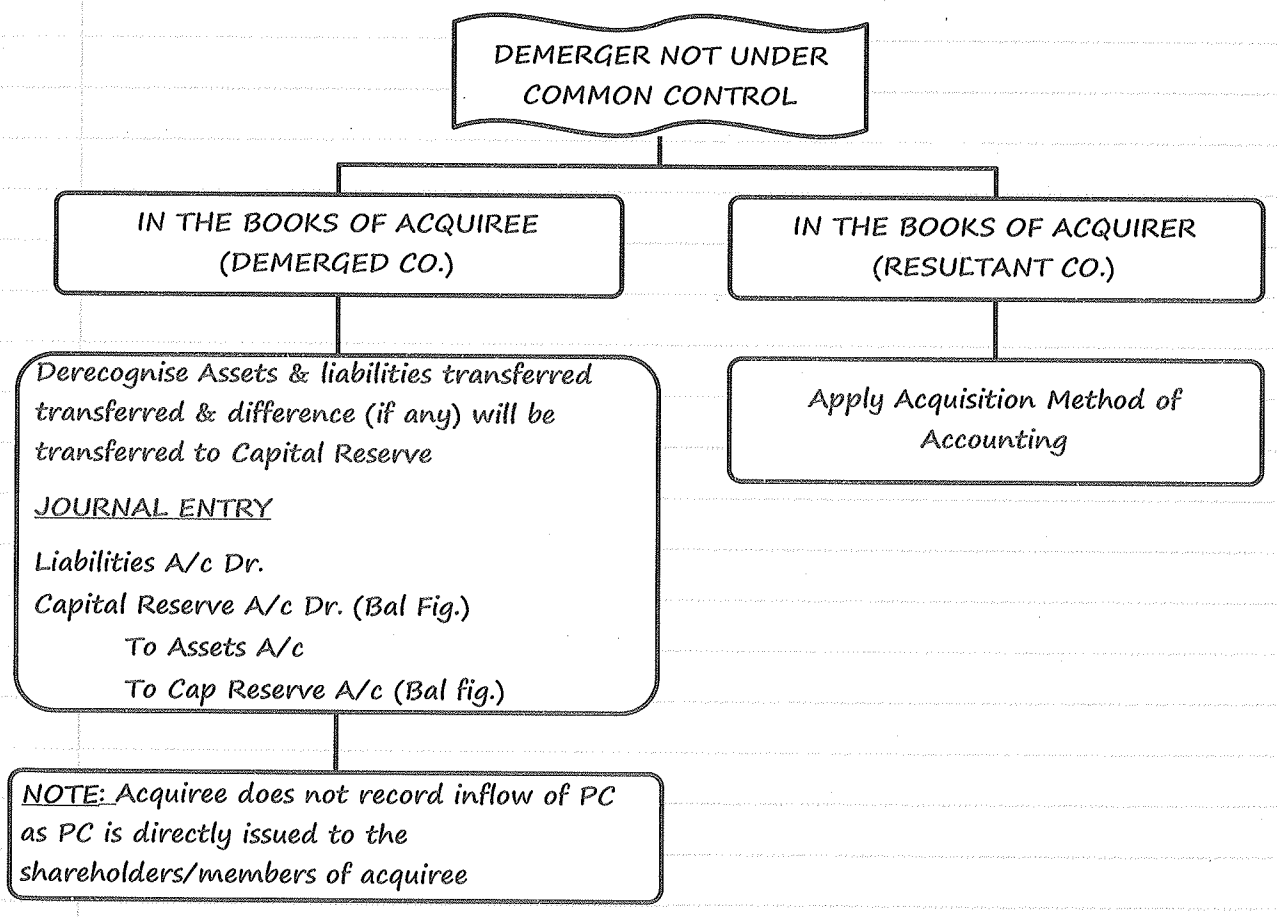
Acquiree = Demerged Co.
Acquirer = Resultant Co.

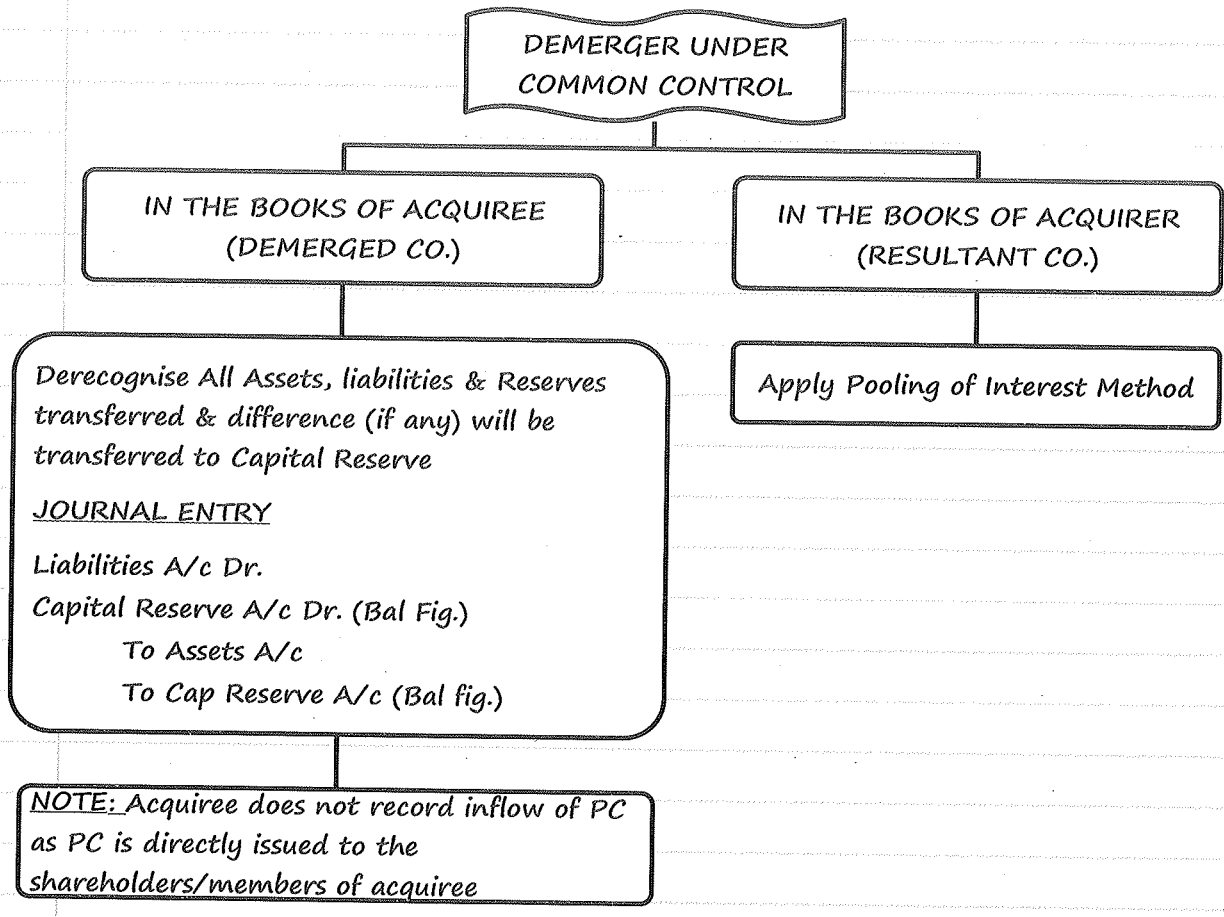
❖ ACCOUNTING FOR DEMERGER



HINT TO IDENTIFY WHETHER DEMERGER IS UNDER COMMON CONTROL OR NOT

✓ If demerged company (Acquiree) had a major shareholder who had control and after such demerger such shareholder was issued shares in the resultant company in the same proportion, then the major shareholder is controlling the company both before and after the company (i.e. it will be demerger under common control)





8. REVERSE ACQUISITION (CONCEPT OF SUBSTANCE OVER LEGAL FORM)

☞ Step 1 of the acquisition method is identifying the acquirer. Acquirer is the entity which obtains control over the acquiree. Generally, the entity which issue consideration is the acquirer. But in some cases, the acquirer may be different from legal acquirer.

☞ A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the ACQUIREE for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the ACQUIRER for accounting purposes for the transaction to be considered a reverse acquisition.

EXAMPLE:

Reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the

equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired.

It results in identifying:

- the public entity as the acquiree for accounting purposes (the accounting acquiree); and
- the private entity as the acquirer for accounting purposes (the accounting acquirer).

❖ STEPS FOR ACCOUNTING OF REVERSE ACQUISITION

I. STEP 1: Determining the Accounting Acquirer

II. STEP 2: Calculation on Deemed PC & Calculation of Goodwill / GBP
(Calculate PC as if Accounting Acquirer would have acquired accounting acquiree. Also, Goodwill / GBP will be calculated Based on Deemed PC)

III. STEP 3: All Assets, Liabilities, Reserve & ESC of Accounting Acquirer will be recorded at BOOK VALUE

IV. STEP 4: The net asset (only assets & liabilities) of Accounting Acquiree will be recorded at FAIR VALUE.

V. STEP 5: Calculation of Goodwill / GBP
(Goodwill / GBP will be calculated Based on Deemed PC)

9. OTHER IMPORTANT POINTS

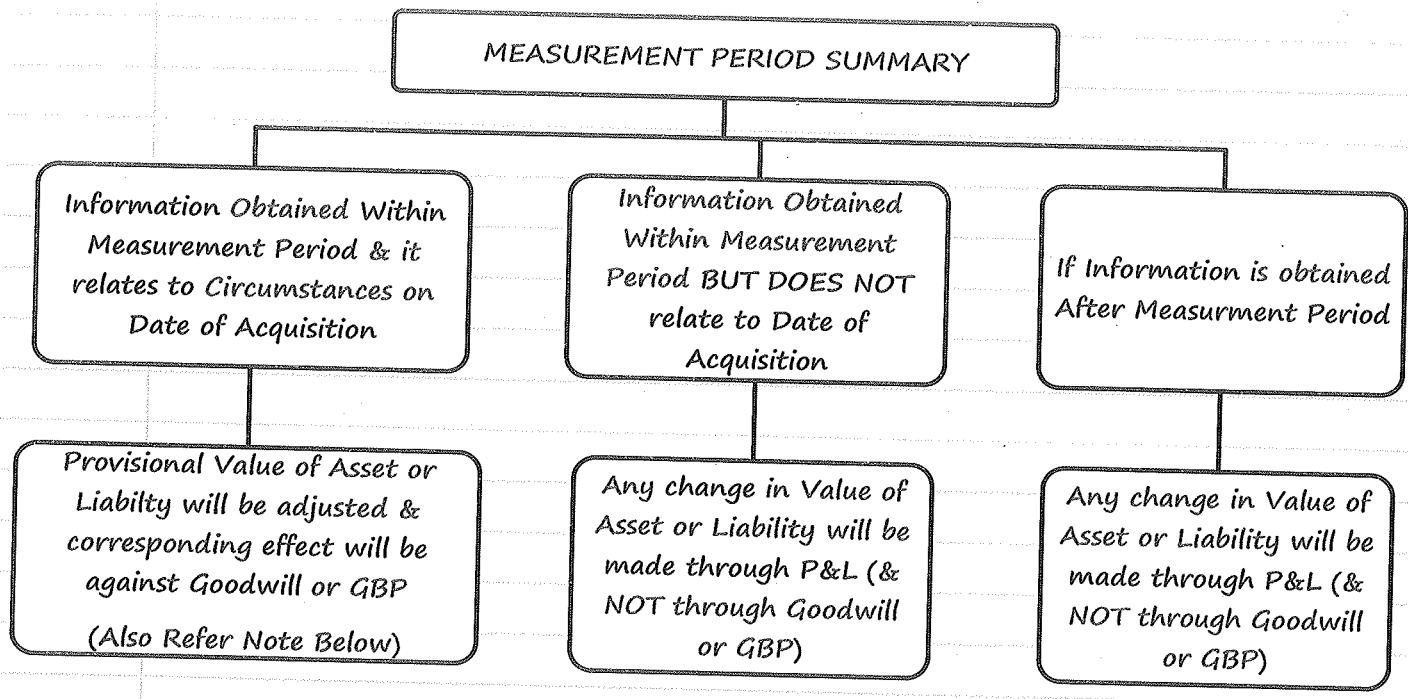
A. MEASUREMENT PERIOD

☞ Ind AS 103 provides a measurement period window wherein if all the required information is not available on the acquisition date.

☞ The measurement period is LOWER of the following:

- Date when acquirer receives the information about facts and circumstances that existed as of the acquisition date OR
- 1 year from the acquisition date.

☞ Any change in the provisional amounts of net assets acquired due to new information available during the measurement period which existed on the acquisition date will be adjusted against GOODWILL or GBP.



NOTE:

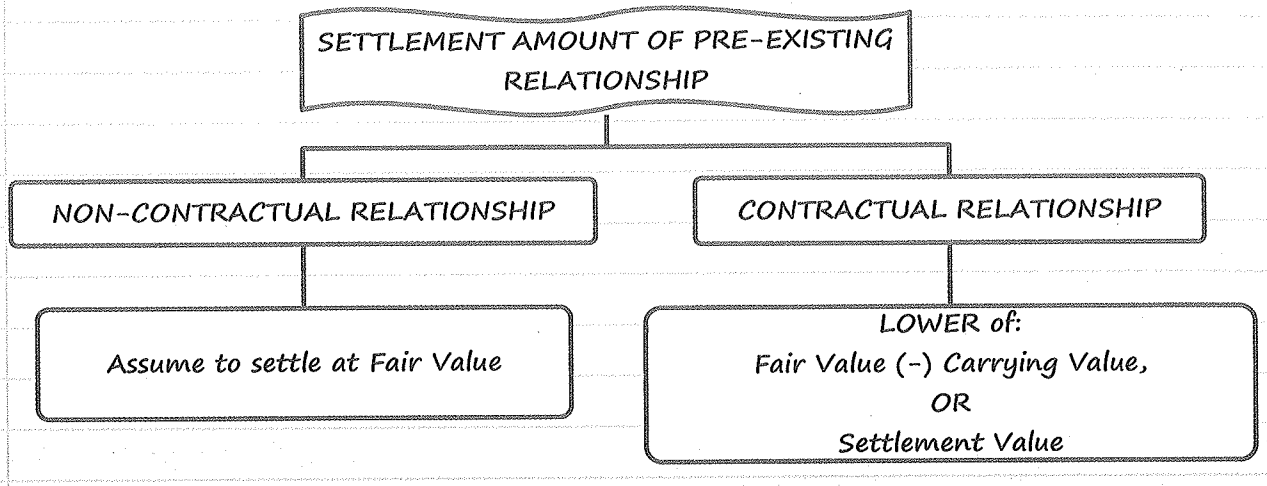
If NCI is based on PSNA & Provisional Amounts of any Asset or Liability Change, then NCI Value will also change

B. DETERMINING WHAT IS PART OF BUSINESS COMBINATION TRANSACTION

☞ The acquirer & acquiree may have a PRE-EXISTING RELATIONSHIP (Contractual OR Non-Contractual) before business combination that is separate from the business combination.

☞ The acquirer shall identify any amount transferred to acquiree as consideration and any amount which is transferred to Acquiree with PC for such Separate transaction shall be deducted from PC and accounted separately.

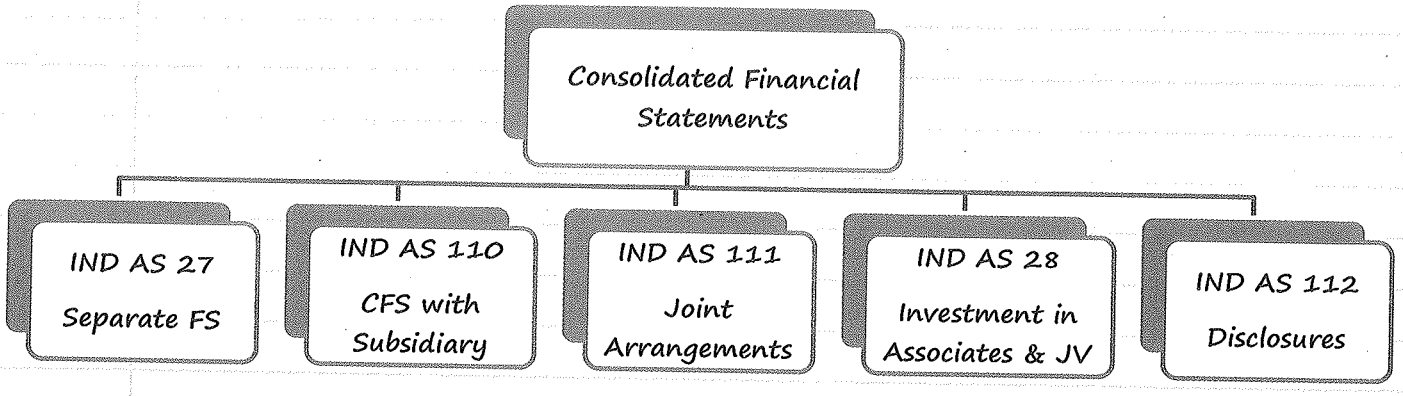
☞ Settlement amount of Pre-Existing Relationship that is assumed to be not part of business combination:



C. A BUSINESS COMBINATION ACHIEVED WITHOUT THE TRANSFER OF CONSIDERATION

Discussed in IND AS 110

"The only thing standing between you and your dream is the will to try and the belief that it is actually possible."



IND AS 27
SEPARATE FINANCIAL STATEMENTS

1. WHAT ARE SEPARATE FINANCIAL STATEMENTS AND HOW THEY ARE PRESENTED?

1.1 What are separate financial statements?

☞ Separate financial statements are those presented by:

- ✓ a parent (i.e. an investor with control of a subsidiary) or
- ✓ an investor with investment in an associate or a joint venture,

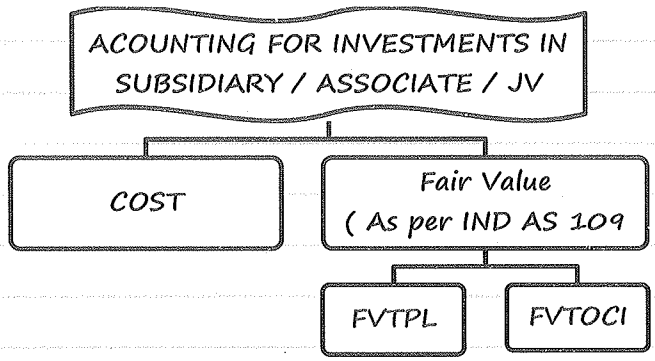
in which the investments are accounted for at cost or in accordance with Ind AS 109 'Financial Instruments'

1.2 How separate financial statements are presented?

☞ Separate financial statements are presented:

- ✓ in addition to CFS; or
- ✓ in addition to financial statements of an investor that does not have investments in subsidiaries but has investments in associates or joint ventures in which investments in associates or joint ventures are accounted for using the equity method.

2. ACCOUNTING FOR INVESTMENTS (IN SUBSIDIARIES, JOINT VENTURES AND ASSOCIATES) IN SEPARATE FS



2.1 APPLY THE SAME ACCOUNTING FOR EACH CATEGORY OF INVESTMENTS.

Example:

☞ An entity that has investments in subsidiaries, associates & joint ventures can account for its investments in subsidiaries & associates at cost and investments in joint ventures in accordance with Ind AS 109. However, if that entity has investments in two associates, it cannot account investment in one associate as cost & investment in other associate in accordance with Ind AS 109. It has to choose either of the method for both the investments in associates.

2.2 INVESTMENTS IN SUBSIDIARY, JOINT VENTURES AND ASSOCIATES CLASSIFIES AS HELD FOR SALE (AS PER IND AS 105)

In such a situation if these investments are accounted for:

- At cost – They will henceforth be accounted for and measured as per Ind AS 105.
- At Fair Value (as per Ind AS 109) – Then they continue to be accounted as per IND AS 109.

2.3 ACCOUNTING WHEN A PARENT CEASES TO BE AN INVESTMENT ENTITY

☞ In such case, the entity shall account for an investment in a subsidiary in either of the following ways:

- ✓ Account at cost. The fair value of the subsidiary at the date of the change of status shall be used as the deemed cost at that date; OR
- ✓ Continue to account in accordance with Ind AS 109

2.4 WHEN AN ENTITY BECOMES AN INVESTMENT ENTITY

- In such case, the entity shall account for an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.
- In that case, the difference between the previous carrying amount of the subsidiary and its fair value at the date of the change of status of the investor shall be recognized as a gain or loss in profit or loss.
- The cumulative amount of any fair value adjustment previously recognized in other comprehensive income in respect of those subsidiaries shall be reclassified to profit or loss as if the investment entity had disposed of those subsidiaries at the date of change in status.

3. RECOGNITION OF DIVIDEND IN SFS

- Dividend shall be recognized in SFS when its right to receive is established.
- Generally, the right to receive the dividend is established when the dividend is approved by the shareholders in their general meeting

4. IMPAIRMENT OF INVESTMENT IN A SUBSIDIARY, JOINT VENTURE OR ASSOCIATE (AS PER IND AS 36)

- There is an indication of impairment of investment if:

a) Carrying amount of investment (in separate financial statements) > Share in Net Assets of Subsidiary / Joint Venture / Associate (including goodwill).

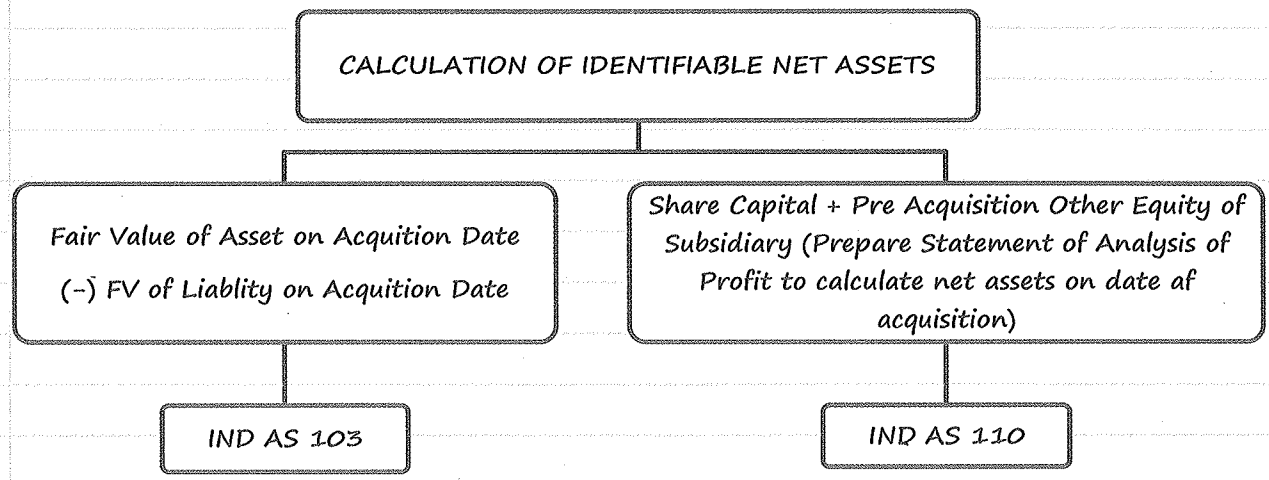
b) Dividend Received > Total Comprehensive income of Subsidiary, Joint Venture OR Associate

IND AS 110
CFS: ACCOUNTING FOR SUBSIDIARIES

1. PROCEDURE FOR CONSOLIDATION:

Step 1: CALCULATION OF PURCHASE CONSIDERATION (As per Ind AS 103)

Step 2: CALCULATION OF IDENTIFIABLE NET ASSETS



Step 3: CALCULATION OF NCI

a) ON DATE OF ACQUISITION (As per IND AS 103)

- Method 1 – Fair Value Method
- Method 2 - Proportionate Share in Net Asset Method

b) NCI POST ACQUISITION ON EACH YEAR END (As per IND AS 110)

Opening Balance on Date of Acquisition	xx
(+) Post Acquisition Share of NCI in Subsidiaries Profit	xx
(-) Dividend Received from Subsidiaries (NCI's Share)	(xx)
(-) Goodwill Impairment (NCI's Share) of Goodwill	(xx)
(If goodwill was as per Full Goodwill Method)	—
	xx

STEP 4: CALCULATION OF GOODWILL / GBP (As per IND AS 103)

STEP 5: CALCULATION OF CONSOLIDATED OTHER EQUITY ON EACH YEAR END

Parents Other Equity	xx
(+) Post Acquisition Share of Parent in Subsidiaries Profit	xx
(-) Dividend From Subsidiary (Only Parent's Share)	(xx)
(-) Unrealised Profit on Downstream Transaction	(xx)
(+) DTA on Above URP	xx
(-) Goodwill Impairment (Parent's Share)	(xx)
(Goodwill As per Full Goodwill Method or Partial Goodwill Method)	
	xx

CONSOLIDATION ENTRY

2. STATEMENT OF NET ASSETS (PRE & POST ACQUISITION OTHER EQUITY)

☞ Adjustment list to calculate net asset through analysis of profit and treatment of post-acquisition profits earned by subsidiary.

PARTICULARS	Pre – Acquisition Profit	Post – Acquisition Profit
Other Equity of Subsidiary		
Opening Balance of Other Equity of Subsidiary	xxx	
Profit During the Year		xxx
(+) Dividend Paid by Subsidiary (100%)		xxx
Evenly Accrued Profit	xxx	xxx
(+)/(-) Time Adjustment	xxx	(xxx)
~~(-) Dividend paid by Subsidiary~~ (Note: The Above will be deducted from: NCI's Share – Step 3 & Parent's Share – Step 5 i.e. Consolidated O.E.)		
(+) Revaluation Gain on Non-Depreciable Asset	xxx	
(-) DTL on Above	(xxx)	
(-) Revaluation Loss on Non-Depreciable Asset	(xxx)	
(+) DTA on Above	xxx	
(+) Revaluation Gain on Depreciable Asset	xxx	
(-) DTL on Above	(xxx)	
(-) Additional Depreciation due to Revaluation Gain on Depreciable Asset		(xxx)
(+) DTL Reversal due to Additional depreciation		xxx
(-) Revaluation Loss on Depreciable Asset	(xxx)	
(+) DTA on Above	xxx	
(+) Savings in Depreciation due to Revaluation Loss on Depreciable Asset		xxx
(-) DTA Reversal due to Savings in depreciation		(xxx)

(+) Revaluation Gain on Current Assets / Liabilities (Eg: Inventory, Trade Payable, Trade Receivable, Investments)	XXX	
(-) DTL on Above	(XXX)	
(-) Reversal of Revaluation Gain on Current Assets / Liabilities (Only if they were sold or settled during the year)		(XXX)
(+) DTL Reversal on Above		XXX
(-) Revaluation Loss on Current Assets / Liabilities	(XXX)	
(+) DTA on Above	XXX	
(+) Reversal of Revaluation Loss on Current Assets / Liabilities (Only if they were sold or settled during the year)		XXX
(-) DTA Reversal on Above		(XXX)
(-) Unrealised Profit on Upstream Transaction		(XXX)
(+) DTA on above		XXX
	XXX	XXX
	⇩ INA	⇩ Will be allocated to Parent & NCI

3. ADJUSTMENT LIST OF ANALYSIS OF PROFIT

A. ASSUMPTION THAT PROFITS HAVE EVENLY ACCRUED THROUGHOUT THE YEAR

☞ When acquisition is made during the year assume that profits have accrued Evenly throughout the year, and disclose this assumption in your solution.

B. WHEN OPENING BALANCE OF OTHER EQUITY OF SUBSIDIARY IS MISSING

☞ In case of Retained Earnings assume opening to be zero and hence full balance was earned during the year

☞ in case of Other Reserves Assume opening to be same as closing.

C. DIVIDEND RECEIVED FROM SUBSIDIARY

i) IN CFS OF PARENT (As per IND AS 110)

☞ Dividend has been declared by subsidiary and hence has been deducted from Current Year Profit of Subsidiary. Hence, the following adjustment is required:

a) Add back dividend to post acquisition profit before time adjustment.

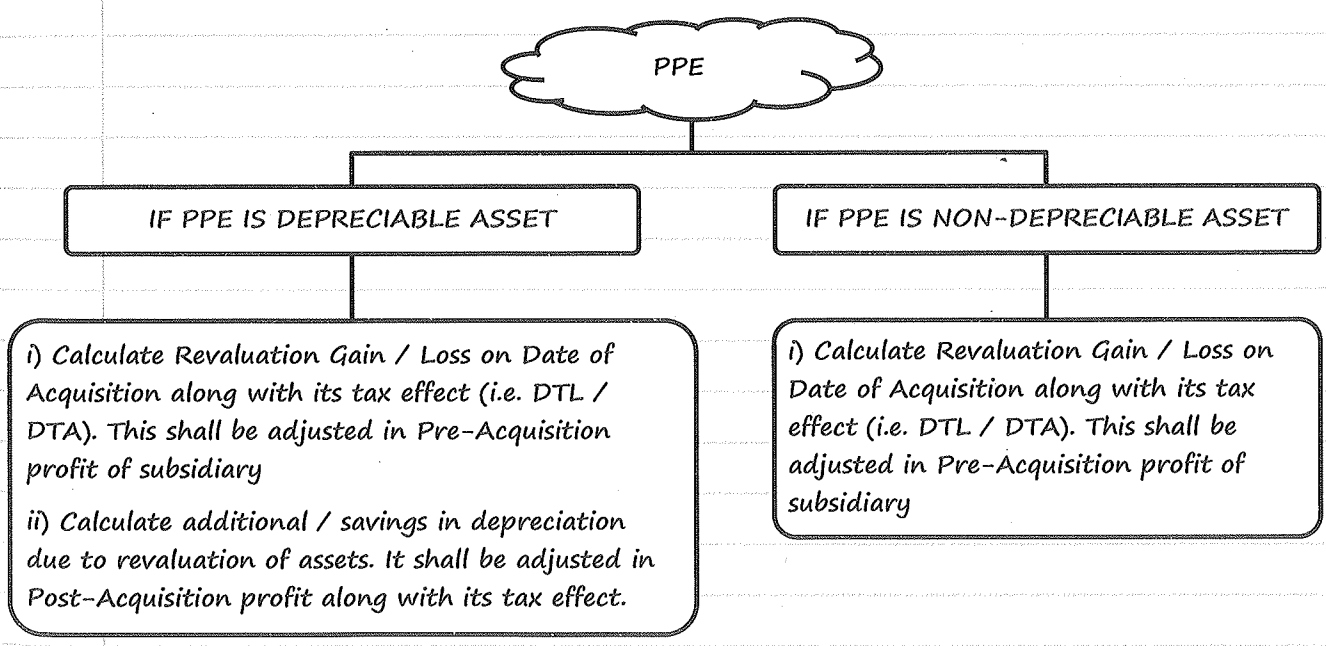
b) Deduct dividend Proportionately:

- Parent's Share - Deduct from Consolidated O.E &
- NCI's Share - Deduct from NCI

D. EFFECT OF REVALUATION OF IDENTIFIABLE NET ASSETS

i) IN CASE OF REVALUATION OF NON-CURRENT ASSET (PPE)

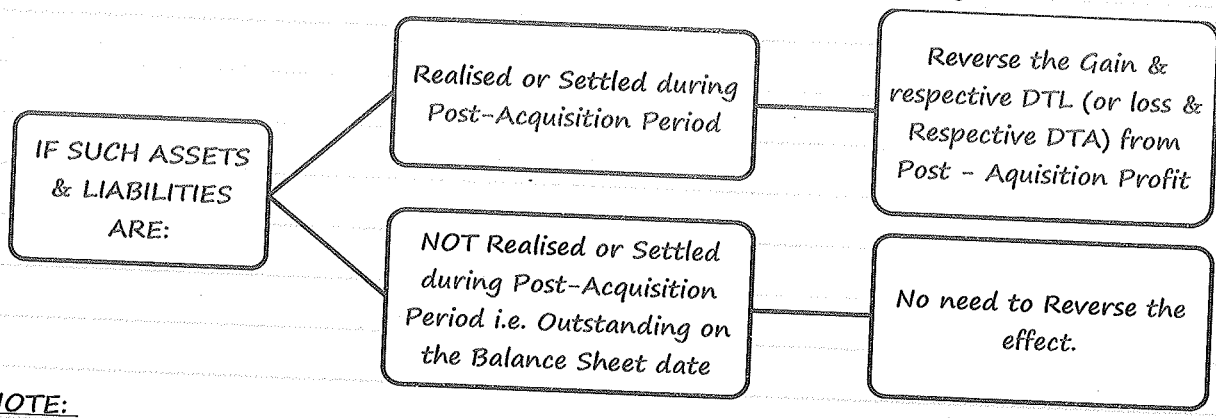
☞ When the fair value of identifiable net asset is different from book value of asset then



ii) IN CASE REVALUATION OF ASSET & LIABILITIES OTHER THAN PPE (EG: DEBTORS, CREDITORS, INVENTORIES, INVESTMENTS)

☞ Calculate Revaluation Gain / Loss on the Date of Acquisition along with its tax effect (i.e.

DTA / DTL). This shall be adjusted in Pre-Acquisition Profit of Subsidiary.



NOTE:

In absence of any information, we will assume that such assets and liabilities are outstanding on Balance Sheet Date.

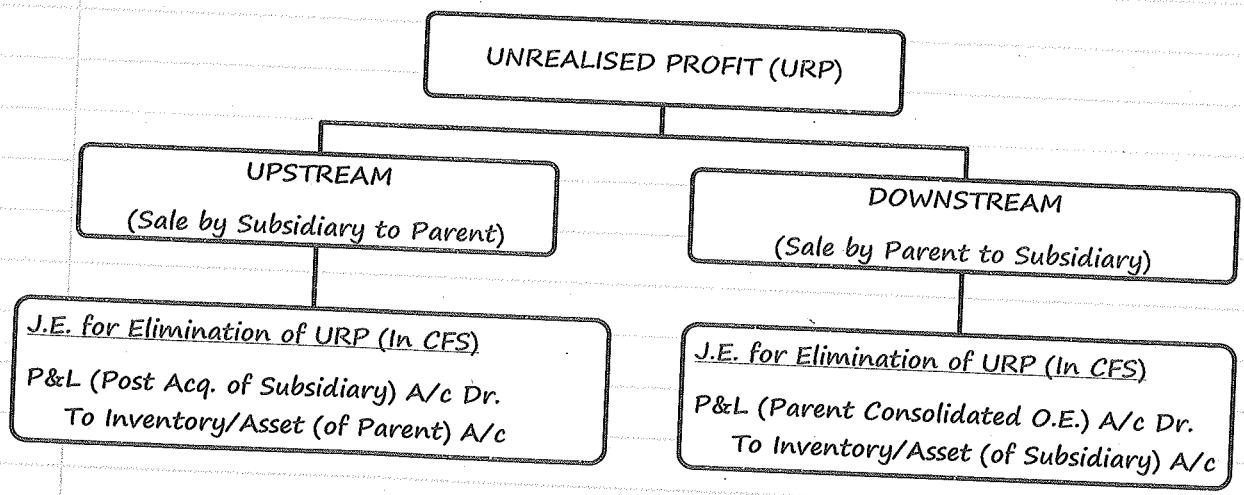
E. UNREALISED PROFIT ON INTER COMPANY TRANSACTIONS (on sale of inventories or on transfer of non-current assets)

i) If the date of transaction between the companies is before the date of Acquisition.

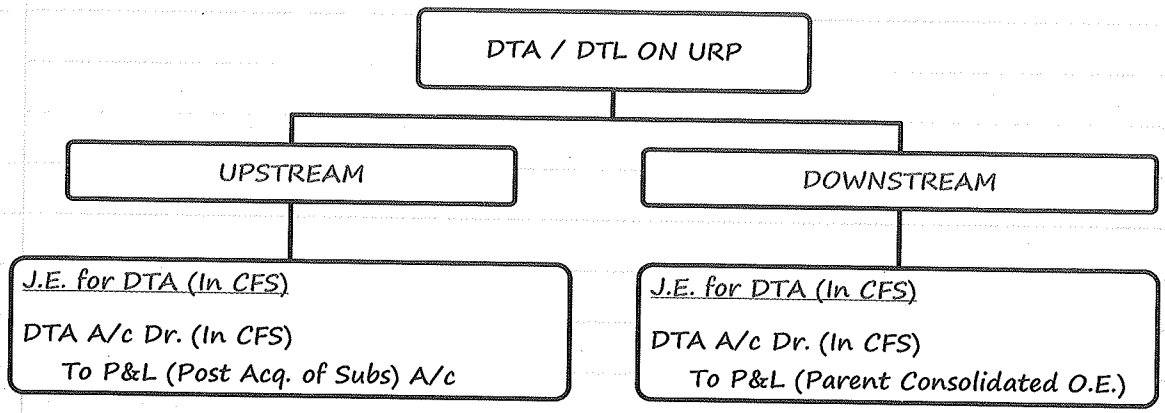
☞ No need to eliminate the unrealized profit. (Ignore such transaction)

ii) If the date of transaction is after the Date of Acquisition

☞ Calculate the amount of Unrealised Profit (Calculate Only when Inventory or asset is outstanding on the Balance Sheet Date)



☞ Due to Reduction in Carrying Amount of Inventory/Asset, Tax Base may be different from Carrying Amount (As the above URP elimination is done only as per A/c's).
Therefore, Create DTA/DTL



NOTE:

☞ The above provisions of URP are applicable only when Inventory/Asset is outstanding on the balance sheet date. If the inventory is sold to outsider before the balance sheet date, then no need to reverse any Unrealised Profit.

❖ SUMMARY ON INTRA-GROUP SALE & PURCHASE ELIMINATION AND URP ELIMINATION

	Date of Transaction is before date of Acquisition	Date of Transaction is after Date of Acquisition & Inventory is outstanding at the year end	Date of Transaction is after Date of Acquisition & Inventory Sold (Full)	Date of Transaction is after Date of Acquisition & Inventory is Partly Outstanding
Whether to eliminate Intra Group Sale & Purchase?	NO	YES (Full)	YES (Full)	YES (Full)
Whether to Eliminate URP?	NO	YES	NO	YES (Only for Part O/s)

4. PREPARATION OF CONSOLIDATED BALANCE SHEET

- Assets and outside liabilities of the subsidiary company are combined with those of the parent company. Effects of appropriate intra group elimination adjustments are given.
- The equity share capital of the subsidiary and investment of parent company in subsidiary are eliminated and goodwill / capital reserve and non-controlling interest are recognised.
- The parent's share in post-acquisition profits of the subsidiary company (added to appropriate concerned account of the parent company) are accounted in consolidated balance sheet.

EXAMPLE 1:

BALANCE SHEET AS ON 31.3.17

	P LTD	S LTD
ASSETS		
Non-current Assets		
PPE	40,000	10,000
Financial Asset		
→ Investments in Subsidiary (Invst made on 31.3.17 – 75%)	25,000	
Current Assets	30,000	14,000
TOTAL	95,000	24,000
EQUITY & LIABILITIES		
EQUITY		
ESC	50,000	18,000
Other Equity	24,000	6,000
LIABILITIES		
Non – Current Liabilities	21,000	
TOTAL	95,000	24,000

Prepare Consolidated Balance Sheet as on 31.03.17

EXAMPLE 2:

BALANCE SHEET AS ON 31.03.18

	P LTD	S LTD
ASSETS		
Non-current Assets		
PPE	20,000	10,000
Financial Asset		
→ Investments in Subsidiary (80%)	30,000	
Current Assets	10,000	12,000
TOTAL	60,000	22,000
EQUITY & LIABILITIES		
EQUITY		
ESC	30,000	10,000
Other Equity	10,000	6,000
LIABILITIES		
Non – Current Liabilities	20,000	6,000
TOTAL	60,000	22,000

Investment was made on 1.04.17

Opening Other Equity of S ltd. was ₹ 4,000

Prepare Consolidated Balance Sheet as on 31.03.18

EXAMPLE 3:

All amounts are same as Example 2 except investment is made on 1/10/17.

EXAMPLE 4: BALANCE SHEET AS ON 31.03.18

	P LTD	S LTD
ASSETS		
Non-current Assets		
PPE	20,000	10,000
Financial Asset		
→ Investments in Subsidiary (80%)	30,000	
Current Assets	10,000	12,000
TOTAL	60,000	22,000
EQUITY & LIABILITIES		
EQUITY		
ESC	30,000	10,000
Other Equity		
→ Retained Earnings	5,000	2,500
→ Other Reserves	5,000	3,500
LIABILITIES		
Non – Current Liabilities	20,000	6,000
TOTAL	60,000	22,000

Investment was made on 1/10/2017.

Opening Retained Earnings is ₹ 500.

Prepare Statement of INA.

EXAMPLE 5:

BALANCE SHEET AS ON 31.03.18

	P LTD	S LTD
ASSETS		
Non-current Assets		
PPE	20,000	10,000
Financial Asset		
→ Investments in Subsidiary (80%)	30,000	
Current Assets	10,000	12,000
TOTAL	60,000	22,000
EQUITY & LIABILITIES		
EQUITY		
ESC	30,000	10,000
Other Equity	10,000	6,000
LIABILITIES		
Non – Current Liabilities	20,000	6,000
TOTAL	60,000	22,000

Investment Date is 1/10/2017. Opening Balance of Retained earnings was 4000.

On 01/11/2017 S ltd paid a dividend @ 10%. Dividend has been recorded by Parent Co. in its own Other Equity.

Prepare Consolidated Balance Sheet as on Year end.

EXAMPLE 6: Revaluation Gain on Assets

BALANCE SHEET AS ON 31.03.18

	P LTD	S LTD
ASSETS		
Non-current Assets		
PPE		
→ Land	40,00,000	30,00,000
→ P&M	20,00,000	15,00,000
Financial Asset		
→ Investments in Subsidiary (100%)	1,00,00,000	-
Current Assets		
Inventory	10,00,000	5,00,000
TOTAL	1,70,00,000	50,00,000
EQUITY & LIABILITIES		
EQUITY		
ESC	70,00,000	20,00,000
Other Equity	30,00,000	10,00,000
LIABILITIES		
Current Liabilities		
Trade Payables	70,00,000	20,00,000
TOTAL	1,70,00,000	50,00,000

Investment was made on 1/10/2017.

Other Equity of S ltd on 01/04/2017 = 6,00,000

On Date of Acquisition the following are the increases in Fair Value.

Land increased by 5,00,000

Inventory increased by 2,00,000

Trade Payable Increased by 3,00,000

Ignore Depreciation if any.

EXAMPLE 7:

All information is same as Example 6.

Additional Information:

Fair Value of P&M on 1/10/2017 was ₹ 25,00,000. Rate of Depreciation on P&M is 25%.

EXAMPLE 8:

Continuing with Example 6 & 7, Assume Tax Rate = 30%

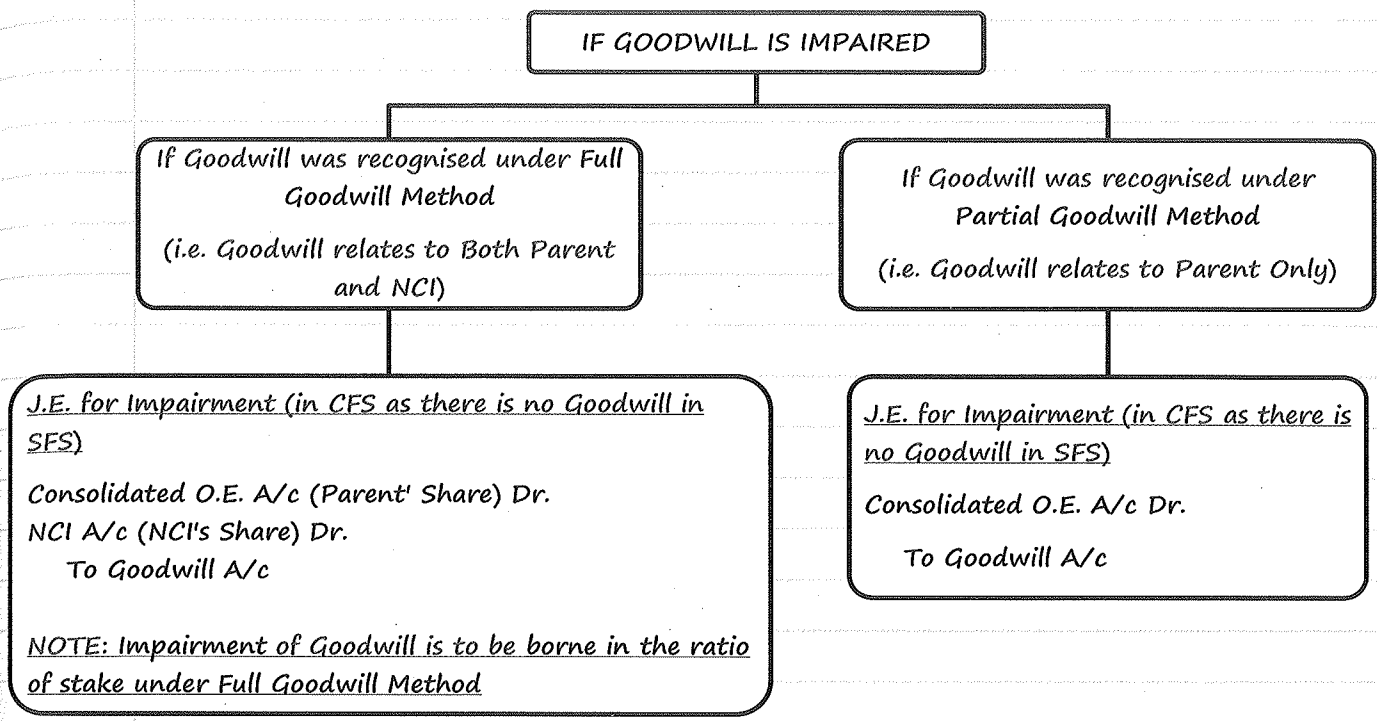
EXAMPLE 9:

Continuing with Example 6, Assume Inventories were sold at year end. Also, assume TP were settled at year end.

Also Assume that Tax Rate is 30%.

5. GOODWILL IMPAIRMENT:

☞ Goodwill arising on business combination is not amortized but it is tested for impairment Annually.



EXAMPLE

P ltd Acquired 75% Equity Shares of S ltd for ₹ 120 lakhs. Total INA od Subsidiary on DOA is ₹ 100 lakhs.

CASE A: NCI is to be calculated based on Fair Value which is ₹ 35 lakhs. Further Goodwill is impaired by ₹ 10 lakhs.

CASE B: NCI is based on PSNA method & Goodwill is impaired by ₹ 10 lakhs.

Calculate Goodwill on Acquisition and discuss the Treatment of Goodwill.

6. STEP ACQUISITION / MULTIPLE ACQUISITION / ACQUISITION ACHIEVED IN STAGES / ACQUISITION OF INTEREST IN SUBSIDIARIES AT DIFFERENT DATES

☞ If any subsidiary is acquired in lots through multiple acquisition, then consolidation begins from the date of obtaining control (i.e. Goodwill will be computed only on date of control)

ACQUISITION WHERE CONTROL WAS OBTAINED ON LATER ACQUISITION

(1st acquisition–10% 2nd acquisition–60%)

(1st acquisition–25% 2nd acquisition–45%)

Control was obtained after second acquisition and hence all 6 Steps of Acquisition will be followed from the date when control is obtained.

Goodwill will also be calculated only when control is obtained

Investment held before obtaining control will be reavlued to its Fair Value in CFS on Date of Acquisition of Control

J.E. to be Passed in CFS
Investment A/c Dr.
To P&L / OCI A/c

NOTE: In SFS the Previously held investment may be at Cost or Fair Value. On Obtaining Control we need not chnage that value in SFS

FURTHER ACQUISITION WHERE CONTROL ALREADY EXISTED IN PREVIOUS ACQUISITION

(1st acquisition–65% 2nd acquisition–10%)

Goodwill will NOT be recomputed or adjusted, as goodwill is computed only on Date of Acquisition of control.

When Parent Acquires Further Investment, NCI's share will be reduced (i.e. NCI will be de-recognised) & Reduction will be done on Pro-rata Basis based on the value of NCI on date of De-recognition of NCI

J.E. In CFS
NCI A/c Dr.
Cons. O.E. (Loss on Acq.) A/c Dr. (B/F)
To Bank A/c
To Cons O.E. (Profit) (B/F)

7. DISPOSAL OF SHARES IN SUBSIDIARY

WITHOUT LOSS OF CONTROL

Eg: Stake Before Disposal - 80%

Disposed 15%

Stake After Disposal is 65%

NCI's share will increase by 15% (i.e. we will recognise NCI)

There are two methods to recognise NCI

1. FAIR VALUE METHOD

- Fair Value of NCI on date of disposal is directly given

OR

- INA of subsidiary Including Goodwill (can be taken as Fair Value of Total Subsidiary) (x) % of NCI by which it is increased

2. PSNA Method

- INA of Subsidiary (x) % of NCI by which it is increased

TOTAL NCI

Opening NCI before Disposal

+ NCI Recognised On disposal (as per above)

WITH LOSS OF CONTROL

Eg: Stake Before Disposal - 80%

Disposed 70%

Stake After Disposal 10%

As Control is Lost, Parent Entity will -Derecognise NCI, INA of Subsidiary, Goodwill/GBP

- Recognise Proceeds Received, Investment Retained (if any) at Fair Value on Date when control is lost

- Reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind ASs, the amounts recognised in OCI in relation to the subsidiary

(Refer Example 1 Below)

- Balance (If any) will be transferred to P&L

WITHOUT LOSS OF CONTROL

JOURNAL ENTRIES

In SFS

Bank A/c Dr.
P&L (Loss on Disposal) A/c Dr. B/F
To Investment (Pro Rata) A/c
To P&L (Profit) A/c - B/F

In CFS

Bank A/c Dr.
Other Equity (Loss) A/c Dr. - B/F
To NCI A/c
To Other Equity (Profit) A/c - B/F

WITH LOSS OF CONTROL

JOURNAL ENTRIES

In SFS

Bank A/c Dr.
P&L (Loss on Disposal) A/c Dr.
To Investment (Pro Rata) A/c
To P&L (Profit on Disposal) A/c

In CFS

Bank A/c Dr.
Investment A/c Dr. (Retained Portion)
NCI A/c Dr.
GBP A/c Dr.
P&L (Loss) A/c Dr. - B/F
To INA A/c
To Goodwill A/c
To P&L (Profit) - B/F

7.1 LOSS OF CONTROL OF A SUBSIDIARY IN TWO OR MORE ARRANGEMENTS (TRANSACTIONS)

☞ A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction.

The above requirement is relevant because Ind AS 110 requires an entity to record gain / loss on disposal of investment in subsidiary in profit or loss only when the control is lost.

☞ In determining whether to account for the arrangements as a single transaction, a parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent should account for the multiple

arrangements as a single transaction:

i) They are entered into at the same time or in contemplation of each other

ii) They form a single transaction designed to achieve an overall commercial effect

iii) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement

iv) One arrangement considered on its own is not economically justified, unless it is considered together with other arrangements. (e.g. when a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market)

8. SUBSIDIARY'S CUMULATIVE PREFERENCE SHARES CLASSIFIED AS EQUITY AND HELD BY NCI

☞ If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the entity shall compute its share of profit or loss after adjusting for the dividends on such shares, whether or not such dividends have been declared.

☞ **Example:**

R Ltd. Hold 80% stake on Y Ltd. Y Ltd. Has also issued 10% cumulative preference shares worth ₹ 10,00,000 to the non-controlling interest. During the year, Y Ltd. Earned profit of ₹ 5,00,000. Y Ltd. Has not declared any dividend on cumulative preference share for current year. In such case, the profit attributable to R Ltd. For current year would be as follows:

	₹
Total profit of Y Ltd.	5,00,000
Dividend on preference shares (10,00,000 x 10%)	(1,00,000)
Net profit	4,00,000
Profit attributable to R Ltd. (4,00,000 x 80%)	3,20,000

9. ELIMINATION OF INTRA – GROUP TRANSACTIONS

☞ Ind AS 110 states that intra - group balances and intra - group transactions should be eliminated in full (In CFS)

EXAMPLE: Liabilities due to one group entity by another will be set off against the corresponding asset in the other group entity's financial statements;

Sales made by one group entity to another should be excluded from turnover and from purchase (or related head) or the appropriate expense heading in the consolidated statement of profit and loss.

☞ Resulting Unrealized Profits(if any) will also be eliminated (Already Discussed above).

10. UNIFORM ACCOUNTING POLICIES

☞ A parent shall prepare CFS using uniform accounting policies for like transactions and other events in similar circumstances. (i.e. Accounting policies of subsidiary should be made uniform with parent for consolidation purpose)

☞ EXAMPLE

A Ltd. (a company incorporated and registered in India) has a subsidiary B Inc. (a company incorporated and registered in United States). A Ltd. Follows Ind AS for the preparation of of its financial statements. However, B Inc. follows generally accepted accounting principles in United States (US GAAP). Hence, while using B Inc.'s financial statements for the purpose of preparing consolidated financial statements of A Ltd., appropriate adjustments should be made to B Inc.'s financial statements to convert its US GAAP financial statements to Ind AS financial statements.

NOTE:

i) If nature of inventory of parent and subsidiary is different then in CFS different Cost Formulas may be used for both the inventories.

ii) Depreciation method, useful life, residual value are not Accounting Policies. These are Accounting Estimates. Hence parent and subsidiaries may have different Depreciation Method or Useful Life of assets.

11. CAN NCI BE NEGATIVE

☞ The entity shall attribute Total Comprehensive Income of Subsidairy (P&L + OCI) to the Parent and to NCI even if this results in the NCI having a deficit balance. (NCI Can be negative when Post Acquisition Share of Subsidiary losses are allocated to NCI).

12. REPORTING DATE

☞ The FS of the parent and its subsidiaries used in the preparation of the CFS shall have the same reporting date.

☞ When the end of the reporting period of parent is different from subsidiary, the subsidiary for consolidation purposes, prepares additional financial information as of the same date as the FS of parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.

☞ If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. The difference between the date of subsidiary's FS and that of CFS shall be no more than 3 months.

13. ACQUISITION OF INTEREST (CONTROL) IN SUBSIDIARIES WITHOUT CONSIDERATION

☞ An entity (say entity A) sometimes obtains control of another entity (say entity B) without transferring consideration. Such circumstances include:

- That another entity (entity B) repurchases a sufficient number of its own shares from an existing investor;
- Minority veto rights lapse that previously kept the investor (entity A) from controlling that another entity (entity B) in which the investor (entity a) held the majority voting rights.
- The investor (entity A) and investee (entity B) agree to combine their businesses by contract alone. The investor (entity A) transfers no consideration in exchange for control of the investee (entity B) and holds no equity interests in the investee, either on the acquisition date or previously.

☞ In a business combination achieved by contract alone, the investor (Parent) will Recognise Net Assets of the investee in accordance with IND AS 103 and Prepare CFS. Investor will Consolidate the FS with the Investee even if it results in allocating all of the value to NCI (as the investor does not hold any Equity Interest).

14. CHAIN HOLDING UNDER CONSOLIDATION

i) MEANING OF CHAIN HOLDING

☞ A parent company can establish control over subsidiary directly or indirectly. Chain-holding refers to situations wherein a parent is controlling a subsidiary indirectly, i.e., having a controlling interest over a company indirectly.

☞ This may happen in number of ways, for example, parent company (P Ltd.) holding controlling interest in a subsidiary (S1 Ltd.), & Such S1 ltd in turn is holding a controlling interest in another company (S2 Ltd.). In this case, P Ltd. is having an indirect control over S2 Ltd. through its direct subsidiary S1 Ltd.

EXAMPLE 1

Parent P Holds 80 % in S1

S1 Holds 80% in S2

In the above case, P holds a controlling interest in S1 which in turn holds a controlling interest in S2. S2 is therefore an indirect subsidiary of P, in other words, a sub-subsidiary of P.

Effective Stake of P Ltd in S2 = 80% x 80% = 64%

EXAMPLE 2:

P ltd holds 75% in S1 Ltd & P ltd also holds 10 % in S2 Ltd.

S1 Ltd Holds 60% in S2 ltd.

Effective Stake of P Ltd in S2 = 10% (+) 75% x 60% = 55%

EXAMPLE 3:

P ltd holds 80% in S1 Ltd

S1 Ltd Holds 60% in S2 ltd.

Effective Stake of P ltd in S2 = 80% x 60% = 48%

REASON:

Just because the stake is less than 50%, it does not mean that P ltd does not control S2 ltd. P can Control S1 ltd 100% & S1 can control S2 ltd. 100%. Hence, P can indirectly control S2 ltd.

In IND AS, Stake in Not important but control is important for Determining Parent Subsidiary relationship.

ii) DATE OF EFFECTIVE CONTROL

☞ The date the sub-subsidiary (S2) comes under the control of the holding company is either:

a) The date P acquired S1 if S1 already holds shares in S2, OR

(Eg: P Pltd acquired 100% is S1 ltd on 31/03/17 & S ltd had acquired 75 % Stake in S2 ltd on 01.04.2016.
In this case, Consolidation of P ltd with S2 ltd will begin from 31/03/17)

b) If S1 ltd acquires share in S2 ltd after the acquition of P ltd, then the date of control of P ltd in S2 ltd will be when S1 ltd acquirer S2 ltd
(E.g. P ltd acquired 100% in S1 ltd on 31. 3. 17 & S1 ltd Acquired 75% Stake S2 ltd on 1.10.18.
In this case, Consolidation of P ltd with S2 ltd will begin from 1.10.18)

NOTE: Date of acquisition / date of effective control is important because PC, Identifiable Net assets, NCI, Goodwill/GBP are calculated on such date.

15. CONSOLIDATED PROFIT & LOSS

i) Parent should consolidate line by line items of Profit & Loss of Subsidiary. Consolidated P&L should be prepared from the Date of Acquisition of Control. Hence, if Control is Acquired during the year then An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary.
Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date
Example:
On the date of acquisition of control by A Ltd over B Ltd., the fair value of B Ltd.'s property, plant and equipment were ₹ 100 lakh and such assets are recorded in the consolidated financial statements of A Ltd. At that value. However, the carrying value of such assets in the books of B Ltd. On that of acquisition were ₹ 80 lakh. Hence, for the purpose consolidated financial
statements, the depreciation expense should be computed based ₹ 100 lakh and not ₹ 80 lakh

ii) Inter Company Income & Expense / Sales & Purchase should also be eliminated.

Journal Entry:

Sales / Income A/c Dr.

To Purchase / Expense A/c.

NOTE: The above Elimination is to be done only when Date of Transaction is after Date of Acqusition.

iii) Dividend Income of Parent received from Subsidiary will be settled off (Only Parent's Share):

Journal Entry

Consolidated P&L (Dividend income of Parent) A/c Dr.

To Other Equity A/c A/c (Reducing Dividend Paid by Subsidairy)

iv) Unrealised Profit within the Group will also be eliminated.

a) Journal Entry in case of Upstream Transaction

Consolidated P&L A/c Dr. (Reducing Profit Earned by Subsidairy)

To Inventory A/c (of Parent – Consolidated B/S)

b) Journal Entry in case of Downstream Transaction

Consolidated P&L A/c Dr. (Reducing Profit Earned by Parent)

To Inventory A/c (of Subsidiary – Consolidated B/S)

NOTE: The effect in Consolidated P&L can be given either by Creating a Separate Head OR by adjusting closing stock (by eliminating the profit element).

v) Additional Depreciation / Savings in Depreciation due to revaluation on Depreciable Assets of Subsidiary and its related Tax Effects.

Journal Entry

Consolidated P&L A/c Dr. (on Revaluation of Subsidiaries Asset)

To PPE A/c (Subsidiaries Asset – Consolidated B/S)

vi) Impairment of Goodwill.

Journal entry in Case of Full Goodwill

Consolidated P&L A/c Dr. (Parent's Share)

NCI A/c Dr. (NCI's Share)

To Goodwill A/c

Journal entry in Case of Partial Goodwill

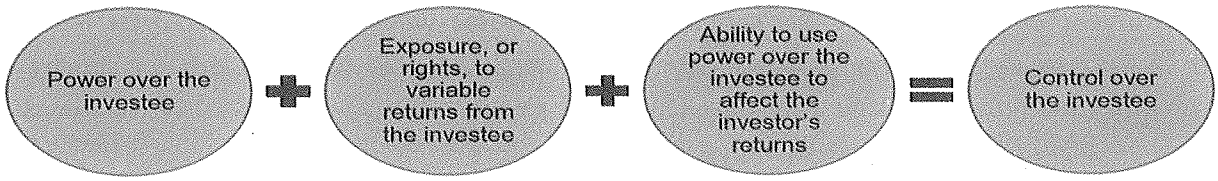
Consolidated P&L A/c Dr.

To Goodwill A/c

NOTE: The above list of Adjustment is illustrative.

16. CONTROL EVALUATION

- An investor controls an investee if and only if the investor has all the following three elements:

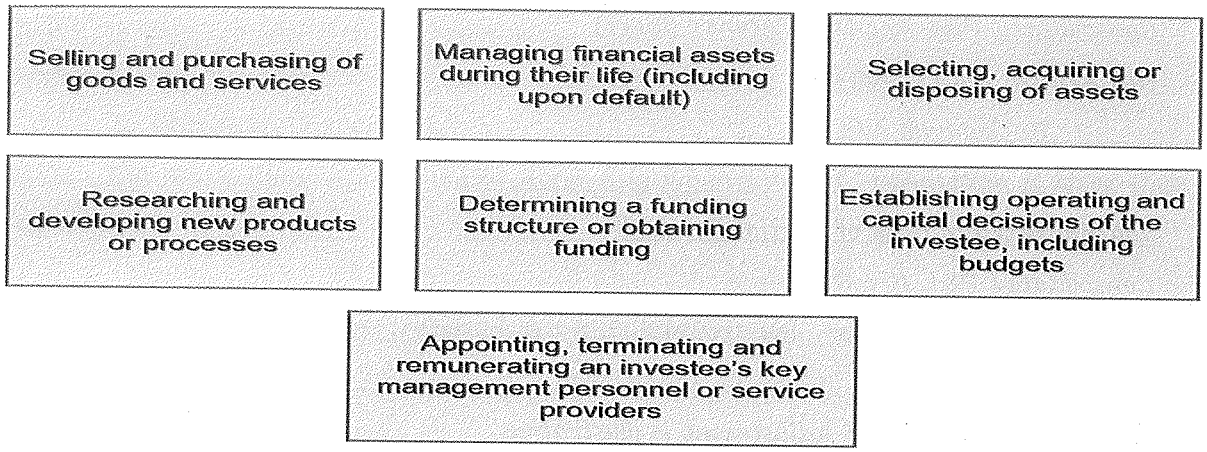


16.1. POWER

- An investor gets power over an investee if it has three elements:
  - ✓ Existing rights that give it
  - ✓ The current ability
  - ✓ To direct the relevant activities of the investee.

16.1.1. HOW TO IDENTIFY THE RELEVANT ACTIVITIES

- Relevant activities are the activities of investee that significantly affect the investee's returns.
- Examples of activities related to operating and financing activities that can be relevant activities include, but not limited to:



16.1.2. CURRENT ABILITY TO DIRECT THE RELEVANT ACTIVITIES

- An investor would have current ability to direct relevant activities if that investor were able to make decisions at the time those decisions need to be taken.
- Current ability to direct the activities of an investee would, in all cases, arise from rights (voting rights, potential voting rights, rights within other arrangements or a combination of these).

16.1.3. RIGHTS THAT GIVE POWER TO AN INVESTOR

- Power arises from rights. The rights that give an investor power over an investee can differ investee by investee. Following are some of the examples (not an exhaustive list) of various forms of rights that, either individually or in combination with other rights, can give power to an investor:

Form of right	Illustration
Voting rights or potential voting rights of an investee.	An investor holding majority of the equity share capital of an investee.
Rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities.	An investor having right to appoint majority of the members of the Board of Director who have power to take decisions related to relevant activities.
Rights to appoint or remove another entity that directs the relevant activities.	Right with an investor to appoint or remove an asset manager who takes decisions related to investments / divestments by a venture capital fund.

Rights to direct the investee to enter, or veto any changes to, transactions for the benefit of the investor.	Right with an investor to direct the investee to sell all its outputs to a group company of the investor at the price determined by investor
Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.	Right related to relevant activities given to a single investor by all other investors through a shareholders' agreement

❖ SUBSTANTIVE RIGHTS VS PROTECTIVE RIGHTS

For the purpose of determination of power over an investee, an investor shall consider only those rights which are substantive. Protective rights are not considered for the determination of power.

Substantive rights	Protective rights
Substantive rights can give the investor power over the investee.	Protective rights do not give investor power over the investee.
Substantive rights relate to the relevant activities of the investee.	Protective rights relate to protect the interest of the party holding those rights without giving the holder the right over the relevant activities of the investee.

☞ The effect of substantive and protective rights is summarised below:

Type of rights held by investor		Type of rights held by other parties		Conclusion on 'power'?
Substantive	+	Protective	=	Investor has power
Protective	+	Substantive	=	Other parties have power
Substantive	+	Substantive	=	Further evaluation needed

❖ Note: Under FRANCHISE Agreement – Rights of Franchisor are Protective Rights

16.1.4. VOTING RIGHTS

1) POWER THROUGH VOTING RIGHTS

☞ In the most straightforward cases, the investor that holds most voting rights has power over

an investee. However, there can be certain cases where an investor can have power even if it holds less than a majority of the voting rights of an investee.

A. Power with a majority of the voting rights

☞ An investor that holds more than half of the voting rights of an investee has power in the following situations:

The relevant activities are directed by a vote of the holder of the majority of the voting rights	OR	A majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights

For example, in case of a company where the decisions related to relevant activities are taken by Board of Directors of the company and the Board members are appointed by shareholder holding majority of the voting rights. Then the shareholder holding majority of the voting rights has power over the company.

B. Power without a majority of voting rights

☞ There can be certain cases where an investor can have power even if it holds less than a majority of the voting rights of an investee. Following are the examples of power without majority voting rights:

i) Contractual arrangement with other vote holders to give the investor rights to exercise voting rights which are sufficient to have power over the investee.

ii) Rights from other contractual arrangements relating to decision making of relevant activities. Such contractual rights in combination with voting rights may give investor power to direct the relevant activities

iii) Size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders. The investor should also consider voting patterns at previous shareholders' meetings to determine whether investor has power over the investee.

iv) Potential voting rights – These are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options or forward contracts. Those potential voting rights are considered only if the rights are substantive. Potential voting

rights are to be considered in combination with voting or other decisions-making rights that the investor might have to assess whether investor has power or not.

v) Combination of all above

2) POWER OTHER THAN THROUGH VOTING RIGHTS

When voting rights cannot have a significant effect on an investee's returns, such as when voting rights relate to administrative tasks only the investor shall consider other evidences. Following are some of the examples of such evidences:

Evidence	Illustration
The investor can appoint or approve the investee's key management personnel who can direct the relevant activities	An investor holds 40% of the voting rights of an investor. However, the investor has right to appoint majority of the board members of investee and the decisions of relevant activities of investee are taken by its board.
The investor can direct the investee to enter, or can veto any changes to, significant transactions for the benefit of the investor	A Ltd. and B Ltd. both holds 50% each of voting rights of an investee and have right to appoint 2 members each in board of investee. The decision of relevant activities of investee are taken in board meetings by majority members. A Ltd. also has right to appoint a chairman of the board who will have a casting vote in case of a deadlock situation.
The investor can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.	X Ltd. has invested in the share capital of P Ltd. Apart from A Ltd. there are 4 other investors in P Ltd. Each investor has right to appoint one member on the board of P Ltd. who will have right to direct the relevant activities of P Ltd. Out of the 4 other investors, 2 investors are related parties of X Ltd. and hence X Ltd. can direct them to appoint their representative on the board as per X Ltd.'s choice. Accordingly, X Ltd. can appoint majority of the members of the board of P Ltd.
The investee's key management personnel are related parties of the	The chief executive officer of the investee and the chief executive officer of the investor are the same

investor	person.
The majority of the members of the investee's governing body are related parties of the investor.	The majority of the board members of the investee are also the board members of the investor.

16.2. EXPOSURE, OR RIGHTS, TO VARIABLE RETURNS FROM AN INVESTEE

☞ Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative. An investor assesses whether returns from an investee are variable

▪ Fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability depends on the investee's ability to generate sufficient income to pay the fee.

☞ Following are some of the examples of variable returns:

Variable returns from an investee		
Dividends, other distributions (eg interest from debt securities) Changes in the value of the investor's investment in that investee.	Remuneration for servicing an investee's assets or liabilities Fees and exposure to loss from providing credit or liquidity support Residual interests in the investee's assets and liabilities on liquidation Tax benefits Access to future liquidity	Returns that are not available to other interest holders For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge, or limiting some operations or assets, to enhance the value of the investor's other assets.

16.3. LINK BETWEEN POWER AND RETURNS

☞ An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.

For example, it is common for a lender to have an exposure to variable returns from a

borrower through interest payments that it receives from the borrower, that are subject to credit risk. However, the lender would not control the borrower if it does not have the ability to affect those interest payments (which is frequently the case).

☞ Thus, an investor with decision-making rights shall determine whether it is a principal or an agent.

☞ An investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly.

16.4. CONTROL OF SPECIFIED ASSETS

☞ An investor shall consider whether it treats a portion of an investee as a deemed separate entity and, if so, whether it controls the deemed separate entity. A deemed separate entity is often called a 'silo'.

For example, an investee is a mutual fund and under the investee there are multiple sub-funds established with different investment objectives like debt-oriented funds, equity-oriented funds, etc. In such case, an assessment should be made as to whether the sub-funds are deemed separate entities as per the conditions mentioned above.

☞ An investor shall assess whether it controls the silo by applying the guidance of control evaluation. If the investor controls the silo, the investor shall consolidate that silo. In that case, other parties exclude that silo when assessing control of, and in consolidating, the investee.

For example, continuing with the above example on identification of a silo, if one of the sub-funds is treated as a silo then the investor that controls that silo will consolidate that sub-fund. Other parties who control other sub-funds will exclude the sub-fund controlled by the investor in their control evaluation and consolidation

17. EXEMPTION FROM PRESENTING CONSOLIDATION FINANCIAL STATEMENTS

I. A parent is not required to present CFS if it meets all of the following four conditions:

i) Condition 1: The parent is either a wholly owned subsidiary or a partially owned subsidiary of another entity. Further its other owners (including those not entitled to vote) have been informed and do not object, to the parent not presenting CFS.

ii) Condition 2: The equity instruments or the debt instruments of the parent are not traded

in a public market. The public market could be a domestic or foreign stock exchange or an over the counter market including local and regional markets.

iii) Condition 3: The parent has neither filed nor is in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market.

iv) Condition 4: The ultimate or any intermediate parent, produces financial statements that are available for public use and comply with Ind AS, in which subsidiaries are consolidated.

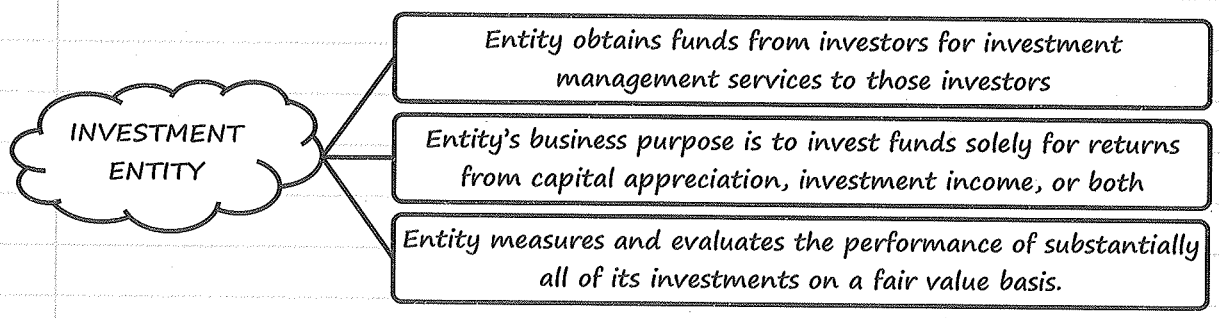
❖ Further, a parent who fulfils the following two conditions is also not required to present consolidated financial statements:

i) Condition 1: The parent is an investment entity (Discussed Below)

ii) Condition 2: The parent is required to measure all its subsidiaries at FVTPL.

II. INVESTMENT ENTITY

A. ELEMENTS OF DEFINITION



Note: It should meet all the above elements to be qualified as an investment entity.

❖ FOR ASSESSING 'INVESTMENT ENTITY', ALSO CONSIDER THE FOLLOWING 4 TYPICAL CHARACTERISTICS

a) Whether it has more than one investment

In some cases, holding one investment does not prevent it from meeting definition if the entity. Eg: if it is in start-up period

b) Whether it has more than one investor

In some cases having one investor does not prevent the entity from meeting definition if the entity. Eg: It is within its initial offering period & entity is still identifying suitable investor

c) Whether its Investors are not related parties of the entity

Having unrelated investors would make it less likely that the entity would obtain benefits other than capital appreciation or investment income.

However, an entity may still qualify as an investment entity even though its investors are related to the entity.

d) Whether it has ownership interests in the form of equity or similar interest

An entity that has significant ownership interests in the form of debt that, may still qualify as an investment entity, provided that the debt holders are exposed to variable returns from changes in the fair value of the entity's net assets.

NOTE: If it does not meet all the four typical characteristics, it may still be an investment entity based on the presumption of substance over form.

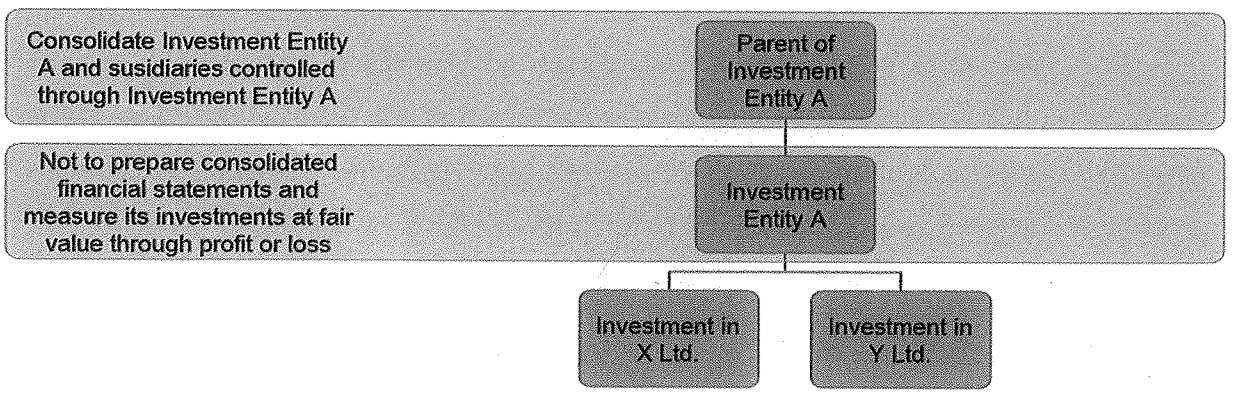
B. CONSOLIDATION NOT REQUIRED

An investment entity shall not consolidate its subsidiaries, Instead it shall measure its investment in subsidiaries at FVTPL in accordance with Ind AS 109.

❖ THERE ARE TWO EXCEPTIONS TO THE ABOVE RULE:

i) An investment entity shall consolidate that subsidiary which provides services related to investment entity's investment activities.

ii) A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity. This is explained in following diagram:



C. ACCOUNTING FOR A CHANGE IN INVESTMENT ENTITY STATUS

i) Accounting when an entity ceases to be an investment entity

☞ In this case, it shall apply Ind AS 103 to any subsidiary that was previously measured at FVTPL. The date of the change of status shall be deemed acquisition date. Fair value of subsidiary at deemed acquisition date shall represent deemed consideration when measuring any goodwill or GBP. All subsidiaries shall be consolidated in accordance with consolidation principles.

ii) Accounting when an entity becomes an investment entity

When an entity becomes an investment entity, it shall cease to consolidate its subsidiaries at the date of the change in status. The investment entity shall apply requirements of loss of control explained earlier to those subsidiaries that it ceases to consolidate as if the investment entity had lost control of those subsidiaries at that date.

IND AS 111
JOINT ARRANGEMENTS

1. DEFINITION

☞ A joint arrangement is an arrangement where two or more parties have JOINT CONTROL over an entity under the CONTRACTUAL AGREEMENT.

2. JOINT CONTROL

Joint Control requires that all the decisions about the relevant activities are being taken UNANIMOUSLY by the parties SHARING CONTROL.

i) COLLECTIVE CONTROL

Here, no single party enjoys full control. All the parties or a group of parties are having collective control over relevant activities which significantly affect the returns or the outcome of the arrangements.

ii) UNANIMOUS DECISION

☞ There has to be unanimous consent of all the parties having joint control on the decisions for the arrangement. It means that any party with joint control can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent.

☞ There may be cases where the contract necessitates a minimum percentage of the voting rights to make decisions about the relevant activities. If that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the contractual arrangement specifies which parties (or combination of parties) are required to agree unanimously to take decisions about the relevant activities of the arrangement.

3. TYPES OF JOINT ARRANGEMENTS

A. JOINT OPERATIONS

i) Joint Arrangements which are NOT structured through a separate legal entity

OR

ii) Joint Arrangements which are structured through separate legal entity BUT the parties have right to individual assets and obligation for liabilities held in the separate Legal Entity

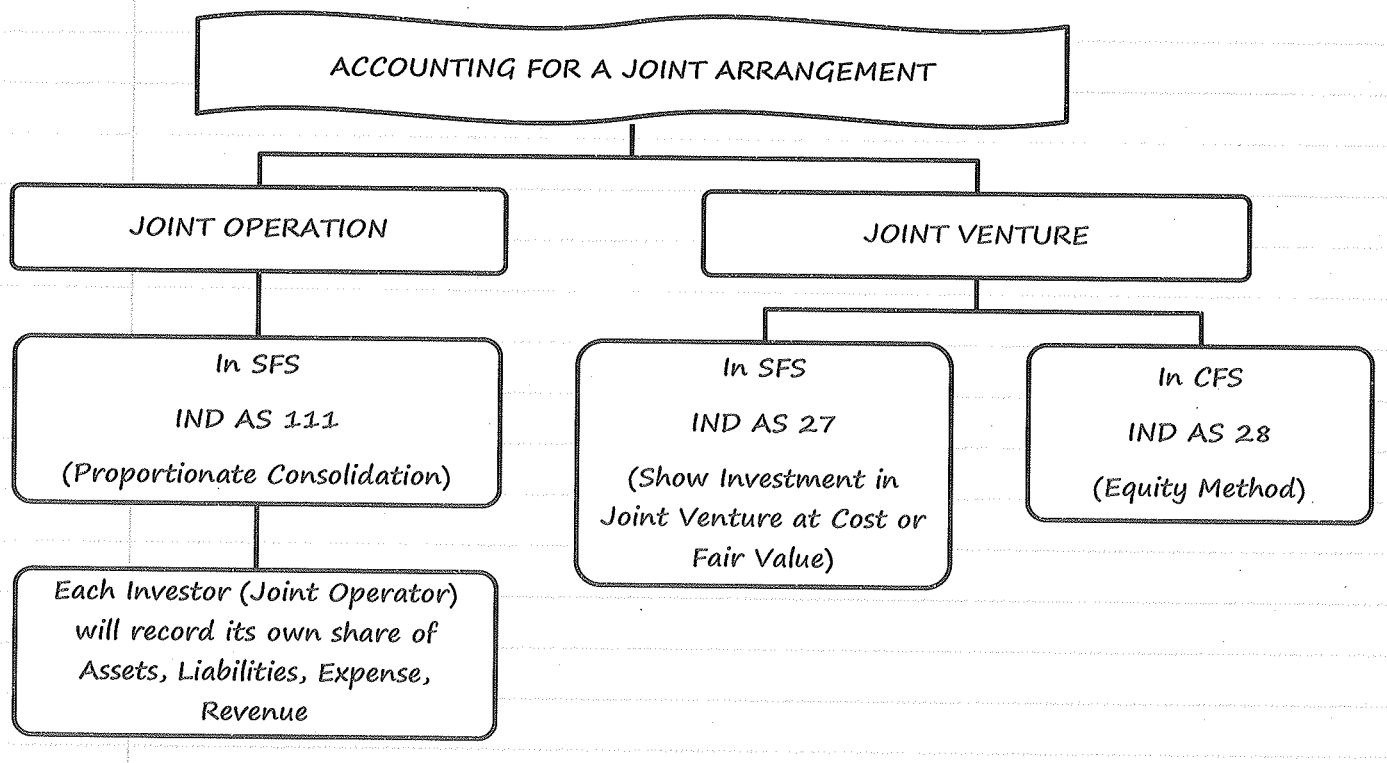
OR

iii) Joint Arrangements is structured through a separate legal entity but its substantially whole output from the Assets of the Arrangement from is allocated to the Investors AND also parties are substantially the only source of cash flows contributing to the continuity of the Joint Arrangement. (The parties will make sure that the output is not sold to the third parties but used by them only)

B. JOINT VENTURES

☞ Joint Arrangement which are structured through a separate legal entity AND Parties are sharing Net Assets in the Joint Arrangement (& Not individual assets and liabilities)

4. ACCOUNTING FOR A JOINT ARRANGEMENT



i) Accounting for sales or contributions of assets to a joint operation in separate and consolidated financial statement of joint operator

☞ When a joint operator sells or contributes any asset to the joint operation, it is in effect transacting with the other parties to the joint operation and hence the joint operator shall recognise gains and losses resulting from such transactions only to the extent of the other parties' interest in the joint operation.

ii) Accounting for purchases of assets from a joint operation in separate and consolidated financial statement of joint operator

☞ When a joint operator purchases any asset from the joint operation, it shall not recognise its share of the gains and losses until it resells those assets to a third party

☞ When above transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed to the joint operation, or of an impairment loss of those assets, those losses shall be recognised fully by the joint operator.

"Success is the sum of small efforts, repeated day in and day out"

IND AS 28
INVESTMENT IN ASSOCIATES & JOINT VENTURES

1. DEFINITION

i) ASSOCIATE

☞ An entity over which the investor has Significant Influence;

ii) JOINT VENTURE

☞ A Joint Arrangement where Parties that have joint control over the arrangement have rights to the net assets of the Arrangement (Already Defined in IND AS 111)

2. SIGNIFICANT INFLUENCE

☞ Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

☞ Significant Influence may arise from Voting Rights as discussed Below:

a) HOLDING 20% OR MORE OF THE VOTING RIGHTS:

If an entity holds, directly or indirectly (eg through subsidiaries), 20% or more of voting power of investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case.

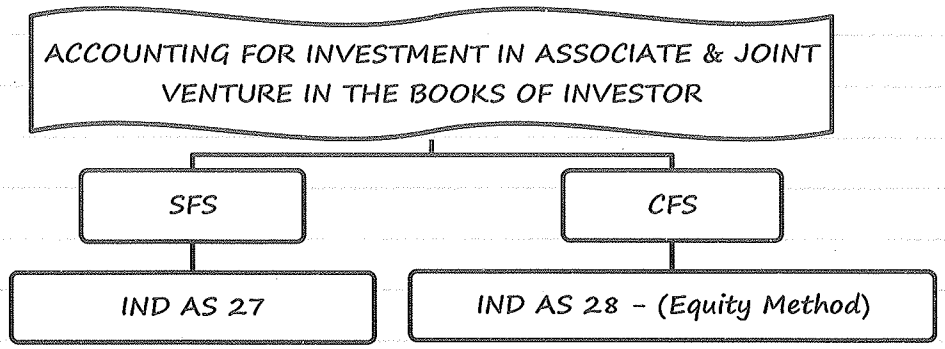
b) HOLDING LESS THAN 20% OF VOTING RIGHTS:

Also, in cases where the entity holds, directly or indirectly (eg through subsidiaries), less than 20 % of voting power of investee, it is presumed that the entity does NOT have significant influence, unless such influence can be clearly demonstrated.

NOTE:

It is worth noting that a substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

3. ACCOUNTING FOR INVESTMENT IN ASSOCIATE & JOINT VENTURE



4. EQUITY METHOD

☞ The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

A. APPLICATION OF EQUITY METHOD

☞ Under the equity method of accounting, an investor shall pass following entries at various stages of investment:

i) Initial entry to record investment done in associate

Investment in B Ltd. A/c Dr.

To Bank A/c

ii) Recording of share in the profit of the associate

Investment in B Ltd. A/c Dr.

To Share in profit of investee (P&L)

iii) Recording of share in the other comprehensive income (OCI) of the associate

Investment in B Ltd. A/c Dr.

To Share in OCI of investee (OCI)

iv) Recording of dividend distributed by associate

Dividend income A/c (P&L)

To Investment in B Ltd. A/c Dr.

B. Equity method procedure

i) Calculation of goodwill / capital reserve and calculation of share in profit / loss of associate or joint venture

☞ On acquisition of the investment, an entity shall identify the goodwill or capital reserve. Difference between cost of investment and entity's share of net fair value of investee's identifiable assets and liabilities is accounted for as:

i) Goodwill – If the cost of investment is greater than investor's share of investee net identifiable assets. The goodwill is not separately presented, it is included in the carrying amount of the investment.

ii) Capital Reserve – If investor's share of investee' net identifiable assets is greater than the cost of investment. Capital Reserve is recognised directly in equity in the period in which the investment is made.

ii) Upstream and downstream transactions between the entity and its associate or joint venture

- 'Upstream' transactions are, for example, sales of assets from an associate or a joint venture to the investor.
- 'Downstream' transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture.

☞ The Entity should eliminate Unrealised Profit or Loss resulting from Upstream & Downstream Transactions to the extent of its own Share)

☞ When downstream transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed, or of an impairment loss of those assets, those losses shall be recognised in full by the investor.

☞ When upstream transactions provide evidence of a reduction in the net realisable value of the assets to be purchased or of an impairment loss of those assets, the investor shall recognise its share in those losses.

iii) Summary of EQUITY METHOD

PARTICULARS	₹	REMARKS
Cost of the Investment (At Cost) {Including Goodwill, if any}	XX	
ADD: Investor's share of investee's profit or loss POST ACQUISITION	XX	Recognised in Investor's Consolidated P&L
ADD: Investor's share of investee's OCI POST ACQUISITION	XX	Recognised in Investor's Consolidated OCI
LESS: Distributions (Dividends) Received from Investee (Only to the Extent of Investor's Share)	XX	Recognised in Investor's Consolidated P&L
LESS: Elimination of Unrealised Profit or Loss resulting from Upstream & Downstream Transactions (Only to the extent of Investor's Share)	XX	Recognised in Investor's Consolidated P&L
LESS: Additional Depreciation due to Fair Value of investee's depreciable asset at acquisition date (Only to the extent of Investor's Share)	XX	Recognised in Investor's Consolidated P&L
LESS: Impairment Losses or Reduction in NRV on Downstream (Full) LESS: Impairment Losses or Reduction in NRV on Upstream (Only its own share of losses)	XX	Recognised in Investor's Consolidated P&L
CARRYING AMOUNT OF INVESTMENT AT REPORTING DATE	XX	

NOTE:

An investment in an associate or a Joint Venture accounted under Equity Method shall be presented as a single line item in the balance sheet under the head Non-Current Assets

iv) Long-term interests in associate or joint venture apart from equity investment

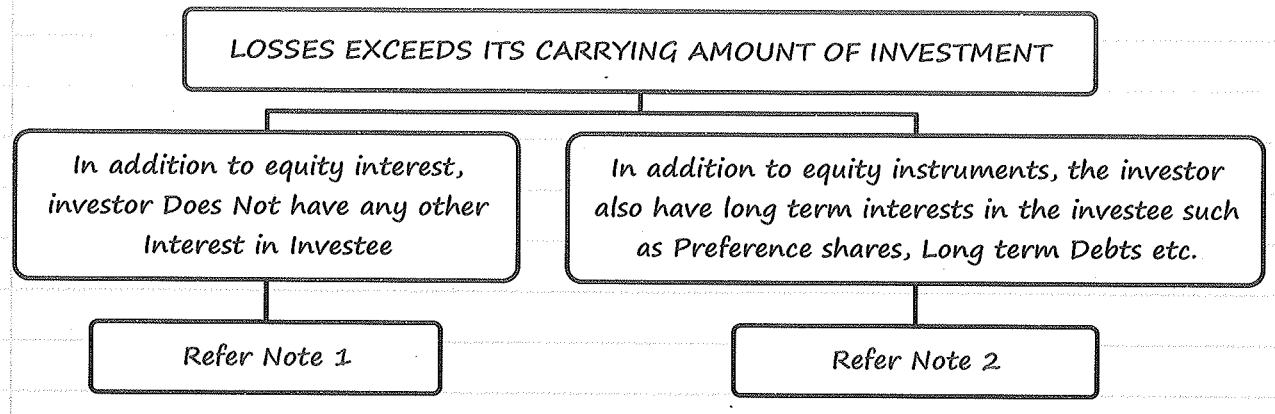
☞ An entity might hold financial instruments in associated or joint ventures which include:

- preference shares and
- long-term receivables or loans,

but do not include trade receivables, trade payables or secured loans.

☞ An entity shall account such long-term interest in accordance with Ind AS 109. Certain requirements of Ind AS 28 also apply to such long-term interests (like allocating share in loss of associate or joint venture to such interests – these are explained below)

v) Loss making associate or joint venture



NOTE 1:

- Investor discontinues recognising its share of further losses.
- Subsequent Share of Profits of the investee is recognised by the investor, only after those profits equals the share of losses Not recognised.

NOTE 2:

- Ind AS 28 states that the losses that exceed the entity's investment in ordinary shares are applied to other components of the entity's interest such as Preference shares, Long term Debts in the associate or joint venture in the reverse order of their superiority.
- It explained in a 3 step process:

a) Step 1: Apply Ind AS 109 independently

Apply Ind AS 109 (such as impairment, fair value adjustments etc.) ignoring any adjustments to carrying amount of long-term interests under Ind AS 28 (such as allocation of losses, impairment etc.)

b) Step 2: True-up past allocations

If necessary, prior years' Ind AS 28 loss allocation is trued up in the current year, because Ind AS 109 carrying value may have changed. This may involve recognizing more prior year's losses, reversing these losses or re-allocating them between different long-term

interests.

c) Step 3: Book current year equity share

Any current year Ind AS 28 losses are allocated to the extent that the remaining long-term interest balance allows. Any current year Ind AS 28 profits reverse any unrecognized prior years' losses and then allocations are made against long-term interests.

vi) Different reporting periods of the entity and its associate or joint venture

☞ Same as discussed in IND AS 110.

vii) Uniform accounting policies

☞ If the accounting policies are not same then adjustments should be made to align the accounting policies of associate or joint venture to those of the entity.

☞ Exception 1

In case of an associate, the adjustment for uniformity of accounting policies with those of the entity will not be done if it is impracticable to do so.

It is to be noted that this exemption is available in case of an associate only and not available for joint venture.

☞ Exception 2

An entity may have interest in an associate or a joint venture that is an investment entity. Such an associate or a joint venture (i.e. investment entity) may also have interest in one or more subsidiaries. When this is the case, such associate or joint venture, being an investment entity, would account for its interest in subsidiaries at fair value. Hence, in such case, the entity can elect to retain the fair value measurement used by the associate or joint venture.

5. IMPAIRMENT LOSSES

☞ After application of the equity method, it is necessary to recognise any additional impairment loss with respect to Investor's net investment in the associate or joint venture.

☞ There has to be substantial objective evidence of impairment. Objective evidences may include

Significant **financial difficulty** of the associate or joint venture

Breach of contract, such as a default in payments by the associate or joint venture

The entity **granting a concession** to associate or joint venture (because of its financial difficulties)

It becoming probable that the associate or joint venture will enter **bankruptcy or other financial reorganisation**

Disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture

Adverse effect in the environment (technological, market, economic or legal) in which associate or joint venture operates

Significant or prolonged decline in the fair value of an investment in an equity instrument below its cost

❖ *Impairment of goodwill included in carrying value of associate or joint venture*

☞ The goodwill on acquisition of associate or joint venture is recognized as part of carrying amount of net investment in associate or joint venture. Such goodwill is not tested separately for impairment, rather entire carrying amount of investment is tested for impairment as a single asset.

❖ *Reversal of Impairment Loss*

☞ Any reversal of impairment loss is recognized in accordance with Ind AS 36 'Impairment of Assets' to the extent that the recoverable amount of the net investment subsequently increases.

6. DISCONTINUING OF EQUITY METHOD

☞ An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture

☞ *Investment becomes a subsidiary*

If the investment becomes a subsidiary, the entity shall account for its investment in accordance with Ind AS 103 and Ind AS 110. Ind AS 103 requires revaluation of the previously held interest in the equity accounted investment at its acquisition date fair value, with recognition of any gain or loss in profit or loss.

☞ *Retained interest in the former associate or joint venture is a financial asset*

Retained interest in the former associate or joint venture that is a financial asset shall be

measured at fair value. The entity shall recognise in profit or loss any difference between:

- the fair value of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and
- the carrying amount of the investment at the date the equity method was discontinued.

☞ Reclassification of items recorded in other comprehensive income (OCI)

On discontinuation of equity method, any share in OCI of associate or joint venture that was previously recognized by entity shall be reclassified to P/L.

The above principle also applies in case there is a reduction in the ownership interest in an associate or joint venture but the investee still continues to be an associate or joint venture. In that case, the reclassification should be done in proportion to the reduction in the ownership interest.

7. EXEMPTIONS FROM APPLYING THE EQUITY METHOD

A. GENERAL CRITERIA

An entity need not apply the equity method to its investment in an associate or a joint venture if all the following apply:

a) The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners have been informed and do not object to, the entity not applying the equity method.

b) The entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).

c) The entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation, for the purpose of issuing any class of instruments in a public market.

d) The ultimate or any intermediate parent of the entity produces consolidated financial statements available for public use that comply with Ind AS.

B. EXEMPTION AVAILABLE WHEN INVESTMENT IS HELD THROUGH INVESTMENT ENTITY

i) Where ENTIRE Investment in associate or joint Venture is held indirectly through a venture capital organisation or a mutual fund, unit trust and similar entities

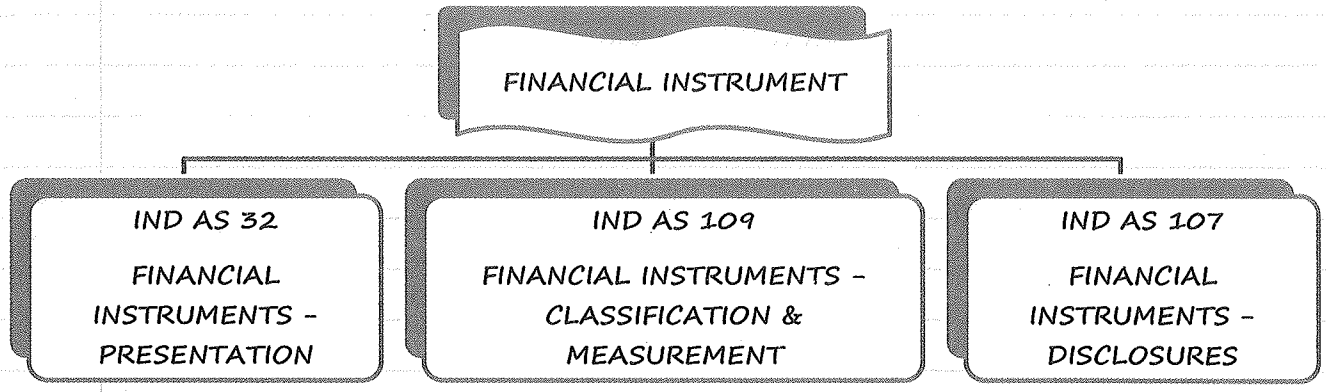
☞ Entity may elect to measure investments in those associates and joint ventures at at FVTPL (As per Ind AS 109)

ii) <u>When a portion of Investment in an associate is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities</u>

☞ Entity may elect to measure that portion of investment in associate at FVTPL (As per Ind AS 109) regardless of whether the venture capital organisation has significant influence over that portion of the investment.

☞ If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation

FINANCIAL INSTRUMENTS



IND AS 32
FINANCIAL INSTRUMENTS – PRESENTATION

1. SCOPE

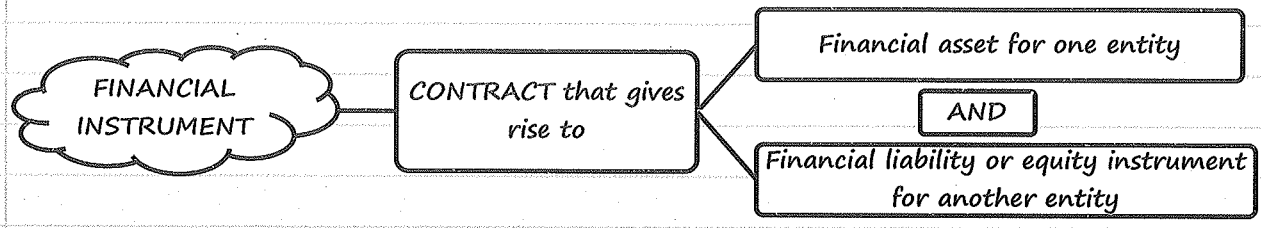
☞ Transaction outside the scope Financial Instruments:

Sl. No.	Particulars	Covered under Ind AS 109	Covered under Ind AS 32	Applicable Ind AS
1	Interest in subsidiaries, Associated, JV (At Costs)	No	No	Ind AS 27
2	Rights and obligations under leases	No	No	Ind AS 116
3	Employers' rights and obligations under employee benefit plans	No	No	Ind AS 19
4	Rights and obligations under an insurance contract	No	No	Ind AS 104
5	Forward contract arising in case of business combination	No	No	Ind AS 103
6	Loan commitment other than covered under Ind AS 109 and Ind AS 32	No	No	Ind AS 37
7	Shared based payments	No	No	Ind AS 102
8	Reimbursement right in respect of	No	No	Ind AS 37

	provision			
9	Rights and obligations under revenue for contracts with customers	No	No	Ind AS 115

2. DEFINTIONS

A. FINANCIAL INSTRUMENT

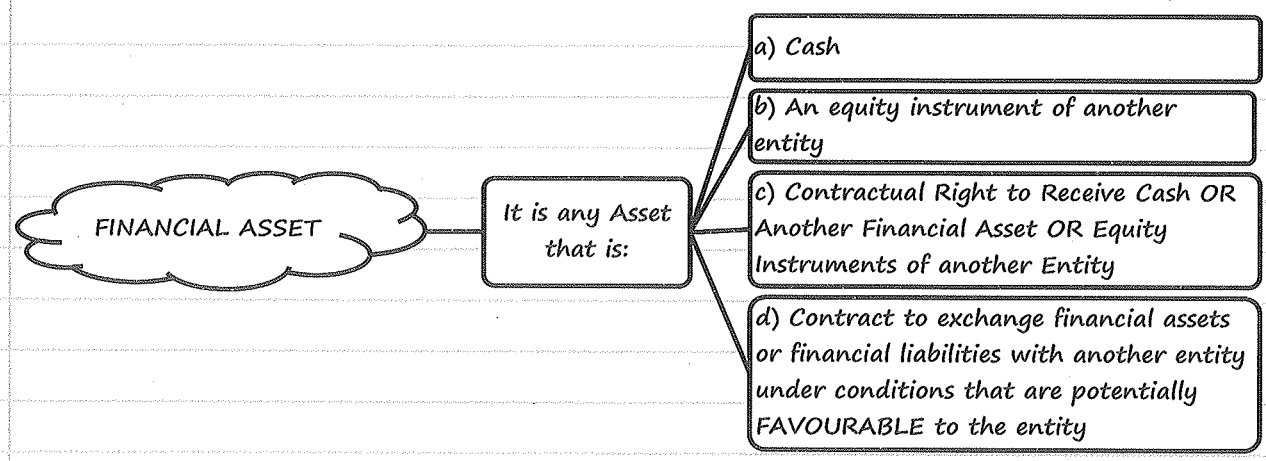


NOTE:

If any assets or liabilities that are NOT contractual are not financial liabilities or financial assets.

For eg.: Income taxes are a statutory obligation and not arising from contract. Also, constructive obligations as defined in Ind AS 37 do not arise from contracts and hence, are not financial liabilities

B. FINANCIAL ASSET (FA)

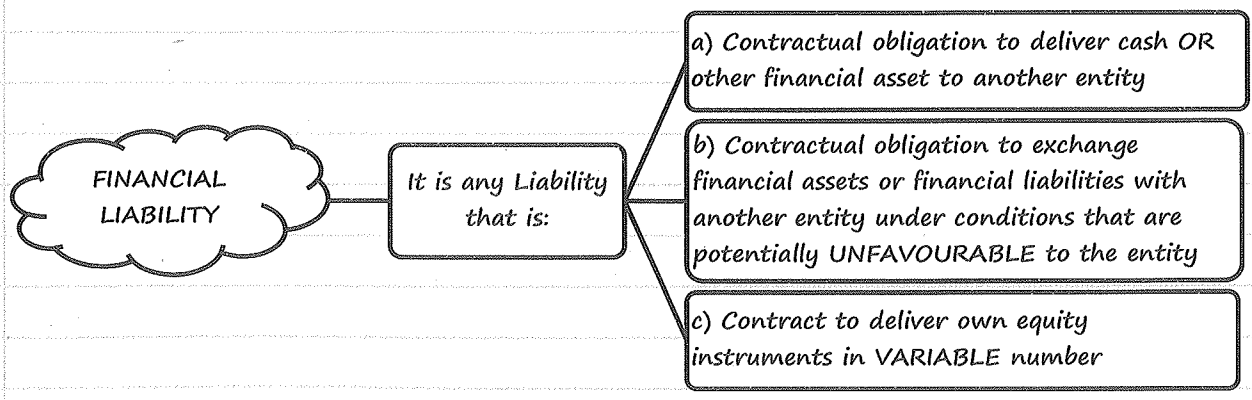


EXAMPLE: EVALUATE THE FA (MTP Nov'23)

S.	Particulars	Whether	Remarks

No.		FA or not	
1	Invst in bonds/debentures	FA	• Contractual right to receive cash.
2	Loans and receivables	FA	• Contractual right to receive cash.
3	Deposits given	FA	• Contractual right to receive cash.
4	Trade & other receivables	FA	• Contractual right to receive cash.
5	Cash and cash equivalents	FA	• Specifically covered in the definition.
6	Bank balance	FA	• Contractual right to receive cash.
7	Invst in equity shares	FA	• Equity instrument of another entity.
8	Perpetual debt instruments Eg. Perpetual bonds, debentures & capital notes.	FA	• Such instruments provide contractual right to receive interest for indefinite future or a right to return of principal under terms that make it very unlikely or very far in the future.
9	Physical assets Eg. Inventories, PPE etc.	No	• Control of such assets does not create a present right to receive cash or another financial asset.
10	Right to use assets Eg. Lease vehicle etc.	No	• Control of such assets does not create a present right to receive cash or another financial asset.
11	Intangibles Eg. Patents, trademark	No	• Control of such assets does not create a present right to receive cash or another financial asset.
12	Prepaid expenses Eg. Prepaid insurance, prepaid rent etc.	No	• These instruments provide future economic benefit in the form of goods or services, rather than the right to receive cash.
13	Advance given for goods and services	No	• These instruments provide future economic benefit in the form of goods or services, rather than the right to receive cash.

C. <u>FINANCIAL LIABILITY</u>



EXAMPLE: EVALUATE THE FL

S. No.	Particulars	Whether FL or not	Remarks
1	Loans payable or bank loan	FL	• Contractual obligation to pay cash / bank.
2	Trade and other payables	FL	• Contractual obligation to pay cash / bank
3	Bills payable / acceptance	FL	• Contractual obligation to pay cash / bank
4	Deposits received	FL	• Contractual obligation to pay cash / bank
5	Mandatory redeemable preferences shares	FL	Contractual obligation to pay cash / bank
6	Financial guarantee given	FL	• Contractual obligation to pay cash, due to the occurrence of certain events.

D. EQUITY

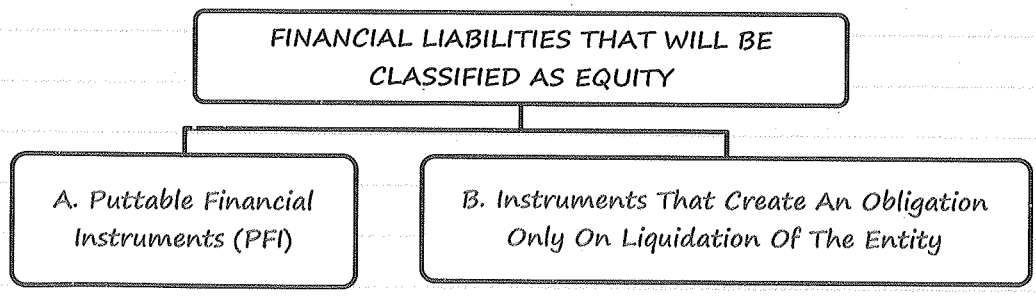
☞ An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

☞ An instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met:

a) The instrument includes no contractual obligation:
   - to deliver cash or another financial asset to another entity; or
   - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

b) If the instrument will or may be settled in the issuer's own equity instruments. (Provided the fixed to fixed test is met – discussed in subsequent point)

3. FINANCIAL LIABILITIES THAT WILL BE CLASSIFIED AS EQUITY



A. PUTTABLE FINANCIAL INSTRUMENTS (PFI)

❖ MEANING:

PFI is a financial instrument that gives the holder the right (but not obligatin) to put the instrument back to the issuer for cash or another financial asset.

EXAMPLE:

Mutual funds and unit trusts, wherein the redemption amount is equal to a proportionate share in the net assets of the entity.

❖ AS PER IND AS 32, PFI ARE CLASSIFIED AS "EQUITY"IF ALL THE FOLLOWING CONDITION ARE FULFILLED (despite the fact that they otherwise meet all the conditions for "financial liability").

i) PFI entitles the holder to a pro rata share of the entity's net assets.

☞ In other words, the instrument should not entitle its holder to a higher or lower share of entity's net assets upon liquidation.

☞ The logic behind this requirement is that entitlement to a pro rata share of the entity's net assets on liquidation is equivalent to having a residual interest in the assets of an entity

ii) No fixed or minimum committed cash flows

iii) PFI is most subordinate to all other classes of instruments, that is, it has no priority over other claims to the entity's assets

iv) PFI in the most subordinate class have identical features.

EXAMPLE

T Motors Ltd. has issued puttable ordinary shares and puttable 'A' ordinary shares whereby holders of ordinary shares are entitled to one vote per share whereas holders of 'A' ordinary shares are not entitled to any voting rights. The holders of two classes of shares are equally entitled to receive share in net assets upon liquidation. Examine whether the financial instrument will be classified as equity.

In this case, neither of the two classes of puttable shares can be classified as equity, as they do not have identical features due to the difference in voting rights. It is not possible for T Motors Ltd. to achieve equity classification of the ordinary shares by designating them as being more subordinate than the 'A' ordinary shares, as this does not reflect the fact that the two classes of share are equally entitled to share in entity's residual assets on liquidation.

v) The issuer must have no other financial instrument or contract that has the effect of substantially restricting or fixing the residual return to the PFI holders.

B. INSTRUMENTS THAT CREATE AN OBLIGATION ONLY ON LIQUIDATION OF THE ENTITY

❖ MEANING:

Here, Liquidation may be certain to occur and outside issuer's control OR uncertain to occur and at the option of holder.

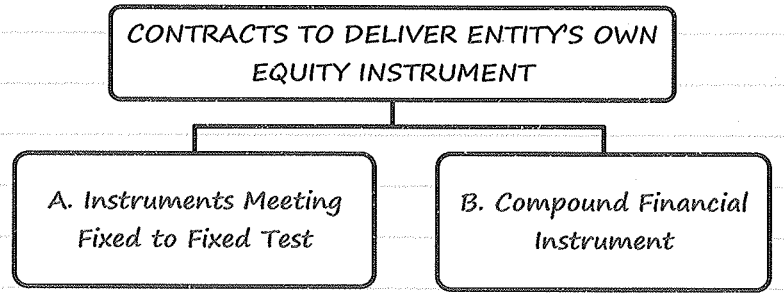
EXAMPLE:

Limited life entities like special purpose vehicles (SPV) for execution of an infrastructure project

❖ AS PER IND AS 32, SUCH INTRUMENTS ARE CLASSIFIED AS "EQUITY" IF ALL OF THE FOLLOWING CONDITIONS ARE FULFILLED

Conditions are same as discussed above in PFI

4. CONTRACTS TO DELIVER ENTITY'S OWN EQUITY INSTRUMENT



A. INSTRUMENTS MEETING THE FIXED TO FIXED TEST

☞ A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments.

☞ A contract that will be settled by delivering a FIXED number of its own equity instruments against settlment of a FIXED consideration will be classified as an Equity Instrument

Sr. N	No. of own equity instruments be issued in settlement	Consideration received (value of debenture redeemed)	Classification
1	Fixed	Variable	Financial Liability
2	Fixed	Fixed	Equity

3	Variable	Fixed	Financial Liability
4	Variable	Variable	Financial Liability

NOTE:

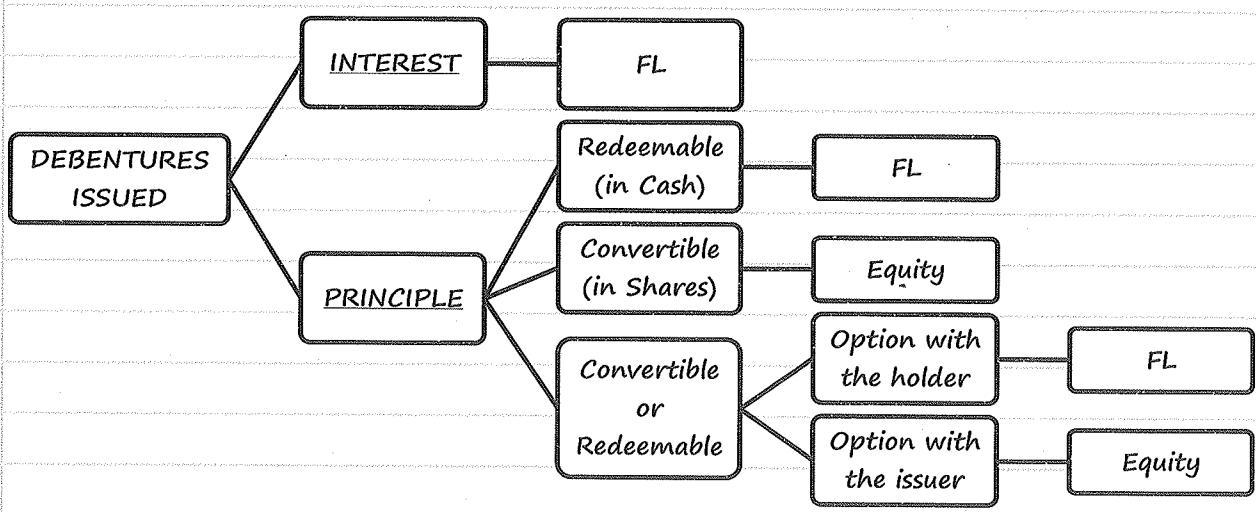
If number of shares to be issued are varying based on time, then they will be considered as Fixed.

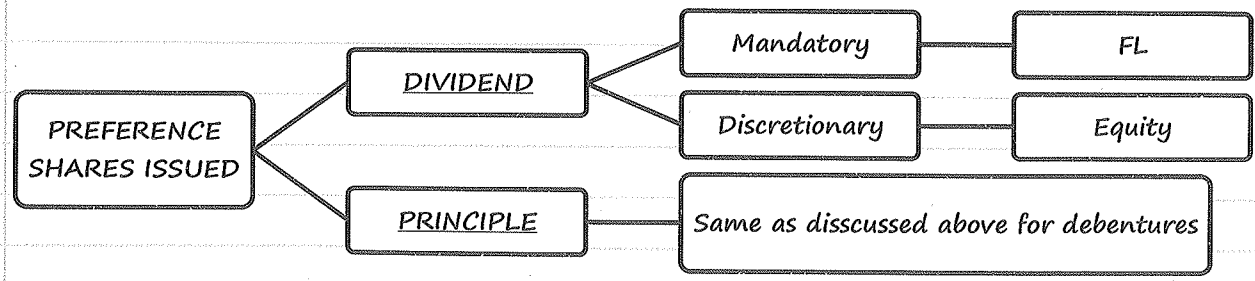
B. COMPOUND FINANCIAL INSTRUMENTS (CFI)

☞ Instruments which have features of both a FL & equity instrument. are called "CFI".

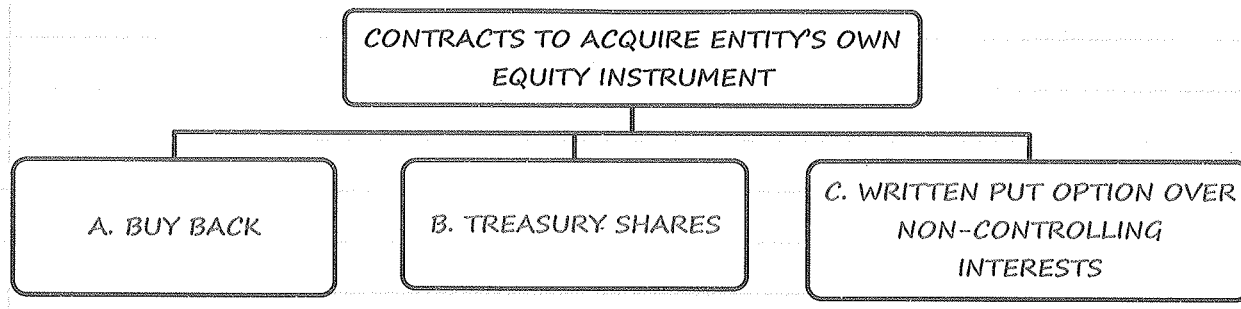
☞ The initial carrying amount of CFI is allocated to its equity & liability components (Discussed Later in the chapter)

NOTE: Instrument is a CFI only from issuers point of view. From holders point of view it is always a Financial Asset Only.





5. CONTRACTS TO ACQUIRE ENTITY'S OWN EQUITY INSTRUMENT



A. BUY-BACK

- When company announces a scheme to buy back on its own equity shares, company has created an obligation which is to be settled Cash and therefore equity will now be reclassified to financial liability on the date when offer is given for buy-back

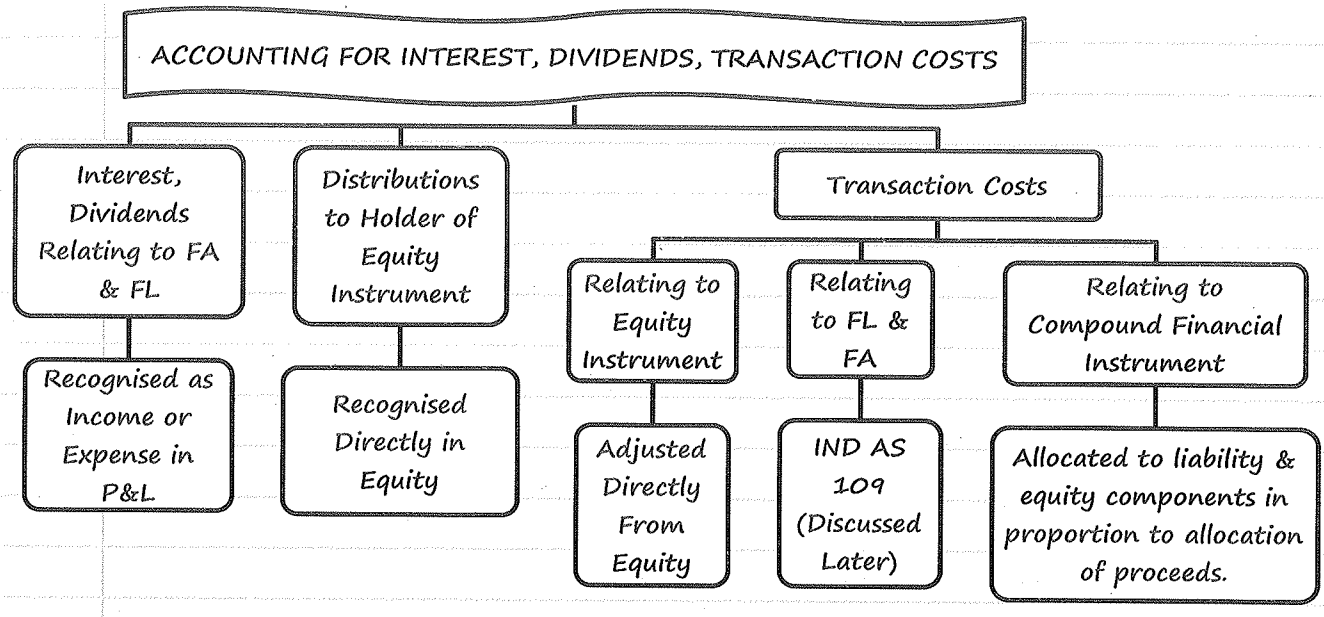
B. TREASURY SHARES

- Treasury shares are the share which are bought back by the issuing company.
- Shares which have been bought back by a company can either be cancelled or held for reissue. (In India, they have to be cancelled within 7 days from the date of buyback)
- When the company holds its own shares as treasury shares for reissue at a later date then:
  - They cannot be classified as an asset on the balance sheet.
  - They are usually presented under the equity capital in balance sheet as a negative number

C. WRITTEN PUT OPTION OVER NON-CONTROLLING INTERESTS (NCI)

- A parent entity may write a put option granting holders of NCI right to sell their shares (of subsidiaries) to the parent at a future date.
- Such Put Option gives rise to a FL for Company writing such Put Option (i.e. Parent Entity)

6. ACCOUNTING FOR INTEREST, DIVIDENDS, TRANSACTION COSTS, ETC.

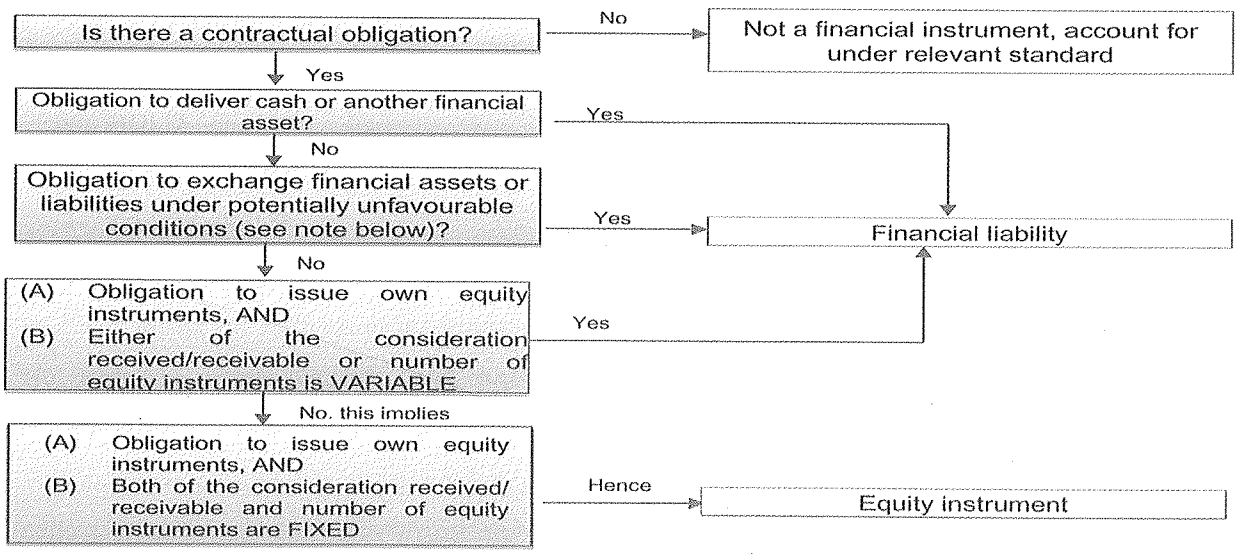


7. OFFSETTING A FINANCIAL ASSET & FINANCIAL LIABILITY

☞ As per Ind AS 32, a FA & FL shall be offset and net amount presented in B/S when, and only when, an

- Entity has a legally enforceable right to set off the recognised amounts; AND
- It intends to settle on a net basis.

❖ SUMMARY



8. CONTRACTS TO BUY OR SELL NON-FINANCIAL ITEMS ('OWN USE EXEMPTION')

- Contracts to buy or sell non-financial items are outside scope of 'financial instruments',
- Following Contracts will be within the scope of IND AS 109 and accounted for as a derivative contract.

(a) Contracts to buy or sell a non-financial item that can be settled NET in cash or another financial instrument or:

(b) when ability to settle net, is not explicit in terms of contract, but entity has a practice of settling similar contracts NET or

(c) Entity has a practice of taking delivery and selling it within a short period after delivery for generating a profit from short-term fluctuations in price;

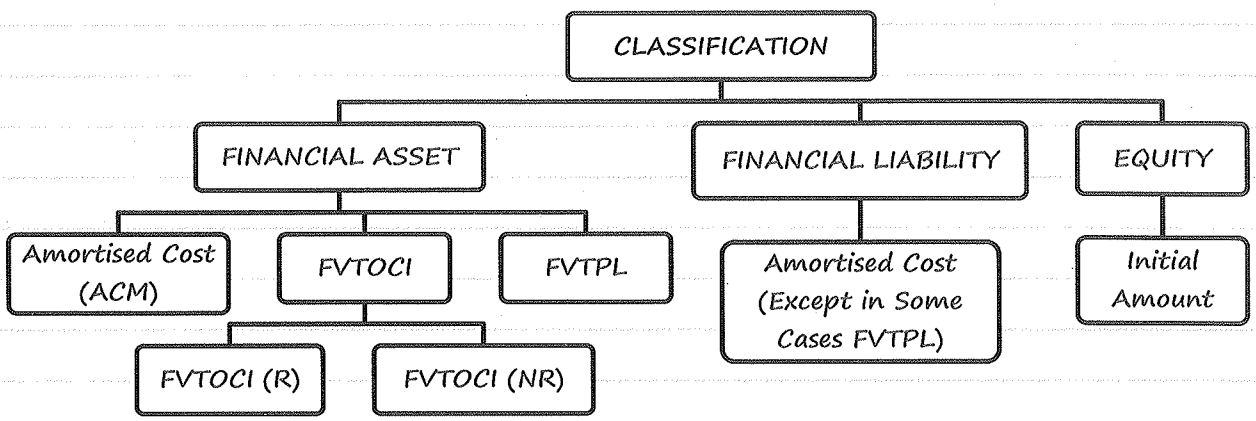
Example: ABC Ltd. enters into a contract to buy 100 tonnes of cocoa beans at 1,000 per tonne for delivery in 12 months. On settlement date market price for cocoa beans is 1,500 per tonne.

If contract cannot be settled net in cash and this contract is entered for delivery of cocoa beans in line with ABC Ltd.'s expected purchase/ usage requirements, then own-use exemption applies.

In such case, contract is considered to be an executory contract outside the scope of Ind AS 109 and hence shall not be accounted as a derivative.

IND AS 109
FINANCIAL INSTRUMENTS – CLASSIFICATION & MEASUREMENT

1. CLASSIFICATION



2. CLASSIFICATION OF FINANCIAL ASSET

☞ Classification of financial assets (FA) is determined based on

- Business Model Test
- Contractual Cash flow Characteristics Test

A. BUSINESS MODEL (BM) TEST

☞ To account for a FA, the entity should assess whether its BM is to

- HOLD
- HOLD OR TRADE
- TRADE ONLY

☞ An entity's BM is determined based on how groups of financial assets are managed together and not based on individual instrument.

☞ However, a single entity may have more than one BM for managing its financial instruments.

For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes.

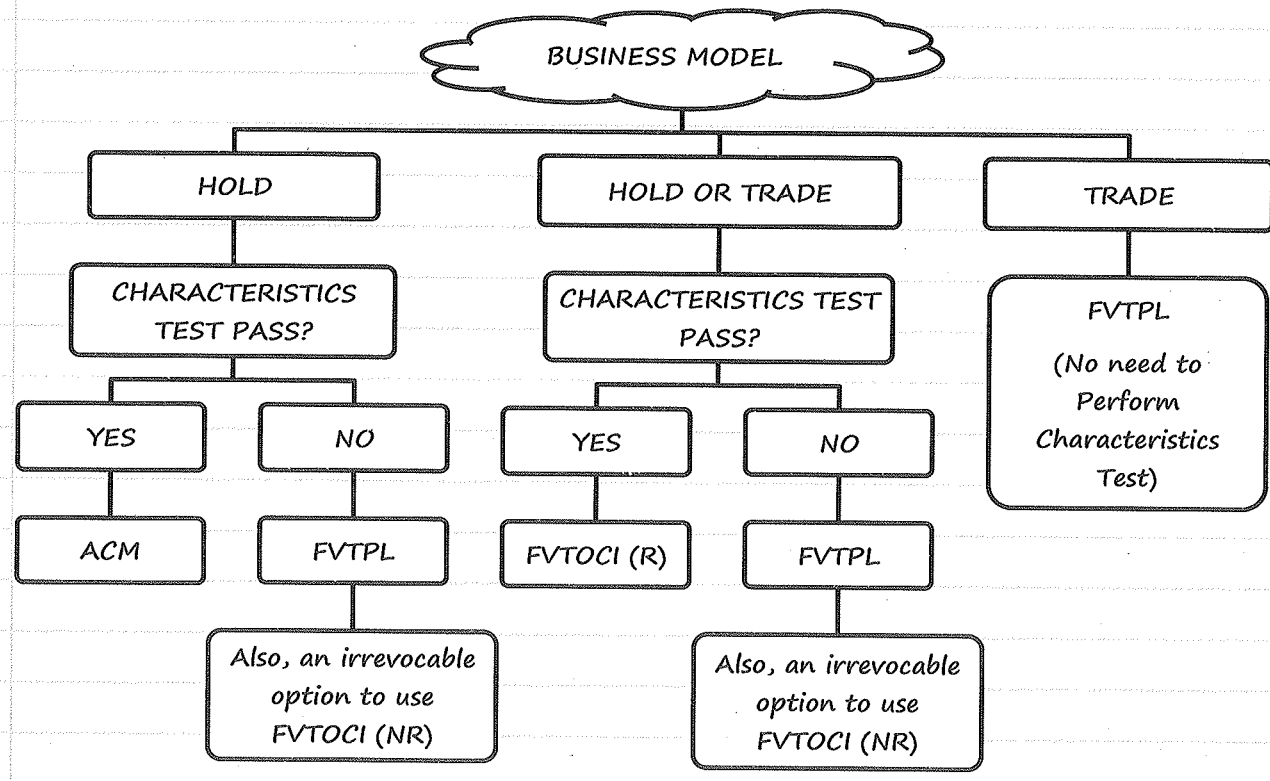
☞ Also, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios.

B. CONTRACTUAL CASH FLOWS CHARACTERISTICS TEST (CCFC Test)

C. Entity has to assess whether the Financial Asset's Contractual Cash Flows are solely payments of principal and interest on the principal amount outstanding. If Yes, then the FA meets this Test. It is a INSTRUMENT SPECIFIC TEST

☞ If nothing is mentioned in the question:

- Redeemable Debentures – Usually meet the CCFC Test
- Redeemable Debentures with Interest Rate Linked to Stock Market Index – Usually will NOT meet CCFC Test
- Redeemable Debentures with Inflation Adjusted Interest Rate – Usually will meet CCFC Test.



NOTE: Company always has an option to use FVTPL for any Financial Asset

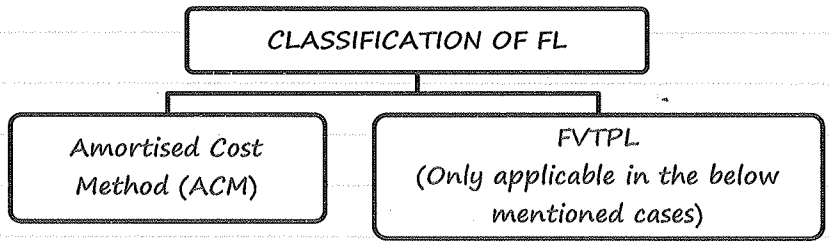
EXAMPLES

Nature of FA	Business Model	Characteristic	Classification	Choice of Alternate

		Test	FA	Method
12% Redeemable Debenture	Hold	Yes	ACM	FVTPL
12% Redeemable Debenture	Hold or trade	Yes	FVTOCI (R)	FVTPL
12% Redeemable Debenture	Trade	Yes	FVTPL	
12% Convertible debenture	Hold	No	FVTPL	FVTOCI (NR)
12% Convertible debenture	Hold or trade	No	FVTPL	FVTOCI (NR)
12% Convertible debenture	Trade	No	FVTPL	
*Equity share of other company	Hold	No	FVTPL	FVTOCI (NR)
*Equity share of other company	Hold on Trade	No	FVTPL	FVTOCI (NR)
*Equity share of other company	Trade	No	FVTPL	

*Note: Ind AS 109 requires all equity investments to be measured at FVTPL as Equity Instrument will never meet the CCFC test. Entities can make an irrevocable election at initial recognition to classify the instruments as at FVOCI (NR).

3. CLASSIFICATION OF FINANCIAL LIABILITY



☞ FINANCIAL LIABILITIES WILL BE CLASSIFIED AS FVTPL IN THE FOLLOWING CASES:

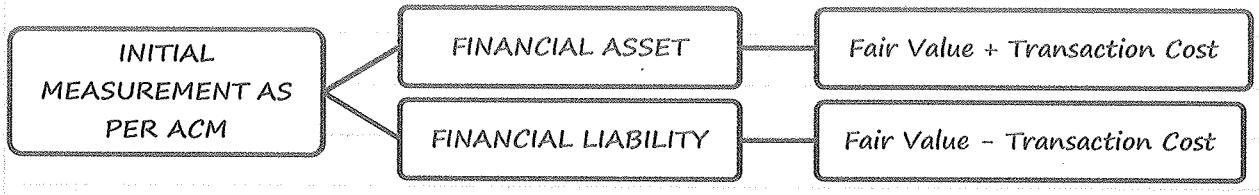
i) Financial Guarantee

ii) Contingent Consideration Payable under Business Combination (If Payable in Cash or Variable Number of Shares, it meets the definition of Financial Liability and it is remeasured at Every Year End through FVTPL)

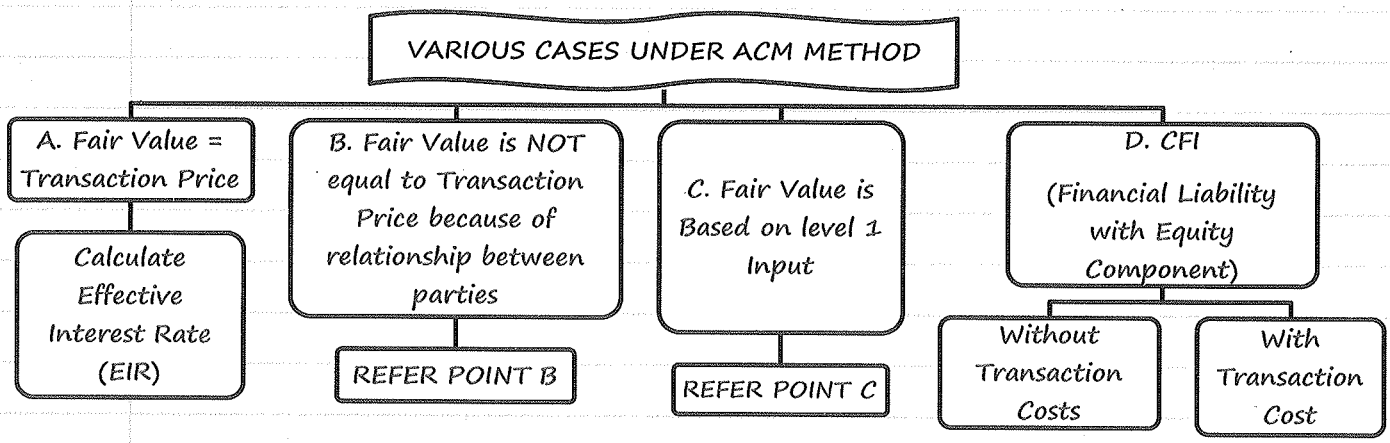
iii) DERIVATIVE FINANCIAL LIABILITY

4. INITIAL MEASUREMENT OF FINANCIAL ASSET & FINANCIAL LIABILITY

I. AMORTISED COST METHOD



☞ Transaction Costs include fees and commission paid to agents, advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs etc.



A. FAIR VALUE = TRANSACTION PRICE

☞ This is the case where transaction is at Market Terms.

☞ Effective Interest Rate (EIR) is calculated such that Present Value of Future Cash Flows = Year 0 Cash Flows

EXAMPLE 1

Mukku Ltd issued 8% Debentures of FV ₹ 1,00,000 at 10% discount redeemable after 5 years. These debentures are Redeemable at Par. Calculate the Value of Debentures in the books of Mukku Ltd each year. Also calculate the Interest to be recognised Each Year.

EXAMPLE 2

AK ltd Purchased Invested in 10% Debentures of Face Value ₹ 50,000. These Debentures are

issued at premium of 10% & redeemed after 3 years @ premium of 15%. Calculate the Value of Investment in the books of AK ltd each year. Also calculate the Interest to be recognised Each Year.

EXAMPLE 3

Mukku Ltd Issued 8% Debentures of FV ₹ 1,00,000 at discount of 10%. Mukku Ltd also incurred Transaction Cost of ₹ 5,000. These Debentures are Redeemable after 5 years at Face Value. Calculate the Value of Debentures in the books of Mukku Ltd. each year. Also calculate the Interest to be recognised Each Year.

B. FAIR VALUE ≠ TRANSACTION PRICE ON INITIAL RECOGNITION

☞ This is Generally the case where transaction is at OFF Market Terms.

☞ Usually, Fair Value = Discounting PV of Future Cash Flows using Fair Market Rate.

FAIR VALUE IS NOT EQUAL TO TRANSACTION PRICE

Financial Asset / Liability will be Recorded at Fair Value
AND
Difference Between Fair Value & Transaction Price
will be Account as per Respective IND AS (Examples Discussed Below)

❖ EXAMPLES OF TRANSACTIONS WHICH ARE CONSIDERED TO BE OFF MARKET

i) Employer gave loan to employee at less than market interest rate

☞ In this case Difference between Fair Value & Transaction Price on Day 1 will be treated as Prepaid Employee Benefit Expense (For Employer) and such Prepaid Expense will be accounted as per IND AS 19

ii) When the lessor receives security deposit (at zero rate of interest) from lessee which is refundable at the end of lease.

☞ In this case, Difference between Fair Value (PV using Market interest rate) & Transaction Price on Day 1 will be treated as Prepaid Lease Rent (ROU Asset - For Lessee) and such

ROU Asset will be accounted as per IND AS 116.

iii) When parent gives loan (lends money) to the subsidiary at zero or less than market interest rate.

☞ In this case, Difference between Fair Value & Transaction Price on Day 1 will be treated as Investment in Subsidiary (For Parent) and Capital Contribution From Parent (For Subsidiary).

iv) When subsidiary gives loan (lends money) to the parent at zero or less than market interest rate.

In this case, Difference between Fair Value & Transaction Price on Day 1 will be treated as DIVIDEND INCOME (For Parent) and DIVIDEND DISTRIBUTION (For Subsidiary).

v) Government provides a loan at less than market interest rate in the form of grant

☞ In this case, Difference between Fair Value & Transaction Price on Day 1 will be treated as Government Grant received from Government (For Borrower) and will be accounted as per IND AS 20.

C. IF FAIR VALUE IN BASED ON LEVEL 1 INPUT OR VALUATION TECHNIQUE THAT USES ONLY OBSERVABLE MARKET INPUT

➢ In this case, Fair Value = Discounting PV of Future Cash Flows using Fair Market Rate

AND

Difference Between Fair Value & Transaction Price will be Transferred to P&L immediately

D. COMPOUND FINANCIAL INSTRUMENT (FINANCIAL LIABILITY WITH EQUITY COMPONENT)

☞ Initial carrying amount of a compound financial instrument is allocated to its equity and liability components. No gain or loss arises from initially recognising the components of the instrument separately.

☞ In this case, Fair Value of FL = Discounting PV of Future Cash Flows using Fair Market Rate

AND

Difference Between Fair Value & Transaction Price will be Transferred to Equity Component

i) WITHOUT TRANSACTION COSTS

In this case, Fair Value of FL = Discounting PV of Future Cash Flows using Fair Market Rate AND

Difference Between Fair Value & Transaction Price will be Transferred to Equity Component

EXAMPLE 4

AK Ltd issued 10% debentures of FV ₹ 25,00,000 Redeemable or Convertible after 5 years. Market Interest Rate without conversion option is 14%.

Case A: Option to Convert is with the Holder

Case B: Option to Convert is with the Issuer

ii) WITH TRANSACTION COST

Calculation of Fair Value of FL & Equity will be done initially assuming there is NO TRANSACTION COST.

Then, ALLOCATE THE TRANSACTION COSTS between Equity Component & Financial Liability Component in the Ratio of Fair Value Calculated above.

The transaction Cost allocated to:

- Equity Component - will be transferred to Other Equity &
- Financial Liability - will be deducted from Financial Liability (Because Financial Liability is recorded on initial recognition at Fair Value (–) Transaction Costs)

EXAMPLE 5

AK Ltd issued 8% Convertible Debentures of Face Value ₹ 80,000 for 3 Years. Option to convert is with the holder of the instrument. Market Interest Rate without the Conversion option is 12% p.a. AK ltd incurred Transaction Costs of 2,000 on issue of such debentures. Show Accounting Treatment in the Books of AK Ltd.

❖ CONVERSION OR EARLY SETTLEMENT OF COMPOUND FINANCIAL INSTRUMENTS

i) CONVERSION OF CFI

☞ On conversion of a convertible instrument at maturity, the entity:

- Derecognises the liability component and recognises it as equity.
- Original equity component remains as equity (although it may be transferred from one line item within equity to another).
- There is no gain or loss on conversion at maturity

ii) EARLY SETTLEMENT OF CFI

a) The issuer starts by allocating settlement price to remaining liability & Equity Component

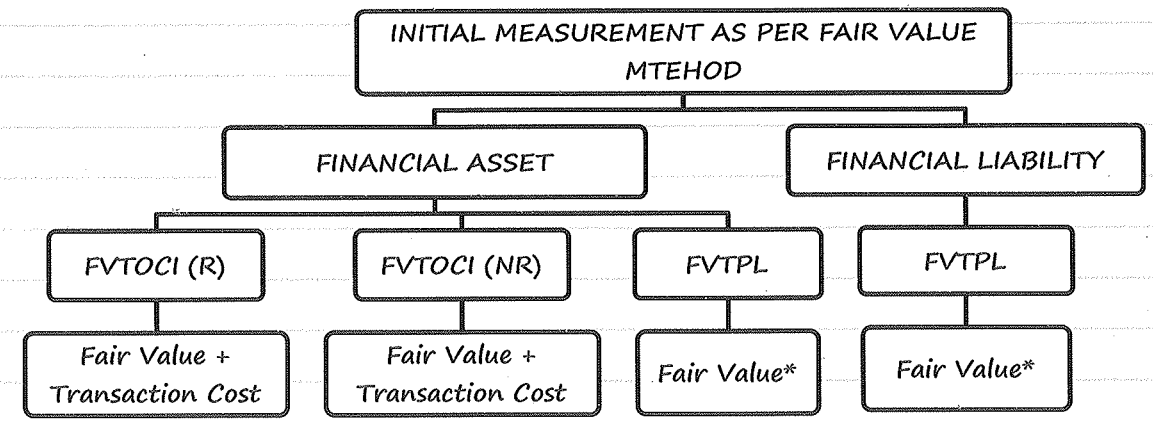
- Value to be allocated to FL will be based on fair value of the remaining liability using a NEW discount rate at the settlement date, and
- Remaining value of settlement amount (i.e. Settlement Price – Value allocated to Financial liability) is allocated to equity component.

b) Once the allocation of consideration is made, any gain or loss is treated, as follows:

- Gain or loss relating to liability component is recognised in P/L; and
- Relating to equity component is recognised in equity.

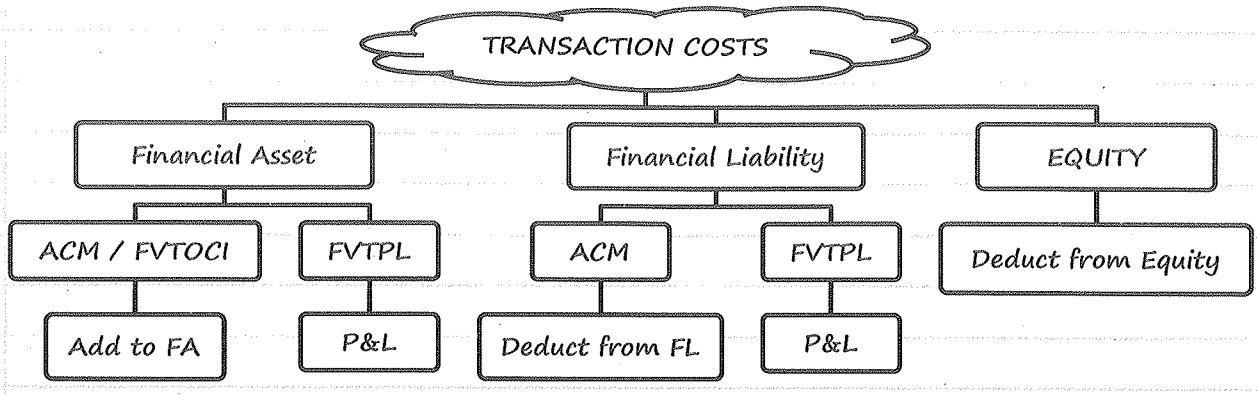
II. INITIAL MEASUREMENT AS PER FAIR VALUE METHOD {FVTPL, FVTOCI (R), FVTOCI (NR)}

☞ Fair Value Method is generally applicable only for financial assets as financial liabilities are to be measured as per ACM (Except in few cases where some financial liabilities are to be measured at FVTPL).



NOTE: Transaction Costs incurred in case of FVTPL will be directly transferred to P&L on DAY 1

❖ TREATMENT OF TRANSACTION COSTS (Summary)



5. SUBSEQUENT MEASUREMENT

(A) FINANCIAL ASSET

	ACM	FVTOCI (R)	FVTOCI (NR)	FVTPL
Initial measurement	Fair Value + Transaction Cost	Fair Value + Transaction Cost	Fair Value + Transaction Cost	Fair Value
Transaction cost	Added to Fair Value	Added to Fair Value	Added to Fair Value	Transfer to P&L
Subsequent measurement at each B/S date	Amortised Cost	Fair Value	Fair Value	Fair Value
Interest / dividend	P&L (As per EIR)	P&L (As per EIR)*	P&L (As per Coupon Rate	P&L (As per Coupon Rate)
Unrealised gain / loss	N.A.	OCI (R)	OCI (NR)	P&L
Realised gain / loss	N.A.	P&L	P&L	P&L
Treatment of previous unrealsied gain / loss on sale	N.A.	Reclassified to P&L OCI (R) To P&L Also transfer within Other equity will take place	Not Reclassified to P&L BUT, transfer within Other Equity will take place O.E. (Unrealised G/L) A/c To O.E. (Gen Res) A/c	N.A.

* Generally, in FVTOCI (R), there are investments in Debt Instruments and Interest in Such

Cases will be based on EIR.

** Generally, in FVTOCI (NR) there are Investments in Equity Instruments and Dividend in such cases will NOT be based on EIR.

(B) FINANCIAL LIABILITY

	Financial Liabilities		Equity
Classification	Amortised Cost	FVTPL	-
Basis of Classification	▪ Default criteria	▪ If held for trading ▪ Entity elects FVTPL (using fair value option)	-
Initial recognition	▪ Fair Value	▪ Fair Value	▪ Fair Value
Subsequent recognition	▪ Amortised cost	▪ Fair Value	▪ No Remeasurement

6. ACCOUNTING OF EQUITY INSTRUMENT

Accounting aspect	Equity instrument
Initial Measurement	Fair Value
Re-measurement	Generally, not re-measured after initial measurement
Recognition of interest, dividends, losses and gains	Retained earnings
Recognition of transaction costs	Deduction from equity

7. RECLASSIFICATION OF FINANCIAL ASSETS & FINANCIAL LIABILITIES

i) FINANCIAL ASSET

☞ An entity shall reclassify financial assets, only if the entity changes its business model for managing those financial assets.

☞ Reclassification is to be done only at the beginning of the year.

☞ Reclassification is Not Permitted for investment in equity instruments that are designated

at FVTOCI (NR) at inception

CASE	EXISTING METHOD	NEW METHOD	ACCOUNTING TREATMENT
1.	ACM	FVTPL	It is measured at fair value on reclassification date. Any gain or loss arising from difference between the previous amortised cost and fair value is recognised in P&L.
2.	ACM	FVTOCI (R)	It is measured at fair value on reclassification date. Any gain or loss arising from difference between the previous amortised cost and fair value is recognised in OCI EIR is NOT adjusted as a result of reclassification.
3.	FVTPL	ACM	It is measured at fair value on reclassification date and this fair value becomes the new gross carrying amount. EIR is computed based on this new gross carrying amount.
4.	FVTPL	FVTOCI (R)	The financial asset continues to be measured at fair value. Previous Gains or losses booked in P&L will not be reclassified to OCI, But Future Unrealised Gain & Losses will be recognised in OCI (R) The EIR is computed on the basis of fair value of asset at reclassification date.
5.	FVTOCI (R)	ACM	Cumulative gain or loss previously recognised OCI is removed from equity and adjusted against fair value of financial asset at reclassification date. As a result, the financial asset is measured at reclassification date as if it had always been measured at amortised cost. EIR is not adjusted as a result of reclassification.
6.	FVTOCI (R)	FVTPL	The financial asset continues to be measured at fair value. The cumulative gain or loss previously recognised in OCI is reclassified to P&L as a reclassification adjustment on the reclassification date. Future Interest will be booked based on Coupon Rate.

ii) FINANCIAL LIABILITY

☞ Financial liabilities are NOT permitted to be reclassified.

8. DERECOGNITION OF FINANCIAL ASSETS

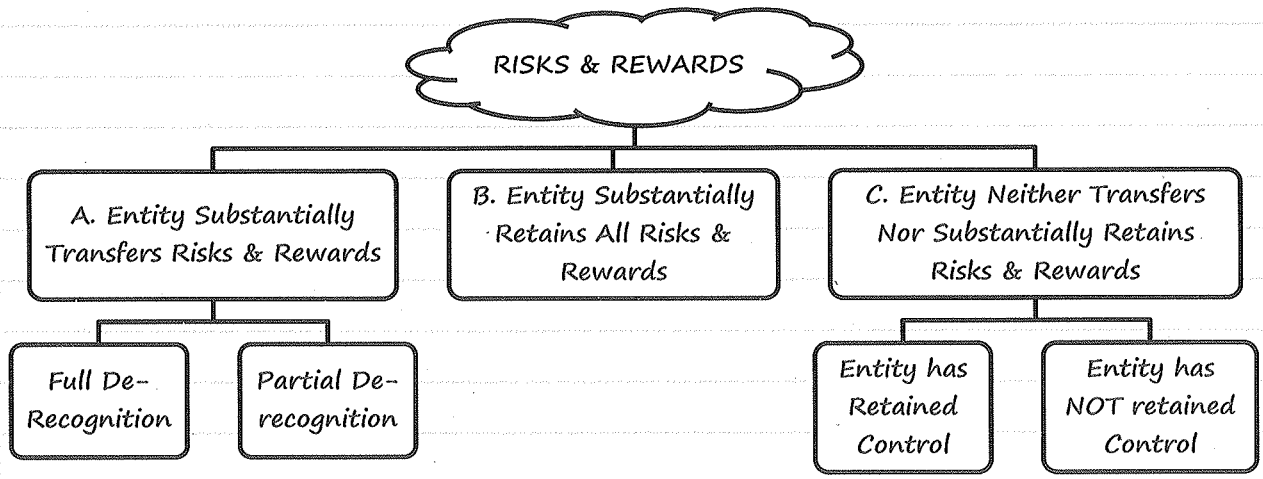
☞ Derecognition refers to the timing of removing a financial asset from the balance sheet. EXAMPLE, if a company gets its trade receivables discounted from a bank, it would need to determine whether it can remove those trade receivables from its balance sheet.

☞ An entity shall derecognize a financial asset when and only when:

a) The Contractual Right to receive cash flows from the Financial Asset Expire; OR

b) It transfers the Financial Asset as explained below.

☞ When an entity transfers a financial asset (as discussed above), it should evaluate the extent to which it retains the risks & rewards of ownership of the financial asset:



A. ENTITY SUBSTANTIALLY TRANSFERS RISKS & REWARDS

i) FULL DERECOGNITION

☞ Full de-recognition applies when Full Financial Asset is transferred & All Risks & Rewards relating to that asset are also transferred.

☞ In Full de-recognition, the company should de-recognise full asset and difference between the carrying amount of the FA de-recognised and consideration received shall be

transferred to P&L (In all methods – as this is Realised Profit)

ii) PARTIAL DE-RECOGNITION

❖ CASE A: Partial De-recognition applies only when it meets ANY ONE of the following 3 conditions:

1. The part transferred comprises only specifically identified cash flows from a financial asset (Example: Sale of Interest Strip)
2. The part transferred comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset (Example: Sale of 50% of Cash flows (Interest + Principal)
3. The part transferred comprises only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (Example: Sale of 50% of Interest Strip)

▪ Steps for Partial Derecognition Accounting (If any of the above 3 conditions are satisfied):
Step 1: Find the fair Values of Part De-recognised & Part Re-cognised
FV of Part Derecognised = Consideration Received from sale
FV of Part Recognised = Directly Given OR Total FV of FA (-) FV of Part Derecognised
Step 2: Split the Carrying Amount of FA into Part De-recognised & Part Retained on the basis of Fair Values (as per Step 1)
Step 3: Remove the Part de-recognised & Retained Portion will continue to appear in the Balance Sheet at Carrying amount (Any gain or loss on part de-recognised will be transferred to P&L)

❖ CASE B: If the FA in Partially de-recognised but it does not meet any of the above 3 conditions (Example: Sale of First 80% of Cash Flows, or sale of first 2 years of Interest)

▪ In that case, de-recognition principles are applied to the financial asset in its entirely i.e. Full Financial Asset will be de-recognised and the retained portion will be recognised at its Fair Value.

❖ In Both CASE A & CASE B – Service Fees might be charged for Partial De-recognition

▪ When the entity charges a service fee (for receiving and transferring the cash flows):

a) If partial de-recognition meets any of the 3 conditions (i.e. CASE A):

- Servicing Asset shall be treated as part that continues to be recognised (i.e. Servicing asset will be present in the part retained).

b) If Partial De-recognition does not meet any of the 3 condition (i.e. CASE B):

- The entity shall recognise the Servicing Asset at its Fair Value.

EXAMPLE 6

Sea Ltd has lent a sum of ₹ 10 lakh @ 18% p.a. for 10 years. The Loan had a fair value of 12,23,960 at the EIR of 13%. To mitigate prepayment risks but at the same time retaining control over the loan, Sea ltd transferred its right to receive the Principal amount of the loan on its maturity with interest, after retaining rights over 10% principal and 4% interest that carries fair value of ₹ 29,000 and ₹ 1,84,620 respectively. The consideration for the transaction was ₹ 9,90,000. The interest component retained includes a 2% fee towards collection of Principal and Interest, that has a fair value of ₹ 65,160 (Servicing Asset). You are required to show the Journal Entries to recognition of the Loan.

B. ENTITY SUBSTANTIALLY RETAINS ALL RISKS & REWARDS

☞ The entity shall not de-recognise the asset and continue to recognise the transferred asset in its entirely and shall recognise a Financial Liability for the consideration received.

EXAMPLE:

i) Factoring with Full Recourse. (i.e. Full Risk with the company and NOT transferred to the factor)

ii) Bill Discounted with Bank

C. ENTITY NEITHER TRANSFERS NOR SUBSTANTIALLY RETAINS RISKS & REWARDS

- In this case, the entity should determine whether it has retained control of the financial asset. It depends on transferee's ability to sell the asset. If transferee, has ability to sell the asset to an unrelated third party the entity has NOT retained control. In all other cases, the entity has retained control.

i) NOT RETAINED CONTROL

☞ Apply Derecognition Accounting

EXAMPLE:

Factoring without recourse

Put Option / Call Option deeply out of the money

Put option / Call Option is deeply in/out of the money (i.e. NOT Known whether Deeply in or out)

ii) RETAINED CONTROL:

☞ It shall continue to recognise the financial asset to the extent of its continuing involvement in the Financial Asset (Example: Factoring with Partial Re-course)

STEPS:

a) Asset transferred is fully derecognised,
b) Fresh asset in the nature of "Continuing Involvement in FA" to the extent of continuing involvement is recognised
c) Associated Liability is also to be recognised with the same amount as step (b) and it shall not be offset with the above asset.
d) Fair Value of Guarantee (involvement) given is also to be recognised (i.e. the total of associated liability will be step c + step d).

EXAMPLE 7

5,00,000 debtors transferred to the factor for ₹ 4,50,000 but risk for ₹ 20,000 retained. Fair Value of Risk Retained/guarantee is ₹ 5,000. Pass Journal Entries

Case A: At the end debtors paid ₹ 4,90,000

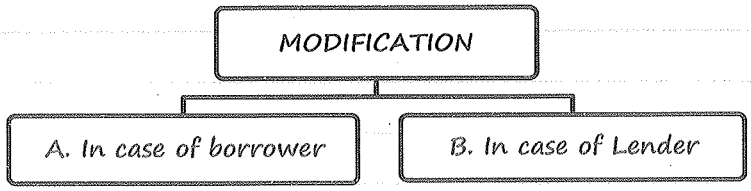
Case B: At the end debtors paid ₹ 5,00,000

Case C: At the end debtors paid ₹ 4,20,000

9. DERECOGNITION OF FINANCIAL LIABILITY

☞ An entity shall de-recognise a financial liability from its balance sheet when it is extinguished i.e. when the obligation specified in the contract is discharged or cancelled or expired.

10. MODIFICATION



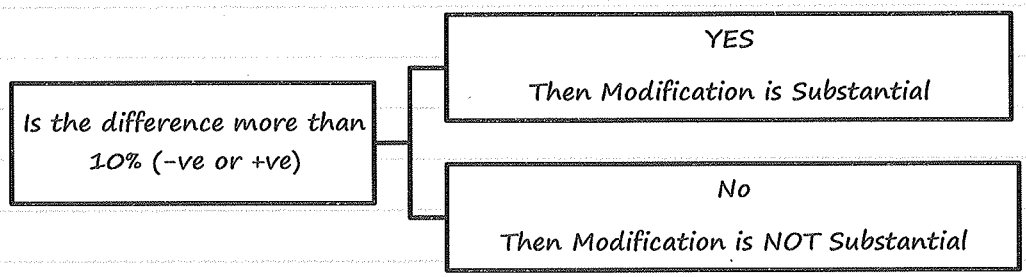
NOTE: Modification Accounting for Borrower is also known as extinguishment accounting

A. IN CASE OF BORROWER (Financial Liability for Borrower) –

STEP 1: Check whether the modification is substantial or not

Carrying Amount of old FL (-) PV of Future Cash Flows (including Transaction Cost) at Original (Old) EIR

Carrying amount of old FL



CASE 1: IF MODIFICATION IS SUBSTANTIAL

STEP 2: Derecognise the Old FL and Recognise the New FL at its Fair Value (Using New EIR – Given in Question Mostly)

STEP 3: Transaction Cost (if any) will be charged to P&L A/c

STEP 4: LAT (After Modification)

CASE 2: IF MODIFICATION IS NOT SUBSTANTIAL

STEP 2: Deduct the Transaction cost from Carrying amount of old FL (Note: Do not derecognise the Old FL as Modification is NOT Substantial)

STEP 3: Compute New EIR

Revised Carrying Amount after Transaction Cost = PV of Revised Future Cash Flows at x % (i.e. EIR)

STEP 4: LAT (After Modification)

(Amendment / Clarification: Ind AS 109 clarified under Step 1 where we check whether modification is substantial or not, we should include (add) Transaction cost - while calculating PV of Future Cash Outflows at OLD EIR

B. IN CASE OF Lender (Financial Asset for Lender)

☞ Any change in cash flows will have no impact on EIR,

STEP 1: CA of Old FA (On Date of Modification)

STEP 2: New Carrying Amount will be computed using ORIGINAL EIR (i.e. PV of Future Revised Cash Flows @ Original EIR)

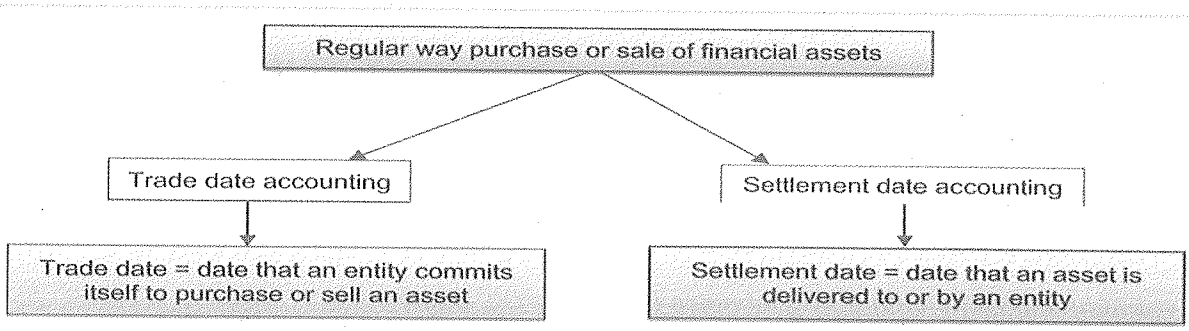
STEP 3: Pass JE & Transfer Difference between old Carrying Amount and New Carrying Amount to:

- P&L – In Max Cases
- If any Pre-existing relationship Exists – Eg: Employer Employee Relationship, then adjust diff will be adjusted with Prepaid EBE

STEP 4: LAT (After Modification)

11. REGULAR WAY PURCHASE OR SALE OF FINANCIAL ASSETS

☞ Ind AS 109 defines a regular way purchase or sale as, a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.



For Example, on the BSE, all transactions in Equity securities, Fixed Income securities and Government securities are settled on "T+2" basis. In this case, "T" is the trade date and

"T+2" is the settlement date.

NOTE:

If a contract is entered into with a broker for purchase or sale of securities which is normally traded on the Bombay Stock Exchange, with a settlement period that differs from the norms mentioned above, it would NOT be regarded as a regular way purchase or sale.

i) TRADE DATE ACCOUNTING

a) Journal Entry in the Books of Buyer of financial asset on Trade Date

Financial Asset A/c Dr.

To Bank / Liability to Pay A/c

NOTE:

The buyer subsequently measures the financial asset in accordance with its classification category.

- FA measured at amortised cost – change in value is not recognised;
- FA measured at FVTPL – change in value is recognised in P&L;

FA A/c Dr.

To FV Gain (P&L) (Difference Between Value on Trade & Settlement Date)

- FA measured at FVTOCI – change in fair value is recognised in OCI.

FA A/c Dr.

To FV Gain (OCI) (Difference Between Value on Trade & Settlement Date)

ii) SETTLEMENT DATE ACCOUNTING

a) Journal Entry in the books of the buyer of financial asset

❖ ON TRADE DATE

Entry will come only if any advance is paid by the Buyer

Advance A/c Dr.

To Bank A/c

If No advance is paid then NO ENTRY on Trade Date

❖ ON SETTLEMENT DATE

FA A/c Dr.

To Bank / Advance A/c

(The amount will be based on Value on Trade Date)

- FA measured at amortised cost – change in value is not recognised;
- FA measured at FVTPL – change in value is recognised in P&L;

FA A/c Dr.

To FV Gain (P&L) (Difference Between Value on Trade & Settlement Date)

- FA measured at FVTOCI – change in fair value is recognised in OCI.

FA A/c Dr.

To FV Gain (OCI) (Difference Between Value on Trade & Settlement Date)

NOTE:

☞ Apply the same method consistently for all purchases and sales of financial assets that are classified in the same way in accordance with Ind AS 109.

☞ The above-mentioned accounting principles apply only to financial assets and Ind AS 109 does not contain any such principles for financial liabilities.

12. IMPAIRMENT

a) SCOPE

☞ An entity shall recognise a credit loss allowance for expected credit losses on the following:

- FA measured at Amortised Cost or Investment in Debt instruments measured at FVTOCI
- Lease Receivable,
- Contract Asset

☞ No impairment loss is recognised for FA measured at FVTPL (Because already Fair Value is recorded through P&L)

b) CREDIT LOSS ALLOWANCE / EXPECTED CREDIT LOSSES (ECL)

☞ A credit loss is the difference between:

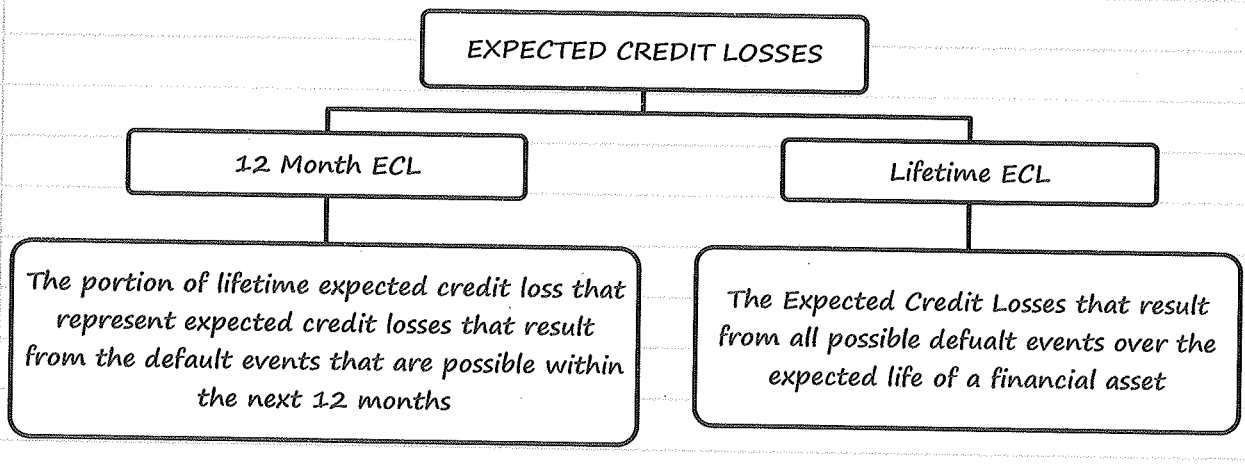
(a) Present value of contractual cash flows that are due under the contract; AND

(b) Present value of cash flows that the entity expects to receive.

This is often referred to as cash short falls. The Cash Flows are discounted at original EIR.

☞ Expected Credit Losses are then calculated using the weighted average of credit losses with the respective risks of a default occurring as the weights.

c) CLASSIFICATION OF EXPECTED CREDIT LOSSES



☞ How the entity determine whether it should apply 12-month ECL or lifetime ECL?

Three Stage Model for Impairment			
Particular	Stage 1	Stage 2	Stage 3
	Initial Recognition	Significant increase in credit risk	Credit Impaired
Credit Risk	Low	Moderate to High	Significant
ECL Model	12 Month ECL	Life-time ECL	Life-time ECL
Interest recognition	Interest on gross recognition	Interest on gross recognition	Interest on net carrying amount

NOTE:

☞ There is a rebuttable presumption that credit risk on a FA has increased significantly when

contractual payments are more than 30 days past due (i.e. apply lifetime ECL). An entity can rebut this presumption if it has reasonable and supportable information that the credit risk has not increased significantly even though contractual payments are more than 30 days past due.

☞ If the credit quality subsequently improves and the lifetime ECL criterion is longer met, then the credit loss reverts back to a 12-Month ECL basis.

13. DERIVATIVES

☞ Derivative as a financial instrument or other contract with all of the following three characteristics:

a) Value changes due to an underlying:

Underlying is a variable which has a changing / dynamic value.

b) No or little initial net investment:

It requires no initial net investment or an initial net investment which is significantly less than required to execute the contract on initial date.

c) Future settlement:

It is settled at a future date.

However, it is NOT relevant whether the derivative is settled gross or not.

❖ ACCOUNTING FOR DERIVATIVES

All derivatives are measured at fair value with changes in fair value On every measurement date (Year end / Quarter end) until settlement being recognized in profit and loss for the period

14. EMBEDDED DERIVATIVES

☞ An embedded derivative is simply a component of a hybrid instrument that also includes a host contract which is non-derivative.

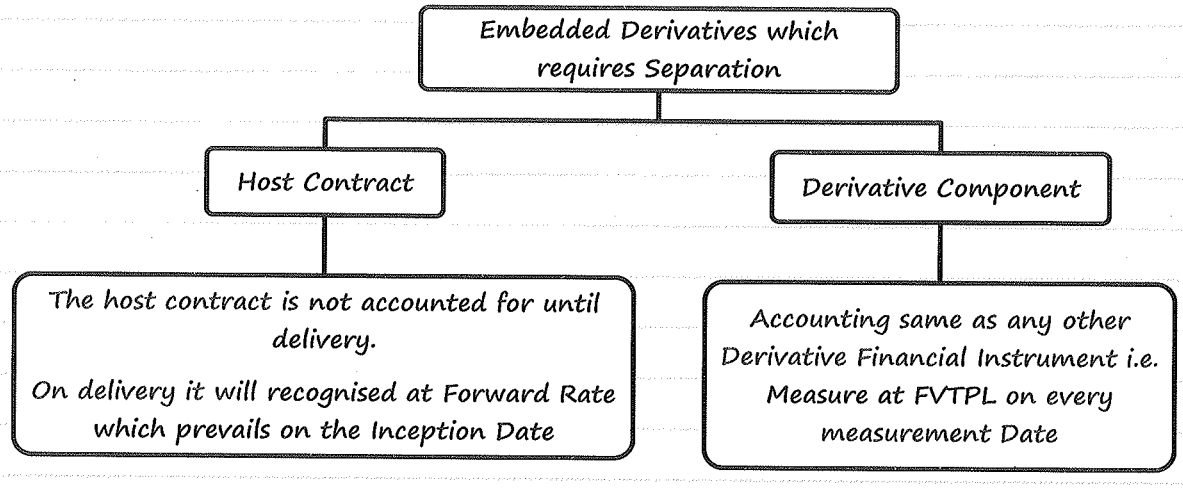
Example:

i) If a Indian company enters into a contract to buy solar panels (Host Contract) from UAE firm, for which delivery is due after 6 months and payment will be in US dollars, then obligation to settle the contract in US Dollars (3rd Currency which is neither the currency of Indian company not UAE Co.) may be evaluated to be an

embedded derivative

☞ When the Host Contract and the embedded derivative are closely related, then no need to separate them.

❖ ACCOUNTING OF HOST CONTRACT AND DERIVATIVE CONTRACT



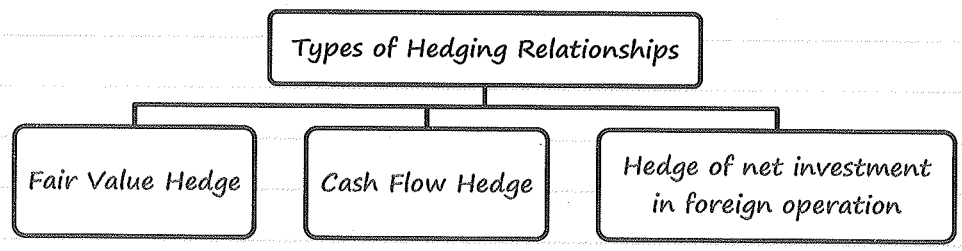
15. HEDGE ACCOUNTING

☞ Entities use a risk management technique called hedging, whereby the entity tries to reduce the impact of future potential costs or losses.

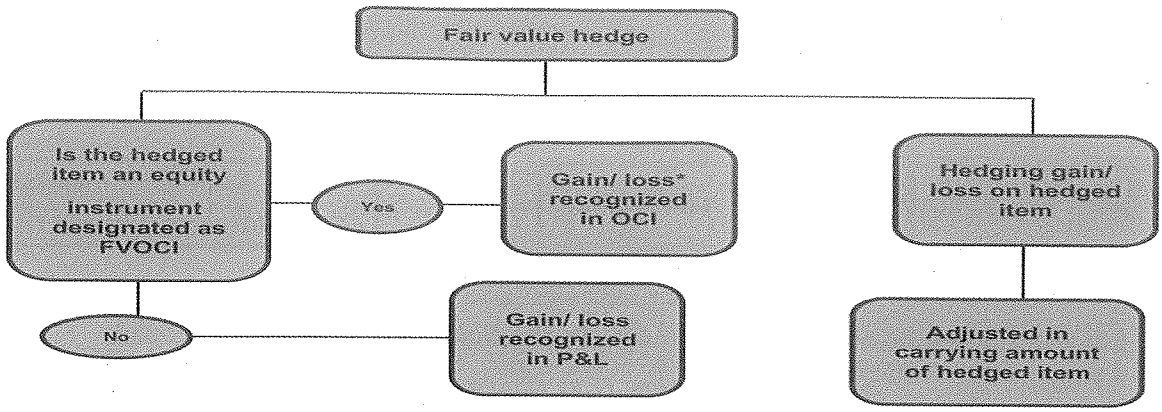
☞ Objective of hedge accounting is to represent, in FS, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (or other comprehensive income)

☞ Hedge accounting is NOT mandatory.

15.1 CLASSIFICATION OF HEDGING RELATIONSHIP



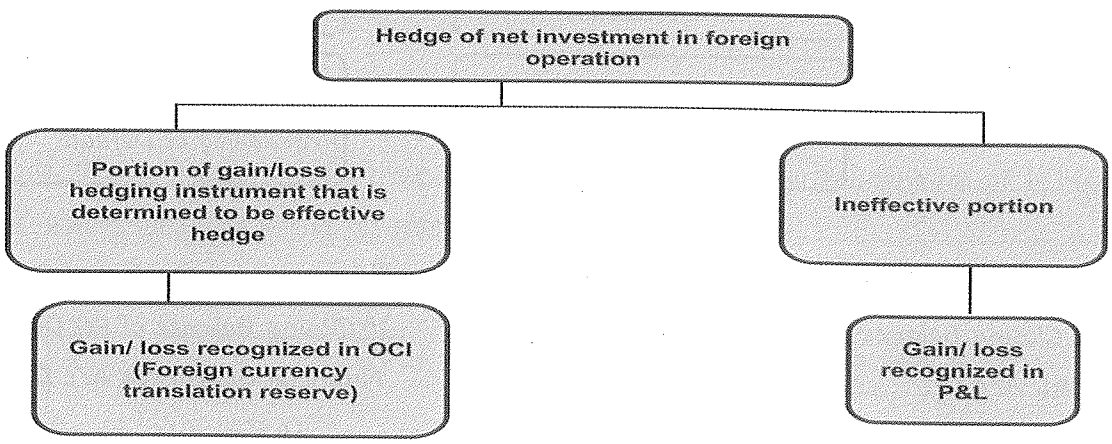
A. FAIR VALUE HEDGE



B. CASH FLOW HEDGE

- A cash flow hedge involves use of a hedging instrument (a derivative) that essentially locks in the amount of a future cash inflow or outflow that would otherwise be impacted by movements in the market exchange rate.
- A cash flow hedge shall be accounted as follows:
  1) Host Contract will be Recorded on date of settlement/delivery at the spot rate on date of settlement/delivery
  2) Hedged Portion: Companies measure hedge effectiveness regularly and recognize gains or losses in OCI(R).
  3) On hedge termination/Expiry - Cumulative Balance of OCI is reclassified to P/L immediately.

C. HEDGE OF NET INVESTMENT IN FOREIGN OPERATION



16. FINANCIAL GUARANTEE (FG)

- Accounting of FG is done in the books of Guarantor / Surety (One who gives guarantee)

A. INITIAL MEASUREMENT

Initial Measurement of FG → Fair Value → PV of Savings in Interest @ EIR (EIR = Interest without Guarantee)

Journal Entry on Initial Measurement (In the Books of Guarantor / Surety)

Case A: If there is any Pre-existing relation (Eg: Guarantor / Surety is Parent and the party for whom guarantee is given is subsidiary)

Investment in Subsidiary A/c Dr.
  To Financial Guarantee A/c

Case B: If there is NO Pre-existing relation

P&L A/c Dr.
  To Financial Guarantee A/c

Note: If guarantor Charges Commission for giving Guarantee

Bank / Re'able A/c Dr.
  To Commission (P&L) A/c

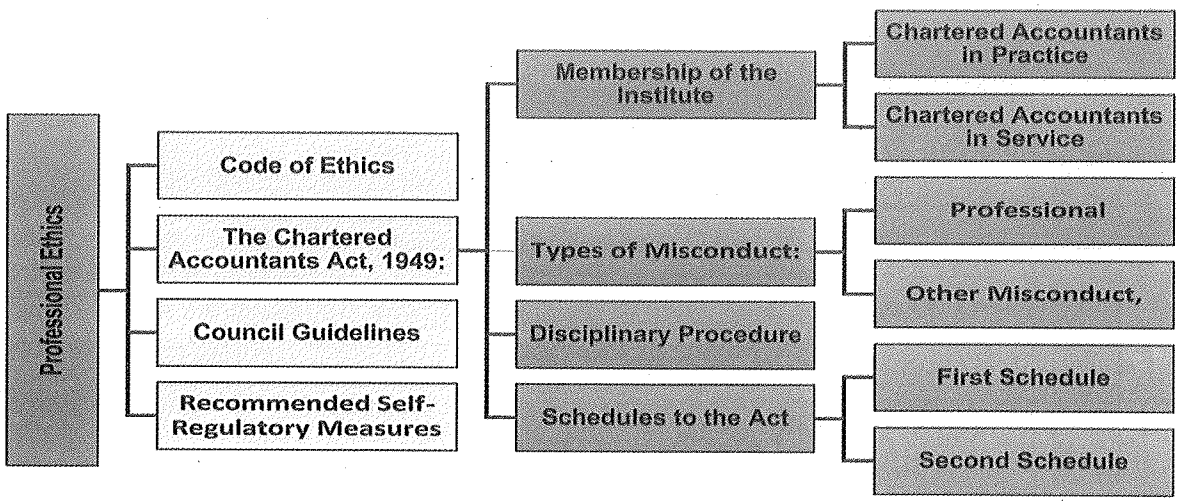
B. SUBSEQUENT MEASUREMENT

HIGHER OF:
- 1. Amount initially recognised less cumulative amortization — Hint: Prepare LAT (Closing Balance of FG at the end of the year)
- 2. Amount of loss allowance — Hint: Principal Amount (x) Probability of Default

Journal Entry on Subsequent Measurement (Entry will be same irrespective of Relationship)

If Closing Balance of FG Increases	If Closing Balance of FG Decreases
P&L A/c Dr.	Financial Guarantee A/c Dr.
To Financial Guarantee	To P&L A/c

PROFESSIONAL AND ETHICAL DUTY OF A CHARTERED ACCOUNTANT



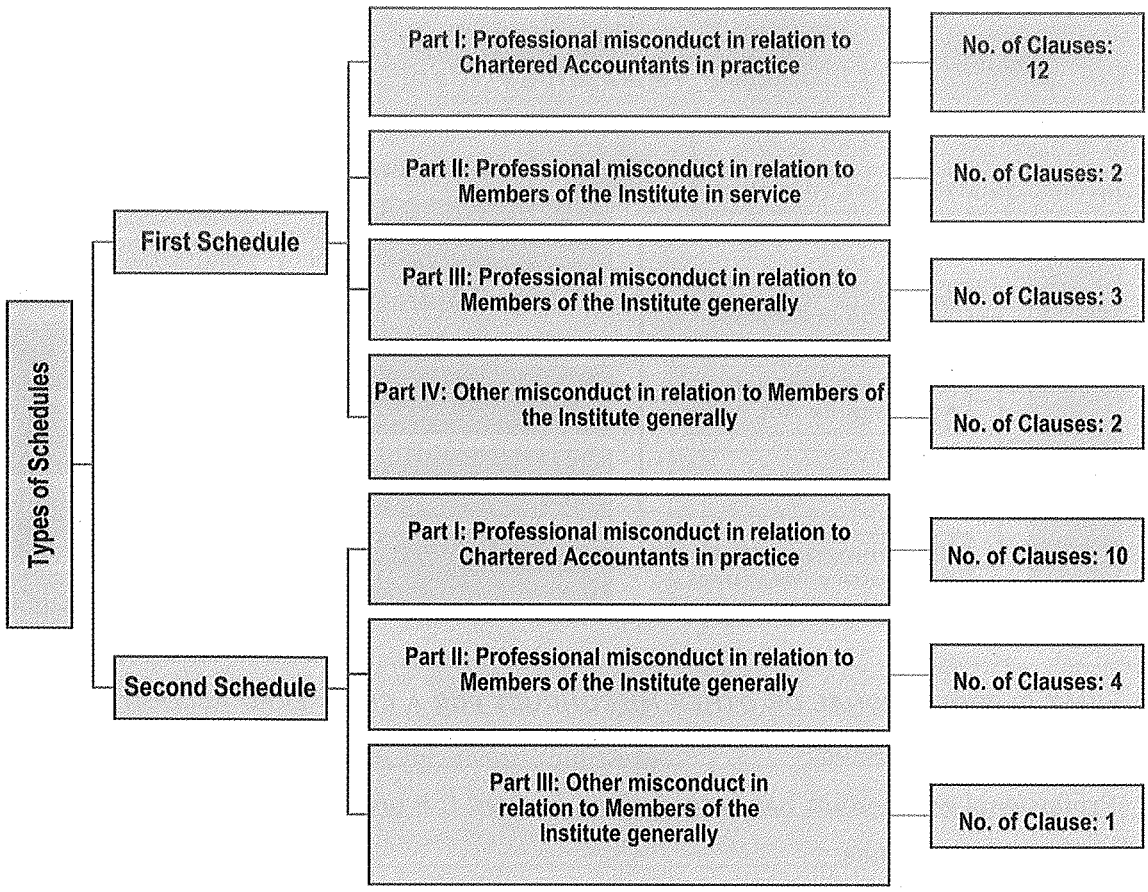
1. WHAT IS PROFESSIONAL OR OTHER MISCONDUCT FOR A CHARTERED ACCOUNTANT?

Professional Misconduct

- Professional misconduct has been defined in Part I, II and III of First Schedule; and Part I & II of Second Schedule.
- A member who is engaged in profession of accountancy whether in practice or service should conduct/restrict his actions in accordance with provisions contained in respective parts of schedules. If he is found guilty of any acts or omissions stated in any of the respective parts of Schedule, he/she shall be deemed to be guilty of professional misconduct.

Other Misconduct

- Other misconduct has been defined in part IV of First Schedule & part III of Second Schedule. These provisions empower Council to inquire into any misconduct of a member even if it does not arise out of his professional work.



The clauses covered in Part I, II & III of Second Schedule have been discussed below. However, for detail explanation, refer 'Professional Ethics' of CA Final Audit.

❖ SECOND SCHEDULE TO THE CHARTERED ACCOUNTANTS ACT, 1949

Part I – Professional Misconduct in relation to Chartered Accountants in Practice

Clause 1

- Discloses Information acquired in the course of his professional engagement to any person other than his client so engaging him without the consent of his client or otherwise than as required by any law for the time being in force.

Clause 2

- Certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice.

Clause 3

- Permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in manner which may lead to the belief that he vouches for the accuracy of the forecast.

Clause 4

- Expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Clause 5

- Fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity.

Clause 6

- Fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity

Clause 7

- Does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

Clause 8

- Fails to obtain sufficient information which is necessary for expression of an opinion, or its exceptions are sufficiently material to negate the expression of an opinion.

Clause 9

- Fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

Clause 10

- Fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

PART II – Professional misconduct in relation to members of the Institute generally

Clause 1

- Contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council*.

Clause 2

- Being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer.

Clause 3

- Includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline. Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

Clause 4

- Defalcates or embezzles money received in his professional capacity.

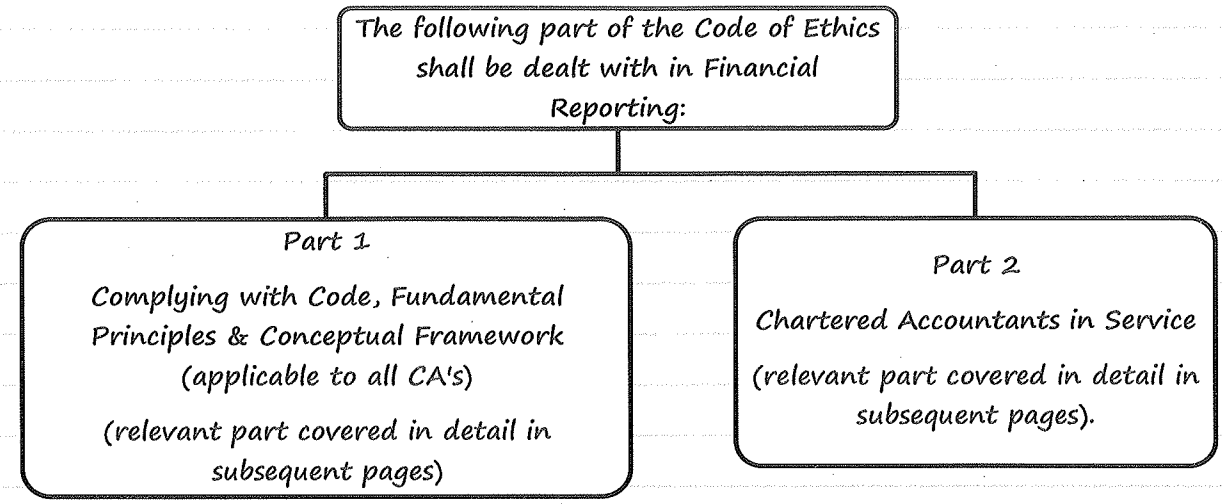
Part III – Other misconduct in relation to members of the Institute generally (1 clause)

Only 1 Clause

- A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.

*Note : Council Guidelines

It states that a member of Institute who is an employee shall exercise due diligence & shall not be grossly negligent in conduct of his duties.



PART 1: COMPLYING WITH THE CODE, FUNDAMENTAL PRINCIPLES AND CONCEPTUAL FRAMEWORK

1. THE FUNDAMENTAL PRINCIPLES

1) Integrity:

- To be straightforward and honest in professional & business relationships
- Shall not knowingly be associated with information where he believes it:
  - (i) Contains a materially false or misleading statement
  - (ii) Contains statements or information provided negligently or
  - (iii) Omits required information.

2) Objectivity

- Not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.

3) Professional Competence and Due Care:

(i) Attain & maintain professional knowledge & skill to ensure that a client or employing organization receives competent professional service;

(ii) Act diligently and in accordance with applicable standards. Diligence encompasses responsibility to act in accordance with requirements of an assignment, carefully, thoroughly and on a timely basis.

(iii) Maintaining professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments.

(iv) Take reasonable steps to ensure those working in a professional capacity in his authority have appropriate training & supervision.

4) Confidentiality

- To respect confidentiality of information acquired as a result of professional & business relationships.
- An accountant shall:

  (a) Be alert to possibility of inadvertent disclosure, in social environment, close business associate or close family member;

  (b) Maintain confidentiality of information
  - within firm or employing organization, (including prospective client);

  (c) Not disclose confidential information acquired as a result of professional & employment relationships
  - outside the firm or employing organization, unless there is a legal or professional duty or right to disclose;
  - for personal advantage or for advantage of a third party;
  - after that relationship has ended;
- Circumstances where CA's are or might be required to disclose confidential information or when such disclosure might be appropriate:

  (a) Disclosure is required by law,

  (b) Disclosure is permitted by law and is authorized by client or employing organization; and

  (c) There is a professional duty or right to disclose, when not prohibited by law:
  - ✓ To comply with the requirements of peer review or quality review of the Institute
  - ✓ To respond to an inquiry or investigation by a professional or regulatory body;
  - ✓ To protect the professional interests of a CA in legal proceedings; or
  - ✓ To comply with technical and professional standards, including ethics requirements.

5) Professional Behaviour

- Avoid any conduct that Chartered Accountant knows might discredit the profession.
- A Chartered Accountant shall be honest and truthful and shall not make:
  - ✓ Exaggerated claims for the services offered, qualifications or experience; or
  - ✓ Disparaging (derogatory) references or comparisons to work of others.

NOTE:

- A CA might face a situation in which complying with one fundamental principle conflicts with others. He should consult, with – Others within firm or employing organization., TCWG, Institute, Legal counsel.
- However, such consultation does not relieve CA from responsibility to exercise professional judgment to resolve conflict or, if necessary, and unless prohibited, disassociate from matter creating conflict.

THE CONCEPTUAL FRAMEWORK

- CA shall apply conceptual framework to
  - ✓ Identify threats to compliance with fundamental principles;
  - ✓ Evaluate threats identified; and
  - ✓ Address threats by eliminating or reducing them to an acceptable level.
- When applying the conceptual framework, the CA shall:
  - ✓ Exercise professional judgment;
  - ✓ Use Reasonable & informed third party test (It is a consideration whether the same conclusions would likely be reached by another party)

PART 2: CHARTERED ACCOUNTANTS IN SERVICE

A. CONFLICTS OF INTEREST

- A Chartered Accountant shall not allow a conflict of interest to compromise professional or business judgment.

1. **Conflict Identification**

Take reasonable steps to identify circumstances that might create a conflict of interest, and threat to compliance with fundamental principles. Such steps shall include identifying:

(a) Nature of relevant interests & relationships between parties involved; and

(b) Activity & its implication for relevant parties.

2. **Threats created by Conflict of Interest**

An action that might eliminate threats is withdrawing from decision-making process.

3. **Disclosure and Consent**

(a) Disclose nature of conflict and how threats were addressed to relevant parties; and

(b) Obtain consent from relevant parties to undertake professional activity when safeguards are applied to address threat.

B. PREPARATION AND PRESENTATION OF INFORMATION

(a) Prepare or present information in accordance with a relevant reporting framework

(b) Exercise professional judgment to:

- ✓ Represent the facts accurately and completely in all material respects;
- ✓ Describe clearly the true nature of business transactions; and
- ✓ Classify & record information in a timely and proper manner;

(c) Not omit anything with the intention of rendering the information misleading.

1. **Use of Discretion in Preparing or Presenting Information**

- Not exercise discretion with intention of misleading others.
- Examples: Determining estimates, accounting policies, timing of transactions, structuring transactions etc. to misrepresent profit or loss.

2. **Relying on the Work of Others**

- Exercise professional judgment and consider the following factors in determining whether reliance on others is reasonable:
  - ✓ Reputation, expertise and resources available to other individual or organization.

- ✓ Whether other individual is subject to applicable professional & ethics standards.

3. Addressing Information that Is or Might be Misleading

- ➢ Knows or has reason to believe that information is misleading, take appropriate actions to seek to resolve the matter.
- ➢ Actions include, discussing with superior, TCWG and requesting such individuals to take appropriate action to resolve the matter. Such action might include:
  - ✓ Having the information corrected.
  - ✓ If the information has already been disclosed to the intended users, informing them of the correct information.
- ➢ Consulting policies & procedures of employing organization (for example, an ethics or whistle-blowing policy) regarding how to address such matters internally

  If information is still misleading:
  - Consult with Institute, Internal or external auditor, Legal counsel.
  - Determining whether any requirements exist to communicate to:
    - ✓ Third parties, including users of information.
    - ✓ Regulatory & oversight authorities.
- ➢ If, appropriate action has not been taken & information is still misleading, he shall refuse to remain associated with the information and it might be appropriate to resign.

C. ACTING WITH SUFFICIENT EXPERTISE

- ➢ Shall not intentionally mislead as to level of expertise or experience possessed.
- ➢ A self-interest threat to compliance with principle of professional competence and due care might be created if a Chartered Accountant has:
  - ✓ Insufficient time for performing or completing the relevant duties.
  - ✓ Incomplete, restricted or otherwise inadequate information for performing the duties.
  - ✓ Insufficient experience, training and/or education.
  - ✓ Inadequate resources for the performance of the duties.
- ➢ Examples of actions that might be safeguards to address such a self-interest threat include:
  - ✓ Obtaining assistance or training from someone with necessary expertise.
  - ✓ Ensuring that there is adequate time available for performing the relevant duties.
  - ✓ If a threat to compliance with principle of professional competence & due care cannot be addressed, he shall determine whether to decline to perform the duties. If he determines

that declining is appropriate, he shall communicate the reasons.

D. FINANCIAL INTERESTS, COMPENSATION AND INCENTIVES LINKED TO FINANCIAL REPORTING AND DECISION MAKING

- Shall not manipulate information or use confidential information for personal gain or for the financial gain of others.

E. INDUCEMENTS, INCLUDING GIFTS AND HOSPITALITY

- An inducement is an object, situation, or action that is used as a means to influence another individual's behaviour, but not necessarily with intent to improperly influence that individual's behaviour.
- An inducement can take many different forms, for example: Gifts, Hospitality, Entertainment, Employment or other commercial opportunities etc.

1. Immediate or Close Family Members

- Remain alert to potential threats created by offering of an inducement:
  (a) By an immediate or close family member of the accountant to a counterparty with whom the accountant has a professional relationship; or
  (b) To an immediate or close family member of the accountant by a counterparty with whom the accountant has a professional relationship.
- If Inducement is being offered, and accountant concludes there is intent to influence behaviour, he shall advise immediate or close family member not to offer or accept the inducement.

F. RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS IN CASE OF EMPLOYMENT WITH LISTED ENTITIES

- When responding to non-compliance or suspected noncompliance, objectives of CA are:
  (a) To comply with principles of integrity & professional behaviour;
  (b) By alerting management, TCWG:
  - ✓ Enable them to rectify or mitigate consequences of identified or suspected non-compliance; or
  - ✓ Deter the non-compliance where it has not yet occurred; and
  - ✓ Take further action in public interest.

1. Responsibilities of All Chartered Accountants

➢ If protocols & procedures exist address non-compliance, consider them in determining how to respond to such non-compliance.

2. Responsibilities of Senior Chartered Accountants in Service

➢ Senior Chartered Accountants are directors, officers or senior employees

a) Addressing the Matter

✓ Discuss with immediate superior, if any. If immediate superior appears to be involved, discuss with the next higher level of authority.

✓ Determine whether disclosure to external auditor, is needed, to enable him to perform the audit.

b) Determining Whether Further Action Is Needed

Further action includes:

✓ Informing management of parent entity (if any)

✓ Disclosing the matter to an appropriate authority as specified under respective law.

✓ Resigning

c) Seeking Advice

Consulting internally, Obtaining legal advice, Consulting on a confidential basis with Institute.

d) Determining Whether to Disclose the Matter to an Appropriate Authority

It would be precluded if doing so would be contrary to law or regulation. Otherwise, the purpose of making disclosure is to enable an appropriate authority to investigate & take action in public interest.

e) Responsibilities of Chartered Accountants Other than Senior Chartered Accountants

If a CA Identifies that noncompliance has occurred or might occur, he shall, inform an immediate superior. If immediate superior appears to be involved, he shall inform next higher level of authority.

If accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action, that disclosure is permitted.

G. PRESSURE TO BREACH THE FUNDAMENTAL PRINCIPLES

➢ A Chartered Accountant shall not:

✓ Allow pressure from others to result in a breach of compliance with fundamental

principles; or

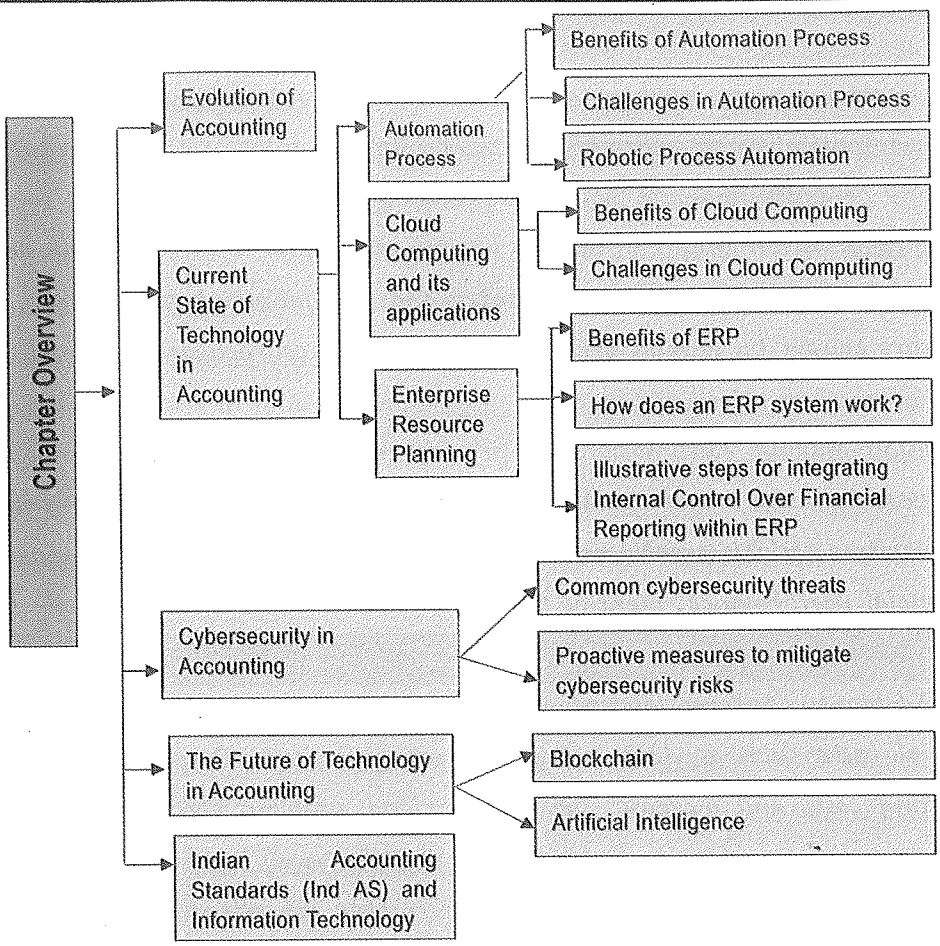
- ✓ Place pressure on others that would result in other individuals breaching fundamental principles.

➢ Discussing circumstances creating the pressure and consulting with others might assist to evaluate the level of the threat. Such discussion & consultation include:

- Discussing with individual who is exerting pressure to seek to resolve it.
- Discussing with superior
- Escalating to Higher levels of management, Internal or external auditors, TCWG.
- Disclosing in line with policies, including ethics & whistleblowing policies.
- Consulting with a colleague, superior, human resources personnel, another CA, Institute, industry associations, Legal counsel.

➢ An action that might eliminate threats created by pressure is request for a restructure / segregation of certain responsibilities & duties so that the accountant is no longer involved with individual or entity exerting pressure.

ACCOUNTING AND TECHNOLOGY



1. THE CURRENT STATE OF TECHNOLOGY IN ACCOUNTING

➢ *It discusses various technologies used in accounting and their impact on profession, including automation, cloud computing, and artificial intelligence*

I) AUTOMATION PROCESS

➢ *Automation is use of software and other tools to automate manual processes, making them faster and more accurate.*

A) <u>Benefits of Automation Process</u>

1) <u>Streamlining Data Entry:</u> *Automation tools, such as optical character recognition (OCR) or barcode recognition technology, can help to automate the entry of data from source*

documents such as receipts and invoices. This can reduce the amount of time and effort required for manual data entry, as well as minimizing the potential for human error.

2) Accelerating Data Processing: Automation can help to process large amounts of data / large volumes of transactions more quickly and accurately than manual methods. For example, software can automatically categorize transactions into the appropriate accounts, calculate tax amounts, and generate financial statements, among other tasks.

3) Enhancing Accuracy: Automation can help to reduce errors and discrepancies in accounting processes. By automating tasks such as data entry and calculations, businesses can minimize the risk of errors caused by human error, improving the accuracy and reliability of their financial data.

4) Improving Decision-Making: Automation can provide real-time insights into financial data, enabling businesses to make informed decisions more quickly. With automated reporting, the time spent on routine tasks is greatly minimized, enabling businesses to gain deeper insights into their financial performance, identify trends and patterns, and adjust their strategies accordingly.

5) Saving Time and Money: Automation reduces the amount of time and resources required to perform manual tasks such as data entry and reconciliations. This results in businesses saving on staffing costs and increases productivity and enabling accountants to focus on higher-level tasks such as analysis and planning.

6) Facilitating Compliance: Automation helps business to stay compliant with regulations and standards by ensuring accounting practices meet the necessary requirements. As seen above, automation ensures accurate data for the purposes of return filing. Further, in case the systems are so programmed, reporting tools can generate financial statements that meet the criteria of Ind AS or Indian GAAP as the case may be. This would ensure minimizing the risk of non-compliance and potential penalties.

B) Challenges in Automation Process

➢ Automation also comes with its own set of potential drawbacks and challenges:

1) Need for ongoing training and education to keep up with latest technology.

2) Risk of data breaches & cyber-attacks, which can compromise the security and confidentiality of financial data.

3) Potential loss of jobs. This can be mitigated by ensuring training to workforce to remain

updated with technology.

C) Robotic Process Automation

- Robotic Process Automation (RPA) is an emerging technology that revolutionizes financial reporting processes. RPA utilizes software robots or "bots" to automate manual and repetitive tasks in financial data processing, analysis, and reporting.
- By mimicking human interactions with digital systems, RPA bots can extract and consolidate data, perform calculations, generate reports, and ensure compliance with accounting standards.
- The adoption of RPA in financial reporting improves accuracy, enhances efficiency, and frees up time.
- Moreover, RPA enables organizations to achieve timely reporting, cost savings, and increased data integrity, ultimately leading to more reliable and insightful financial information.

II) CLOUD COMPUTING

- Cloud computing refers to the delivery of computing services over the internet. It allows accountants to access their data and software from any device with an internet connection.

A) Common Applications / Cases of Cloud Computing

1) Cloud Storage: Services like Dropbox, Google Drive, and Microsoft OneDrive offer cloud storage solutions that allow users to store and access their files and data from anywhere with an internet connection. Users can save documents, photos, videos, and other files in the cloud and synchronize them across multiple devices.
2) Software as a Service (SaaS): SaaS platforms provide cloud-based software applications that users can access and utilize via the internet. Examples include Salesforce for customer relationship management (CRM), Slack for team collaboration, and QuickBooks Online for accounting and financial management.
3) Infrastructure as a Service (IaaS): IaaS providers offer virtualized computing resources, including servers, storage, and networking infrastructure, on a pay-as-you-go basis. Examples include Amazon Web Services (AWS), Microsoft Azure, and Google Cloud Platform. These platforms allow businesses to scale their IT infrastructure based on demand without the need for physical hardware.

4) Platform as a Service (PaaS): PaaS providers offer cloud-based platforms that enable developers to build, deploy, and manage applications without the complexity of infrastructure management. Examples include Microsoft Azure App Service, and Google App Engine.
5) Cloud-based Communication and Collaboration: Applications like Microsoft Teams, Google Workspace (formerly G Suite), and Zoom provide cloud-based communication and collaboration tools that facilitate real-time messaging, video conferencing, file sharing, and project management.
6) Cloud-based E-commerce: Few platforms enable businesses to set up and manage online stores using cloud infrastructure. These platforms provide features like product catalogues, payment processing, inventory management, and customer analytics.
7) Big Data Analytics: Cloud computing enables organizations to process and analyze large volumes of data efficiently. Services like Amazon Redshift, Google BigQuery, and Microsoft Azure Data Lake Analytics provide scalable infrastructure for big data processing and analytics, empowering businesses to derive valuable insights from their data.

B) **Benefits of Cloud Computing**

➢ Following are some of the ways in which Cloud Computing has positively impacted accounting:

1) Improved accessibility: Cloud-based accounting software allows users to access their financial data from any location with an internet connection. This has increased accessibility and flexibility for accountants and business owners, allowing them to work remotely and collaborate in real-time.
2) Enhanced security: Cloud-based accounting software providers typically offer advanced security features such as encryption, firewalls, and multi-factor authentication helping in the protection of sensitive financial data from cyber threats and data breaches.
3) Increased scalability: Cloud-based accounting software allows businesses to easily scale up or down based on their changing needs. As a business grows, it can easily add new users and features without having to invest in additional hardware or software.
4) Reduced costs: Cloud-based accounting software typically requires less upfront investment in hardware and software, as well as ongoing maintenance costs. This can help businesses save money on IT expenses and redirect those funds to other areas of the business. For example,

the costs of installing Microsoft Office Suite on a laptop or desktop is far more expensive than subscribing to the Office 365 Suite, which is a web-based download. Further, the web-based download also provides the options of continuous free updates unlike its Office Suite offline counterpart.

5) Streamlined collaboration: Cloud-based accounting software allows multiple users to collaborate in real-time, reducing the need for manual data entry and communication. This can help to streamline workflows and reduce errors caused by miscommunication.

6) Improved reporting and analytics: Cloud-based accounting software often includes powerful reporting and analytics tools that allow businesses to gain deeper insights into their financial performance. This can help businesses make more informed decisions and identify areas for improvement.

C) **Challenges in Cloud Computing**

➢ Following are the potential challenges which may emerge in cloud computing:

1) Since cloud-based software are completely online, they could be prone to hackers who could 'steal' data or passwords or compromise the integrity of the processed data, thereby causing disruptions to the businesses.

2) Strong net connectivity is a must for cloud-computing to be a success.

III) Enterprise Resource Planning (ERP)

➢ ERP is used for managing day-to-day business activities like procurement, project management, accounting, risk management, compliance, and supply chain operations.

➢ ERP systems connects and corelates a multitude of business processes and enable the flow of data between them.

➢ ERP are designed around a common database. These are then interconnected with business processes driven by workflows across business departments (e.g. finance, human resources, engineering, marketing, and operations), connecting systems and people who use them.

➢ Data integrity is assured for every task performed throughout the organization

A) **Benefits of ERP**

1) Improved business insight from real-time information generated by reports

2) Less operational costs through streamlined business processes and best practices

3) Enhanced collaboration of users sharing data in contracts, requisitions, and purchase orders
4) Better efficiency through a common user experience across many business functions and well-defined business processes
5) Consistent infrastructure from the back office to the front office
6) Increased user-adoption rates from a common user experience and design
7) Reduction in risk through improved data integrity and financial controls
8) Less management and operational costs through uniform and integrated systems

B) How does an ERP system work?

- ERP systems work by using a defined, standard data structure. Information entered by one department is immediately available to authorized users across business.
- Real-time data is then interlinked into business processes and workflows across departments. Managers check if one location is doing significantly better than another site and can figure out why. Finance department can use ERP for comparison of sales, profits and other financial data to help executives in understanding the performance of the organisation and also for setting new targets.
- ERP systems deliver the most value when a company has modules for each major business function and ensures timely and accurate data entry.

C) Illustrative steps for integrating Internal Control Over Financial Reporting (ICOFR) with an ERP

- ICOFR with an ERP offers key advantage of streamlining financial processes, ensuring data integrity, and promoting effective internal controls. By automating and standardizing procedures, ERP system reduces manual effort and minimizes risk of errors. It enables segregation of duties, real-time visibility into financial data, comprehensive audit trails, enhanced reporting capabilities, and proactive risk mitigation. This integration strengthens financial control, accuracy, and compliance, ultimately enabling better decision-making and reducing the likelihood of fraud or errors.

The following are illustrative steps for integrating ICOFR within ERP:

1) Verify that process includes identification and updating of internal & external financial reporting requirements and deadlines.

The finance team regularly reviews the regulatory guidelines and reporting requirements set by the regulators and ensures that the ERP system's financial closing process is aligned with these requirements. Examples are listed companies to declare quarterly results as per LODR, filing of periodical returns under GST, Income Tax, Labour laws, etc.,

2) Review the documented process to ensure it aligns with organization's financial reporting policies & regulatory guidelines.

The finance team reviews documented process in ERP and cross-checks it with organization's financial reporting policies and regulatory guidelines to ensure consistency. Examples are accounting polices relating to Property plant and equipment, depreciation, Inventory etc.,

3) Use ERP system's change management functionality to track & validate changes made to the financial closing & reporting process.

When changes are made to the financial closing and reporting process, the finance team uses the ERP system's change management functionality to track and record these changes. They review system logs and audit trail for changes made to the financial closing and reporting process are as per defined roles and responsibilities for change control, including change initiators, approvers, and change management teams.

4) Verify that changes to the process are authorized by designated individuals with appropriate authority using system logs.

Finance team reviews system logs, audit trail and confirms that any changes to financial closing & reporting process were authorized by designated individuals with the appropriate authority, such as the CFO or finance manager.

5) Review the change requests, approvals, and documentation within the ERP system to ensure proper authorization & validation of process changes.

6) Validate that roles & responsibilities are clearly defined within ERP system by reviewing users access matrix configurations & system logs.

Review system logs and audit trail with Responsibility assignment matrix (RAM). RAM is a tool used in project management and (ERP) implementations to define and communicate the roles and responsibilities of individuals or teams involved in a project or process. The matrix clarifies who is responsible, accountable, consulted, and informed for each task or deliverable within the ERP implementation.

7) Assess qualifications & training records of individuals assigned to financial reporting roles

within the ERP system.

8) Validate that individuals responsible for financial reporting have necessary understanding of organization's operations and appropriate accounting knowledge.

The finance team validates that individuals responsible for financial reporting within the ERP system have a comprehensive understanding of the organization's operations and possess appropriate accounting knowledge. For example, verify HR records of those involved in accounting have appropriate knowledge.

9) Validate that decisions on alternative accounting treatments for significant events or transactions are documented & approved by management.

Reviewing the Journal vouchers listing by identifying non routine transactions. Review the system of Standardizing voucher types. This involves defining a set of predefined templates or formats for different types of journal entries to ensure consistency and accuracy in recording financial data.

10) Review ERP system for documentation of accounting treatment decisions, including approvals and communication to the audit committee.

Documentation of accounting treatment decisions refers to the process of recording and maintaining comprehensive documentation regarding the rationale, analysis, and conclusions related to accounting treatments chosen for specific transactions or events like recognising long term construction projects.

11) Review ERP system's user administration functionality to ensure appropriate individuals have access to financial reporting process.

Review system logs and audit trail with Responsibility assignment matrix (RAM).

12) Review whether proper KYC validation controls are in place for creating account masters & review the process for identifying related party transactions.

Separate ledger coding for related parties for auto tabulating transactions to present as per Schedule III of Companies Act, 2013.

13) Validate that ERP captures & documents appropriate accounting treatment for each non-routine event, transaction, and account balance by reviewing Journal Vouchers listing.

14) Use ERP system's audit trail & reporting capabilities to validate that all postings have occurred in correct accounting period.

In an ERP system, the accounting date and transaction date are captured and stored as part of the transactional data. They are used in various processes, such as journal entry

creation, financial statement generation, period-end closing activities, and audit trails. Understanding the distinction between these dates is important for accurate financial reporting, compliance, and analysis of business transactions within the ERP system.

15) Review system's controls for preventing backdating or unauthorized adjustments to postings by reviewing posting date & transactions date of entries.

2. CYBERSECURITY IN ACCOUNTING

- Organizations have legal & ethical obligations to disclose cybersecurity incidents with financial implications.
- A cybersecurity breach can have significant consequences, including financial losses, reputational damage, and loss of sensitive client data. In all cases, aim of the attack would be either stealing sensitive financial data or disrupting operations or demand ransom money.

A) Common cybersecurity threats

1) Phishing attacks: Phishing attacks are a common cybersecurity threat that involves tricking users into clicking on malicious links or providing sensitive information.
2) Malware attacks: Malware attacks involve infecting computers or networks with malicious software that can steal data or disrupt operations.
3) Ransomware attacks: Ransomware attacks involve encrypting files or locking users out of systems and demanding a ransom payment in exchange for restoring access.
4) Insider threats: Insider threats involve malicious actions by employees or other insiders who have access to sensitive data.
5) Denial of Service (DoS) attacks: DoS attacks involve overwhelming a system or network with traffic to disrupt operations.
6) Supply chain attacks: Supply chain attacks involve compromising third-party software or hardware to gain access to a system or network.

B) Proactive measures to mitigate cybersecurity risks

1) Password management: Strong passwords are critical for protecting sensitive financial data. Accounting professionals should ensure that all passwords are complex and changed

regularly.

2) **Encryption:** Encryption can be used to protect sensitive data during transmission and storage. The IT Team of an organization should ensure that all sensitive data is encrypted using appropriate methods.

3) **Access control:** Access control is critical for preventing unauthorized access to financial data. Accounting professionals should ensure that access to sensitive data is limited to authorized personnel and that appropriate access controls are in place. The access controls should be continuously reviewed and updated based on any changes in the management or employee structure.

4) **Network security:** Network security is critical for protecting financial data from cyberattacks. It should be ensured that firewalls and other security measures are in place to prevent unauthorized access to the network.

5) **Employee training:** Employee training is critical for ensuring that all staff members are aware of the importance of cybersecurity and understand how to protect sensitive financial data.

6) **Data backup:** Regular data backups are critical for ensuring that financial data is not lost in the event of a cyberattack. Accounting professionals should ensure that data backups are performed regularly and that backups are stored securely.

7) **Incident response planning:** Accounting professionals should have a clear incident response plan in place in the event of a cyberattack. This plan should include procedures for detecting, containing, and mitigating the impact of a cyberattack.

3. THE FUTURE OF TECHNOLOGY IN ACCOUNTING

I) BLOCKCHAIN

- Blockchain is a decentralized & transparent ledger that enables secure and immutable transactions. Unlike traditional centralized systems, blockchain offers a distributed network where information is shared and verified by multiple participants, eliminating the need for intermediaries and enhancing data integrity.
- From a financial statement preparation perspective, blockchain holds immense potential to streamline processes, enhance transparency, and improve accuracy & reliability of financial reporting.

A) Key impacts of blockchain on financial reporting

1) Enhanced Transparency: Blockchain technology provides a decentralized and immutable ledger, where transactions are recorded and stored in a transparent and tamper-proof manner. This increased transparency ensures that financial data is accurately captured and can be easily audited, promoting trust and reliability in financial reporting.

2) Improved Data Integrity: Blockchain's distributed ledger ensures that each transaction is verified and encrypted, preventing unauthorized modifications or tampering. This feature enhances data integrity, reducing the risk of fraudulent activities and errors in financial reporting.

3) Streamlined Audit Processes: Blockchain technology enables real-time access to financial data, eliminating the need for time-consuming and manual data reconciliation processes. Auditors can directly access the blockchain ledger to verify transactions, reducing audit time and enhancing efficiency in financial reporting.

4) Enhanced Security: Blockchain incorporates advanced cryptographic algorithms, making it highly secure against unauthorized access or data breaches. Financial data stored on the blockchain is encrypted and protected, minimizing the risk of data manipulation or unauthorized disclosure, thus strengthening the security of financial reporting.

5) Simplified Reconciliation: Blockchain's decentralized ledger eliminates the need for reconciling multiple versions of data across different systems. With a single shared source of truth, financial reporting processes become more streamlined, reducing reconciliation efforts and potential errors.

6) Cost Reduction: By eliminating intermediaries and central authorities, blockchain reduces the costs associated with traditional financial reporting processes. It eliminates the need for third-party verification and reconciliation, leading to cost savings for organizations.

7) Enhanced Audit Trail: Blockchain maintains a comprehensive and immutable audit trail of all transactions, providing a transparent and traceable record of financial activities. This audit trail simplifies the identification and investigation of any irregularities or discrepancies, improving the accuracy and reliability of financial reporting.

8) Real-time Financial Reporting: With blockchain's real-time data availability and consensus mechanism, financial reporting can be performed more frequently and with greater accuracy. Organizations can generate up-to-date financial statements, enabling stakeholders to make informed decisions based on the most current financial information.

II) ARTIFICIAL INTELLIGENCE (AI)

- AI refers to simulation of human intelligence in machines, enabling them to perform tasks that would typically require human intervention.
- Apart from the aspects of automation, accuracy, fraud detection and cost savings, the most important feature is enabling predictive analytics.
- AI can be used to analyze large amounts of data & make predictions about future trends, which can be useful for forecasting financial performance and identifying potential risks.
- Artificial Intelligence (AI) and Machine Learning (ML) are technologies that enable computers to learn and perform tasks without being explicitly programmed to do so. AI and ML enable accounting professionals to automate routine tasks, improve decision-making processes, and reduce errors.

A) Benefits of AI and ML when used in accounting

1) Automated Data Entry: AI & ML algorithms can process and extract data from invoices, receipts and other documents, reducing need for manual data entry. AI & ML algorithms can also review bank statements and pass entries in system, followed by bank reconciliation, thereby automating entire process, saving time & improving efficiency.
2) Fraud Detection: AI can help detect fraud by analysing large amounts of data and identifying patterns that may indicate fraudulent activity.
3) Financial Forecasting: ML can be used to develop predictive models that can forecast financial performance based on historical data, market trends, and other factors.
4) Accounting Automation: AI can analyse financial statements and other data to identify errors or inconsistencies, making accounting more efficient and accurate.
5) Tax Compliance: AI can help automate tax compliance by analysing financial data and identifying tax obligations, ensuring that businesses remain compliant with tax regulations.

B) Challenges with Artificial Intelligence

- Along with the advantages of AI and ML, there are following potential challenges and risks associated with the adoption of AI and machine learning like:

1) Data privacy
2) Security concerns

3) Technical complexity

4) Need to train employees in an organization to extract capabilities of AI from the system

4. INDIAN ACCOUNTING STANDARDS (IND AS) AND INFORMATION TECHNOLOGY

- Ind AS consists of specific principles for various accounting topics, such as revenue recognition, leasing, financial instruments, employee benefits, consolidation, and many more. These principles provide detailed guidance on how to account for transactions in accordance with principles of measurement & recognition.
- For implementation of Ind AS, technology will play key role in automating process. However, role of technology for such processing is directly related to configuration at Account level with rule-based validations.
- Configuration implements pre-defined validation rules within system to identify discrepancies or noncompliance with Ind AS.
- If the account level configuration is not done properly, then the next phase of using technology will be after generating the reports. In such scenario, use of technology is about applications such as Microsoft Excel or Google Sheets which can be used to perform such validations from Ind AS point of view and then generate the report. This is purely dependent on human intelligence rather than on technology, except for the cases where AI is involved with proper training using machine learning.