

# Ind AS 1: Presentation of Financial Statements

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## Section A – Practical & Relevant Theory Questions

### Complete Set of Financial Statements

#### Question 1

A Company presents financial results for three years (i.e. one for current year and two comparative years) internally for the purpose of management information every year in addition to the general purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purposes. During current year, management thought why not they should present third year statement of profit and loss also in the general purpose financial statements. It will save time and will be available easily whenever management needs this in future.

With reference to above background, answer the following:

- (i) Can management present the third statement of profit and loss as additional comparative in the general purpose financial statements?
- (ii) If management present third statement of profit and loss in the general purpose financial statement as comparative, is it necessary that this statement should be compliant of Ind AS?
- (iii) Can management present third statement of profit and loss only as additional comparative in the general purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?

#### Answer

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

#### Question 2

A retail chain acquired a competitor in March, 20X1 and accounted for the business combination under

Ind AS 103 on a provisional basis in its 31<sup>st</sup> March, 20X1 annual financial statements. The business combination accounting was finalised in 20X1-20X2 and the provisional fair values were updated. As a result, the 20X0-20X1 comparatives were adjusted in the 20X1-20X2 annual financial statements. Does the restatement require opening balance sheet (that is, additional balance sheet) as of 1<sup>st</sup> April, 20X0?

**Answer**

An additional balance sheet is **not required**, because the acquisition had no impact on the entity's balance sheet at 1<sup>st</sup> April, 20X0.

**Question 3**

A Company while preparing the financial statements for financial year 20X1-20X2, erroneously booked excess revenue of ₹ 10 Crore. The total revenue reported in financial year 20X1-20X2 was ₹ 80 Crore. However, while preparing the financial statements for 20X2-20X3, it discovered that excess revenue was booked in financial year 20X1-20X2 which it now wants to correct in the financial statements. However, the management of the Company is not sure whether it need to present the third balance sheet as additional comparative.

With regard to the above background, answer the following:

- (i) Is it necessary to provide third balance sheet at the beginning of preceding period in this case?
- (ii) The Company wants to correct the errors during financial year 20X2-20X3 by giving impact in the figures of current year only. Is the contention of management correct?

**Answer**

- (i) No**, as per Para 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:
  - (a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
  - (b) the retrospective application, retrospective restatement or reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.
- (ii) No**, management need to correct the previous year figures to correct the error but need not to furnish third balance sheet at the beginning of preceding period.

**Question 4**

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

S. No.	Matters
(i)	There are qualifications in the audit report of the Company with reference to two Ind AS.
(ii)	Is it mandatory to add the word 'standalone' before each components of financial statements?

(iii)	The Company is Indian Company and preparing and presenting its financial statements in ₹. Is it necessary to write in the financial statements that the financial statements have been presented in ₹.
(iv)	The Company had sales transactions with 10 related party parties during previous year. However, during current year, there are no transactions with 4 related parties out of aforesaid 10 related parties. Hence, Company is of the view that it need not disclose sales transactions with these 4 parties in related party disclosures because with these parties there are no transactions during current year.

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

### **Answer**

- (i)** Yes, an entity whose financial statements comply with Ind AS shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with Ind AS unless they comply with all the requirements of Ind AS. (Refer Para 16 of Ind AS 1)
- (ii)** No, but need to disclose in the financial statement that these are individual financial statement of the Company. (Refer Para 51(b) of Ind AS 1)
- (iii)** Yes, Para 51(d) of Ind AS 1 inter alia states that an entity shall display the presentation currency, as defined in Ind AS 21 prominently, and repeat it when necessary for the information presented to be understandable.
- (iv)** No, as per Para 38 of Ind AS 1, except when Ind AS permit or require otherwise, an entity shall **present comparative information** in respect of the preceding period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.

## **General Features of Financial Statements**

### **Question 5**

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

### **Answer**

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

**Question 6**

Entity XYZ is a large manufacturer of plastic products for the local market. On 1<sup>st</sup> April, 20X6 the newly elected government unexpectedly abolished all import tariffs, including the 40 percent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency ₹ appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products.

Before 20X6 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ went into losses. As at 31<sup>st</sup> March, 20X7, entity XYZ's equity was ₹ 1,000. During the second quarter of financial year ended 31<sup>st</sup> March 20X7, the management restructured entity's operations. That restructuring helped reduce losses for the third and fourth quarters to ₹ 400 and ₹ 380, respectively. During the year ended 31<sup>st</sup> March, 20X7, entity XYZ reported a loss of ₹ 4,000. In January 20X7, the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15<sup>th</sup> March, 20X7, the government announced that it would reintroduce limited plastic import tariffs at 10 percent in 20X8. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term.

Management of the entity XYZ undertook a going concern assessment at 31<sup>st</sup> March, 20X7. Management projects/forecasts that imposition of a 10 percent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31<sup>st</sup> March, 20X7 annual financial statements?

**Answer**

Going concern is a general feature to be considered while preparing the financial statements. As per Ind AS 1, when preparing financial statements, management shall **make an assessment of an entity's ability to continue as a going concern**. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. When management is aware, in making its assessment, of **material uncertainties** related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall **disclose those uncertainties**. An entity is required to disclose the facts, if the financial statements are not prepared on a going concern basis. Along with the reason, as to why the financial statements are not prepared on a going concern basis.

While assessing the going concern assumption, an entity is required to take into consideration all factors covering atleast but not limited to 12 months from the end of reporting period.

On basis of Ind AS 1 and facts and circumstances of this case, the **following disclosure is appropriate:**

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

**Note 1: Basis of preparation**

On the basis of management's assessment at 31<sup>st</sup> March 20X7, the **financial statements have been prepared on the going concern basis**. However, management's assessment assumes that the government will reintroduce limited plastic import tariffs and that the currency exchange rate will remain constant. On 15<sup>th</sup> March 20X7, the government announced that limited import tariffs will be imposed in 20X8. However, the government emphasised that the tariff would not be as protective as the 40 percent tariff in effect before 20X7.

Provided that ₹ does not strengthen, management projects/forecasts that a 10 percent tariff on all plastic products would result in entity XYZ returning to profitability. As at 31<sup>st</sup> March, 20X7 entity XYZ had net assets of ₹ 1,000. If import tariffs are not imposed and currency exchange rates remain unchanged, entity XYZ's liabilities could exceed its assets by the end of financial year 20X7-20X8. On the basis of their assessment of these factors, management believes that entity XYZ is a going concern.

### **Offsetting of Items in Financial Statements**

#### **Question 7**

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

#### **Answer**

On the basis of the guidance regarding offsetting, net presentation in the given case would not be appropriate, as it would not reflect substance of the transaction and would detract from the ability of users to understand the transaction.

Accordingly, the commission received by the company as an agent is the gross revenue of the company. The amount of commission paid by it to the sub-agent should be considered as an expense and should **not be offset** against commission earned by it.

#### **Question 8**

Is offsetting permitted under the following circumstances?

- (a) Expenses incurred by a holding company on behalf of subsidiary, which is reimbursed by the subsidiary - whether in the separate books of the holding company, the expenditure and related reimbursement of expenses can be offset?
- (b) Whether profit on sale of an asset against loss on sale of another asset can be offset?
- (c) When services are rendered in a transaction with an entity and services are received from the same entity in two different arrangements, can the receivable and payable be offset?

#### **Answer**

- (a) As per paragraph 33 of Ind AS 1, offsetting is permitted only when the offsetting reflects the substance of the transaction.

In this case, the agreement/arrangement between the holding and subsidiary company needs to be considered. If the arrangement is to reimburse the cost incurred by the holding company on behalf of the subsidiary company, the same may be **presented net**. It should be ensured that the substance of the arrangement is that the payments are actually in the nature of reimbursement.

- (b) Paragraph 35 of Ind AS 1 requires an entity to present on a net basis gains and losses arising from a group of similar transactions. Accordingly, gains or losses arising on disposal of various items of property, plant and equipment shall be **presented on net basis**. However, gains or losses should be presented separately if they are material.
- (c) Ind AS 1 prescribes that assets and liabilities, and income and expenses should be reported

separately, unless offsetting reflects the substance of the transaction. In addition to this, as per paragraph 42 of Ind AS 32, a financial asset and a financial liability should be offset if the entity has legally enforceable right to set off and the entity intends either to settle on net basis or to realise the asset and settle the liability simultaneously.

In accordance with the above, the receivable and payable should be offset against each other and **net amount is presented** in the balance sheet if the entity has a legal right to set off and the entity intends to do so. Otherwise, the receivable and payable should be reported separately.

### **Material Items Vs Exceptional Items**

#### **Question 9**

As per the statutory requirements, exceptional items are required to be disclosed whereas Ind AS 1 requires separate disclosures of material items and how these are to be presented in the financial statements. Does that imply that 'exceptional' means 'material'? How should these be presented in the financial statements? Give examples of exceptional items.

#### **Answer**

Exceptional items is neither defined in Division II Schedule III nor in Ind AS. However, paragraph 85, 86, 97 and 98 of Ind AS 1 has reference to such items.

Para 85 of Ind AS 1 states that additional line items, headings and subtotals in the statement of profit and loss shall be presented, when such presentation is relevant to an understanding of the entity's financial performance.

Further, para 86 of Ind AS 1 states that disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense.

Para 97 of Ind AS 1 states that when items of income or expense are **material**, an entity shall **disclose** their nature and amount **separately**.

As per Ind AS 1, **materiality depends on the size and nature** of the omission or misstatement judged in the surrounding circumstances. The size or nature **of the item**, or a combination of both, could be the determining factor.

The format of Statement of Profit and Loss requires determination of profit/(loss) before exceptional items and tax and thereafter exceptional items are required to be shown.

Hence, **all material items are not exceptional** items. In other words, **exceptional items are those** items which **meet the test of 'materiality'** (size and nature) **and** the test of **'incidence'**.

Generally, items of income or expense fulfilling the above-mentioned criteria are classified as **exceptional items** and are **disclosed separately**.

Para 98 of Ind AS states that circumstances that would give rise to the separate disclosure of items of income and expense **includes**:

- (a) **write-downs of inventories to net realisable value** or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
- (b) **restructurings of activities of an entity and reversals of any provisions for costs of restructuring;**

- (c) **disposals of items of property, plant and equipment;**
- (d) **disposals of investments;**
- (e) **discontinued operations;**
- (f) **litigation settlements; and**
- (g) **other reversals of provisions.**

### **Classification of Assets and Liabilities as Current and Non Current**

#### **Question 10**

X Ltd. provides you the following information:

Raw material stock holding period:	3 months
Work-in-progress holding period:	1 month
Finished goods holding period:	5 months
Debtors collection period:	5 months

You are requested to compute the operating cycle of X Ltd.

#### **Answer**

The **operating cycle** of X Ltd. will be computed as under:

Raw material stock holding period + Work-in-progress holding period + Finished goods holding period + Debtors collection period = 3 + 1 + 5 + 5 = **14 months**

#### **Question 11**

X Ltd. provides you the following information:

Raw material stock holding period:	3 months
Work-in-progress holding period:	1 month
Finished goods holding period:	5 months
Debtors collection period:	5 months

The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?

#### **Answer**

In this case, the **operating cycle of X Ltd. is 14 months**. Since the trade payables are expected to be settled within the operating cycle i.e. 12.5 months, they should be **classified as a current**.

#### **Question 12**

B Ltd. produces aircrafts. The length of time between first purchasing raw materials to make the aircrafts and the date the company completes the production and delivery is 9 months. The company receives payment for the aircrafts 7 months after the delivery.

- (a) What is the length of operating cycle?
- (b) How should it treat its inventory and trade receivables?

**Answer**

- (a) The length of the **operating cycle** will be **16 months**.
- (b) Assuming the inventory and trade receivables will be realised within normal operating cycle, i.e., 16 months, both the inventory as well as trade receivables should be **classified as current**.

**Question 13**

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

- (a) Will the inventory and the trade receivables be current in nature?
- (b) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different?

**Answer**

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

- (a) In this case, time lag between the purchase of inventory and its realisation into cash is **19 months** [11 months + 8 months]. Both inventory and the debtors would be **classified as current** if the entity expects to realise these assets in its normal operating cycle.
- (b) **No, the answer will be the same** as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and realisation into cash is **28 months** [15 months + 13 months]. Both inventory and debtors would be **classified as current** if the entity expects to realise these assets in the normal operating cycle.

**Question 14**

Assume operating cycle to be of twelve months. Classify the following deposits given by an entity in automobile industry during the year ended 31<sup>st</sup> March, 20X1 either as current asset or non-current asset. Give reasons.

- (i) Electricity deposit paid to permanently enhance the power load of the factory.
- (ii) Tender deposit. Tender is likely to be opened & awarded to lowest bidder within next six months.
- (iii) GST demand deposited with the department against which the entity has filed an appeal before the appellate authorities. Appeal is likely to be heard after 30<sup>th</sup> June, 20X2.
- (iv) Earnest money deposit on award of a long-term job contract to be completed by 31<sup>st</sup> May, 20X2. Earnest money is returnable only on completion of the job work.

**Answer**

- (i) **Electricity Deposit** - At all points of time, the deposit is recoverable on demand, when the connection is not required. However, practically, such electric connection is required as long as the entity exists. Hence, from a commercial reality perspective, an entity does not expect to realise the asset within twelve months from the end of the reporting period. Hence, electricity deposit should be classified as a **non-current asset**.
- (ii) **Tender Deposit** - In the given case, tender is likely to be opened and awarded to the lowest bidder within six months. Therefore, it is expected that the refund of tender deposit will also be received within a few days or a month from the date of tender being opened and awarded. Hence, tender deposit will be classified as **current asset** in the books of entity as on 31<sup>st</sup> March, 20X1.
- (iii) **GST Demand Deposit paid under dispute** - Since appeal is likely to be heard after 30<sup>th</sup> June, 20X2 i.e., 15 months from 31<sup>st</sup> March, 20X1 (reporting date), it should classify such GST demand deposit as **non-current asset**.
- (iv) **Earnest Money Deposit** - Since the job contract is of long term in nature and is expected to be completed by 31<sup>st</sup> May, 20X2, i.e., 14 months from 31<sup>st</sup> March, 20X1 (reporting date), the earnest money deposit should be classified as **non-current asset**.

**Question 15**

XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e., 31<sup>st</sup> March, 20X2.

In addition to above, there are following items/transactions which took place during financial year 20X1-20X2.

S. N.	Items/Transactions
(i)	The company has some trade receivables which are due after 15 months from date of balance sheet. So, the company expects that the payment will be received within the period of operating cycle.
(ii)	The company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the company does not expect that it will be able to pay these payables within the operating cycle because the nature of business is such that generally projects get delayed and payments from customers also get delayed.
(iii)	The company was awarded a contract of ₹ 100 Crore on 31 <sup>st</sup> March, 20X2. As per the terms of the contract, the company made a security deposit of 5% of the contract value with the customer, of ₹ 5 crore on 31 <sup>st</sup> March, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract.
(iv)	The company has also given certain contracts to third parties and have received security deposits from them of ₹ 2 Crore on 31 <sup>st</sup> March, 20X2 which are repayable on completion of the contract but if contract is cancelled before the contract term of 18 months, then it becomes payable immediately. However, the company does not expect the cancellation of the contract.

Considering the above items/transactions answer the following:

- (i) The company wants to present the trade receivable as current despite the fact that these are receivables in 15 months' time. Does the decision of presenting the same as current is correct?

- (ii) The company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the Company. Does the decision of presenting the same as non-current is correct?
- (iii) Can security deposit of ₹ 5 Crore made by company with the customers be presented as current?
- (iv) Can the security deposit of ₹ 2 Crore taken by the company from contractors be presented as non-current?

**Answer**

- (i) **Yes**, but additionally company also need to disclose amounts that are receivable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)
- (ii) **No**, the Company cannot disclose these payables as non-current and the Company also need to disclose amounts that are payable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)
- (iii) **No**, because the amount will be received after the operating cycle of the Company. (Refer Para 66 of Ind AS 1)
- (iv) **No**, because the amount may be required to be paid before completion of the contract in case the contract is cancelled. (Refer Para 69 of Ind AS 1).

**Question 16**

Charm Limited (the 'Company') is a manufacturing company, which has assessed its operating cycle to be 15 months. The Company has some trade receivables which are receivable within a period of 12 months from the reporting date i.e. 31<sup>st</sup> March 20X1.

With respect to the following transactions, which took place during the financial year 20X0-20X1, give your opinion based on relevant Ind AS:

- (i) The Company has received a contract of ₹ 10 crore on 31<sup>st</sup> March 20X1. The terms of the contract require the Company to make a security deposit of 20% of the contract value with the customer. The Company made a security deposit of ₹ 2 crore on 31<sup>st</sup> March 20X1. This contract will be completed in about 14 months. 70% of the deposit will be refunded immediately and the balance 30% of the deposit will be refunded after 3 months from the completion of the contract. The Company wants to present the security deposit of ₹ 2 crore as non-current. Is the management's decision correct?
- (ii) The Company has some trade receivables that are due after 14 months from the date of the balance sheet; the management of the Company expects to receive the amount within the period of the operating cycle. Despite the fact that these are receivables in 14 months, the management would like to present these as current. Is the management's decision correct?
- (iii) In the normal course of business, the Company has given 2 contracts and received a total security deposit of ₹ 4 crore. ₹ 3 crore is received from X Limited and ₹ 1 crore is received from Y Limited on 31<sup>st</sup> March 20X1. These are repayable on completion of the contract. However, if the contract is cancelled within the contract term of 18 months, then the deposit becomes payable immediately. The Company is positive about the contract with X Limited but is in doubt about the contract received from Y Limited. The Company wants to present the amount of ₹ 3 crore as non-current and ₹ 1 crore as current in the balance sheet. Is the management's decision correct?

- (iv) The Company is planning to replace a machinery. It has given an advance of ₹ 1 crore for purchase of new machinery which will be delivered in 6 months from the date of the balance sheet. It has sold the old machinery for ₹ 0.5 crore, the payment of which is due in 10 months from the date of the balance sheet. The Company wants to present both these amounts as current since they will be settled within twelve months from the end of the reporting period. Is the management's decision correct?

**Answer**

Operating cycle of Charm Limited = 15 months

- (i) The security deposit made by the Company with the customers be classified as **current assets to the extent of 70%** (₹ 2 crore x 70% = ₹ 1.40 crore) as it will be refunded immediately on completion of 14 months of contract i.e. within the operating cycle of 15 months.

However, **30%** of the security deposit will be refunded after 3 months of completion of the contract (14 + 3 = 17 months) i.e. after 2 months of operating cycle (Operating cycle of the Company is 15 months). Hence, it will be **classified as non-current**. Therefore, **management's decision is not correct**. (Refer Para 66 of Ind AS 1)

- (ii) Yes, the Company's decision of presenting the trade receivables as Current Assets is **correct** despite the fact that these are receivables in 14 months' time since the operating cycle of the company is 15 months and any event arising due to trade will be considered as current if its settlement is within the tenure of operating cycle. Additionally, the Company also need to disclose amounts that are receivable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)

- (iii) Paragraph 69(d) of Ind AS 1 states that an entity shall classify a liability as current when it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

Although it is expected that X Limited will fulfil the contract and the deposit will not be refunded, but in case of cancellation within the contract term, refund of security deposit is a condition that is not within control of the entity. Hence, Charm Limited does **not have an unconditional right to defer settlement** of liability for at least twelve months after reporting period. Accordingly, the deposit will have to be classified as **current liability in case of both X and Y Limited**.

- (iv) Yes, the management decision to classify the **payment of ₹ 0.5 crore as a current asset is correct** since the payment will be realised in less than twelve months from the end of the reporting period.

Capital advances are advances given for procurement of Property, Plant and Equipment etc. Typically, companies do not expect to realize them in cash. Rather, over the period, these get converted into non-current assets. Hence, capital advances should be treated as other non-current assets irrespective of when the Property, Plant and Equipment is expected to be received.

Under Ind AS Schedule III, Capital Advances are not to be classified under Capital Work in Progress since they are specifically to be disclosed under other non-current assets.

Accordingly, **advance of ₹ 1 crore given for purchase of machinery is 'Capital advance' which will be classified as non-current** as it relates to acquisition of non-current item i.e., machinery. Hence, **management decision to classify it as current is incorrect**.

**Question 17**

OMN Ltd has a subsidiary MN Ltd. OMN Ltd provides a loan to MN Ltd at 8% interest to be paid annually. The loan is required to be paid whenever demanded back by OMN Ltd.

How should loan be classified in financial statements of OMN Ltd? Will it be any different for MN Ltd?

**Answer**

The demand feature might be primarily a form of protection or a tax-driven feature of the loan. Both parties might expect and intend that the loan will remain outstanding for the foreseeable future. If so, the instrument is, in substance, long-term in nature, and accordingly, OMN Ltd would classify the loan as a non-current asset.

However, OMN Ltd would classify the loan as a **current asset** if both the parties intend that it will be repaid within 12 months of the reporting period.

**MN Ltd** would classify the **loan as current** because it does not have the right to defer repayment for more than 12 months, regardless of the intentions of both the parties.

The classification of the instrument could affect initial recognition and subsequent measurement. This might require the entity's management to exercise judgement, which could require disclosure under judgements and estimates.

**Question 18**

On 1<sup>st</sup> April, 20X3, Charming Ltd issued 1,00,000 ₹ 10 bonds for ₹ 10,00,000. On 1<sup>st</sup> April, each year interest at the fixed rate of 8 percent per year is payable on outstanding capital amount of the bonds (i.e. the first payment will be made on 1<sup>st</sup> April, 20X4). On 1<sup>st</sup> April each year (i.e. from 1<sup>st</sup> April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 bonds at ₹ 10 per bond. In its balance sheet at 31<sup>st</sup> March, 20X4, how should this be presented in the financial statements?

**Answer**

Charming Ltd must present **₹ 80,000 accrued interest and ₹ 1,00,000 current portion** of the non-current bond (i.e. the portion repayable on 1<sup>st</sup> April, 20X4) **as current liabilities**.

The **₹ 9,00,000** due later than 12 months after the end of the reporting period is presented as a **non-current liability**.

**Special Cases of Classification of Loan Liability**

**Question 19**

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

- (a) How should such loan be classified in the balance sheet of the entity?
- (b) Will the answer be different if new facility is agreed upon after the end of the reporting period?
- (c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is

from another bank?

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

**Answer**

- (i) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liability for at least twelve months after the reporting period, the loan should be classified as **non-current**.
- (ii) **Yes**, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period, since assessment is required to be made based on terms of the existing loan facility. As at the end of the reporting period, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence, the loan is to be classified as **current**.
- (iii) **Yes**, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this case, loan has to be repaid within a period of 9 months from the end of the reporting period, therefore, it will be classified as **current liability**.
- (iv) **Yes**, the answer will be different and the loan should be classified as **current**. This is because, as per paragraph 73 of Ind AS 1, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

**Question 20**

Alpha Tech Limited, an Indian listed company, has availed on 1<sup>st</sup> July 20X0, a short-term loan facility of ₹ 50 crore from XYZ Bank Limited repayable on 30<sup>th</sup> June 20X1. Alpha Tech Limited prepares its financial statements as at 31<sup>st</sup> March of each year. On 15<sup>th</sup> March 20X1, Alpha Tech and XYZ Bank Limited enter into a formal, unconditional agreement to roll over the outstanding loan into a new long-term facility of ₹ 50 crore repayable on 30<sup>th</sup> June 20X6.

- (i) Discuss the classification of the aforesaid loan in the Balance Sheet of Alpha Tech Limited as at 31<sup>st</sup> March 20X1.
- (ii) Will your answer to (i) change if the new arrangement of Alpha Tech Limited with XYZ Bank Limited was signed after 31<sup>st</sup> March 20X1, but before the financial statements of Alpha Tech Limited were approved for issue?
- (iii) Will your answer to (i) change if the original loan from XYZ Bank Limited is paid on the due date i.e. 30<sup>th</sup> June 20X1 out of the funds released on the same date by ABC Bank Limited under a new 5 year facility by ABC Bank Limited? The agreement with ABC Bank Limited is signed on 31<sup>st</sup> March 20X1.
- (iv) Will your answer to (i) change if Alpha Tech Limited is yet to sign any new agreement with any of the banks but has the intention and potential to refinance the loan and continue discussions with banks as of 31<sup>st</sup> March 20X1?

Justify your response with reference to the relevant provisions of Ind AS 1.

**Answer**

- (i) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liability for at least twelve months after the reporting period, the loan should be classified as **non-current**.
- (ii) Yes, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period, since assessment is required to be made based on terms of the existing loan facility. As at the end of the reporting period, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence, the loan is to be classified as **current**.
- (iii) Yes, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this case, loan has to be repaid within a period of 3 months from the end of the reporting period, therefore, it will be classified as **current liability**.
- (iv) Yes, the answer will be different and the loan should be classified as **current**. This is because, as per paragraph 73 of Ind AS 1, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

**Question 21**

In December 20X1, an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 20X5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by 24<sup>th</sup> March, 20X2, failing which the loan becomes payable on demand. As on 24<sup>th</sup> March, 20X2, the entity has not been able to get the promoter's contribution. On 25<sup>th</sup> March, 20X2, the entity approached the bank and obtained a grace period upto 30<sup>th</sup> June, 20X2 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on 31<sup>st</sup> March, 20X2.

- (a) As on 31<sup>st</sup> March, 20X2, how should the entity classify the loan?
- (b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 20X2, the entity approached the bank and got the compliance date extended upto 30<sup>th</sup> June, 20X2 for getting promoter's contribution. In this case will the loan classification as on 31<sup>st</sup> March, 20X2 be different from (a) above?

**Answer**

- (a) Paragraph 75 of Ind AS 1, inter alia, provides, "An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment." In present case, following the default, **grace period** within which entity can rectify the breach is **less than twelve months** after the reporting period. Hence as on 31<sup>st</sup> March 20X2, the loan will be **classified as current**.
- (b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case,

whether actual breach has taken place or not is to be assessed on 30<sup>th</sup> June 20X2, i.e., after the reporting date. Consequently, **in the absence of actual breach** of the loan covenant as on 31<sup>st</sup> March 20X2, the loan will retain its **classification as non-current**.

### Question 22

Entity A had obtained a long-term bank loan during January 20X1, which is subject to certain financial covenants. One of such covenants states that during the tenure of the loan, debt equity ratio of 65:35 is to be maintained at all time. In case of breach of this covenant, the loan will be repayable immediately. The loan agreement also states that these covenants will be assessed at the end of each quarter and reported to the bank within a month from the end of each quarter. If the covenants are breached at this time, the loan will be repayable immediately. The entity closes its annual accounts as on 31<sup>st</sup> March every year.

You are required to show how the loan will be classified as on 31<sup>st</sup> March 20X2, if:

- (i) At the financial year end, Entity A determines that it is not in breach of any of the covenants.
- (ii) At the quarter ending 31<sup>st</sup> December 20X1, Entity A's debt equity ratio became 75:25 and thus breaches the covenant, however it obtains a waiver from the bank. The terms of the waiver specify that if Entity A rectifies the breach within a period of 12 months from the reporting date, then the bank cannot demand repayment immediately on account of the breach during this period. Entity A expects to rectify the breach by raising additional equity capital by means of a rights issue to the existing shareholders and expects that the issue will be fully subscribed.
- (iii) Considering the same facts as in (ii) above, except obtaining the waiver clause, what would be your answer?

### Answer

Para 74 of **Ind AS 1** 'Presentation of Financial Statements', states that where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

However, an entity classifies the liability as non-current, if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which lender cannot demand immediate repayment.

- (i) The entity has obtained a long-term loan during January, 20X1. Since repayment period of the loan is not mentioned, it is assumed that on 31<sup>st</sup> March 20X2, the repayment period of the loan is more than 12 months. Further, the entity has **not breached the covenants** specified in the loan; therefore, as at 31<sup>st</sup> March, 20X2, the loan will be **classified as 'non-current liability**.
- (ii) In the second case, though there is a breach of covenant on 31<sup>st</sup> December, 20X1 i.e. before reporting date of 31<sup>st</sup> March, 20X2, yet the bank had **agreed to provide a period of grace for twelve months** from the reporting period, within which the entity A can rectify the breach and during this period bank cannot demand immediate repayment. Also, entity A has intention to rectify the breach. Thus, entity A will classify the liability of bank loan as **non-current liability** in its books as at 31<sup>st</sup> March, 20X2.

- (iii) Since the covenant for bank loan has been **breached** during the quarter ended 31<sup>st</sup> December, 20X1 and reported to the bank within one month from the end of the quarter i.e. by 31<sup>st</sup> January, 20X2, the bank loan becomes repayable immediately. Therefore, it will be presented as **current liability** in the books of entity A as on 31<sup>st</sup> March, 20X2.

### **Question 23**

Company A has taken a long-term loan from Company B. In the month of December 20X1, there has been a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on 31<sup>st</sup> March, 20X2. In the month of May 20X2, Company started negotiation with the Company B for not to demand payment as a consequence of the breach. The financial statements were approved for issue in month of June 20X2. In the month of July 20X2, both the companies agreed that the payment will not be demanded immediately as a consequence of breach of material provision. Advise on the classification of the liability as current/non-current.

### **Answer**

As per para 74 of **Ind AS 1**, "Presentation of Financial Statements", where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach."

An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

In the given case, Company B (the lender) **agreed** for not to demand payment but only **after** the reporting date and the **financial statements were approved** for issuance. The financial statements were approved for issuance in the month of June 20X2 and both companies agreed for not to demand payment in the month of July 20X2 although negotiation started in the month of May 20X2 but could not agree before June 20X2 when financial statements were approved for issuance.

Hence, the liability should be **classified as current** in the financial statement as at 31<sup>st</sup> March, 20X2.

### **Question 24**

A Limited, an Indian Company has a foreign subsidiary, B Inc. Subsidiary B Inc. has taken a long term loan from a foreign bank, which is repayable after in the year 20X9. However, during the year ended 31<sup>st</sup> March, 20X2, it breached one of the conditions of the loan, as a consequence of which the loan became repayable on demand on the reporting date. Subsequent to year end but before the approval of the financial statements, B Inc. rectified the breach and the bank agreed not to demand repayment and to let the loan run for its remaining period to maturity as per the original loan terms. While preparing its standalone financial statements as per IFRS, B Inc. has classified this loan as a current liability in accordance with IAS 1, Presentation of Financial Statements.

Whether A limited is required to classify such loan as current while preparing its consolidated financial statement under Ind AS?

### Answer

As per paragraph 74 of Ind AS 1, where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the **lender agreed, after the reporting period and before the approval of the financial statements** for issue, not to demand payment as a consequence of the breach.

The above position under Ind AS 1 differs from the corresponding position under IAS 1. As per paragraph 74 of IAS 1, when an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.

Accordingly, the loan liability recognised as current liability by B Inc. in its standalone financial statements prepared as per IFRS, should be aligned as per Ind AS in the consolidated financial statements of A Limited and should be **classified as non-current in the consolidated financial statements of A Limited** in accordance with Ind AS 1.

## **Section B – Fully Irrelevant Theoretical Questions**

### **Question 1**

(SM)

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

### **Answer**

These should be classified as current.

### **Question 2**

(SM)

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

### **Answer**

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

### **Question 3**

(SM)

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

### **Answer**

Ind AS 1 provides that some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity’s normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period.

In accordance with the above, income received in advance would be classified as current liability since it is a part of the working capital, which the entity expects to earn within its normal operating cycle.

**Question 4**

(SM)

An entity has the following trial balance line items. How should these items be classified, i.e., current or non-current as per Ind AS 1?

- (a) Receivables (viz., receivable under a contract of sale of goods in which an entity deals)
- (b) Advance to suppliers
- (c) Income tax receivables [other than deferred tax]
- (d) Insurance spares

**Answer**

- (a)** As per paragraph 66(a) of Ind AS 1, an entity shall classify an asset as current when it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle.

Paragraph 68 provides the guidance that current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period.

In accordance with above, the receivables that are considered a part of the normal operating cycle will be classified as current asset.

If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

- (b)** As discussed in point (a) above, advances to suppliers for goods and services would be classified in accordance with normal operating cycle if it is given in relation to the goods or services in which the entity normally deals. If the advances are considered a part the normal operating cycle, it would be classified as a current asset. If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.
- (c)** Classification of income tax receivables [other than deferred tax] will be driven by paragraph 66(c) of Ind AS 1, i.e., based on the expectation of the entity to realise the asset. If the receivable is expected to be realised within twelve months after the reporting period, then it will be classified as current asset else non-current asset.

- (d)** Para 8 of Ind AS 16 states that items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

Accordingly, insurance spares that are treated as an item of property, plant and equipment would normally be classified as non-current asset whereas insurance spare that are treated as inventory will be classified as current asset if the entity expects to consume it in its normal operating cycle.

# Ind AS 34: Interim Financial Reporting

## Section A – Practical & Relevant Theory Questions

### Profit/Loss of Interim Period

#### Question 1

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

Qtr. I	Qtr. II	Qtr. III	Qtr. IV
ending 30 <sup>th</sup> June	ending 30 <sup>th</sup> September	ending 31 <sup>st</sup> December	ending 31 <sup>st</sup> March
10%	10%	60%	20%

For the first quarter ending on 30<sup>th</sup> June, 20X1, ICPL has provided the following information:

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

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

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

#### Answer

#### Result of the first quarter ending 30<sup>th</sup> June

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

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

**Question 2**

ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of ₹ 20,00,000 for the third quarter of 20X1.

Following adjustments are made while computing the net profit:

- (i) Bad debts of ₹ 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.
- (ii) Additional depreciation of ₹ 4,50,000 resulting from the change in the method of depreciation.
- (iii) Exceptional loss of ₹ 28,000 incurred during the third quarter. 50% of exceptional loss have been deferred to next quarter.
- (iv) ₹ 5,00,000 expenditure on account of administrative expenses pertaining to the third quarter is deferred on the argument that the fourth quarter will have more sales; therefore, fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.

Ascertain the correct net profit to be shown in the Interim Financial Report of third quarter to be presented to the Board of Directors.

**Answer**

In the instant case, the quarterly net profit has not been correctly stated. As per Ind AS 34, Interim Financial Reporting, the quarterly net profit should be adjusted and restated as follows:

- (i) The **treatment of bad debts is not correct** as the expenses incurred during an interim reporting period should be recognised in the same period. Accordingly, ₹ 50,000 should be deducted from ₹ 20,00,000.
- (ii) Recognising **additional depreciation** of ₹ 4,50,000 in the same quarter is **correct** and is in tune with Ind AS 34.
- (iii) Treatment of **exceptional loss is not** as per the principles of Ind AS 34, as the entire amount of ₹ 28,000 incurred during the third quarter should be recognized in the same quarter. Hence ₹ 14,000 which was deferred should be deducted from the profits of third quarter only.
- (iv) As per Ind AS 34 the income and expense should be recognised when they are earned and incurred respectively. As per para 39 of Ind AS 34, the costs should be anticipated or deferred only when:
  - (i) it is appropriate to anticipate or defer that type of cost at the end of the financial year, and
  - (ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, **treatment** done relating to deferment of ₹ 5,00,000 is **not correct** as expenditures are uniform throughout all quarters.

Thus, considering the above, the **correct net profits** to be shown in Interim Financial Report of the third quarter shall be **₹ 14,36,000** (₹ 20,00,000 – ₹ 50,000 – ₹ 14,000 – ₹ 5,00,000).

**Question 3**

Dhruv Limited, a production company, sells television to various companies all over India. Company's financial year ends on 31<sup>st</sup> March. For the financial year 20X1-20X2, the company had a net profit after taxes of ₹ 2,40,00,000. It prepares and publishes an interim financial report for each quarter of the year. The net profit of the company for the second quarter of 20X2-20X3 is ₹ 56,00,000.

Following adjustments are to be made while computing the net profit of second quarter:

- (i) The company has a practice of declaring bonus of 5% of its profit after taxes of previous financial year. It has a history of doing so and the amount is recognised equally in each quarter. It declared bonus on 1<sup>st</sup> June 20X2 but recognised the full amount in second quarter.
- (ii) The company intends to incur major repair and renovation expense for the office building. For this purpose, it has started seeking quotations from vendors. It also has tentatively identified a vendor and expected costs are ₹ 34,00,000. It provided for the same in this quarter.
- (iii) Exceptional loss of ₹ 4,20,000 incurred during the second quarter due to workers' strike. 50% of exceptional loss has been deferred to next quarter.

Ascertain the correct net profit with reasons to be shown in the Interim Financial Report of second quarter to be presented to the Board of Directors.

### Answer

In the instant case, the quarterly net profit has not been correctly stated. As per Ind AS 34, Interim Financial Reporting, the quarterly net profit should be adjusted and restated as follows:

- (i) A liability for bonus may arise out of legal agreement or constructive obligation because of which it has no alternative but to pay the bonus and accordingly, needs to be accrued in the annual financial statements. Bonus liability is accrued in interim financial statements on the same basis as they are accrued for annual financial statements.

In the given case, since the company has past record of declaring annual bonus every year, the same may be accrued using a reasonable estimate (applying the principles of Ind AS 19, Employee Benefits) while preparing its interim results.

Accordingly, Bonus amount to be charged in the second quarter would be ₹ 2,40,00,000 x 5% x  $\frac{1}{4}$   
= ₹ 3,00,000

**Bonus of ₹ 9,00,000 (₹ 12,00,000 – ₹ 3,00,000) must be reversed.**

- (ii) The cost of a planned major repair and renovation that is expected to occur in later part of the year is not considered for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.

Hence, ₹ 34,00,000 provided in the second quarter **must be reversed.**

- (iii) Treatment of exceptional loss is not as per the principles of Ind AS 34, as the entire amount of ₹ 4,20,000 incurred during the second quarter should be recognized in the same quarter.

Hence, ₹ 2,10,000 which was deferred **should be deducted** from profits of second quarter only.

Thus, considering the above, the **correct net profits** to be shown in Interim Financial Report of the second quarter shall be: ₹ 96,90,000 (₹ 56,00,000 + ₹ 9,00,000 + ₹ 34,00,000 – ₹ 2,10,000)

### Question 4

Hero Ltd. reported a profit before tax of ₹ 8 lakhs for the third quarter ending 31<sup>st</sup> December 20X1. On enquiry, you observe the following:

- (i) Dividend income of ₹ 8 lakhs received during the quarter has been recognized to the extent of ₹ 2 lakhs only.

- (ii) 60% of sales promotion expenses of ₹ 30 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in fourth quarter are expected to be high.
- (iii) ₹ 4 lakhs extraordinary gain received in third quarter was allocated equally to the third and fourth quarter.
- (iv) Cumulative loss of ₹ 30 lakhs resulting from change in method of inventory valuation was recognized in the third quarter. Out of this loss, ₹ 10 lakhs relate to previous quarters.
- (v) Sale of investment in the first quarter resulted in a gain of ₹ 40 lakhs. The company had apportioned this equally to the four quarters.

You are required to discuss the treatment of the above observations and ascertain the adjusted profit/loss before tax for the third quarter.

**Answer**

As per para 37 and para 39 of Ind AS 34 “Interim Financial Reporting”, seasonal or occasional **revenue and cost** within a financial year **should not be** anticipated or **deferred** as of interim date if it would not be appropriate to anticipate or defer the same at the end of the entity’s financial year. Therefore, dividend income, extraordinary gain, and gain on sale of investment received during 3<sup>rd</sup> quarter should be recognised in the 3<sup>rd</sup> quarter only.

Similarly, sales promotion expenses incurred in 3<sup>rd</sup> quarter should also be charged in 3<sup>rd</sup> quarter only.

Further, as per the standard, if there is change in the accounting policy within the current financial year, then such a change should be applied retrospectively by restating the financial statements of prior interim periods of the current financial year.

The **change in the method of inventory valuation is a change in the accounting policy**. Therefore, the prior interim periods’ financial statements should be restated by applying the change in the method of valuation **retrospectively**.

Accordingly, the adjusted profit before tax for the 3<sup>rd</sup> quarter will be as follows:

**Statement showing Adjusted Profit Before Tax for Third Quarter ending 31<sup>st</sup> December, 20X1**

	<b>₹ in lakhs</b>
Profit before tax (as reported)	8
Add: Dividend income ₹ (8 – 2) lakhs	6
Extraordinary gain ₹ (4 – 2) lakhs	2
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively	10
	26
Less: Sales promotion expenses (60% of ₹ 30 lakhs)	(18)
Gain on sale of investment (occasional gain should not be deferred)	(10)
<b>Adjusted Profit before tax for the third quarter</b>	<b>(2)</b>

**Tax Expense of Interim Period**

**Question 5**

An entity reports quarterly, earns ₹ 1,50,000 pre-tax profit in the first quarter but expects to incur

losses of ₹ 50,000 in each of the three remaining quarters. The entity operates in a jurisdiction in which its estimated average annual income tax rate is 30%.

The management believes that since the entity has zero income for the year, its income-tax expense for the year will be zero. State whether the management's views are correct or not? If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

**Answer**

As illustrated in para 30 (c) of Ind AS 34 'Interim financial reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Accordingly, the **management's contention** that since the net income for the year will be zero no income tax expense shall be charged quarterly in the interim financial report, is **not correct**. Since the effective tax rate or average annual income tax rate is already given in the question as 30%, the income tax expense will be recognised in each interim quarter based on this rate only. The **following table shows the correct income tax expense to be reported each quarter** in accordance with Ind AS 34:

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

**Question 6**

An entity's accounting year end is 31<sup>st</sup> December, but its tax year end is 31<sup>st</sup> March. The entity publishes an interim financial report for each quarter of the year ended 31<sup>st</sup> December, 20X1. The entity's profit before tax is steady at ₹ 10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31<sup>st</sup> March, 20X1 and 30% for the year ended 31<sup>st</sup> March, 20X2.

How the related tax charge would be calculated for the year 20X1 and its quarters.

**Answer**

**Table showing computation of tax charge:**

	Quarter ending 31 <sup>st</sup> Mar, 20X1 (₹)	Quarter ending 30 <sup>th</sup> June, 20X1 (₹)	Quarter ending 30 <sup>th</sup> Sept, 20X1 (₹)	Quarter ending 31 <sup>st</sup> Dec, 20X1 (₹)	Year ending 31 <sup>st</sup> Dec, 20X1 (₹)
Profit before tax	10,000	10,000	10,000	10,000	40,000
Less: Tax charge	<b>2,500</b>	<b>3,000</b>	<b>3,000</b>	<b>3,000</b>	<b>11,500</b>
	7,500	7,000	7,000	7,000	28,500

Since an entity's accounting year is not same as the tax year, more than one tax rate might apply during the accounting year. Accordingly, the entity should apply the effective tax rate for each interim period to the pre-tax result for that period.

**Question 7**

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

**Answer**

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

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

$$= ₹ 3,000 \text{ lakhs}^* \times 40/100 = ₹ 1,200 \text{ lakhs}$$

$$*(₹ 3,600 \text{ lakhs} - ₹ 600 \text{ lakhs}) = ₹ 3,000 \text{ lakhs}$$

$$\text{Average annual effective tax rate} = (₹ 1,200 \text{ lakhs} / ₹ 3,600 \text{ lakhs}) \times 100 = 33.33\%$$

$$\text{Tax expense to be shown in each quarter} = ₹ 900 \text{ lakhs} \times 33.33\% = ₹ 300 \text{ lakhs}$$

**Question 8**

Spicer Ltd., a listed company, prepares interim financial reports at the end of each quarter.

The following information is provided:

- (i) On 1<sup>st</sup> April, 20X1, Spicer Ltd. has brought forward losses of ₹ 620 lakh under Income Tax Act. No Deferred Tax Asset has been recognized by management of company for such losses in view of uncertainty over company's ability to earn profits in foreseeable future and set off these losses.
- (ii) Due to sudden change in government policies, the company's business turned around and it has reported quarterly earnings of ₹ 650 lakh and ₹ 360 lakh respectively for the first two quarters of financial year 20X1-20X2 and anticipates net earnings of ₹ 720 lakh in the coming half year ended March 20X2 of which ₹ 160 lakh will be the loss in the quarter ended December 20X1.
- (iii) The tax rate for the company is 25% with a 10% surcharge.

You are required to calculate the amount of Tax Expenses to be reported for each quarter of the financial year 20X1-20X2.

**Answer**

It is assumed that net profit for all the quarters of the year 20X1-20X2 excludes the brought forward losses of ₹ 620 lakh.

**Computation of estimated total earnings for the year 20X1-20X2**

Quarter	Earnings before tax (₹ in lakhs)	
1	650	(actual)
2	360	(actual)
3	(160)	(estimated)
4	720 + 160 = 880	(estimated)
	<b>1,730</b>	(estimated)

$$\text{Tax rate for the company} = 25 \times 110\% = 27.5\%$$

**Computation of Average Annual Effective Tax Rate**

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

$$= (\text{₹ } 1,730 \text{ lakhs} - \text{₹ } 620 \text{ lakhs}) \times 27.5\% = \text{₹ } 305.25 \text{ lakhs}$$

As per Ind AS 34, income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income-tax rate expected for the full financial year.

Thus, average annual effective tax rate =  $(\text{₹ } 305.25 \text{ lakhs} / \text{₹ } 1,730 \text{ lakhs}) \times 100 = 17.645\%$  (approx.)

**Tax expense to be shown in each quarter**

Quarter	Earnings before tax (₹ in lakhs)	Tax expense @ 17.645%
1	650	114.69
2	360	63.52
3	(160)	(28.23)
4	720 + 160 = 880	155.27
	1,730	305.25

**Question 9**

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

**Answer**

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

$$\text{Expected total Income} = \text{₹ } 15,000 [\text{₹ } 60,000 - (\text{₹ } 15,000 \times 3)]$$

$$\text{Expected tax as per slabs} = \text{₹ } 15,000 \times 20\% = \text{₹ } 3,000$$

$$\text{Average Annual Income tax rate} = \text{₹ } 3,000 / \text{₹ } 15,000 = 20\%$$

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

**Question 10**

Narayan Ltd. provides you the following information and asks you to calculate the tax expense for each quarter, assuming that there is no difference between the estimated taxable income and the estimated accounting income:

Estimated Gross Annual Income (inclusive of Estimated Capital Gains of ₹ 8,00,000) is ₹ 33,00,000

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

Tax Rates: On Capital Gains	12%
On Other Income: First ₹ 5,00,000	30%
Balance Income	40%



**Answer**

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

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

Quarters	Allocations
<b>First Quarter</b>	<ul style="list-style-type: none"> <li>➤ Actual fixed production overheads = ₹ 2,500</li> <li>➤ Fixed production overheads based on the allocation rate of ₹ 5 per unit <b>allocated to actual production</b> = ₹ 5 x 400 = <b>₹ 2,000</b></li> <li>➤ <b>Unallocated</b> fixed production overheads to be <b>charged as expense</b> as per Ind AS 2 and consequently as per Ind AS 34 = <b>₹ 500</b></li> </ul>
<b>Second Quarter</b>	<ul style="list-style-type: none"> <li>➤ Actual fixed production overheads on year-to-date basis = ₹ 5,000</li> <li>➤ Fixed production overheads <b>absorbed</b> on year-to-date basis = 1,000 x ₹ 5 = <b>₹ 5,000</b></li> <li>➤ Earlier, ₹ 500 was not allocated to production in the 1<sup>st</sup> quarter. To give effect to the entire ₹ 5,000 to be allocated in the second quarter, as per Ind AS 34, <b>₹ 500 are reversed</b> by way of a credit to the statement of <b>profit and loss</b> of the 2<sup>nd</sup> quarter and debit to cost of production.</li> </ul>
<b>Third Quarter</b>	<ul style="list-style-type: none"> <li>➤ Actual production overheads on year-to-date basis = ₹ 7,500</li> <li>➤ Fixed production overheads <b>allocated</b> on year-to-date basis = 1,500 x ₹ 5 = <b>₹ 7,500</b></li> <li>➤ There is <b>no under</b> or over recovery of allocated overheads. Hence, no further action is required.</li> </ul>
<b>Fourth Quarter</b>	<ul style="list-style-type: none"> <li>➤ Actual fixed production overheads on year-to-date basis = ₹ 10,000</li> <li>➤ Fixed production overheads <b>allocated</b> on year-to-date basis = 1,900 x ₹ 5 = <b>₹ 9,500</b></li> <li>➤ <b>₹ 500</b>, i.e., [₹ 2,500 - (₹ 5 x 400)] <b>unallocated</b> fixed production overheads in the 4<sup>th</sup> quarter, <b>are to be expensed off</b> as per the principles of Ind AS 2 and Ind AS 34 by way of a charge to the statement of profit and loss.</li> <li>➤ Unallocated productions overheads for the year ₹ 500 (i.e. ₹ 10,000 - ₹ 9,500) are expensed in the Statement of profit and loss as per Ind AS 2.</li> </ul>

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

## **Section B – Fully Irrelevant Theoretical Questions**

### Question 1

The entity's financial year ends on 31<sup>st</sup> March. What are the "reporting periods" for which financial statements (condensed or complete) in the interim financial report of the entity as on 30<sup>th</sup> September, 20X1 are required to be presented, if:

- (i) Entity publishes interim financial reports quarterly
- (ii) Entity publishes interim financial reports half-yearly.

### Answer

Paragraph 20 of Ind AS 34, Interim Financial Reporting states as follows:

"Interim reports shall include interim financial statements (condensed or complete) for periods as follows:

- (a) balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year.
- (b) statements of profit and loss for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year.
- (c) statement of changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.
- (d) statement of cash flows cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

Accordingly, periods for which interim financial statements are required to be presented are provided herein below:

#### (i) Entity publishes interim financial reports quarterly

The entity will present the following financial statements (condensed or complete) in its interim financial report of 30<sup>th</sup> September, 20X1:

<b>Balance sheet at</b>	30 <sup>th</sup> September 20X1	31 <sup>st</sup> March 20X1	–	–
<b>Statement of profit and loss for</b>	3 months ended 30 <sup>th</sup> September 20X1	3 months ended 30 <sup>th</sup> September 20X0	6 months ended 30 <sup>th</sup> September 20X1	6 months ended 30 <sup>th</sup> September 20X0
<b>Statement of changes in equity for</b>	6 months ended 30 <sup>th</sup> September 20X1	6 months ended 30 <sup>th</sup> September 20X0		
<b>Statement of cash flows for</b>	6 months ended 30 <sup>th</sup> September 20X1	6 months ended 30 <sup>th</sup> September 20X0	–	–

#### (ii) Entity publishes interim financial reports half-yearly

The entity's financial year ends 31<sup>st</sup> March. The entity will present following financial statements (condensed or complete) in its half-yearly interim financial report of 30<sup>th</sup> September, 20X1:

<b>Balance sheet at</b>	<b>30<sup>th</sup> September, 20X1</b>	<b>31<sup>st</sup> March, 20X1</b>
<b>Statement of profit and loss for</b>	<b>6 months ending 30<sup>th</sup> September, 20X1</b>	<b>6 months ending 30<sup>th</sup> September, 20X0</b>
<b>Statement of changes in equity for</b>	<b>6 months ending 30<sup>th</sup> September 20X1</b>	<b>6 months ending 30<sup>th</sup> September 20X0</b>
<b>Statement of cash flows for</b>	<b>6 months ending 30<sup>th</sup> September 20X1</b>	<b>6 months ending 30<sup>th</sup> September 20X0</b>

**Question 2**

(SM)

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

**Answer**

Loss should be recognised in the second quarter of the year.

**Question 3**

(MTP N23)

ABC Ltd. requires assistance on whether the following revenue can be anticipated or cost can be deferred as of 30<sup>th</sup> June, 20X1 while preparing the interim financial statements:

- (i) Dividend income from its investment which is declared in September of every year.
- (ii) 60% of the advertising cost for the whole year is incurred by ABC Ltd. in the first quarter and the remaining 40% in the second quarter.

**Answer**

Paragraphs 37 and 38 of Ind AS 34, Interim Financial Reporting state that revenues that are received seasonally, cyclically, or occasionally within a financial year shall not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the entity's financial year. Examples include dividend revenue, royalties, and government grants. Additionally, some entities consistently earn more revenues in certain interim periods of a financial year than in other interim periods, for example, seasonal revenues of retailers. Such revenues are recognised when they occur.

Further, for costs incurred unevenly during the financial year, para 39 of Ind AS 34 states that costs that are incurred unevenly during an entity's financial year shall be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.

In view of the above guidance, in the given case, dividend income received by ABC Limited cannot be anticipated and recognised in financial statements as of 30<sup>th</sup> June, 20X1.

Further, considering that 60% of advertising cost for the whole year has been incurred by ABC Ltd during the first quarter and 40% in the second quarter, it is a cost incurred unevenly. Applying principles of paragraph 39, it is not appropriate to defer the charge of an incurred advertising expense (60% of whole year cost) at the end of the quarter. Accordingly, all the advertising costs incurred till 30<sup>th</sup> June, 20X1 should be charged to P&L while preparing its financial statements as of 30<sup>th</sup> June, 20X1.

**Question 4**

(SM)

PQR Ltd. is preparing its interim financial statements for quarter 3 of the year. How the following transactions and events should be dealt with while preparing its interim financials:

- (i) It makes employer contributions to government-sponsored insurance funds that are assessed on an annual basis. During Quarter 1 and Quarter 2 larger amount of payments for this contribution were made, while during the Quarter 3 minor payments were made (since contribution is made upto a certain maximum level of earnings per employee and hence for higher income employees, the maximum income reaches before year end).
- (ii) The entity intends to incur major repair and renovation expense for the office building. For this purpose, it has started seeking quotations from vendors. It also has tentatively identified a vendor and expected costs that will be incurred for this work.
- (iii) The company has a practice of declaring bonus of 10% of its annual operating profits every year. It has a history of doing so.

**Answer**

Paragraph 28 of Ind AS 34, Interim Financial Reporting states that an entity shall apply the same accounting recognition and measurement principles in its interim financial statements as are applied in its annual financial statements.

Further, paragraphs 32 and 33 of Ind AS 34, Interim Financial Reporting state that for assets, the same tests of future economic benefits apply at interim dates and at the end of an entity's financial year. Costs that, by their nature, would not qualify as assets at financial year-end would not qualify at interim dates either. Similarly, a liability at the end of an interim reporting period must represent an existing obligation at that date, just as it must at the end of an annual reporting period.

An essential characteristic of income (revenue) and expenses is that the related inflows and outflows of assets and liabilities have already taken place. If those inflows or outflows have taken place, the related revenue and expense are recognised otherwise not. The Conceptual Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

Considering the above guidance, while preparing its interim financials, the transactions and events of the given case should be dealt with as follows:

- (i) If employer contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised using an estimated average annual effective contribution rate in its interim financial statements, even though a large portion of the payments have been made early in the financial year. Accordingly, it should work out an average effective contribution rate and account for the same accordingly, in its interim financials.
- (ii) The cost of a planned overhaul expenditure that is expected to occur in later part of the year is not anticipated for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.
- (iii) A bonus is anticipated for interim reporting purposes, if and only if,
  - (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and
  - (b) a reliable estimate of the obligation can be made. Ind AS 19, Employee Benefits provides guidance in this regard.

A liability for bonus may arise out of legal agreement or constructive obligation because of which it has no alternative but to pay the bonus and accordingly, needs to be accrued in the annual financial statements.

Bonus liability is accrued in interim financial statements on the same basis as they are accrued for annual financial statements. In the instant case, bonus liability of 10% of operating profit for the year to date may be accrued.

In the given case, since the company has past record of declaring annual bonus every year, the same may be accrued using a reasonable estimate (applying the principles of Ind AS 19, Employee Benefits) while preparing its interim results.

# Ind AS 108: Operating Segments

## Section A – Practical & Relevant Theory Questions

### Reportable Segment

#### Question 1

X Ltd. has identified 4 operating segments for which revenue data is given below:

	External Revenue (₹)	Internal Revenue (₹)	Total (₹)
Segment A	30,00,000	Nil	30,00,000
Segment B	6,50,000	Nil	6,50,000
Segment C	8,50,000	1,00,000	9,50,000
Segment D	5,00,000	49,00,000	54,00,000
<b>Total Revenue</b>	<b>50,00,000</b>	<b>50,00,000</b>	<b>1,00,00,000</b>

Additional information:

Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years.

Which of the segments would be reportable under the criteria identified in Ind AS 108?

#### Answer

Threshold amount is ₹ 10,00,000 (₹ 1,00,00,000 × 10%).

**Segment A exceed** quantitative threshold (₹ 30,00,000 > ₹ 10,00,000) and hence **reportable segment**.

**Segment D exceed** quantitative threshold (₹ 54,00,000 > ₹ 10,00,000) and hence **reportable segment**.

Segment B & C do not meet quantitative threshold amount and not be classified as reportable segment.

However, the total **external revenue** generated by these two **segments A & D represent only 70%** [(₹ 35,00,000/₹ 50,00,000) × 100] of the entity's total external revenue. If the total external revenue reported by operating segments constitutes **less than 75%** of the entity total external revenue, additional operating segments should be identified as reportable segments until at least 75% of the revenue is included in reportable segments.

In case of X Ltd., it is given that Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years. In accordance with the requirement of Ind AS 108, X Ltd. **designates this start-up segment C as a reportable segment**, making total **external revenue** attributable to **reportable segments 87%** [(₹ 43,50,000/₹ 50,00,000) × 100] of total entity revenues.

**In this situation, Segments A, C and D will be reportable segments** and Segment B will be shown as other segment.

**Alternatively**, segment B can be considered as a reportable segment as well as it meets the definition of operating segment. If Segment B is considered as reportable segment:

External revenue reported: ₹ 30,00,000 + ₹ 6,50,000 + ₹ 5,00,000 = ₹ 41,50,000

% of Total External Revenue = ₹ 41,50,000/₹ 50,00,000 = 83%

Accordingly, Segment A, B & D will be reportable segment & Segment C will be shown as other segment.

**Question 2**

ABC Limited has 5 operating segments namely A, B, C, D and E. The profit/loss of respective segments for the year ended 31<sup>st</sup> March, 20X1 are as follows:

Segment	Profit/(Loss) (₹ in crore)
A	780
B	1,500
C	(2,300)
D	(4,500)
E	6,000
<b>Total</b>	<b>1,480</b>

Based on the quantitative thresholds, state which of the above segments A to E would be considered as reportable segments for the year ending 31<sup>st</sup> March, 20X1.

**Answer**

With regard to quantitative thresholds to determine reportable segment relevant in context of instant case, paragraph 13(b) of Ind AS 108 may be noted which provides as follows:

“The absolute amount of its reported profit or loss is 10 percent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.”

In compliance with Ind AS 108, the segment profit/loss of respective segment will be compared with the greater of the following:

- (i) All segments in profit, i.e., A, B and E - Total profit ₹ 8,280 crores.
- (ii) All segments in loss, i.e., C and D - Total loss ₹ 6,800 crores.

**Greater of the above = ₹ 8,280 crores**

Based on the above, **reportable segments will be determined as follows:**

Segment	Profit/(Loss) (₹ in crore)	As absolute % of ₹ 8,280 crore	Reportable segment
A	780	9%	No
B	1,500	18%	Yes
C	(2,300)	28%	Yes
D	(4,500)	54%	Yes
E	6,000	72%	Yes
<b>Total</b>	<b>1,480</b>		

Hence **B, C, D, E** are reportable segments.

**Question 3**

X Ltd. has identified the following business components:

Segment	Revenue (₹)		Profit (₹)	Assets (₹)
	External	Internal		
Pharma	97,00,000	Nil	20,00,000	55,00,000

## Ind AS 108: Operating Segments

FMCG	Nil	4,00,000	2,50,000	25,00,000
Ayurveda	3,00,000	Nil	2,00,000	4,00,000
Allopathy	8,00,000	41,00,000	5,50,000	6,00,000
Total for the entity	1,08,00,000	45,00,000	30,00,000	90,00,000

Which of the segments would be reportable as per the criteria prescribed in Ind AS 108?

**Answer**

**Quantitative thresholds are calculated below:**

Segments	Pharma	FMCG	Ayurveda	Allopathy
% segment sales to total sales	63.40	2.61	1.96	32.03
% segment profit to total profits	66.67	8.33	6.67	18.33
% segment assets to total assets	61.11	27.78	4.44	6.67

**Segment Pharma** would separately **reportable** since they meet all three size criteria, though any one criteria is required.

**FMCG segment** does not satisfy the revenue and profit test but does satisfy the asset test. So, it would be separately **reportable**.

Ayurveda segment does not meet any threshold. It may not be classified as reportable segment.

**Allopathy** segment satisfy the revenue and profit test but does not satisfy the asset test. So, it would be separately **reportable**.

### Question 4

XYZ Ltd. has eight segments namely A, B, C, D, E, F, G and H. The information regarding respective segments for the year ended 31<sup>st</sup> March, 20X1 is as follows:

Segments	A	B	C	D	E	F	G	H
External sales	0	255	15	10	15	50	25	35
Inter-segment sales	100	60	30	5	-	-	-	-
Total	100	315	45	15	15	50	25	35
Segment Profit/(Loss)	5	(90)	15	(5)	8	(5)	5	7
Segment assets	15	47	5	11	3	5	5	9

Identify which of the above segments out of A to H would be considered as reportable segments of XYZ Ltd. for the year ending 31<sup>st</sup> March, 20X1?

**Answer**

An entity has eight segments and the relevant information is as follows:

**Criterial 1: Segment revenue is 10% or more of total external + intersegment sales**

Segments	A	B	C	D	E	F	G	H	Total
Total sales	100	315	45	15	15	50	25	35	600
% to total sales	16.7	52.5	7.5	2.5	2.5	8.3	4.2	5.8	
<b>Reportable segments</b>	<b>A</b>	<b>B</b>							

**Criteria 2: 10% or more of segment result**

Consider segment profit and loss separately in absolute terms

Segments	A	B	C	D	E	F	G	H	Total
Segment Profit	5	-	15	-	8	-	5	7	40
Segment loss	-	90	-	5	-	5	-	-	100

Since segment loss is greater, we select 100 as evaluating the segment percentage.

Segments	A	B	C	D	E	F	G	H	Total
% to segment loss	5	90	15	5	8	5	5	7	
<b>Reportable segments</b>		<b>B</b>	<b>C</b>						

**Criteria 2: 10% or more of segment assets**

Segments	A	B	C	D	E	F	G	H	Total
Assets	15	47	5	11	3	5	5	9	100
%	15	47	5	11	3	5	5	9	100
<b>Reportable segments</b>	<b>A</b>	<b>B</b>		<b>D</b>					

Based on the above 3 criteria, the Reportable Segments are A, B, C & D.

However, 75% test for external sales should also be checked.

Reportable Segments	A	B	C	D	TOTAL
External sales	0	255	15	10	280
Total entity's sales (external)					405
<b>% of reportable segments external sales to entity's sales</b>					<b>69.14%</b>
<b>Required percentage</b>					<b>75%</b>

Hence, in above scenario, additional operating segments need to be identified as reportable segments, till 75% test is satisfied, even if those segments do not satisfy quantitative threshold limits.

**Disclosure of Segment Information in Financial Statements**

**Question 5**

X Ltd. operates in coating industry. Its business segments comprise Coating (consisting of decorative, automotive, industrial paints and related activities) and Others (consisting of chemicals, polymers and related activities). Certain information for financial year 20X1-20X2 is given below: (₹ in lakhs)

Segments	External Revenue (including GST)	GST	Other operating income	Result	Asset	Liabilities
Coating	2,00,000	5,000	40,000	10,000	50,000	30,000
Others	70,000	3,000	15,000	4,000	30,000	10,000

Additional information:

- (i) Unallocated income net of expenses is ₹ 3,000 lakhs
- (ii) Interest and bank charges is ₹ 2,000 lakhs
- (iii) Income tax expenses is ₹ 2,000 lakhs (current tax ₹ 1,950 lakhs and deferred tax ₹ 50 lakhs)

- (iv) Unallocated Investments are ₹ 10,000 lakhs and other assets are ₹ 10,000 lakhs.
- (v) Unallocated liabilities, Reserve & surplus and share capital are ₹ 20,000 lakhs, ₹ 30,000 lakhs & ₹ 10,000 lakhs respectively.
- (vi) Depreciation amounts for coating and others are ₹ 1,000 lakhs and ₹ 300 lakhs respectively.
- (vii) Capital expenditure for coating and others are ₹ 5,000 lakhs and ₹ 2,000 lakhs respectively.
- (viii) Revenue from outside India is ₹ 62,000 lakhs and asset outside India ₹ 10,000 lakhs.

Based on the above information, comment how X Ltd. would disclose information about reportable segment revenue, profit or loss, assets & liabilities for financial year 20X1-20X2.

**Answer**

**Segment information:** Information about operating segment

- (i) the company's operating segments comprise:  
 Coatings: consisting of decorative, automotive, industrial paints and related activities.  
 Others: consisting of chemicals, polymers and related activities.

(ii) Segment revenues, results and other information. (₹ in Lakhs)

		Coating	Others	Total
<b>1.</b>	<b>Revenue</b>			
	External Revenue (gross)	2,00,000	70,000	2,70,000
	GST	(5,000)	(3,000)	(8,000)
	External Revenue (net)	1,95,000	67,000	2,62,000
	Other operating income	40,000	15,000	55,000
	<b>Total Revenue</b>	<b>2,35,000</b>	<b>82,000</b>	<b>3,17,000</b>
<b>2.</b>	<b>Results</b>			
	Segment results	10,000	4,000	14,000
	Unallocated income (net of unallocated exp.)			3,000
	<b>Profit from operation before interest, taxation and exceptional items</b>			<b>17,000</b>
	Interest and bank charges			(2,000)
	Profit before exceptional items			15,000
	Exceptional items			Nil
	<b>Profit before taxation</b>			<b>15,000</b>
	Income Taxes			
	- Current taxes			(1,950)
	- Deferred taxes			(50)
	<b>Profit after taxation</b>			<b>13,000</b>
<b>3.</b>	<b>Other Information</b>			
<b>(a)</b>	<b>Assets</b>			
	Segment Assets	50,000	30,000	80,000
	Unallocated Investments			10,000
	Unallocated assets			10,000

**Ind AS 108: Operating Segments**

	Total Assets			1,00,000
<b>(b)</b>	<b>Liabilities/Shareholder's funds</b>			
	Segment liabilities	30,000	10,000	40,000
	Unallocated liabilities			20,000
	Share capital			10,000
	Reserve and surplus			30,000
	<b>Total liabilities/shareholder's funds</b>			<b>1,00,000</b>
<b>(c)</b>	<b>Others</b>			
	Capital Expenditure	(5,000)	(2,000)	(7,000)
	Depreciation	(1,000)	(300)	(1,300)
<b>Geographical Information</b>				
		<b>India (₹)</b>	<b>Outside India (₹)</b>	<b>Total (₹)</b>
	Revenue	2,55,000	62,000	3,17,000
	Assets	90,000	10,000	1,00,000
	Capital expenditure	7,000	-	7,000

**Notes:**

- (i) The operating segments have been identified in line with the Ind AS 108, taking into account the nature of product, organisation structure, economic environment and internal reporting system.
- (ii) Segment revenue, results, assets and liabilities include the respective amounts identifiable to each of the segments. Unallocable assets include unallocable fixed assets and other current assets. Unallocable liabilities include unallocable current liabilities and net deferred tax liability.
- (iii) Corresponding figures for previous year have not been provided. However, in practical scenario the corresponding figures would need to be given.

**Question 6**

Haymond Limited has three segments H, M & D. The following information is provided for the year ending 31<sup>st</sup> March, 20X1: **All amounts are in ₹ Lakhs**

Particulars	Segments			Head Office
	H	M	D	
Sales to M	500	-	-	-
Sales to D	-	5	-	-
Other Sales (Domestic)	10	-	-	-
Sales (Export)	680	170	40	-
Segment result	30	5	(8)	-
Reallocated cost from Head Office	4	2	2	-
Interest cost	2	3	1	-
Non-current Assets	20	4	12	5
Net Current Assets	12	4	9	3
Non-current Liabilities	2	1	12	2

Other Information:

- (i) Share Capital amounts to ₹ 40 lakhs
- (ii) Reserve & Surplus amounts to ₹ 12 lakhs

Prepare segment information as per Ind AS 108.

**Answer**

**(a) Information about operating segment**

- (i) The company's operating segment comprise: H, M & D
- (ii) Segment revenue, results and other information

**Segment Information/Report of Haymond Ltd. (₹ in lakhs)**

Particulars	Reportable Segments			Total
	H	M	D	
<b>1. Segment Revenue</b>				
External Sales:				
Domestic	10	-	-	10
Export	680	170	40	890
<b>Total Revenue</b>	<b>690</b>	<b>170</b>	<b>40</b>	<b>900</b>
<b>2. Results</b>				
Segment result	30	5	(8)	27
Reallocated cost	(4)	(2)	(2)	(8)
<b>Profit from operation before interest, taxation and exceptional items</b>	<b>26</b>	<b>3</b>	<b>(10)</b>	<b>19</b>
Finance cost (Interest expense)	(2)	(3)	(1)	(6)
<b>Profit before tax &amp; exceptional items</b>	<b>24</b>	<b>0</b>	<b>(11)</b>	<b>13</b>
<b>3. Information related to assets &amp; liabilities</b>				
Reportable segment non-current assets	20	4	12	36
Reportable segment net current assets	12	4	9	25
<b>Total segment assets</b>	<b>32</b>	<b>8</b>	<b>21</b>	<b>61</b>
Head office assets [5 + 3]				8
<b>Total Assets</b>				<b>69</b>
Segment non-current liabilities	2	1	12	15
Head office liabilities				2
Share capital				40
Reserve and surplus				12
<b>Total liabilities and shareholder's funds</b>				<b>69</b>

**(b) Geographical Information**

₹ in lakhs

	Domestic	Foreign	Total
Revenue [External Sales]	10	890	900
Assets	69	-	69

## **Section B – Fully Irrelevant Theoretical Questions**

### **Question 1**

ABC Ltd. manufactures and sells healthcare products, and food and grocery products. Three products namely A, B & C are manufactured. Product A is classified as healthcare product and product B & C are classified as food and grocery products. Products B & C are similar products. Discrete financial information is available for each manufacturing locations and for the selling activity of each product. There are two line managers responsible for manufacturing activities of products A, B & C. Manager X manages product A and Manager B manages products B & C. The operating results of health care products (product A) and food and grocery products (products B & C) are regularly reviewed by CODM. Identify operating segments of ABC Ltd.

### **Answer**

In this situation both the healthcare, and food and grocery product line meet the criteria for operating segments set out above. Therefore, it is likely that ABC Ltd.'s operating segments would be classified as being (i) healthcare and (ii) food and grocery segments.

Not every part of an entity is necessarily an operating segment or part of an operating segment. For example, corporate headquarters or some functional departments may not earn revenues or may earn revenues that are only incidental to the activities of the entity and would not be operating segments. For the purposes of Ind AS 108, an entity's post-employment benefit plans are not operating segments.

### **Question 2**

X Ltd. is engaged in the manufacture and sale of two distinct type of products A & B. X Ltd. supplies the product in the domestic market in India as well as in Singapore. There are two regional managers responsible for manufacturing activities of product A & B worldwide and also two other managers responsible for different geographical areas. For internal reporting purposes, X Ltd. provides information product-wise and as per geographical location of company. The CODM regularly reviews the operating results of both sets of components.

Comment how should X Ltd. identify its operating segments.

### **Answer**

In this situation, both the geographical sales areas and product areas may meet the criteria for operating segment. However, in such situation, it is more difficult to determine clearly which set of components should be identified as the entity's operating segments. In such situation the entity should determine which set of components constitutes the operating segments by reference to the core principle. The core principle is that the entity should disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. The entity should also assess whether the identified operating segments could realistically represent the level at which the CODM is assessing performance and allocating resources.

Therefore, X Ltd. should consider all the above factors and apply judgement to determine which component should be disclosed as operating segment.

**Question 3**

(SM)

The CEO along with other Board members do a review of financial information about various business segments and take decisions on the basis of discrete information available for these segments and are correctly identified as Chief Operating Decision Maker (CODM). Review of only revenue information is done for decision making about those segments by the CODM. As per CODM, many segments require minimal costs due to centralization of costs.

Analyse whether the review of only the revenue related information is sufficient for these segments to be considered as operating segments for the purposes of Ind AS 108 'Operating Segments'?

**Answer**

Many entities would be considering the decision making for segments on the basis of revenue growth – especially the ones aggressively trying to build a market share. Common examples would be businesses into technology sector or those creating or launching new products from time to time. For them, the decision making for different regional segments would need revenue growth and related information for further investment decision.

Merely examining revenue data by CODM without taking into account the corresponding expenses involved in generating that revenue may not provide adequate insights for determining how to allocate resources and measure the performance of a segment.

However, in the instant case, the logic given by the CODM is that since many segments require minimal costs (due to centralization of costs), therefore, revenue-only data is a fair representation of the operating results.

In the above case, review of the information that is based only on revenue data may be appropriate to consider that the segment meets the definition of an operating segment.

**Question 4**

(SM)

CODM of XY Ltd. receives and reviews multiple sets of information when assessing the businesses' overall performance to take a decision on resources allocation. It receives the information as under:

- Level 1 Report: Summary report for all 4 regions
- Level 2 Report: Summary report for 20 Sub-regions within those regions
- Level 3 Report: Detailed report for 50 Branches within the sub-regions

State what factors and level should be considered for determining an operating segment.

**Answer**

We need to consider multiple factors (including but not limited to below):

- The process that CODM may use to assess the performance (Key Financial Matrix, KPIs, Ratio etc.);
- Identify the segment managers and their responsibility areas;
- The process of budgeting for resource allocations.

**Question 5**

(SM)

XY Ltd. has operations in France, Italy, Germany, UK and India. It wishes to apply aggregation criteria

on geographical basis.

State how will the aggregation criteria apply for reporting segments in the given scenario.

**Answer**

XY Ltd. needs to assess and prove that each country possesses the same economic characteristics. Factors including exchange control regulations, currency risks and economic conditions are required to be considered.

Considering above factors, it may be possible to aggregate the results of France, Italy and Germany (falling within EU region) and results of UK and India may be separately reported (no aggregation is permitted).

**Question 6**

(SM)

X Ltd. is engaged in the business of manufacturing and selling papers. Varieties of paper like adhesive paper, anti-rust paper, antique paper, art paper etc., are manufactured and sold by X Ltd.

State whether X Ltd. should classify these papers into different segments.

**Answer**

Two or more operating segments may be aggregated into a single operating segment if the segments have similar economic characteristics, and the segments are similar with respect to various factors like nature of the product and production process, type of customers, method of distribution and regulatory requirement.

In case of X Ltd., so far as varieties of paper concerned, if all factors such as nature of the product and production process, type of customers, method of distribution and regulatory requirement are common, there is no need to create different segments for each type of paper.

**Question 7**

(SM)

T Ltd is engaged in transport sector, running a fleet of buses at different routes. T Ltd has identified 3 operating segments:

- Segment 1: Local Route
- Segment 2: Inter-city Route
- Segment 3: Contract Hiring

The characteristics of each segment are as under:

Segment 1: The local transport authority awards the contract to ply the buses at different routes for passengers. These contracts are awarded following a competitive tender process; the ticket price paid by passengers are controlled by the local transport authority. T Ltd would charge the local transport authority on a per kilometer basis.

Segment 2: T Ltd operates buses from one city to another, prices are set by T Ltd on the basis of services provided (Deluxe, Luxury or Superior).

Segment 3: T Ltd also leases buses to schools under a long-term arrangement.

While Segment 1 has been showing significant decline in profitability, Segment 2 is performing well in

respect of higher revenues and improved margins. The management of the company is not sure why is the segment information relevant for users when they should only be concerned about the returns from overall business. They would like to aggregate the Segment 1 and Segment 2 for reporting under 'Operating Segment'

State whether it is appropriate to aggregate Segments 1 and 2 with reference to Ind AS 108 'Operating Segments'; and also discuss, in the above context, whether disclosure of segment information is relevant to an investor's appraisal of financial statements.

**Answer**

Ind AS 108 'Operating Segments' requires operating segments to be aggregated to present a reportable segment if the segments have similar economic characteristics, and the segments are similar in each of the following aggregation criteria:

- (a) The nature of the products and services
- (b) The nature of the production process
- (c) The type or class of customer for their products and services
- (d) The methods used to distribute their products or provide their services
- (e) If applicable, the nature of the regulatory environment

While products and services are similar, the customers for those products and services are different.

In Segment 1, the decision to award the contract is in the hands of the local authority, which also sets prices and pays for the services. The company is not exposed to passenger revenue risk, since a contract is awarded by competitive tender.

On the other hand, in the inter-city segment, the customer determines whether a bus route is economically viable by choosing whether or not to buy tickets. T Ltd sets the ticket prices but will be affected by customer behavior or feedback. T Ltd is exposed to passenger revenue-risk, as it sets prices which customers may or may not choose to pay.

Operating Segment provides information that makes the financial statements more useful to investors. In making the investment decisions, investors and creditors consider the returns they are likely to make on their investment. This requires assessment of the amount, timing and uncertainty of the future cash flows of T Ltd as well as of management's stewardship of T Ltd's resources. How management derives profit is therefore relevant information to an investor.

Inappropriately aggregating segments reduces the usefulness of segment disclosures to investors. Ind AS 108 requires information to be disclosed that is not readily available elsewhere in the financial statements, therefore it provides additional information which aids an investor's understanding of how the business operates and is managed.

In T Ltd.'s case, if the segments are aggregated, then the increased profits in segment 2 will hide the decreased profits in segment 1. However, the fact that profits have sharply declined in segment 1 would be of interest to investors as it may suggest that future cash flows from this segment are at risk.

It is not mandatory to aggregate segments. An entity, if desires, can disclose separately information about segments that meet all the criteria. However, with regard to upper limit on number of segments to be reported, the entity should consider whether a practical limit has been reached.

**Question 8**

(SM)

An entity has branches in different parts of the country – catering to different customers and selling local made products (a product of one region is not sold in any other region). No region or product contributes more than 5% to total revenue of the entity.

Discuss how many segments are reportable.

**Answer**

Under the quantitative threshold, external revenue of reportable segments must be  $\geq 75\%$  of total external revenue of the entity. Considering above case, minimum 15 operating segments need to be reportable [ $75\%$  (threshold)/ $5\%$  (revenue)].

**Question 9**

(SM)

GH Ltd. has four distinct operating segments. The management of GH is concerned as it is unsure on how common costs be reasonably allocated to different operating segments. They intend to allocate management charges, interest costs of internal funding, cost of management of properties and pension costs.

Analyse whether such costs need to conform to accounting policies as used to prepare the financial statements.

**Answer**

Ind AS 108 does not prescribe any specific basis but suggests that a reasonable basis to be used in allocation of common costs. Here, it may not be reasonable to allocate management charges to most profitable segment. However, it may be reasonable to charge interest costs of internal funding on the basis of actual usage over time, even if majority of funds are used for running a loss-making segment.

A reasonable manner of allocation of above costs could be:

**Management Charges:** These may be allocated based on Net Assets invested or Revenue earned by the segments. It needs to be understood if there is an operating segment which is yet to earn revenue, it would fail to have any costs being allocated.

**Interest costs:** As mentioned above, these may be allocated on the basis of actual usage and time.

**Cost of management of properties:** Based on value of property used at each segment.

**Pension costs:** Based on salary expenses of each segment.

**Question 10**

(SM)

An entity uses the weighted average cost formula to assign costs to inventories and cost of goods sold for financial reporting purposes, but the reports provided to the chief operating decision maker use the First-In, First-Out (FIFO) method for evaluating the performance of segment operations.

State the cost formula to be used for Ind AS 108 disclosure purposes.

**Answer**

The entity should use First-In, First-Out (FIFO) method for its Ind AS 108 disclosures, even though it uses the weighted average cost formula for measuring inventories for inclusion in its financial

statements. Where chief operating decision maker uses only one measure of segment asset, same measure should be used to report segment information. Accordingly, in the given case, the method used in preparing the financial information for the chief operating decision maker should be used for reporting under Ind AS 108.

However, reconciliation between the segment results and results as per financial statements needs to be given by the entity in its segment report.