



Paper 1

Financial Reporting

Chapter-wise compilation
of RTP, MTP and PYP

May'24

11



*Modified as per
new scheme*



*Amended as per
May'24*

Attempts
Compilation



CA

(Once you print this write your name in this blank to give you the much-needed motivation. Remember what you see is what you achieve!)

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GETTING THE MOST FROM THIS BOOK

A QUICK GUIDE

1 INITIAL READING

After your initial reading of a particular chapter in your study material, go through the questions in our 3, 5, and 11 attempt's compilations, focusing on the chapter you've just covered. Make note of challenging questions for later reference.

2 FIRST REVISION

During your first revision, revisit the marked questions. If you still can't answer them, highlight them in red and review the related concepts to improve your understanding. This process helps you to grasp the key concepts and address your weak points

3 KEEP GOING WITH THE REVISIONS

Repeat the reading and revision process as often as possible before your exams. Each iteration will enhance your confidence and knowledge.

4 EXAMINERS COMMENTS

Pay attention to the examiner's comments in our compilations, as they highlight common mistakes. Learning from these errors will help you avoid them in your exams



Frequently Asked Questions

1. Why RTP's, MTP's and PYP's?

RTP's, MTP's, and PYP's are extremely important to ensure that you reproduce ICAI language. These questions train you to understand what is important and what is expected of you. At least 41% of questions* are asked from previous RTP's, MTP's and PYP's.

2. What is included?

In this compiler, all questions from the last 3, 5 or 11 attempts depending on the one you have selected will be available. There will be references to the marks and the attempt from which they were asked. Identical or similar questions have been removed and references for both attempts are mentioned.

3. What is the benefit of Chapter-wise?

We have categorized each and every question from all Old RTPs, MTP's, and PYP's into chapters. This means that you don't have to wait until you've completed your entire syllabus to tackle an RTP, MTP, or past paper. You can start solving these questions to check your conceptual clarity right after finishing a particular chapter.

4. What does amended for the latest attempt mean?

When we reviewed all the questions from the past 11 attempts of RTP, MTP, and PYP's, we didn't just segregate them Chapterwise; we also updated them to reflect the latest provisions. All the answers provided in the compilation are applicable for the May 2024 examination. So, there's no need to stress about outdated or incorrect information.

5. How are Old RTP's, MTP's & PYP's beneficial for me?

All old RTPs, MTPs, and PYPs have been organized according to the new syllabus issued by ICAI. This means that if a specific chapter from the old scheme is not included in the new scheme, it has been omitted. If a particular chapter in the new scheme is based on concepts from two or more chapters in the old scheme, it has been adapted to align with how the chapter should be in the new scheme. If a chapter is only partially included in the new scheme, the questions related to those specific concepts are only included in the corresponding chapter of the new scheme. A comprehensive reconciliation of the chapters between the new scheme and the old scheme is provided on the following page.

6. What if a new attempt is added post my purchase?

If you have purchased materials for the May 2024 attempt, you will receive a file with the questions segregated Chapterwise specifically for that attempt.

7. What does N/A mean?

It could mean any of the following:

1. No questions from that chapter have been included in the selected attempts.
2. The chapter is newly introduced, and as a result, no questions have been previously asked in RTP's, MTP's, or PYP's.

*This is on an average based on the last 11 attempts

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21 MTPS: March’18, April’18, Aug’18, Oct’18, May’19, April’19, Oct’19, May’20, Oct’20, March’21, April’21, Oct ’21, Nov ’21, March ’22, April ’22, Sep ’22 , Oct ’22, March ’23 , April ’23, Sep ’23 & Oct ’23

11 PYPs: May’18, Nov’18, May’19, Nov’19, Nov’20, Jan’21, July ’21, Dec ’21, May’22, Nov ’22, May ’23

12 RTPs: May’18, Nov’18, May’19, Nov’19, May’20, Nov’20, May’21, Nov ’21, May ’22, Nov ’22, May ’23, Nov ’23



Chapter 1

Introduction to Indian Accounting Standards

Question 1

Fresh Vegetables Limited (FVL) was incorporated on 2nd April, 20X1 under the provisions of the Companies Act, 2013 to carry on the wholesale trading business in vegetables. As per the audited accounts of the financial year ended 31st March, 20X7 approved in its annual general meeting held on 31st August, 20X7 its net worth, for the first time since incorporation, exceeded ₹ 250 crore. The financial statements since inception till financial year ended 31st March, 20X6 were prepared in accordance with the Companies (Accounting Standards) Rules 2006. It has been advised that henceforth it should prepare its financial statements in accordance with the Companies (Indian Accounting Standards) Rules, 2015.

The following additional information is provided by the Company:

- FVL has in the financial year 20X2-20X3 entered into a 60:40 partnership with Logistics Limited and incorporated a partnership firm 'Vegetable Logistics Associates' (VLA) to carry on the logistics business of vegetables from farm to market.
- FVL also has an associate company Social Welfare Limited (SWL) that was incorporated in July, 20X5 as a charitable organization and registered under section 8 of the Companies Act, 2013. Social Welfare Limited has been the associate company of FVL since its incorporation.

Examine the applicability of Ind AS on VLA & SWL. (RTP May '22)

Answer 1

Applicability of Ind AS in general:

- Currently Ind AS is applicable to the following companies except for companies other than banks and Insurance Companies, on mandatory basis:
 - (a) All companies which are listed or in process of listing in or outside India on Stock Exchanges.
 - (b) Unlisted companies having net worth of ₹ 250 crore or more but less than ₹ 500 crore.
 - (c) Holding, Subsidiary, Associate and Joint venture of above.
- Companies listed on SME exchange are not required to apply Ind AS on mandatory basis.
- Once a company starts following Ind AS either voluntarily or mandatorily on the basis of criteria specified, it shall be required to follow Ind AS for all the subsequent financial statements even if any of the criteria specified does not subsequently apply to it.
- Application of Ind AS is for both standalone as well as consolidated financial statements if threshold criteria met or adopted voluntarily.
- Companies meeting the thresholds for the first time at the end of an accounting year shall apply Ind AS from the immediate next accounting year with comparatives.
- Companies not covered by the above roadmap shall continue to apply existing Accounting Standards notified in the Companies (Accounting Standards) Rules, 2006.

Since the net worth of FVL in immediately preceding year exceeded ₹ 250 crore, Ind AS is applicable to it. The entity VLA and SWL have to be examined as they may fall in criteria (c) above.

Applicability of Ind AS on VLA

Joint arrangement can be either joint operation or joint venture. However, for the purpose of identifying the applicability of Ind AS, the Act defines Joint venture (as an explanation to section 2(6) of the Companies Act, 2013), as follows:

"The expression 'joint venture' means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement".

Accordingly, if an entity is classified as joint operation and not joint venture, then Ind AS would not be applicable to such entity.



In the case of VLA, if partners conclude that they have rights in the assets and obligations for the liabilities relating to the partnership firm then this would be a joint operation. However, Ind AS would not be applicable on VLA in such a case since it is the case of joint operation (and not a joint venture).

Alternatively, if partners conclude that they have joint control of the arrangement and have rights to the net assets of the arrangement relating to the partnership firm, then this would be a joint venture. In such a case, Ind AS would be applicable to them.

Applicability of Ind AS on SWL

Social Welfare Limited (SWL) is the associate company of FVL. Accordingly, Ind AS would be applicable on SWL too irrespective of the fact that SWL has been incorporated as a charitable organization.





Chapter 2

Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)

Question 1

Explain Financial capital maintenance and Physical capital maintenance as per the Framework and differentiate it. (MTP 4 Marks March '18)

Answer 1

A. Financial Capital maintenance

Under this concept, a profit is earned only if the financial (**or money**) amount of the net assets at the end of the period exceeds the financial (**or money**) amount of net assets at the beginning of the period, after excluding any distribution to, and contribution from, owners during the period. Financial Capital Maintenance can be measured in either nominal monetary units or units of constant purchasing power. (May 22)

B. Physical Capital maintenance

Under this concept, a profit is earned only if the physical productive capacity or operating capability of the entity (or resources and funds needed to achieve that capacity) (May 22) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

C. Major differences between Physical Capital & Financial Capital

The principle difference between the two concepts of capital maintenance is the treatment of the effect of changes in the prices of assets and liabilities of the entity. (May 22)

- The physical capital maintenance concept requires the adoption of the current cost basis as measurement whereas financial capital maintenance concept does not require the use of a particular basis of measurement.
- Financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increase in the prices of assets held over the period, conventionally referred to as holding gains are conceptually profits. They might not be recognized as such however, until the assets are disposed of in an exchange transaction. (May 22) When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and hence as part of equity. (May 22)
- Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

Question 2

What is Equity, Income and Expenses as per 'Framework for Financial Reporting under Ind AS'? How the information with respect to income and expenses helps the users in understanding of the financial statements? (MTP 5 Marks , Oct'22)

Answer 2

Equity: Equity claims are claims on the residual interest in the assets of the entity after deducting all its liabilities. In other words, they are claims against the entity that do not meet the definition of liability.

Income and Expenses: Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

Income and expenses are the elements of financial statements that relate to an entity's financial



performance. Users of financial statements need information about both an entity's financial position and its financial performance. Hence, although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.

Different transactions and other events generate income and expenses with different characteristics. Providing information separately about income and expenses with different characteristics can help users of financial statements to understand the entity's financial performance.

Question 3

Defense Innovators Limited is a public sector undertaking and is engaged in the construction of warships and submarines. XYZ Private Limited approached Defense Innovators Limited for construction of "specially designed" ships for it, which will be used by XYZ Private Limited for transportation of specific goods. The offer was accepted by the Defense Innovators Limited and both the companies entered into an agreement for the construction and delivery of 3 specially designed ships on 'Fixed Price' basis with variable component in respect to certain items.

Base and depot (B & D) spares for all three ships shall be procured by Defense Innovators Limited and will be paid on the cost of the item with certain percentage.

The contract states that "certain equipment" out of variable cost items, will be supplied by XYZ Private Limited at 'free of cost' for installation on board of ship. It is, therefore, to be noted as under:

- (i) **Some equipment is procured by Defense Innovators Limited in the presence of the XYZ Private Limited's representative for technical scrutiny as well as negotiating the prices. The vendors of these equipment are paid by Defense Innovators Limited. The cost of the equipment along with the cost of installation and profit thereon is claimed and reimbursed by XYZ Private Limited to Defense Innovators Limited.**
- (ii) **There is certain other equipment for which orders are directly placed and also paid by the XYZ Private Limited. This equipment is known as 'Buyer Furnished Equipment (BFE)' and are delivered to the company 'free of cost' for installing in the ship. The labour cost of Installation of these are already included in the price component of the contract. BFEs are returned to the buyer after completion of the ship. The period required for construction of one ship was approximately four years. Whether the cost of Buyer Furnished Equipment's (BFE's) supplied by XYZ Private Limited to Defense Innovators Limited for-installing the same in the ships can be considered as 'inventory' by Defense Innovators Limited and then on delivery of ship will be recognized as revenue in its books of account? Elaborate. (MTP 6 Marks March '23 & RTP May '22)**

Answer 3

Before any item can be recognized as an inventory, it should meet the definition of 'asset' as given in the Conceptual Framework for Financial Reporting under Ind AS, issued by the Institute of Chartered Accountants of India as follows:

"An asset is a present economic resource controlled by the entity as a result of past events and economic resource is a right that has the potential to produce economic benefits".

The orders in respect of Buyer Furnished Equipment's (BFEs) are directly placed by the buyer and payment in respect of them is made by the buyer. These are then supplied to the company for installing in the ship and the buyer pays installation charges which are included in the contract price. Thus, the company has neither incurred any cost on BFEs nor any amount is recoverable on account of such equipment except installation charges. Accordingly, such equipment are not 'assets' that may be considered as a part of its contract work-in progress.

In fact, after installation in the ship, BFEs are returned to the buyer after completion of the ship. Thus, these are only held by the company in the capacity of a bailee. Since, it cannot be considered as an 'asset', therefore, it can neither be considered as 'inventory' nor as 'work-in-progress'.

Further, it can also not be considered as a part of sale value or revenue of the company as no consideration would be receivable with respect to the cost of such equipment.

On the basis of the above, it can be concluded that:

- (i) The BFEs cannot be considered as inventories / Work-in-progress for Defense Innovators Limited.



- (ii) The BFE's cost cannot be considered as part of sales value / contract revenue to Defense Innovators Limited.

Question 4

Mr. Unique commenced business on 1/04/17 with Rs. 20,000 represented by 5,000 units of the product @ Rs. 4 per unit. During the year 2017-18, he sold 5,000 units @ Rs. 5 per unit. During 2017-18, he withdraw Rs. 4,000.

- 31/03/18: Price of the product @ Rs. 4.60 per unit
- Average price indices: 1/4/17: 100 & 31/3/18: 120

Find out:

- Financial capital maintenance at Historical Cost
- Financial capital maintenance at Current Purchasing Power
- Physical Capital Maintenance (PYP 5 Marks May'19)

Answer 4

Financial Capital Maintenance at historical costs

	Rs.	Rs.
Closing capital (Rs. 25,000 – Rs. 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At historical cost)	-	
Introduction (At historical cost)	20,000	(20,000)
Retained profit		1,000

Financial Capital Maintenance at current purchasing power

	Rs.	Rs.
Closing capital (Rs. 25,000 – Rs. 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At closing price) (5,000 x Rs. 4.80)	24,000	
Introduction (At closing price)	Nil	(24,000)
Retained profit		(3,000)

Physical Capital Maintenance

	Rs.	Rs.
Closing capital (Rs. 25,000 – Rs. 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At current cost) (5,000 x Rs. 4.60)	23,000	
Introduction (At current cost)	Nil	(23,000)
Retained profit		(2,000)

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Most of the examinees had not attempted this part of the question. Those who had attempted were also not able to either complete it or do it correctly.

Question 5

Discuss the following in the context of 'Conceptual Framework for Financial Reporting under Indian Accounting Standards':

- The cost constraint on useful financial information
- Executory contracts. (PYP 5 Marks ,May '22)

Answer 5

- The cost constraint on useful financial information;

Role of Cost: Cost is a pervasive constraint on the information that can be provided by financial



reporting. Reporting financial information imposes costs, and it is important that these costs are justified by the benefits of reporting that information.

Basis of Assessment of Cost: Both the providers and users of financial information incur costs in reporting and analyzing financial information. In applying the cost constraint, ICAI assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in formulating a proposed Ind AS, the ICAI seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that Ind AS. In most situations, assessments are based on a combination of quantitative and qualitative information.

Cost Perspective: Due to the inherent subjectivity, assessments of different individuals about the costs and benefits of reporting particular items of financial information will vary. Therefore, ICAI seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities.

(ii) Executory Contracts:

Definition: An executory contract is a contract, or a portion of a contract, that is equally unperformed — neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

Outcome of Executory Contract: An executory contract establishes a combined right and obligation to exchange economic resources. The rights and obligations are inter-dependent and cannot be separated. Hence, the combined rights and obligations constitute a single asset or liability.

The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable.

Basis of Disclosure: Whether such an asset or liability is included in the financial statements depends on both the recognition criteria and the measurement basis selected for the asset or liability, including, if applicable, any test for whether the contract is onerous.

Question 6 (Also includes concepts of Chp 7.6- Ind AS 38 Intangible Assets)

Explain the criteria in the Conceptual Framework for Financial Reporting for the recognition of an asset and discuss whether there are inconsistencies with the criteria in Ind AS 38. (PYP 6 Marks Nov 22 & Old & New SM)

Answer 6

The Conceptual Framework defines an asset as a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits. Assets should be recognized if they meet the Conceptual Framework definition of an asset and such recognition provides users of financial statements with information that is useful i.e. it is relevant as well as results in faithful representation. However, the criteria of a cost-benefit analysis always exists i.e. the benefits of the information must be sufficient to justify the costs of providing such information. The recognition criteria outlined in the Conceptual Framework allows for flexibility in the application in amending or developing the standards.

Para 8 of Ind AS 38 'Intangible Assets', defines an intangible asset as an identifiable non-monetary asset without physical substance. Further, Ind AS 38 defines an asset as a resource:

- (a) controlled by an entity as a result of past events; and
- (b) from which future economic benefits are expected to flow to the entity.

Furthermore, Para 21 of Ind AS 38 states that an intangible asset shall be recognized if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

This requirement is applicable both in case of an externally acquired intangible asset or an internally generated intangible asset. The probability of expected future economic benefits must be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset. Further, as per Para 33 of Ind AS 38, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations. If the recognition criteria are not satisfied, Ind AS 38 requires the expenditure to be expensed as and when it is incurred.

It is notable that the Conceptual Framework does not prescribe a 'probability criterion'. As long as there is a potential to produce economic benefits, even with a low probability, an item can be recognized as an asset according to the Conceptual Framework. However, in terms of intangible assets, it could be argued that recognizing an intangible asset having low probability of generating economic benefits would not be useful to the users of financial statements given that the asset has no physical substance.

The recognition criteria and definition of an asset under Ind AS 38 are different as compared to those outlined in the Conceptual Framework. To put in simple words, the criteria in Ind AS 38 are more specific, but definitely do provide information that is relevant and a faithful representation. When viewed from the prism of relevance and faithful representation, the requirements of Ind AS 38 in terms of recognition appear to be consistent with the Conceptual Framework.

Question 7

Discuss with respect to 'Conceptual Framework for Financial Reporting under Indian Accounting Standards', 'faithful representation', one of the qualitative characteristics of financial information. (6 Marks May '23)

Answer 7

EITHER

Faithful representation

To be useful, financial information must faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon.

To be a perfectly faithful representation, a depiction would have following three characteristics:

- **Complete:** A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations.
- **Neutral:** A neutral depiction is without bias in the selection or presentation of financial information. Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated, and liabilities and expenses are not understated. Equally, the exercise of prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses.
- **Free from error:** Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, being free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.



Chapter 3.1

Ind AS 1: Presentation of Financial Statements

Question 1.

Entity A has undertaken various transactions in the financial year ended 31st March, 20X1. Identify and present the transactions in the financial statements as per Ind AS 1. Rs.

Remeasurement of defined benefit plans	2,57,000
Current service cost	1,75,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000
Income tax expense	35,000
Share based payments cost	3,35,000

(MTP 4 Marks April '21 & March '18 & Old & New SM)

Answer 1.

Items impacting the Statement of Profit and Loss for the year ended 31st March, 20X1 (Rs.)

Current service cost	1,75,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Income tax expense	35,000
Share based payments cost	3,35,000

Items impacting the other comprehensive income for the year ended 31st March, 20X1 (Rs.)

Remeasurement of defined benefit plans	2,57,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000

Question 2.

In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual installments starting from December 20X5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 20X2, failing which the loan becomes payable on demand. As on March 24, 20X2, the entity has not been able to get the promoter's contribution. On March 25, 20X2, the entity approached the bank and obtained a grace period up to June 30, 20X2 to get the promoter's contribution. The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 20X2.

- (i) As on March 31, 20X2, examine the classification of the loan to be done by the entity as per Ind AS?
- (ii) Assume in anticipation that it may not be able to get the promoter's contribution by due date. In February 20X2, the entity approached the bank and got the compliance date extended up to June 30, 20X2 for getting promoter's contribution. In this case, examine whether the loan classification as on March 31, 20X2 be different from (a) above? (MTP 6 Marks March '18)(Old & New SM) (Similar concept but different figures -PYP May'22 5 Marks)



Answer 2.

- (i) 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 the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 20X2, the loan will be classified as current.
- (ii) 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 June 30, 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 20X2, the loan will retain its classification as non-current.

Question 3.

A Limited has prepared the following draft balance sheet as on 31st March 20X1:

(₹ in crore)

Particulars	31st March, 20X1	31st March, 20X0
ASSETS		
Cash	250	170
Cash equivalents	70	30
Non-controlling interest's share of profit for the year	160	150
Dividend declared and paid by A Limited	90	70
Accounts receivable	2300	1800
Inventory at cost	1500	1650
Inventory at fair value less cost to complete and sell	180	130
Investment property	3100	3100
Property, plant and equipment (PPE) at cost	5200	4700
Total	12,850	11,800
CLAIMS AGAINST ASSETS		
Long term debt (₹ 500 crore due on 1st January each year)	3,300	3,885
Interest accrued on long term debt (due in less than 12 months)	260	290
Share Capital	1,130	1,050
Retained earnings at the beginning of the year	1,875	1,740
Profit for the year	1,200	830
Non-controlling interest	830	540
Accumulated depreciation on PPE	1,610	1,240
Provision for doubtful receivables	200	65
Trade payables	880	790
Accrued expenses	15	30
Warranty provision (for 12 months from the date of sale)	600	445
Environmental restoration provision (restoration expected in 20X6)	765	640
Provision for accrued leave (due within 12 months)	35	25
Dividend payable	150	230
Total	12,850	11,800

Prepare a consolidated balance sheet using current and non-current classification in accordance with



Ind AS 1. Operating cycle of the entity is 12 months. (MTP 10 Marks, April 22) (Old & New SM)

Answer 3

A Limited Consolidated Balance Sheet as at 31st March 20X1 (₹ in crore)

Particulars	Note	31st March, 20X1	31st March, 20X0
ASSETS			
Non-current assets			
(a) Property, plant and equipment	1	3,590	3,460
(b) Investment property		3,100	3,100
Total non-current assets		6,690	6,560
Current assets			
(a) Inventory	2	1,680	1,780
(b) Financial assets			
(i) Trade and other receivables	3	2,100	1,735
(ii) Cash and cash equivalents	4	320	200
Total current assets		4,100	3,715
Total assets		10,790	10,275
EQUITY & LIABILITIES			
Equity attributable to owners of the parent			
Share capital		1,130	1,050
Other Equity	5	2,825	2,350
Non-controlling interests		830	540
Total equity		4,785	3,940
LIABILITIES			
Non-current liabilities			
(a) Financial Liabilities			
(i) Borrowings - Long-term debt	6	2,800	3,385
(b) Provisions			
(i) Long-term provisions (environmental restoration)		765	640
Total non-current liabilities		3,565	4,025
Current liabilities			
(a) Financial Liabilities	7		
(i) Trade and other payables (Other than micro enterprises and small enterprises)	8	895	820
(ii) Current portion of long-term debt		500	500
(iii) Interest accrued on long-term debt		260	290
(iv) Dividend payable		150	230
(b) Provisions			
(i) Warranty provision		600	445
(ii) Provisions for accrued leave		35	25
Total current liabilities		2,440	2,310
Total liabilities		6,005	6,335
Total equity and liabilities		10,790	10,275

Working Notes:



Notes	Particulars	Basis	Calculation ₹ in crore	Amount ₹ in crore
1	Property, plant and equipment	Property, plant and equipment (PPE) at cost less Accumulated (depreciation on PPE	5,200 – 1,610 (4,700 – 1,240)	3,590 (3,460)
2	Inventory	Inventory at cost add Inventory at fair value less cost to complete and sell	1,500 + 180 (1,650 + 130)	1,680 (1,780)
3	Trade and other receivables	Accounts receivable less Provision for doubtful receivables	2,300 – 200 (1,800 – 65)	2,100 (1,735)
4	Cash and cash equivalents	Cash and Cash equivalents	250 + 70 (170 + 30)	320 (200)
5	Other Equity	Retained earnings at the beginning of the year add Profit for the year less Non-controlling interest's share of profit for the year less Dividend declared by A Limited	1,875 + 1,200 – 160 – 90 (1,740 + 830 – 150 – 70)	2,825 (2,350)
6	Long-term debt	Long-term debt less Due on 1st January each year	3,300 – 500 (3,885 – 500)	2,800 (3,385)
7	Trade & other payables	Trade payables add Accrued expenses	880 + 15 (790 + 30)	895 (820)
8	Current portion of long- term debt	Due on 1st January each year	- -	500 (500)

Note: Figures in brackets represent the figures for the comparative year.

Question 4

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?

- Receivables (viz., receivable under a contract of sale of goods in which an entity deals)
- Advance to suppliers
- Income tax receivables [other than deferred tax]
- Insurance spares (MTP 5 Marks Sep'22, RTP May'21)

Answer 4

- As per paragraph 66(a) of Ind AS 1, an entity shall classify an asset as current when it expects to realize 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.
- 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
- 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, the insurance spares that are treated as an item of property, plant and equipment would normally be classified as non-current asset whereas insurance spares that are treated as inventory will be classified as current asset if the entity expects to consume it in its normal operating cycle.

Question 5

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? (RTP May '22, MTP 4 Marks March '23 & Old & New SM)

Answer 5

Inventory and debtors need to be classified in accordance with the requirement of paragraph 66(a) of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same or intends to sell or consume it in its normal operating cycle.

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

Additional information as required by paragraph 61 of Ind AS 1 will be required to be made by the entity, which provides "Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

- (a) No more than twelve months after the reporting period, and
- (b) More than twelve months after the reporting period."

Question 6

Company A has taken a long term loan arrangement from Company B. In the month of December 20X1, there has been a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on March 31, 20X2. In the month of May 20X2, the Company started negotiation with the Company B for not to demand payment as a consequence of the breach. The financial statements were approved for the issue in the month of June 20X2. In the month of July 20X2, both company 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. (RTP May'18 & Old & New SM)

Answer 6

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.

In the given case, Company B (the lender) agreed for not to demand payment but only after 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 for the year ended March 31, 20X2.

Question 7

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) Should the loan be classified as current or non-current in the balance sheet of the entity?**
- (b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?**
- (c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?**
- (d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation? (RTP Nov '19)**

Answer 7

Para 69 of Ind AS 1 defines current liabilities as follows:

An entity shall classify a liability as current when:

- (i) it expects to settle the liability in its normal operating cycle;
- (ii) it holds the liability primarily for the purpose of trading;
- (iii) the liability is due to be settled within twelve months after the reporting period; or
- (iv) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

Accordingly, following will be the classification of loan in the given scenarios:

- a) 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.
- b) Yes, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period because as per paragraph 72 of Ind AS 1, "an entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if: (a) the original term was for a period longer than twelve months, and (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are approved for issue." 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.
- c) 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.



- d) 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 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? (RTP Nov '21 & Old & New SM)

Answer 8

- (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, if any, between the holding and subsidiary company needs to be considered. If the arrangement is to reimburse the cost incurred by the holding company on behalf of the subsidiary company, the same may be presented net. It should be ensured that the substance of the arrangement is that the payments are actually in the nature of reimbursement.
- (b) Paragraph 35 of Ind AS 1 requires an entity to present on a net basis gains and losses arising from a group of similar transactions. Accordingly, gains or losses arising on disposal of various items of property, plant and equipment shall be presented on net basis. However, gains or losses should be presented separately if they are material.
- (c) Ind AS 1 prescribes that assets and liabilities, and income and expenses should be reported separately, unless offsetting reflects the substance of the transaction. In addition to this, as per paragraph 42 of Ind AS 32, a financial asset and a financial liability should be offset if the entity has legally enforceable right to set off and the entity intends either to settle on net basis or to realise the asset and settle the liability simultaneously.

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

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'? Give examples. How should these be presented in the financial statements? (RTP Nov'22)

Answer 9

Exceptional items have not been defined in Indian Accounting Standards (Ind AS). However, paragraph 97 of Ind AS 1 requires that when items of income or expense are material, an entity shall disclose their nature and amount separately.

As per Ind AS 1, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Materiality depends on the nature or magnitude of information, or both and it could be the determining factor. When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Generally, items of income or expense



fulfilling the abovementioned criteria are classified as exceptional items and are disclosed separately.

From the above, it appears that 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'.

Following are some examples which may give rise to a separate disclosure of items as an 'exceptional item' in financial statements if they meet the test of 'materiality' and 'incidence':

- (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 the activities of an entity and reversals of any provisions for the 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

Question 10

Mike Ltd. has undertaken following various transactions in the financial year ended 31.03.2018:
(Rs.)

(a)	Re-measurement of defined benefit plans	1,54,200
(b)	Current service cost	1,05,000
(c)	Changes in revaluation surplus	75,000
(d)	Gains and losses arising from translating the monetary assets in foreign currency	45,000
(e)	Gains and losses arising from translating the financial statements of a foreign operation	39,000
(f)	Gains and losses arising from investments in equity instruments designated at fair value through other comprehensive income	60,000
(g)	Income tax expenses	21,000
(h)	Share based payments cost	2,01,000

Identify and present the transactions in the financial statements as per Ind AS 1. (PYP 4 Marks, May'19)

Answer 10

Items impacting the Statement of Profit and Loss for the year ended 31st March, 2018
(Rs.)

Current service cost	1,05,000
Gains and losses arising from translating the monetary assets in foreign currency	45,000
Income tax expenses	21,000
Share based payments cost	2,01,000

Items impacting the Other Comprehensive Income for the year ended 31st March, 2018
(Rs.)

Premeasurement of defined benefit plans	1,54,200
Changes in revaluation surplus	75,000
Gains and losses arising from translating the financial statements of a foreign operation	39,000



Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	60,000

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees failed to correctly identify the nature of transactions and present them either in the Profit and Loss or Other Comprehensive Income.

Question 11

Entity A had obtained a long-term bank loan during January 2019, 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 31st March every year.

You are required to show how the loan will be classified as on 31st March 2020, 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 31st December 2019, 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? (PYP 5 Marks, Jan '21)

Answer 11

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 the lender cannot demand immediate repayment.

- (i) The entity has obtained a long-term loan during January, 2019. Since repayment period of the loan is not mentioned in the question, it is assumed that on 31st March 2020, 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 31st March, 2020, the loan will be classified as 'non-current liability'.
- (ii) In the second case, though there is a breach of covenant on 31st December, 2019 i.e. before reporting date of 31st March, 2020, 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 31st March, 2020.
- (iii) Since the covenant for the bank loan has been breached during the quarter ended 31st December, 2019 and reported to the bank within one month from the end of the quarter i.e. by 31st January, 2020, the bank loan becomes repayable immediately. Therefore, it will be presented as current liability in the books of entity A as on 31st March, 2020.

**Question 12**

Charm Limited (the 'Company') is a manufacturing company, which is into manufacturing of wires and cables and 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. 31st March 2021.

With respect to the following transactions, which took place during the financial year 2020-2021, give your opinion based on relevant Ind AS:

- The Company has received a contract of ₹ 10 crore on 31st March 2021. 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 31st March 2021. 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?
- 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?
- 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 31st March 2021. 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?
- 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? (PYP 4 Marks July 21)

Answer 12

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.

Darshan Panicker | 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 the control of the entity. Hence, Charm Limited does not have an unconditional right to defer settlement of the liability for at least twelve months after the 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 realized 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.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees did the classification correct but were not able to substantiate the same in a crisp manner. Many examinees failed to understand the concept of capital advances; hence, wrongly classified advance of ` 1 crore for purchase of machinery as current asset. Further examinees were not able to appreciate that the lengthy operating cycle of more than 12 months also leads to classification of item as current.

Question 13 (Illustration)

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

- (a) How should such loan be classified in the balance sheet of the entity?
- (b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?
- (c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?
- (d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation? (Old & New SM) (PYP 5 Marks May '23)

Answer 13

- (a) 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.
- (b) 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.
- (c) 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.

- (d) 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 14

A holding company [being the entity under consideration] gives a loan / intercorporate deposit to a subsidiary that is recoverable on demand, at a rate of interest at 10%.

- (a) Should such loan be disclosed as a current/non-current asset in the books of the holding company? How relevant would the commercial reality of the transaction be in comparison to the legal terms of the transaction?**
- (b) How this loan / inter-corporate deposit that is repayable on demand would be classified in the books of the subsidiary? (MTP 4 Marks Oct 21)**

Answer 14

- (a)** Paragraph 66 (c) of Ind AS 1 provides that an asset shall be classified as current when an entity expects to realise the asset within a period of twelve months after the reporting period. To determine the expectation of the entity, the commercial reality of the transaction should also be considered. If the loans have been given with an understanding that these loans would not be called for repayment even though a clause may have been added that these are recoverable on demand, it should be classified as a non-current asset.
- (b)** Paragraph 69(c) of Ind AS 1 provides that a liability should be classified as current if the liability is due to be settled within twelve months after the reporting period. Since the loan/inter- corporate deposit would become due immediately as and when demanded and presuming that the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period, it should be classified as current liability.



Chapter 3.2

Ind AS 34: Interim Financial Reporting

Question 1

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- Rs.33,00,000 (inclusive of Estimated Capital Gains of Rs. 8,00,000)

Estimated Income of Quarter I is Rs. 7,00,000,

Quarter II is Rs. 8,00,000,

Quarter III (including Estimated Capital Gains of Rs. 8,00,000) is Rs. 12,00,000 and

Quarter IV is Rs. 6,00,000.

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

(MTP 6 Marks Oct 21 & Old & New SM) (Similar concept but different figure- PYP 6 Marks, Nov'20)

Answer 1

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

If different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries) to the extent practicable, a separate rate is applied to each individual category of interim period pre-tax income.

	Rs.
Estimated annual income exclusive of estimated capital gain (33,00,000 – 8,00,000) (A)	<u>25,00,000</u>
Tax expense on other income:	
30% on Rs. 5,00,000	1,50,000
40% on remaining Rs. 20,00,000	<u>8,00,000</u>
(B)	<u>9,50,000</u>
Weighted average annual income tax rate = B/A = 9,50,000/25,00,000 = 38%	

Tax expense to be recognized in each of the quarterly reports

		Rs.
Quarter I - Rs. 7,00,000 x 38%		2,66,000
Quarter II - Rs. 8,00,000 x 38%		3,04,000
Quarter III - Rs. (12,00,000 - 8,00,000) x 38%	1,52,000	
Rs. 8,00,000 x 12%	<u>96,000</u>	2,48,000
Quarter IV - Rs. 6,00,000 x 38%		<u>2,28,000</u>
		<u>10,46,000</u>



Question 2

Company A expects to earn ₹ 15,000 pre-tax profit each quarter and has a corporate tax slab of 20 percent on the first ₹ 20,000 of annual earnings and 40 per cent on all additional earnings. Actual earnings match expectations. Calculate the amount of income tax to be shown in each quarter. (MTP 4 Marks April 22 & Old SM)

Answer 2

The following table shows the amount of income tax expense that is reported in each quarter:

Expected Total Income	= 15,000 x 4 = ₹ 60,000
Expected Tax as per slabs	= 20,000 x 20% + 40,000 x 40% = ₹ 20,000
Average Annual Income tax rate	= 20,000/60,000 x 100 = 33.33%

Amount (₹)

	Q1	Q2	Q3	Q4
Profit before tax	15,000	15,000	15,000	15,000
Tax expense	5,000	5,000	5,000	5,000

Question 3

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

- Dividend income from its investment which is declared in September of every year.
- 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. (MTP 5 Marks Sep '23)

Answer 3

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 30th 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 30th June, 20X1 should be charged to P&L while preparing its financial statements as of 30th June, 20X1.

Question 4

An entity reports quarterly, earns Rs. 1,50,000 pre-tax profit in the first quarter but expects to incur losses of Rs. 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. If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34. (RTP Nov'19)(Old & New SM)

Answer 4

As per para 30 (c) of Ind AS 34 'Interim Financial Reporting', income tax expense is **recognized 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. 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 Rs.)	Effective tax rate	Tax expense (in Rs.)
First Quarter	1,50,000	30%	45,000
Second Quarter	(50,000)	30%	(15,000)
Third Quarter	(50,000)	30%	(15,000)
Fourth Quarter	(50,000)	30%	(15,000)
Annual	0		0

Question 5

An entity's accounting year ends is 31st December, but its tax year end is 31st March. The entity publishes an interim financial report for each quarter of the year ended 31st December, 2019. The entity's profit before tax is steady at Rs.10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31st March, 2019 and 30% for the year ended 31st March, 2020. How the related tax charge would be calculated for the year 2019 and its quarters? (RTP Nov'20 & Old & New SM)

Answer 5

Table showing computation of tax charge:

	Quarter ending 31 st March, 2019	Quarter ending 30th June, 2019	Quarter ending 30th September, 2019	Quarter ending 31st December, 2019	Year ending 31st December, 2019
	Rs.	Rs.	Rs.	Rs.	Rs.
Profit before tax	10,000	10,000	10,000	10,000	40,000
Tax charge	(2,500)	(3,000)	(3,000)	(3,000)	(11,500)
	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 6 (Also includes concepts of Chapter - Ind AS 8 -Accounting Policies, Changes in Accounting Estimates and Errors)

While preparing interim financial statements for the half-year ended 30 September 20X2, an entity discovers a material error (an improper expense accrual) in the interim financial statements for the period ended 30 September 20X1 and the annual financial statements for the year ended 31 March 20X2. The entity does not intend to restate the comparative amounts for the prior period presented in the interim financial statements as it believes it would be sufficient to correct the error by restating the comparatives in the annual financial statements for the year ended 31 March 20X3. Is this acceptable? Discuss in accordance with relevant Ind AS. (RTP Nov '21)

Answer 6

Paragraph 42 of Ind AS 8, inter alia, states that an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by restating the comparative amounts for the prior period(s) presented in which the error occurred.

Paragraph 28 of Ind AS 34 requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements (except for accounting policy changes made after

the date of the most recent annual financial statements that are to be reflected in the next annual financial statements).

Paragraph 15B of Ind AS 34 cites 'corrections of prior period errors' as an example of events or transactions which need to be explained in an entity's interim financial report if they are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period.

Paragraph 25 of Ind AS 34, Interim Financial Statements, states as follows:

"While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognized and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from nondisclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period."

In view of the above, the entity is required to correct the error and restate the comparative amounts in interim financial statements for the half-year ended 30 September 20X2.

Question 7

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. (RTP Nov'22)**

Answer 7

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.

Question 8

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

- (i) Entity publishes interim financial reports quarterly
- (ii) Entity publishes interim financial reports half-yearly. (RTP May '23)

Answer 8

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 30th September, 20X1:

Balance sheet at	30th September 20X1	31st March 20X1	-	-
Statement of profit and loss for	3 months ended 30th September 20X1	3 months ended 30th September 20X0	6 months ended 30th September 20X1	6 months ended 30th September 20X0

Statement of changes in equity for	6 months ended 30th September 20X1	6 months ended 30th September 20X0		
Statement of cash flows for	6 months ended 30th September 20X1	6 months ended 30th September 20X0	-	-

(ii) Entity publishes interim financial reports half-yearly

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

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

Question 9

Heavy Limited has a plant with normal capacity to produce 90,000 units of a product per annum and expected fixed production overhead for the year is ₹ 18,00,000. There are no quarterly / seasonal variations. Hence, normal expected production of each quarter is uniform. The actual production of the year is 87,000 units. The production details of each quarter are as under:

Quarter I:	20,000 units
Quarter II:	24,000 units
Quarter III:	23,500 units
Quarter IV:	19,500 units

Calculate the allocation of fixed production overhead for all the four quarters. Will the quarterly results affect annual result? Give your answer as per Ind AS 34 read with Ind AS 2. (PYP 5 Marks July 21)

Answer 9

Since it is considered that there is no quarterly / seasonal variation, then normal expected production for each quarter is 22,500 units (90,000 units / 4 quarters) and fixed production overheads for the quarter are ₹ 4,50,000 (₹ 18,00,000 / 4 quarters). Fixed production overhead to be allocated per unit of production in every quarter will be ₹ 20 per unit.

(Fixed overheads / Normal production i.e. ₹ 4,50,000 / 22,500 units)

Particulars	Quarters			
	I	II	III	IV
Actual fixed production overheads on year to date basis (₹)	4,50,000	9,00,000	13,50,000	18,00,000
Actual production (Units)	20,000	24,000	23,500	19,500
Actual production year to date basis (Units)	20,000	44,000	67,500	87,000
Fixed overheads to be absorbed on year to date basis (₹)	4,00,000	8,80,000	13,50,000	17,40,000

Under recovery year to date (₹)	50,000	20,000	NIL	60,000

Quarter I:

Unallocated fixed production overheads ₹ 50,000 (i.e. ₹ 4,50,000 – ₹ 4,00,000) to be charged as expense as per Ind AS 2 and consequently as per Ind AS 34 .

Quarter II:

Since production increased in second quarter by 1,500 units (24,000 – 22,500) i.e. more than the normal expected production, hence ₹ 30,000 (1,500 units x ₹ 20 per unit) will be reversed by way of a credit to the statement of profit and loss of the 2 nd quarter and debit to cost of production / inventory cost.

Quarter III:

Earlier, ₹ 50,000 was not allocated to production / inventory cost in the 1 st quarter. Out of it, ₹ 30,000 was reversed in the 2nd quarter. To allocate entire ₹ 13,50,000 till third quarter to the production, as per Ind AS 34, remaining ₹ 20,000 (₹ 50,000 – ₹ 30,000) will be reversed by way of a credit to the statement of profit and loss of the 3 rd quarter and debit to the cost of production / inventory cost.

Quarter IV:

Unallocated fixed production overheads ₹ 60,000 {i.e. ₹ 4,50,000 – (₹ 20 x 19,500)} in the 4th quarter will be expensed off as per the principles of Ind AS 2 and Ind AS 34 by way of a charge to the statement of profit and loss.

For the year:

The cumulative result of all the quarters would also result in unallocated overheads of ₹ 60,000, thus, meeting the requirements of Ind AS 34 that the quarterly results should not affect the measurement of the annual result.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Examinees failed to account for the variation in the production in each quarter and erred in the computation of allocation of overheads i.e. under / over absorption for each quarter.

Question 10

Pharma Ltd. manufactures surgical items. Pharma Ltd. has shown a net profit of ₹ 50,00,000 for the second quarter of 2020-2021.

Following adjustments are made while computing the net profit:

- Bad debts of ₹ 2,60,000 incurred during the quarter. 40% of the bad debts have been deferred to the next quarter.
- Additional depreciation of ₹ 5,20,000 resulting from the change in the method of depreciation.
- Exceptional loss of ₹ 8,16,000 incurred during the second quarter.
60% of exceptional loss has been deferred to next quarter.
- ₹ 4,70,000 expenditure on account of sales expenses pertaining to the second quarter is deferred on the argument that the third quarter will have more sales, therefore, third quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.

Analyse and ascertain the correct net profit to be shown in the interim financial results of the second quarter to be presented to the Board of Directors as per Ind AS 34. (PYP 4 Marks Dec '21) (Similar to but different figures- PYP Nov'18 4 Marks, MTP Apr'21 5 Marks, Old & New SM)

Answer 10

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:

- The treatment of bad debts is not correct as the expenses incurred during an interim reporting period should be recognized in the same period. Accordingly, ₹ 1,04,000 (₹ 2,60,000 x 40%) should be deducted from ₹ 50,00,000 in the second quarter itself.



- (ii) Recognizing additional depreciation of ₹ 5,20,000 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 ₹ 8,16,000 incurred during the second quarter should be recognized in the same quarter. Hence ₹ 4,89,600 (ie. ₹ 8,16,000 x 60%) which was deferred for next quarter should be deducted from the profits of second quarter only.
- (iv) (a) 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 it is appropriate to anticipate or defer that type of cost at the end of the financial year; and
(b) Costs are incurred unevenly during the financial year of an enterprise.

Therefore, the treatment done relating to deferment of ₹ 4,70,000 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 second quarter shall be

		₹
Net Profit of second quarter		50,00,000
Adjustments		
Less: Bad debts wrongly deferred to third quarter	1,04,000	
Exceptional loss wrongly deferred to third quarter	4,89,600	
Sales expenses wrongly deferred to third quarter	4,70,000	(10,63,600)
Revised Profit		39,36,400





Chapter 3.3

Ind AS 7: Statement of Cash Flows

Question 1.

A Ltd., whose functional currency is Indian Rupee, had a balance of cash and cash equivalents of Rs. 2,00,000, but there are no trade receivables or trade payables balances as on 1st April, 20X1. During the year 20X1-20X2, the entity entered into the following foreign currency transactions:

- A Ltd. purchased goods for resale from Europe for €2,00,000 when the exchange rate was €1 = Rs. 50. This balance is still unpaid at 31st March, 20X2 when the exchange rate is €1 = Rs. 45. An exchange gain on retranslation of the trade payable of Rs. 5,00,000 is recorded in profit or loss.
- A Ltd. sold the goods to an American client for \$ 1,50,000 when the exchange rate was \$1 = Rs. 40. This amount was settled when the exchange rate was \$1 = Rs. 42. A further exchange gain regarding the trade receivable is recorded in the statement of profit or loss.
- A Ltd. also borrowed €1,00,000 under a long-term loan agreement when the exchange rate was €1 = Rs. 50 and immediately converted it to Rs. 50,00,000. The loan was retranslated at 31st March, 20X2 @ Rs. 45, with a further exchange gain recorded in the statement of profit or loss.
- A Ltd. therefore records a cumulative exchange gain of Rs. 18,00,000 (10,00,000 + 3,00,000 + 5,00,000) in arriving at its profit for the year.
- In addition, A Ltd. records a gross profit of Rs. 10,00,000 (Rs. 60,00,000 – Rs. 50,00,000) on the sale of the goods.
- Ignore taxation.

How cash flows arising from the above transactions would be reported in the statement of cash flows of A Ltd. under indirect method?(MTP 6 Marks Oct '19 & 8 Marks April '18)

Answer 1.

Statement of cash flows

Particulars		Amount (Rs.)
Cash flows from operating activities		
Profit before taxation (10,00,000 + 18,00,000)	28,00,000	
Adjustment for unrealized exchange gains/losses:		
Foreign exchange gain on long term loan [€ 2,00,000 x Rs. (50 – 45)]	(10,00,000)	
Decrease in trade payables [1,00,000 x Rs. (50 – 45)]	<u>(5,00,000)</u>	
Operating Cash flow before working capital changes	13,00,000	
Changes in working capital (Due to increase in trade payables)	<u>50,00,000</u>	
Net cash inflow from operating activities		63,00,000
Cash inflow from financing activity		<u>50,00,000</u>
Net increase in cash and cash equivalents		1,13,00,000
Cash and cash equivalents at the beginning of the period		<u>2,00,000</u>
Cash and cash equivalents at the end of the period		<u>1,15,00,000</u>

Question 2

During the financial year 20X1-20X2, Akola Limited have paid various taxes & reproduced the below mentioned records for your perusal:



- Capital gain tax of Rs. 20 crore on sale of office premises at a sale consideration of Rs. 100 crore.
- Income Tax of Rs. 3 crore on Business profits amounting Rs. 30 crore (assume entire business profit as cash profit).
- Dividend Distribution Tax of Rs. 2 crore on payment of dividend amounting Rs. 20 crore to its shareholders.
- Income tax Refund of Rs. 1.5 crore (Refund on taxes paid in earlier periods for business profits).

You need to determine the net cash flow from operating activities, investing activities and financing activities of Akola Limited as per relevant Ind AS. (MTP 4 Marks March '21, MTP 5 Marks April '23, RTP Nov'20, Old & New SM)

Answer 2.

Para 36 of Ind AS 7 inter alia states that when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Accordingly, the transactions are analyzed as follows:

Particulars	Amount (in crore)	Activity
Sale Consideration	100	Investing Activity
Capital Gain Tax	(20)	Investing Activity
Business profits	30	Operating Activity
Tax on Business profits	(3)	Operating Activity
Dividend Payment	(20)	Financing Activity
Dividend Distribution Tax	(2)	Financing Activity
Income Tax Refund	1.5	Operating Activity
Total Cash flow	86.5	

Activity wise	Amount (in crore)
Operating Activity	28.5
Investing Activity	80
Financing Activity	(22)
Total	86.5

Question 3

From the following data of Galaxy Ltd., prepare statement of cash flows showing cash generated from Operating Activities using direct method as per Ind AS 7:

	31.3.20X2 (₹)	31.3.20X1 (₹)
Current Assets:		
Inventory	1,20,000	1,65,000
Trade receivables	2,05,000	1,88,000
Cash & cash equivalents	35,000	20,500
Current Liabilities:		
Trade payable	1,95,000	2,15,000
Provision for tax	48,000	65,000
Summary of Statement of Profit and Loss		₹
Sales	85,50,000	
Less: Cost of sales	(56,00,000)	29,50,000
Other Income		
Interest income	20,000	
Fire insurance claim received	1,10,000	1,30,000



Depreciation	(24,000)	30,80,000
Administrative and selling expenses	(15,40,000)	
Interest expenses	(36,000)	
Foreign exchange loss	(18,000)	(16,18,000)
Net Profit before tax and extraordinary income		14,62,000
Income Tax		(95,000)
Net Profit		13,67,000

Additional information:

- (i) Trade receivables and Trade payables include amounts relating to credit sale and credit purchase only.
- (ii) Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date. (MTP 8 Marks, Sep'22, RTP Nov '21, Old & New SM)

Answer 3

**Statement of Cash Flows from Operating Activities (Direct Method)
of Galaxy Ltd. for the year ended 31 March 20X2**

Particulars	₹	₹
Operating Activities:		
Cash received from Trade receivables (W.N. 3)		85,33,000
Less: Cash paid to Suppliers (W.N.2)	55,75,000	
Payment for Administration and Selling expenses	15,40,000	
Payment for Income Tax (W.N.4)	1,12,000	(72,27,000)
		13,06,000
Adjustment for exceptional items (fire insurance claim)		1,10,000
Net cash generated from operating activities		14,16,000

Working Notes:

1. Calculation of total purchases

Cost of Sales = Opening stock + Purchases – Closing Stock

₹ 56,00,000 = ₹ 1,65,000 + Purchases – ₹ 1,20,000 Purchases = ₹ 55,55,000

2. Calculation of cash paid to Suppliers

Trade Payables

	₹		₹
To Bank A/c (balancing figure)	55,75,000	By Balance b/d	2,15,000
To Balance c/d	1,95,000	By Purchases (W.N. 1)	55,55,000
	57,70,000		57,70,000

3. Calculation of cash received from Customers

Trade Receivables

	₹		₹
To Balance b/d	1,88,000	By Bank A/c (balancing figure)	85,33,000
To Sales	85,50,000	By Balance c/d	2,05,000
	87,38,000		87,38,000

4. Calculation of tax paid during the year in cash

Provision for tax

	₹		₹



To Bank A/c (balancing figure)	1,12,000	By Balance b/d	65,000
To Balance c/d	48,000	By Profit and Loss A/c	95,000
	1,60,000		1,60,000

Question 4

Entity A acquired a subsidiary, entity B, during the year. Summarized information from the consolidated statement of profit and loss and balance sheet is provided, together with some supplementary information.

Consolidated statement of profit and loss	Amount(Rs.)
Revenue	3,80,000
Cost of sales	(2,20,000)
Gross profit	1,60,000
Depreciation	(30,000)
Other operating expenses	(56,000)
Interest cost	(4,000)
Profit before taxation	70,000
Taxation	(15,000)
Profit after taxation	55,000

Consolidated balance sheet	20X2	20X1
	Amount(Rs.)	Amount(Rs.)
Assets		
Cash and cash equivalents	8,000	5,000
Trade receivables	54,000	50,000
Inventories	30,000	35,000
Property, plant and equipment	1,60,000	80,000
Goodwill	18,000	—
Total assets	2,70,000	1,70,000
Liabilities		
Trade payables	68,000	60,000
Income tax payable	12,000	11,000
Long term debt	1,00,000	64,000
Total liabilities	1,80,000	1,35,000
Shareholders' equity	90,000	35,000
Total liabilities and shareholders'	2,70,000	1,70,000

Other information

All of the shares of entity B were acquired for Rs. 74,000 in cash. The fair values of assets acquired and liabilities assumed were:

Particulars	Amount (Rs.)
Inventories	4,000
Trade receivables	8,000
Cash	2,000
Property, plant and equipment	1,10,000
Trade payables	(32,000)
Long term debt	(36,000)



Goodwill	<u>18,000</u>
Cash consideration paid	<u>74,000</u>

Prepare statement of cash flows of Entity A.(MTP 10 Marks May '20 & RTP May '20)(Old & New SM) (Similar concept but different figures- PYP Nov'20 8 Marks)

Answer 4

This information will be incorporated into the consolidated statement of cash flows as follows:

Statement of cash flows for 20X2 (extract)	Amount	Amount
	(Rs.)	(Rs.)
Cash flows from operating activities		
Profit before taxation	70,000	
Adjustments for non-cash items:		
Depreciation	30,000	
Decrease in inventories (Note 1)	9,000	
Decrease in trade receivables (Note 2)	4,000	
Decrease in trade payables (Note 3)	(24,000)	
Interest paid to be included in financing activities	4,000	
Taxation (11,000 + 15,000 – 12,000)	(14,000)	
<i>Net cash inflow from operating activities</i>		79,000
Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000 – 2,000)	(72,000)	
<i>Net cash outflow from investing activities</i>		(72,000)
Cash flows from financing activities		
Interest paid	(4,000)	
<i>Net cash outflow from financing activities</i>		(4,000)
Increase in cash and cash equivalents		3,000
Cash and cash equivalents at the beginning of the year		<u>5,000</u>
Cash and cash equivalents at the end of the year		<u>8,000</u>

Working Notes:

1. Inventories

Total inventories of the Group at the end of the year	Rs. 30,000
Inventories acquired during the year from subsidiary	<u>(Rs. 4,000)</u>
	Rs. 26,000
Opening inventory	<u>(Rs. 35,000)</u>
Decrease in inventory	<u>Rs. 9,000</u>

2. Trade Receivables

Total trade receivables of the Group at the end of the year	Rs. 54,000
Trade receivables acquired during the year from subsidiary	<u>(Rs. 8,000)</u>
	Rs. 46,000
Opening trade receivables	<u>(Rs. 50,000)</u>
Decrease in trade receivables	<u>Rs. 4,000</u>

3. Trade Payables

Trade payables at the end of the year	Rs. 68,000
Trade payables of the subsidiary assumed during the year	<u>(Rs. 32,000)</u>
	Rs. 36,000



Opening Trade payable Decrease
in Trade payables

(Rs. 60,000)
Rs. 24,000

Question 5

Following is the balance sheet of Kuber Limited for the year ended 31st March, 20X2 (Rs. in lacs)

	20X2	20X1
ASSETS		
Non-current Assets		
Property, plant and equipment	13,000	12,500
Intangible assets	50	30
Other financial assets	145	170
Deferred tax asset (net)	855	750
Other non-current assets	800	770
Total non-current assets	14,850	14,220
Current assets		
Financial assets		
Investments	2,300	2,500
Cash and cash equivalents	220	460
Other current assets	195	85
Total current assets	2,715	3,045
Total Assets	17,565	17,265
EQUITY AND LIABILITIES		
Equity		
Equity share capital	300	300
Other equity	12,000	8,000
Total equity	12,300	8,300
Liabilities		
Non-current liabilities		
Long-term borrowings	2,000	5,000
Other non-current liabilities	2,740	3,615
Total non-current liabilities	4,740	8,615
Current liabilities		
Financial liabilities		
Trade payables	150	90
Bank Overdraft	75	60
Other current liabilities	300	200
Total current liabilities	525	350
Total liabilities	5,265	8,965
Total Equity and Liabilities	17,565	17,265

Additional Information:

- (1) Profit after tax for the year ended 31st March, 20X2- Rs. 4,450 lacs
- (2) Interim Dividend paid during the year - Rs. 450 lacs
- (3) Depreciation and amortization charged in the statement of profit and loss during the



current year are as under

(a) Property, Plant and Equipment - Rs. 500 lacs

(b) Intangible Assets - Rs. 20 lacs

(4) During the year ended 31st March, 20X2 two machineries were sold for Rs. 70 lacs. The carrying amount of these machineries as on 31st March, 20X2 is Rs. 60 lacs.

(5) Income taxes paid during the year Rs. 105 lacs

Using the above information of Kuber Limited, construct a statement of cash flows under indirect method. Other non-current / current assets and liabilities are related to operations of Kuber Ltd. and do not contain any element of financing and investing activities. (RTP Nov 19) (Old & New SM)

Answer 5

Statement of Cash Flows

		Rs. in lacs
Cash flows from Operating Activities		
Net Profit after Tax	4,450	
Add: Tax Paid	<u>105</u>	
	4,555	
Add: Depreciation & Amortisation (500 + 20)	520	
Less: Gain on Sale of Machine (70-60)	(10)	
Less: Increase in Deferred Tax Asset (855-750)	<u>(105)</u>	
	4,960	
Change in operating assets and liabilities		
Add: Decrease in financial asset (170 - 145)	25	
Less: Increase in other non-current asset (800 - 770)	(30)	
Less: Increase in other current asset (195 - 85)	(110)	
Less: Decrease in other non-current liabilities (3,615 – 2,740)	(875)	
Add: Increase in other current liabilities (300 - 200)	100	
Add: Increase in trade payables (150-90)	<u>60</u>	
	4,130	
Less: Income Tax	<u>(105)</u>	
Cash generated from Operating Activities		4,025
Cash flows from Investing Activities		
Sale of Machinery	70	
Purchase of Machinery [13,000-(12,500 – 500-60)]	(1,060)	
Purchase of Intangible Asset [50-(30-20)]	(40)	
Sale of Financial asset - Investment (2,500 – 2,300)	<u>200</u>	
Cash outflow from Investing Activities		(830)
Cash flows from Financing Activities		
Dividend Paid	(450)	
Long term borrowings paid (5,000 – 2,000)	<u>(3,000)</u>	
Cash outflow from Financing Activities		(3,450)
Net Cash outflow from all the activities		(255)
Opening cash and cash equivalents (460 – 60)		<u>400</u>
Closing cash and cash equivalents (220 – 75)		<u>145</u>

Question 6

From the following data, identify the nature of activities as per Ind AS 7. (RTP May'21)

S.no.	Nature of transaction
1	Cash paid to employees
2	Cash paid for development of property costs
3	Borrowings repaid
4	Cash paid to suppliers
5	Loan to Director
6	Bonus shares issued
7	Dividends paid
8	Cash received from trade receivables
9	Proceeds from sale of PPE
10	Depreciation of PPE
11	Advance received from customers
12	Purchased goodwill
13	Payment of promissory notes

Answer 6

S. No.	Nature of transaction	Activity as per Ind AS 7
1	Cash paid to employees	Operating activity
2	Cash paid for development costs	Investing activity
3	Borrowings repaid	Financing activity
4	Cash paid to suppliers	Operating activity
5	Loan to Director	Investing activity
6	Bonus shares issued	Non-cash item
7	Dividends paid	Financing activity
8	Cash received from trade receivables	Operating activity
9	Proceeds from sale of PPE	Investing activity
10	Depreciation of PPE	Non-cash item
11	Advance received from customers	Operating activity
12	Purchased goodwill	Investing activity
13	Payment of promissory notes	Financing activity

Question 7

What will be the classification for following items in the statement of cash flows of both

(i) Banks / Financial institutions and (ii) Other Entities?

S.No.	Particulars
1.	Interest received on loans and advances given
2.	Interest paid on deposits and other borrowings
3.	Interest and dividend received on investments in subsidiaries, associates and in other entities
4.	Dividend paid on preference and equity shares, including tax on dividend paid on preference and equity shares by other entities
5.	Finance charges paid by lessee under finance lease
6.	Payment towards reduction of outstanding finance lease liability
7.	Interest paid to vendor for acquiring fixed asset under deferred payment basis



8.	Principal sum payment under deferred payment basis for acquisition of fixed assets
9	Penal interest received from customers for late payments
10.	Penal interest paid to suppliers for late payments
11.	Interest paid on delayed tax payments
12.	Interest received on tax refunds

(RTP Nov'22) (Old & New SM)

Answer 7

The following are the classification of various activities in the Statement of Cash Flows:

S.No.	Particulars	Classification for reporting cash flows	
		Banks / financial institutions	Other entities
1.	Interest received on loans and advances given	Operating Activities	Investing activities
2.	Interest paid on deposits and other borrowings	Operating Activities	Financing activities
3.	Interest and dividend received on investments in subsidiaries, associates and in other entities	Investing activities	Investing activities
4.	Dividend paid on preference and equity shares, including tax on dividend paid on preference and equity shares by other entities	Financing activities	Financing activities
5.	Finance charges paid by lessee under finance lease	Financing activities	Financing activities
6.	Payment towards reduction of outstanding finance lease liability	Financing activities	Financing activities
7.	Interest paid to vendor for acquiring fixed asset under deferred payment basis	Financing activities	Financing activities
8.	Principal sum payment under deferred payment basis for acquisition of fixed assets	Investing activities	Investing activities
9.	Penal interest received from customers for late payments	Operating Activities	Operating Activities
10.	Penal interest paid to suppliers for late payments	Operating Activities	Operating Activities
11.	Interest paid on delayed tax payments	Operating Activities	Operating Activities
12.	Interest received on tax refunds	Operating Activities	Operating Activities

Question 8

One of the subsidiaries of Build well Ltd. submitted to Central Finance its Summarized Statement of Profit and Loss and Balance Sheet.

Summarized Statement of Profit and Loss for the year ended 31st March, 20X3

Particulars	Amount (₹)
Net sales	2,52,00,000



Less: Cash cost of sales	(1,92,00,000)
Depreciation	(6,00,000)
Salaries & wages	(24,00,000)
Operating expenses	(14,00,000)
Provision for taxation	(8,80,000)
Net Operating Profit	7,20,000
Non-recurring income – profit on sale of equipment	1,20,000
	8,40,000
Retained earnings and profit brought forward	15,18,000
	23,58,000
Dividends declared and paid during the year	(7,20,000)
Profit & loss balance as on 31st March, 20X3	16,38,000

Summarized Balance Sheet

Assets	31st March, 20X2	31st March, 20X3
Property, Plant and Equipment:		
Land	4,80,000	9,60,000
Buildings and Equipment	36,00,000	57,60,000
Current Assets		
Cash	6,00,000	7,20,000
Inventories	16,80,000	18,60,000
Trade Receivables	26,40,000	9,60,000
Advances	78,000	90,000
Total Assets	90,78,000	1,03,50,000

Liabilities & Equity		
Share capital	36,00,000	44,40,000
Surplus in profit & loss	15,18,000	16,38,000
Trade Payables	24,00,000	23,40,000
Outstanding expenses	2,40,000	4,80,000
Income tax payable	1,20,000	1,32,000
Accumulated depreciation on buildings and equipment	12,00,000	13,20,000
Total	90,78,000	1,03,50,000

The original cost of equipment sold during the year 20X2-20X3 was ₹ 7,20,000. Prepare a statement of cash flows the year ended 31st March 20X3. (RTP Nov '23)

Answer 8

Statement of Cash Flows for the year ended 31st March, 20X3 (Indirect method)

Particulars	₹	₹
Cash flow from operating activities:		
Net Profit before taxes and extraordinary items (7,20,000 + 8,80,000)	16,00,000	



Add: Depreciation	<u>6,00,000</u>	
Operating profit before working capital changes	22,00,000	
Increase in inventories	(1,80,000)	
Decrease in trade receivables	16,80,000	
Advances	(12,000)	
Decrease in trade payables	(60,000)	
Increase in outstanding expenses	<u>2,40,000</u>	
Cash generated from operations	38,68,000	
Less: Income tax paid (Refer W.N.4)	<u>(8,68,000)</u>	
Net cash from operations		30,00,000
Cash from investing activities:		
Purchase of land	(4,80,000)	
Purchase of building & equipment (Refer W.N.2)	(28,80,000)	
Sale of equipment (Refer W.N.3)	<u>3,60,000</u>	
Net cash used for investment activities		(30,00,000)
Cash flows from financing activities:		
Issue of share capital	8,40,000	
Dividends paid	<u>(7,20,000)</u>	
Net cash from financing activities:		<u>1,20,000</u>
Net increase in cash and cash equivalents		1,20,000
Cash and cash equivalents at the beginning		<u>6,00,000</u>
Cash and cash equivalents at the end		<u>7,20,000</u>

Working Notes:

1. Building & Equipment Account

Particulars	₹	Particulars	₹
To Balance b/d	36,00,000	By Sale of assets	7,20,000
To Cash / bank (purchases)(bal. fig)	28,80,000	By Balance c/d	57,60,000
	<u>64,80,000</u>		<u>64,80,000</u>

2. Building & Equipment Accumulated Depreciation Account

Particulars	₹	Particulars	₹
To Sale of asset (acc. depreciation)	4,80,000	By Balance b/d	12,00,000
To Balance c/d	13,20,000	By Profit & Loss A/c (provisional)	<u>6,00,000</u>
	<u>18,00,000</u>		<u>18,00,000</u>



3. Computation of sale price of Equipment

Particulars	₹
Original cost	7,20,000
Less: Accumulated Depreciation	<u>(4,80,000)</u>
Net cost	2,40,000
Profit on sale of assets	<u>1,20,000</u>
Sale proceeds from sale of assets	<u>3,60,000</u>

4. Provision for tax Account

Particulars	₹	Particulars	₹
To Bank A/c	8,68,000	By Balance b/d	1,20,000
To Balance c/d	1,32,000	By Profit & Loss A/c (provisional)	8,80,000
	<u>10,00,000</u>		<u>10,00,000</u>

Question 9

Z Ltd. (India) has an overseas branch in USA. It has a bank account having balance of USD 7,000 as on 1st April 2019. During the financial year 2019-2020, Z Ltd. acquired computers for its USA office for USD 280 which was paid on same date. There is no other transaction reported in USA or India.

Exchange rates between INR and USD during the financial year 2019-2020 were:

Date	USD 1 to INR
1 st April 2019	70.00
30 th November 2019	71.00 (Date of purchase of computer)
31 st March 2020	71.50
Average for 2019-2020	70.50

Please prepare the extract of Cash Flow Statement for the year ended 31st March 2020 as per the relevant Ind AS and also show the foreign exchange profitability from these transactions for the financial year 2019-2020? (PYP 5 Marks, Jan'21)

Answer 9

In the books of Z Ltd.

Statement of Cash Flows for the year ended 31st March 2020

	₹	₹
<u>Cash flows from operating activities</u>		
Net Profit (Refer Working Note)	10,360	
Adjustments for non-cash items:		
Foreign Exchange Gain	<u>(10,360)</u>	
Net cash outflow from operating activities		0
<u>Cash flows from investing activities</u>		
Acquisition of Property, Plant and Equipment	<u>(19,880)</u>	
Net cash outflow from Investing activities		(19,880)
<u>Cash flows from financing activities</u>		<u>0</u>
Net change in cash and cash equivalents		(19,880)
Cash and cash equivalents at the beginning of the year i.e.		4,90,000



1 st April 2019		
Foreign Exchange difference		<u>10,360</u>
Cash and cash equivalents at the end of the year i.e.		
31 st March 2020		<u>4,80,480</u>

Working Note:

Computation of Foreign Exchange Gain

Bank Account USD	Date	USD	Exchange Rate	₹
Opening balance	1.4.2019	7,000	70.00	4,90,000
Less: Purchase of Computer	30.11.2019	<u>280</u>	71.00	<u>19,880</u>
Closing balance calculated		6,720		4,70,120
Closing balance (at year end spot rate)	31.3.2020	6,720	71.50	<u>4,80,480</u>
Foreign Exchange Gain credited to				
Profit and Loss account				<u>10,360</u>

Question 10

In the year 2020-2021, one land was sold for ₹ 5 crore and another land purchased for ₹ 3 crore by XYZ Limited. Company reported Cash Flow on a Net Basis in Cash Flow Statement i.e. ₹ 2 crore in Investing Activity as Cash receipt from Sale of Land. Advise whether treatment given as above is correct or not as per the provisions of Ind AS 7. Also, calculate the cash from operations by indirect method from the following information: (PYP 6 Marks Dec '21)

Operating Statement of XYZ Limited for the year ended 31st March, 2021

Particulars	₹
Sales	20,00,000
Less: Cost of goods sold	(14,00,000)
Administration & selling overheads	(2,20,000)
Depreciation	(28,000)
Interest paid	(12,000)
Loss on sale of asset	(8,000)
Profit before tax	3,32,000
Less: Tax	(1,20,000)
Profit after tax	2,12,000

Balance Sheet as on 31st March

	2021 (₹)	2020 (₹)
Assets		
Non-current assets		
Property, plant and equipment	3,00,000	2,60,000
Investment	48,000	40,000
Current assets		
Inventories	48,000	52,000
Trade receivables	40,000	28,000
Cash and cash equivalents	24,000	20,000
Total	4,60,000	4,00,000
Equity and liabilities		
Shareholders' funds	2,40,000	2,00,000



Non-current Liabilities	1,32,000	1,40,000
Current liabilities		
Trade payables	48,000	32,000
Expenses payables	40,000	28,000
Total	4,60,000	4,00,000

Answer 10

(i) Correct treatment of cash flow:

If nothing is specifically mentioned, then as per Ind AS 7, the cash flows will be presented on gross basis. Gross basis means the receipts would be shown separately and the payments will be shown separately. Accordingly, in the year 2020-2021, while presenting the information, entity will show separately cash outflow from investing activity of ₹ 3 crore for purchase of land and cash inflow from investing activity of ₹ 5 crore from sale of land.

(ii) Cash flow from Operations by Indirect Method

	₹
Profit After Tax	2,12,000
Add back / (Less): Depreciation	28,000
Interest paid	12,000
Loss on sale of an asset	8,000
Adjustments for changes in inventory and operating receivables and payables	2,60,000
Decrease in inventory	4,000
Increase in trade receivables	(12,000)
Increase in trade payables	16,000
Increase in expenses payables	12,000
Net cash generated from operating activity	2,80,000

Question 11

Z Ltd. has no foreign currency cash flow for the year 20X1. It holds some deposit in a bank in the USA. The balances as on 31.12.20X1 and 31.12.20X2 were US\$ 100,000 and US\$ 102,000 respectively. The exchange rate on December 31, 20X1 was US\$1 = ₹ 45. The same on 31.12.20X2 was US\$1 = ₹ 50. The increase in the balance was on account of interest credited on 31.12.20X2. Thus, the deposit was reported at ₹ 45,00,000 in the balance sheet as on December 31, 20X1. It was reported at ₹ 51,00,000 in the balance sheet as on 31.12.20X2. How these transactions should be presented in cash flow for the year ended 31.12.20X2 as per Ind AS 7? (RTP May'19, Old & New SM)

Answer 11

The profit and loss account was credited by ₹ 1,00,000 (US \$ 2000 × ₹ 50) towards interest income. It was credited by the exchange difference of US\$ 100,000 × (₹ 50 - ₹ 45) that is, ₹ 500,000. In preparing the cash flow statement, ₹ 500,000, the exchange difference, should be deducted from the 'net profit before taxes'. However, in order to reconcile the opening balance of the cash and cash equivalents with its closing balance, the exchange difference ₹ 500,000, should be added to the opening balance in note to cash flow statement. Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

Question 12

Company A acquires 70% of the equity stake in Company B on July 20, 20X1. The consideration paid for this transaction is as below:

(a) Cash consideration of ₹ 15,00,000

(b) 200,000 equity shares having face of ₹ 10 and fair value of ₹ 15 per share.



On the date of acquisition, Company B has cash and cash equivalent balance of ₹ 2,50,000 in its books of account.

On October 10, 20X2, Company A further acquires 10% stake in Company B for cash consideration of ₹ 8,00,000.

Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7. (RTP May'18, Old & New SM)

Answer 12

As per para 39 of Ind AS 7, the aggregate cash flows arising from obtaining control of subsidiary shall be presented separately and classified as investing activities.

As per para 42 of Ind AS 7, the aggregate amount of the cash paid or received as consideration for obtaining subsidiaries is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

Further, investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

As per para 42A of Ind AS 7, cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity, as defined in Ind AS 110, and is required to be measured at fair value through profit or loss. Such transactions are accounted for as equity transactions and accordingly, the resulting cash flows are classified in the same way as other transactions with owners.

Considering the above, for the financial year ended March 31, 20X2 total consideration of

₹15,00,000 less ₹250,000 will be shown under investing activities as "Acquisition of the subsidiary (net of cash acquired)".

There will not be any impact of issuance of equity shares as consideration in the cash flow statement however a proper disclosure shall be given elsewhere in the financial statements in a way that provides all the relevant information about the issuance of equity shares for non - cash consideration.

Further, in the statement of cash flows for the year ended March 31, 20X3, cash consideration paid for the acquisition of additional 10% stake in Company B will be shown under financing activities.



Chapter 4.1

Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors

Question 1

In years During the year ended 31st March,20X2, Blue Ocean group changed its accounting policy for depreciating property, plant and equipment, so as to apply components approach fully, whilst at the same time adopting the revaluation model.

before 20X1-20X2, Blue Ocean group's asset records were not sufficiently detailed to apply a components approach fully. At the end of 31st March, 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X1-20X2.

The results are shown as under:

Property, plant and equipment at the end of 31st March,20X1

	Rs.
Cost	25,000
Depreciation	(14,000)
Net book value	11,000
Depreciation expense for 20X1-20X2 (on old basis)	1,500
Some results of the engineering survey:	
Valuation	17,000
Estimated residual value	3,000
Average remaining asset life (years)	7

However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.

The board of directors considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X1-20X2.

Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Blue Ocean group's new policy prospectively from the start of 20X1-20X2. Blue Ocean group's tax rate is 30 per cent. Compute the impact of change in accounting policy related to change in carrying amount of Property, Plant & Equipment under revaluation method and impact on taxes based on the basis of information provided. Show the impact of each item affected on financial statements by the analysis of stated issue. (MTP 6 Marks May '20)

Answer 1

As per Ind AS 8 'Accounting Policies, Accounting Estimates and Errors, prospective application of a change in accounting policy has to be done since retrospective application is not practicable.

Property, plant and equipment at the end of 31st March,20X2:

	Rs.
As per the engineering survey:	
Valuation of PPE	17,000
Estimated residual value	3,000
Average remaining asset life (years)	7
Depreciation expense on existing property, plant and equipment for 20X1-20X2 (new basis)(17,000 – 3,000)/7	2,000



From the start of 20X1-20X2, Blue Ocean group changed its accounting policy for depreciating property, plant and equipment, so as to apply components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of the year 20X1-20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively or prospectively from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years.

The impact on the financial statements for 20X1-20X2 would be as under:

Particulars	Rs.
Increase the carrying amount of property, plant and equipment at the start of the year (17,000-11,000)	6,000
Increase the opening deferred tax provision (6,000 x 30%)	1,800
Create a revaluation surplus at the start of the year (6,000 – 1,800)	4,200
Increase depreciation expense by (Rs.2,000 – Rs.1,500)	500
Reduce tax expense on depreciation (30%)	150

Question 2

An entity charged off certain expenses as finance costs in its financial statements for the year ended 31st March 20X1. While preparing annual financial statements for the year ended 31st March 20X2, management discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March 20X1). Would this reclassification of expenses from finance costs to other expenses in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet? (MTP 5 Marks April '21, Old & New SM)

Answer 2

Paragraph 41 of Ind AS 8 states as follows: "Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period."

In accordance with the above, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 20X2, the comparative amounts for the year ended 31st March 20X1 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1st April 20X0). Therefore, the entity is not required to present a third balance sheet.

Question 3

WLL Ltd. was incorporated on 1st April, 20X1 and follows Ind AS in preparing its financial statements. In preparing its financial statements for financial year ending 31st March, 20X4, WLL Ltd. used these



useful lives for its property, plant, and equipment:

Buildings :	15 years
Plant and machinery :	10 years
Furniture and fixtures :	7 years

On 1st April, 20X4, the entity decides to review the useful lives of the property, plant, and equipment. For this purpose, it hired external valuation experts. These independent experts certified the remaining useful lives of the property, plant, and equipment of WLL Ltd. on 1st April, 20X4 as

Buildings :	10 years
Plant and machinery :	7 years
Furniture and fixtures :	5 years

WLL Ltd. uses the straight-line method of depreciation. The original cost of the various components of property, plant, and equipment were

Buildings :	₹1,50,00,000
Plant and machinery :	₹ 1,00,00,000
Furniture and fixtures :	₹ 35,00,000

Compute the impact on the statement of profit and loss for the year ending 31st March, 20X5, if WLL Ltd. decides to change the useful lives of the property, plant, and equipment in compliance with the recommendations of external valuation experts. Assume that there were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised. (MTP 7 Marks Oct 21)

Answer 3

1. The annual depreciation charges prior to the change in estimate were:

Buildings:	$\text{₹ } 1,50,00,000 / 15 = \text{₹ } 10,00,000$
Plant and machinery:	$\text{₹ } 1,00,00,000 / 10 = \text{₹ } 10,00,000$
Furniture and fixtures:	$\text{₹ } 35,00,000 / 7 = \text{₹ } 5,00,000$
Total =	₹ 25,00,000 (A)

2. The revised annual depreciation for the year ending 31st December, 20X4, would be

Buildings :	$[\text{₹ } 1,50,00,000 - (\text{₹ } 10,00,000 \times 3)]/10 = \text{₹ } 12,00,000$
Plant and machinery :	$[\text{₹ } 1,00,00,000 - (\text{₹ } 10,00,000 \times 3)]/7 = \text{₹ } 10,00,000$
Furniture and fixtures :	$[\text{₹ } 35,00,000 - (\text{₹ } 5,00,000 \times 3)]/5 = \text{₹ } 4,00,000$
Total =	₹ 26,00,000 (B)

3. The impact on Statement of profit and loss for the year ending 31st March, 20X5

$$\begin{aligned} &= (B) - (A) \\ &= \text{₹ } 26,00,000 - \text{₹ } 25,00,000 \\ &= \text{₹ } 1,00,000 \end{aligned}$$

Change in the useful lives of the various items of property, plant and equipment is a change in accounting estimate. Change in accounting estimate is to be adjusted prospectively in the period in which the estimate is amended and, if relevant, to future periods if they are also affected.

Question 4

Given the decreased revenue in financial year 20X1-20X2, management of PQR Ltd is keen to identify ways to reduce the overall impact on profit and loss. A consultant has suggested that they could



explore changing the basis of depreciation from SLM to hours-in-use but not entirely sure if this is permitted. Annual depreciation charge for financial year 20X1-20X2 would be ₹ 25 lacs using SLM and ₹ 7 lacs using new method. This difference is significant for PQR Ltd.'s financial statements. What are the considerations in determining whether a change in depreciation methodology is appropriate, and how should this change be accounted for? Given the risk of charging lower depreciation per annum and the possibility that the asset will be depreciated over a period longer than it would otherwise be (under SLM basis), what other safeguards do you suggest, in order to ensure compliance with relevant standards in Ind AS and its framework? (MTP 6 Marks Nov 21)

Answer 4

As illustrated in per para 32 of Ind AS 8, Change in method of depreciation is a change in accounting estimates. Considerations in determining whether the change in depreciation methodology is appropriate:

Paragraphs 60 and 61 of Ind AS 16, Property, Plant and Equipment, state that the depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern.

Accounting procedure:

Such a change is accounted for as a change in an accounting estimate in accordance with Ind AS 8. Depreciation is a function of several factors, with extent of usage and efflux of time being its primary determinants. The hours-in-use method relates the amount of periodic depreciation charge only to one of the above two factors, namely, the extent of usage as reflected by the number of hours. This method may therefore be said to be appropriate as per para 62 of Ind AS 16. Determination of depreciation method involves an accounting estimate; depreciation method is not a matter of an accounting policy. Accordingly, as per Ind AS 8 and Ind AS 16, a change in depreciation method shall be accounted for as a change in accounting estimate, i.e; prospectively. However, given the possibility that the asset will be depreciated over a period longer than it would be under SLM basis, the company will need to assess if there are any impairment triggers and carry out impairment testing as required under Ind AS 36.

Question 5

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

Cheery Limited's accounting records for 20X4-20X5 show sales of ₹ 1,04,000, cost of goods sold of ₹ 86,500 (including ₹ 6,500 for the error in opening inventory), and income taxes of ₹ 5,250.

In 20X3-20X4, Cheery Limited reported:

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

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

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

State how the above will be treated /accounted in Cheery Limited's Statement of Profit and Loss, Statement of Changes in Equity and in Notes wherever required for current period and earlier period(s) as per relevant Ind AS. (MTP 12 Marks Oct'22, RTP Nov'19, Old & New SM)



Answer 5

Cheery Limited Extract from the Statement of Profit and Loss

	(Restated)	
	20X4-20X5	20X3-20X4
	₹	₹
Sales	1,04,000	73,500
Cost of goods sold	(80,000)	(60,000)
Profit before income taxes	24,000	13,500
Income tax @ 30%	(7,200)	(4,050)
Profit	16,800	9,450
Basic and diluted EPS	3.36	1.89

Cheery Limited Statement of Changes in Equity

	Share capital	Retained earnings	Total
Balance at 31st March, 20X3	50,000	20,000	70,000
Profit for the year ended 31st March, 20X4 as restated		9,450	9,450
Balance at 31st March, 20X4	50,000	29,450	79,450
Profit for the year ended 31st March, 20X5		16,800	16,800
Balance at 31st March, 20X5	50,000	46,250	96,250

Extract from the Notes

Some products that had been sold in 20X3-20X4 were incorrectly included in inventory at 31st March, 20X4 at ₹ 6,500. The financial statements of 20X3-20X4 have been restated to correct this error. The effect of the restatement on those financial statements is summarized below:

	Effect on 20X3-20X4
(Increase) in cost of goods sold	(6,500)
Decrease in income tax expenses (6,000 – 4,050)	1,950
(Decrease) in profit (14,000 – 9,450)	(4,550)
(Decrease) in basic and diluted EPS (2.8 – 1.89)	(0.91)
(Decrease) in inventory	(6,500)
Decrease in income tax payable	1,950
(Decrease) in equity	(4,550)

There is no effect on the balance sheet at the beginning of the preceding period i.e. 1st April, 20X3.

Question 6

ABC Ltd. changed its method adopted for inventory valuation in the year 2018-2019. Prior to the change, inventory was valued using the first in first out method (FIFO). However, it was felt that in order to match current practice and to make the financial statements more relevant and reliable, a weighted average valuation model would be more appropriate.

The effect of the change in the method of valuation of inventory was as follows:

- 31st March, 2017 - Increase of Rs. 10 million
- 31st March, 2018 - Increase of Rs. 15 million
- 31st March, 2019 - Increase of Rs. 20 million

Profit or loss under the FIFO valuation model are as follows:

	2018-2019	2017-2018
Revenue	324	296



Cost of goods sold	<u>(173)</u>	<u>(164)</u>
Gross profit	151	132
Expenses	<u>(83)</u>	<u>(74)</u>
Profit	<u>68</u>	<u>58</u>

Retained earnings at 31st March, 2017 were Rs. 423 million Present the change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8. (RTP May'19, MTP 4 Marks Oct'18, Old & New SM)

Answer 6

Profit or loss under weighted average valuation method is as follows:

	2018-2019	2017-2018 (Restated)
Revenue	324	296
Cost of goods sold	<u>(168)</u>	<u>(159)</u>
Gross profit	156	137
Expenses	<u>(83)</u>	<u>(74)</u>
Profit	<u>73</u>	<u>63</u>

Statement of changes in Equity (extract)

	Retained earnings	Retained earnings (Original)
At 1 st April, 2017	423	423
Change in inventory valuation policy	<u>10</u>	-
At 1st April, 2017 (Restated)	433	-
Profit for the year 2017-2018	<u>63</u>	<u>58</u>
At 31st March, 2018	496	481
Profit for the 2018-2019	<u>73</u>	<u>68</u>
At 31st March, 2019	<u>569</u>	<u>549</u>

Question 7

While preparing the financial statements for the year ended 31st March, 20X3, Alpha Limited has observed two issues in the previous year Ind AS financial statements (i.e. 31st March, 20X2) which are as follows:

Issue 1:

The company had presented certain material liabilities as non-current in its financial statements for periods as on 31st March, 20X2. While preparing annual financial statements for the year ended 31st March, 20X3, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 20X2).

Issue 2:

The company had charged off certain expenses as finance costs in the year ended 31st March, 20X2. While preparing annual financial statements for the year ended 31st March, 20X3, it was discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 20X2).

What is your analysis and recommendation in respect of the issues noted with the previously presented set of financial statements for the year ended 31st March, 20X2? (RTP May '20)

**Answer 7**

As per paragraph 41 of Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

Accordingly, the stated issues in question are to be dealt as under:

Issue 1

In accordance with para 41, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended March 31, 20X3, the comparative amounts as at 31 March 20X2 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period. Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1 April 20X1 in addition to the comparatives for the financial year 20X1-20X2.

Issue 2

In accordance with para 41, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31 March, 20X3, the comparative amounts for the year ended 31 March 20X2 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1 April 20X1). Therefore, the entity is not required to present a third balance sheet.

Question 8

In 20X3-20X4, after the entity's 31 March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred Rs.100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 March 20X3. An additional Rs.20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, Rs.5,000 of which relates to items of inventory at 31 March 20X3. The defective inventory was reported at cost Rs. 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at Rs.18,000. The accounting estimates made in preparing the 31 March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Analyse the above situation in accordance with relevant Ind AS. (RTP May '21, May'23, Old & New SM)

Answer 8

Ind AS 8 is applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.



A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset. This change in accounting estimate is an outcome of the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Further, the effect of change in an accounting estimate, shall be recognized prospectively by including it in profit or loss in: (a) the period of the change, if the change affects that period only; or (b) the period of the change and future periods, if the change affects both.

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

- (a) was available when financial statements for those periods were approved for issue; and
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud. On the basis of above provisions, the given situation would be dealt as follows:

The defect was neither known nor reasonably possible to detect at 31 March 20X3 or before the financial statements were approved for issue, so understatement of the warranty provision Rs. 1,00,000 and overstatement of inventory Rs. 2,000 (Note 1) in the 31 March 20X3 financial statements are not a prior period errors.

The effects of the latent defect that relate to the entity's financial position at 31 March 20X3 are changes in accounting estimates.

In preparing its financial statements for 31 March 20X3, the entity made the warranty provision and inventory valuation appropriately using all reliable information that the entity could reasonably be expected to have obtained and had taken into account the same in the preparation and presentation of those financial statements.

Consequently, the additional costs are expensed in calculating profit or loss for 20X3-20X4.

Working Note:

Inventory is measured at the lower of cost (ie Rs. 15,000) and fair value less costs to complete and sell (i.e. Rs. 18,000 originally estimated minus Rs. 5,000 costs to rectify latent defect) = Rs. 13,000.

Question 9

In its financial statements for the year ended 31st March, 20X2, Y Ltd. reported ₹ 73,500 revenue (sales), ₹ 53,500 cost of sales, ₹ 6,000 income tax expense, ₹ 20,000 retained earnings at 1st April, 20X1 and ₹ 34,000 retained earnings at 31st March, 20X2.

In 20X2-20X3, after the 20X1-20X2 financial statements were approved for issue, Y Ltd. discovered that some products sold in 20X1-20X2 were incorrectly included in inventories at 31st March, 20X2 at their cost of ₹ 6,500.

In 20X2-20X3, Y Ltd. changed its accounting policy for the measurement of investments in associates after initial recognition from cost model to the fair value model as per Ind AS 109. It acquired its only investment in an associate for ₹ 3,000 many years ago. The associate's equity is not traded on a securities exchange (that is, a published price quotation is not available). The fair value of the investment was determined reliably using an appropriate equity valuation model on 31 st March, 20X3 at ₹ 25,000 (20X1-20X2: ₹ 20,000 and 20X0-20X1: ₹ 18,000).

At 31st March, 20X3, as a result of usage of improved lubricants, Y Ltd. reassessed the useful life of Machine A from four years to seven years. Machine A is depreciated on the straight-line method to a Nil residual value. It was acquired for ₹ 6,000 on 1st April, 20X0.

Inventories of the type manufactured by Machine A were immaterial at the end of each reporting period.

Y Ltd.'s accounting records for the year ended 31st March, 20X3, before accounting for change in accounting policy and change in accounting estimate, record ₹ 1,04,000 revenue (sales), ₹ 86,500 cost of sales (including ₹ 6,500 for the error in opening inventory and ₹ 1,500 depreciation for Machine A) and ₹ 5,250 income tax expense.

Y Ltd. presents financial statements with one year of comparative information.

For simplicity, the tax effect of all items of income and expenses should be assumed to be 30% of the gross amount.

Draft an extract showing how the correction of the prior period error, change in accounting policy and change in accounting estimate could be presented in the Statement of Profit and Loss and Statement of Changes in Equity (Retained Earnings) and disclosed in the Notes of Y Ltd. for the year ended 31st March, 20X3. (RTP Nov '23)

Answer 9

**Extract of Y Ltd.'s Statement of Profit and
Loss for the year ended 31st March, 20X3**

	20X2-20X3	Reference to W.N.	20X1- 20X2 Restated	Reference to W.N.
	₹		₹	
Revenue	1,04,000		73,500	
Cost of sales (20X1-20X2 previously ₹ 53,500)	<u>(79,100)</u>	1	<u>(60,000)</u>	4
Gross profit	24,900		13,500	
Other income — change in the measurement policy i.e. the value of investment in associate at FVTPL	<u>5,000</u>	2	<u>2,000</u>	5
Profit before tax	29,900		15,500	
Income tax expense	<u>(8,970)</u>	3	<u>(4,650)</u>	6
Profit for the year	<u>20,930</u>		<u>10,850</u>	

**Extract of Y Ltd.'s Statement of Changes in Equity (Retained Earnings)
for the year ended 31st March, 20X3**

	20X2-20X3	Reference to W.N.	20X1-20X2 Restated	Reference to W.N.
	₹		₹	
Retained earnings, as restated, at the beginning of the year				
- as previously stated	34,000		20,000	



- effect of the correction of a prior period error	(4,550)	7	-	
- effect of a change in accounting policy	<u>11,900</u>	13	<u>10,500</u>	12
	41,350		30,500	
Profit for the year	<u>20,930</u>		<u>10,850</u>	
Retained earnings at the end of the year	<u>62,280</u>		<u>41,350</u>	

Y Ltd.

Extract of Notes to the Financial Statements for the year ended 31st March, 20X3 Note X : Change in Accounting Estimates

Due to usage of improved lubricants the estimated useful life of the machine used for production was increased from four years to seven years. The effect of the change in the useful life of the machine is to reduce the depreciation allocation by ₹ 900 in 20X2-20X3 and 20X3-20X4. The after-tax effect is an increase in profit for the year of ₹ 630 for each of the two years.

Depreciation expense in 20X4-20X5 to 20X6-20X7 is increased by ₹ 600 because of revision in the useful life of machinery, as under the initial estimate, the asset would have been fully depreciated at the end of 20X3-20X4. The after-tax effect for these three years is a decrease in profit for the year by ₹ 420 per year.

Note Y : Correction of Prior Period Error

In 20X2-20X3 the entity identified that ₹ 6,500 products that had been sold in 20X1-20X2 were included erroneously in inventory at 31st March, 20X2. The financial statements of 20X1-20X2 have been restated to correct this error. The effect of the restatement is ₹ 6,500 increase in the cost of sales and ₹ 4,550 decrease in profit for the year ended 31st March, 20X2 after decreasing income tax expense by ₹ 1,950. This resulted in ₹ 4,550 (decrease) restatement of retained earnings at 31st March, 20X2.

Note Z : Change in Accounting Policy

In 20X2-20X3 the entity changed its accounting policy for the measurement of investments in associates from cost model to fair value model as per Ind AS 109. Management judged that this policy provides reliable and more relevant information because dividend income and changes in fair value are inextricably linked as integral components of the financial performance of an investment in an associate and measurement at fair value is necessary if that financial performance is to be reported in a more meaningful way. This change in accounting policy has been accounted for retrospectively. The comparative information has been restated. A new line item, 'Other income — change in the fair value of investment in associate', has been added in the Statement of Profit and Loss and Retained Earnings. The effect of the restatement has been to add income of ₹ 2,000 as a result of the increase in value of the associate during the year ended 31st March, 20X2 which resulted in ₹ 1,400 increase in profit for the year (after including a resulting increase in income tax expense of ₹ 600). This, together with ₹ 10,500 (increase) restatement of retained earnings at 31st March, 20X1, resulted in a ₹ 11,900 increase in retained earnings at 31st March, 20X2. Furthermore, profit for the year ended 31st March, 20X3 was ₹ 3,500 higher (after deducting ₹ 1,500 tax effect) as a result of recording a further ₹ 5,000 (W.N.2) increase in the fair value of the investment in an associate.

Working Notes:

1. ₹ 86,500 (given) minus ₹ 6,500 correction of error (now recognised as an expense in 20X1-20X2) minus ₹ 900 (W.N.9) effect of the change in accounting estimate.



2. ₹ 25,000 fair value (20X2-20X3) minus ₹ 20,000 fair value (20X1-20X2) = ₹ 5,000 (the effect of applying the new accounting policy (fair value model) in 20X2-20X3).
3. ₹ 5,250 + ₹ 1,950 (W.N.8) + 30% (₹ 900 (W.N.9) reduction in depreciation resulting from the change in accounting estimate) + 30% (₹ 5,000 increase in the fair value of investment property — change in accounting policy) = ₹ 8,970.
4. ₹ 53,500 as previously stated + ₹ 6,500 (products sold and incorrectly included in closing inventory in 20X1-20X2) = ₹ 60,000 (that is, the prior period error is corrected retrospectively by restating the comparative amounts).
5. ₹ 20,000 fair value (20X1-20X2) minus ₹ 18,000 fair value (20X0-20X1) = ₹ 2,000 (the effect in 20X1-20X2 of the change in accounting policy for investments in associates from the cost model to the fair value model).
6. ₹ 6,000 as previously stated minus ₹ 1,950 (W.N.8) correction of prior period error + 30% (₹ 2,000 change in accounting policy) = ₹ 4,650.
7. ₹ 6,500 (products sold and incorrectly included in inventory in 20X1 -20X2) – ₹ 1,950 (W.N.8) (tax overstated in 20X1-20X2) = ₹ 4,550.
8. ₹ 6,500 (products sold and incorrectly included in inventory in 20X1 -20X2) x 30% (income tax rate) = ₹1,950.
9. ₹ 1,500 depreciation (using old estimate, that is, ₹ 6,000 cost ÷ 4 years) minus ₹ 600 (W.N.10) (using new estimate of useful life) = ₹ 900.
10. ₹ 3,000 (W.N.11) carrying amount ÷ 5 years remaining useful life = ₹ 600 depreciation per year.
11. [₹ 6,000 cost minus (₹ 1,500 depreciation x 2 years)] = ₹ 3,000 carrying amount at 31st March, 20X2.
12. (₹ 18,000 fair value of investment in associates at 31 st March, 20X1 minus ₹ 3,000 carrying amount based on the cost model at the same date) x 0.7 (to reflect 30% income tax rate) = ₹ 10,500 (effect of a change in accounting policy (from cost model to fair value model)).
13. ₹ 10,500 (W.N.12) + [₹ 2,000 (W.N.5) x 0.7 (to reflect 30% income tax rate)] = ₹ 11,900.

Question 10

Orange Ltd. is going to prepare its annual financial statements for the year ending 31st March, 2022, in the process it discovered that a provision for constructive obligation for payment of bonus to selected employees in the corporate office (material in amount) which was required to be recognized in the annual financial statements for the year ended 31st March, 2020 was not recognized due to oversight of facts. The bonus was paid during the financial year ended 31st March, 2021 and was recognized as an expense in the annual financial statements for the said year.

As a finance manager of the company, you are required to analyse whether the situation relating to constructive obligation for payment of bonus is an error requiring retrospective restatement of comparatives considering that the amount is material. (PYP 5 Marks Nov 22, Old & New SM)

Answer 10

As per paragraph 41 of Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

As per paragraph 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 if, inter alia, it makes a



retrospective restatement of items in its financial statements and the retrospective restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, expenses for the year ended 31st March, 2020 and liabilities as at 31st March, 2020 were understated because of non-recognition of bonus expense and related provision. Expenses for the year ended 31 st March, 2021, on the other hand, were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for the year ended 31st March, 2022, the entity should:

- (a) restate the comparative amounts (i.e., those for the year ended 31 st March, 2021) in the statement of profit and loss; and
- (b) present a third balance sheet as at the beginning of the preceding period (i.e., as at 1st April, 2020) wherein it should recognise the provision for bonus and restate the retained earnings.

Question 11

While preparing interim financial statements for the half-year ended 30th September, 20X1, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30th June, 20X1. The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management's view is acceptable? (RTP Nov'22 Old & New SM)

Answer 11

Paragraph 41 of Ind AS 8, inter alia, states that financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

As regards the assessment of materiality of an item in preparing interim financial statements, paragraph 25 of Ind AS 34, Interim Financial Statements, states as follows:

"While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period."

As per the above, while materiality judgements always involve a degree of subjectivity, the overriding goal is to ensure that an interim financial report includes all the information that is relevant to an understanding of the financial position and performance of the entity during the interim period. It is therefore not appropriate to base quantitative assessments of materiality on projected annual figures when evaluating errors in interim financial statements.

Accordingly, the management is required to correct the error in the interim financial statements since it is assessed to be material in relation to interim period data.

Question 12 (Illustration)

Entity ABC acquired a building for its administrative purposes and presented the same as property, plant and equipment (PPE) in the financial year 20X1-20X2. During the financial year 20X2-20X3, it relocated the office to a new building and leased the said building to a third party. Following the change in the usage of the building, Entity ABC reclassified it from PPE to investment property in the financial year 20X2-20X3. Should Entity ABC account for the change as a change in accounting policy? (PYP 5 Marks Dec'21, Old & New SM)

Answer 12

Paragraph 16(a) of Ind AS 8 provides that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

As per Ind AS 16, 'property, plant and equipment' are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period."

As per Ind AS 40, 'investment property' is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:

- (a) use in the production or supply of goods or services or for administrative purposes; or
- (b) sale in the ordinary course of business."

As per the above definitions, whether a building is an item of property, plant and equipment (PPE) or an investment property for an entity depends on the purpose for which it is held by the entity. It is thus possible that due to a change in the purpose for which it is held, a building that was previously classified as an item of property, plant and equipment may warrant reclassification as an investment property, or vice versa. Whether a building is in the nature of PPE or investment property is determined by applying the definitions of these terms from the perspective of that entity. Thus, the classification of a building as an item of property, plant and equipment or as an investment property is not a matter of an accounting policy choice.

Accordingly, a change in classification of a building from property, plant and equipment to investment property due to change in the purpose for which it is held by the entity is not a change in an accounting policy.



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Chapter 4.2

Ind AS 10: Events after the Reporting Period

Question 1

Discuss with reasons whether these events are in nature of adjusting or non-adjusting and the treatment needed in light of accounting standard Ind AS 10.

- (i) Moon Ltd. won an arbitration award on 25th April, 20X1 for Rs. 1 crore. From the arbitration proceeding, it was evident that the Company is most likely to win the arbitration award. The directors approved the financial statements for the year ending 31.03.20X1 on 1st May, 20X1. The management did not consider the effect of the above transaction in Financial Year 20X0-20X1, as it was favourable to the Company and the award came after the end of the financial year.
- (ii) Zoom Ltd. has a trading business of Mobile telephones. The Company has purchased 1000 mobiles phones at Rs. 5,000 each on 15th March, 20X1. The manufacturers of phone had announced the release of the new version on 1st March, 20X1 but had not announced the price. Zoom Ltd. has valued inventory at cost of Rs. 5,000 each at the year ending 31st March, 20X1.

Due to arrival of new advance version of Mobile Phone on 8th April, 20X1, the selling prices of the mobile stocks remaining with Company was dropped at Rs. 4,000 each.

The financial statements of the company valued mobile phones @ Rs. 5,000 each and not at the value @ Rs. 4,000 less expenses on sales, as the price reduction in selling price was effected after 31.03.20X1.
- (iii) There as an old due from a debtor amounting to Rs. 15 lakh against whom insolvency proceedings was instituted prior to the financial year ending 31st March, 20X1. The debtor was declared insolvent on 15th April, 20X1.
- (iv) Assume that subsequent to the year end and before the financial statements are approved, Company's management announces that it will restructure the operation of the company. Management plans to make significant redundancies and to close a few divisions of company's business; however, there is no formal plan yet. Should management recognise a provision in the books, if the company decides subsequent to end of the accounting year to restructure its operations? (MTP 8 Marks March '21 & Nov '21 & PYP Nov '19)

Answer 1

As per Ind AS 10, the treatment of stated issues would be as under:

(i) Adjusting event:

It is an adjusting event as it is the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. Even though winning of award is favorable to the company, it should be accounted in its books as receivable since it is an adjusting event.

(ii) Adjusting event:

The sale of inventories after the reporting period may give evidence about their net realizable value at the end of the reporting period, hence it is an adjusting event as per Ind AS 10. Zoom Limited should value its inventory at Rs. 40,00,000. Hence, appropriate provision must be made for Rs. 15 lakh.

(iii) Adjusting event:

As per Ind AS 10, the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognized impairment loss for that asset needs to be adjusted.

The bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period.

**(iv) Non – adjusting event:**

Announcing or commencing the implementation of a major restructuring after reporting period is a non-adjusting event as per Ind AS 10. Though this is a non-adjusting event occurred after the reporting period, yet it would result in disclosure of the event in the financial statements, if restructuring is material.

This would not require provision since as per Ind AS 37, decision to restructure was not taken before or on the reporting date. Hence, it does not give rise to a constructive obligation at the end of the reporting period to create a provision.

Question 2

In the plant of PQR Ltd., there was a fire on 10th May, 20X1 in which the entire plant was damaged and the loss of ₹ 40,00,000 is estimated. The claim with the insurance company has been filed and a recovery of ₹ 27,00,000 is expected. The financial statements for the year ending 31st March, 20X1 were approved by the Board of Directors on 12th June, 20X1. Show how should it be disclosed? (MTP 4 Marks March '22) (RTP Nov'20, Old & New SM)

Answer 2

Events after the reporting period are those events, favorable and unfavorable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue.

Two types of events can be identified:

- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
- (b) those that are indicative of conditions that arose after the reporting period (non adjusting events after the reporting period).

In the instant case, since fire took place after the end of the reporting period, it is a non-adjusting event. However, in accordance with paragraph 21 of Ind AS 10, disclosures regarding material non-adjusting event should be made in the financial statements, i.e., the nature of the event and the expected financial effect of the same.

With regard to going concern basis followed for preparation of financial statements, the company needs to determine whether it is appropriate to prepare the financial statements on going concern basis, if there is only one plant which has been damaged due to fire. If the effect of deterioration in operating results and financial position is so pervasive that management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so, preparation of financial statements for the financial year 20X0- 20X1 on going concern assumption may not be appropriate. In that case, the financial statements may have to be prepared on a basis other than going concern.

However, if the going concern assumption is considered to be appropriate even after the fire, no adjustment is required in the financial statements for the year ending 31st March, 20X1.

Question 3

Mac Ltd. purchased goods on credit from Toy Ltd. for Rs. 580 lakhs for export. The export order was cancelled. Mac Ltd. decided to sell the same goods in the local market with a price discount. Toy Ltd. was requested to offer a price discount of Rs. 10%. Toy Ltd. Wants to adjust the sales figure to the extent of the discount requested by Mac Ltd. Discuss whether such a treatment in the books of Toy Ltd. is justified as per the provisions of the relevant Ind AS. Also, Toy Ltd. entered into a sale deed for its Land on 15 th March, 20X1. But registration was done with the registrar on 20th April, 20X1. But before registration, is it possible to recognize the sale and the gain at the balance sheet date? Give reasons in support of your answer. (RTP May'18)

Answer 3

Toy Ltd. had sold goods to Mac Ltd on credit worth for Rs. 580 lakhs and the sale was completed in all respects. Mac Ltd.'s decision to sell the same in the domestic market at a discount does not affect the amount recorded as sales by Toy Ltd.

The price discount of 10% offered by Toy Ltd. after request of Mac Ltd. was not in the nature of a discount given during the ordinary course of trade because otherwise the same would have been given at the time of sale itself. However, there appears to be an uncertainty relating to the collectability of the debt, which has arisen subsequent to sale. Therefore, it would be appropriate to make a separate provision to reflect the uncertainty relating to collectability rather than to adjust the amount of revenue originally recorded. Hence such discount should be charged to the Statement of Profit and Loss and not shown as deduction from the sales figure.

With respect to sale of land, both sale and gain on sale of land earned by Toy Ltd. shall be recognized in the books at the balance sheet date. In substance, the land was transferred with significant risk & rewards of ownership to the buyer before the balance sheet date and what was pending was merely a formality to register the deed. The registration post the balance sheet date only confirms the condition of sale at the balance sheet date as per Ind AS 10 "Events after the Reporting Period."

Question 4

ABC Ltd. received a demand notice on 15th June, 2017 for an additional amount of Rs. 28,00,000 from the Excise Department on account of higher excise duty levied by the Excise Department compared to the rate at which the company was creating provision and depositing the same. The financial statements for the year 2016 -17 are approved on 10th August, 2017. In July, 2017, the company has appealed against the demand of Rs. 28,00,000 and the company has expected that the demand would be settled at Rs. 15,00,000 only. Show how the above event will have a bearing on the financial statements for the year 2016-17. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly. (RTP Nov'19, Old & New SM)

Answer 4

Ind AS 10 defines 'Events after the Reporting Period' as follows:

Events after the reporting period are those events, favorable and unfavorable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
- (b) those that are indicative of conditions that arose after the reporting period (non- adjusting events after the reporting period)

In the instant case, the demand notice has been received on 15th June, 2017, which is between the end of the reporting period and the date of approval of financial statements. Therefore, it is an event after the reporting period. This demand for additional amount has been raised because of higher rate of excise duty levied by the Excise Department in respect of goods already manufactured during the reporting period. Accordingly, condition exists on 31st March, 2017, as the goods have been manufactured during the reporting period on which additional excise duty has been levied and this event has been confirmed by the receipt of demand notice. Therefore, it is an adjusting event.

In accordance with the principles of Ind AS 37, the company should make a provision in the financial statements for the year 2016-17, at best estimate of the expenditure to be incurred, i.e., Rs. 15,00,000.

Question 5 (also Included Ind AS 36: Impairment of Assets)

H Ltd. constructed a warehouse at a cost of ₹ 10 lakhs in 2015. It first became available for use by H



Ltd. on 1st January 2016. On 29th January 2020, H Ltd. discovered that its warehouse was damaged. During early February 2020, an investigation revealed that the damage was due to a structural fault in the construction of the warehouse. The fault became apparent when the warehouse building leaked severely after heavy rainfall in the week ended 27th January 2020. The discovery of the fault is an indication of impairment. So, H Ltd. was required to estimate the recoverable amount of its warehouse at 31st December 2019. This estimate was ₹ 6,00,000. Furthermore, H Ltd. reassessed the useful life of its warehouse at 20 years from the date that it was ready for use. Before discovering the fault, H Ltd. had depreciated the warehouse on the straight-line method to a nil residual value over its estimated 30-year useful life.

Seepage of rain water through the crack in the warehouse caused damage to inventory worth about ₹ 1,00,000 (cost price) and became un-saleable. The entire damaged inventory was on hand as at 31st December, 2019. H Ltd. has not insured against any of the losses.

It accounts for all its property, plant and equipment under the cost model. H Ltd.'s annual financial statements for the year ended 31st December, 2019 were approved for issue by the Board of Directors on 28th February, 2020.

You are required to :

- (i) Prepare accounting entries to record the effects of the events after the end of the reporting period in the accounting records of H Ltd. for the year ended 31st December, 2019. Kindly ignore tax impact;
- (ii) Discuss disclosure requirement in above case as per relevant Ind AS; and
- (iii) Will your answer be different if there was no structural fault and damage to the warehouse had been caused by an event that occurred after 31st December, 2019? (PYP 8 Marks, Jan' 21)

Answer 5

- (i) **Journal Entries on 31st December 2019**

	₹	₹
Depreciation expense A/c (W.N.1) Dr. To Warehouse or Accumulated depreciation A/c (Being additional depreciation expense recognised for the year ended 31 st December 2019 arising from the reassessment of the useful life of the warehouse)	19,608	19,608
Impairment loss A/c (W.N.2) Dr. To Warehouse or Accumulated depreciation A/c (Being impairment loss recognised due to discovery of structural fault in the construction of warehouse at 31 st December 2019)	2,47,059	2,47,059

- (ii)

- (a) The damage to warehouse is an adjusting event (occurred after the end of the year 2019) for the reporting period 2019, since it provides evidence that the structural fault existed at the end of the reporting period. It is an adjusting event, in spite of the fact that fault has been discovered after the reporting date.

The effects of the damage to the warehouse are recognised in the year 2019 reporting period. Prior periods will not be adjusted because those financial statements were prepared in good faith (eg regarding estimate of useful life, assessment of impairment indicators etc) and had not affected the financials of prior years.

- (b) Damage of inventory due to seepage of rainwater ₹ 1,00,000 occurred during the year 2020. It is a non-adjusting event after the end of the 2019 reporting period since the inventory was in good condition at 31 st December 2019. Hence, no accounting has been done for it in the year 2019.

H Ltd. must disclose the nature of the event (i.e. rain-damage to inventories) and an estimate of the financial effect (i.e. ₹ 1,00,000 loss) in the notes to its 31st December 2019 annual financial statements.

- (iii) If the damage to the warehouse had been caused by an event that occurred after 31st December 2019 and was not due to structural fault, **then it would be considered as a non-adjusting event** after the end of the reporting period 2019 as the warehouse would have been in a good condition at 31st December 2019.

Working Notes:

1. Calculation of additional depreciation to be charged in the year 2019

Original depreciation as per SLM already charged during the year 2019

$$= ₹10,00,000 / 30 \text{ years} = ₹33,333.$$

Carrying value at the end of 2018 = 10,00,000 – (₹33,333 x 3 years) = ₹9,00,000
 Revised depreciation = 9,00,000 / 17 years = ₹52,941

Additional depreciation to be recognized in the books in the year 2019
 = ₹52,941 – ₹33,333 = ₹19,608

2. Calculation of impairment loss in the year 2019

Carrying value after charging depreciation for the year 2019

$$= ₹9,00,000 - ₹52,941 = ₹8,47,059$$

Recoverable value of the warehouse = ₹ 6,00,000
 Impairment loss = Carrying value - Recoverable value

$$= ₹8,47,059 - ₹6,00,000 = ₹2,47,059$$

Question 6

Discuss the following situations as per Ind AS 10:

- i) The financial statements of a Company for the year 2021-2022 are approved by the management and were sent on 5th June, 2022 for review and approval to its supervisory board i.e., Board of Directors. The supervisory board approves the financial statements on 26th June, 2022. The financial statements are then made available to shareholders on 4th July, 2022. The financial statements are approved by shareholders in their annual general meeting on 18th August, 2022 and then filed with Ministry of Corporate Affairs (MCA) on 19th August, 2022. Determine & discuss the date on which financial statements were approved.

A Company is in litigation with Income Tax Department with respect to allowability of certain exemptions for financial year 2018-2019. No provision for tax has been made for disallowances of exemptions as the

- ii) Company was under bonafide belief based on a legal opinion that it will succeed in litigation. On 21st April, 2023, the Hon'ble Supreme Court rejected the Company's claim. The Order is received on 30th April, 2023. The financial statements for the financial year 2022-2023 of the Company are yet to be approved. The earlier year's financial statements stands approved. Advise in financial statements of which financial year the impact of the Order of the Hon'ble Supreme Court should be recognized.
- iii) Z Limited while preparing its financial statements on 31st March, 2023 made a provision for doubtful debts @ 6% on accounts receivables. In the last week of January, 2023, a debtor for ₹ 3 lakhs had suffered heavy loss due to fire; the loss was not covered by any insurance policy. Z Limited, considering the event of fire made a provision @ 60% of the amount receivables from that debtor apart from the general provision @ 6% on remaining debtors. The same debtor was declared insolvent on 10th April, 2023. The financial statements have not yet been approved. You

are required to suggest whether the company should provide for the full loss arising out of insolvency of the debtor in the financial statements for the year ended 31st March, 2023.

- iv) D Limited acquired equity shares of another company on 1st March, 2023 at a cost of ₹ 28 lakhs. The fair market value of these shares on 31st March, 2023 was ₹ 35 lakhs and the company measured it at ₹ 35 lakhs (assume that it is classified as FVTOCI as per Ind AS 109 and change in fair value is transferred to 'fair value fluctuation reserve'). Due to market conditions subsequent to the reporting date, the value of investments drastically came down to ₹ 20 lakhs. The financial statements have not yet been approved. You are required to suggest whether D Limited should value the investments at ₹ 35 lakhs or ₹ 20 lakhs as on 31st March, 2023.
- v) Tanmay Limited was in negotiation with Varun Limited from 1st December, 2022 to acquire land for ₹ 5.00 crores. The negotiations were concluded in the first week of April 2023. The transaction was completed by last week of April, 2023. In which financial year, the purchase of land should be recognized? (PYP 5 Marks May '23)

Answer 6

- i) As per Ind AS 10, in the case of a company, the financial statements will be treated as approved when board of directors approves the same. Hence in the given case, the financial statements are approved for issue on 26th June, 2022 (date of approval by the Board of Directors for issue of financial statements to the shareholders).
- ii) An event after the reporting period is an adjusting event if it provides evidence of a condition existing at the end of the reporting period. Court order received after the reporting period (but before the financial statements are approved) provides evidence of the liability existing at the end of the reporting period. Therefore, the event will be considered as an adjusting event and, accordingly, the amount will be adjusted in financial statements for the financial year 2022-2023.
- iii) In the instant case, the fire took place in January, 2023 (i.e. before the end of the reporting period). Therefore, the condition existed at the end of the reporting date though the debtor is declared insolvent after the reporting period. Accordingly, full provision for bad debt amounting to ₹ 3 lakhs should be made to cover the loss arising due to the bankruptcy of the debtor in the financial statements for the year ended 31st March, 2023.
- iv) A decline in fair value of investments between the end of the reporting period and the date when the financial statements are approved for issue is a non-adjusting event. The decline in fair value does not normally relate to the condition of the investments at the end of the reporting period but reflects circumstances that have arisen subsequently. Therefore, D Limited should value the investments at ₹ 35 lakhs as on 31st March, 2023.
- v) As per Ind AS 10, an entity should adjust the financial statements for the events that occurred after the reporting period, but before the financial statements are approved for issue, if those events provide evidence of conditions that existed at the end of the reporting period.

In this case, negotiations continued with Varun Limited to acquire land from 1st December, 2022 till first week of April, 2023. Since on the reporting date, the condition was only on proposal state and transaction was completed on 1st week of April 2023, the event will be considered as a non-adjusting event as per Ind AS 10. Purchase of land should be recognized in the financial year 2023-2024.

However, the same may be disclosed in the Notes to Accounts for due information to the users of the financial statements.

Question 7 (Illustration)

Company XYZ Ltd. was formed to secure the tenders floated by a telecom company for publication of telephone directories. It bagged the tender for publishing directories for Pune circle for 5 years. It has made a profit in 20X1- 20X2, 20X2-20X3, 20X3-20X4 and 20X4-20X5. It bid in tenders for publication of directories for other circles – Nagpur, Nashik, Mumbai, Hyderabad but as per the



results declared on 23rd April, 20X5, the company failed to bag any of these. Its only activity till date is publication of Pune directory. The contract for publication of directories for Pune will expire on 31st December 20X5. The financial statements for the

F.Y. 20X4-20X5 have been approved by the Board of Directors on 10th July, 20X5. Whether it is appropriate to prepare financial statements on going concern basis? (RTP May'19, Old & New SM)

Answer 7

With regard to going concern basis to be followed for preparation of financial statements, paras 14 & 15 of Ind AS 10 states that-

An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.

In accordance with the above, an entity needs to change the basis of accounting if the effect of deterioration in operating results and financial position is so pervasive that management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

In the instant case, since contract is expiring on 31st December 20X5 and it is confirmed on 23rd April, 20X5, (i.e., after the end of the reporting period and before the approval of the financial statements), that no further contract is secured, it implies that the entity's operations are expected to come to an end by 31st December 20X5. Accordingly, if entity's operations are expected to come to an end, the entity needs to make a judgement as to whether it has any realistic possibility to continue or not. In case, the entity determines that it has no realistic alternative of continuing the business, preparation of financial statements for 20X4-20X5 and thereafter on going concern basis may not be appropriate.

Question 8 (Includes concepts of Chapter 9.2- Ind AS 37: Provisions, Contingent Liabilities and Contingent Assets & Ind AS 36: Impairment of Assets)

A manufacturer gives warranties to the purchasers of its goods. Under the terms of the warranty, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale to the purchasers.

On 30 April 20X1, a manufacturing defect was detected in the goods manufactured by the entity between 1 March 20X1 and 30 April 20X1. At 31 March 20X1 (the entity's reporting date), the entity held approximately one week's sales in inventories.

The entity's financial statements for the year ended 31 March 20X1 have not yet been finalised.

Three separate categories of goods require separate consideration: Category 1—defective goods sold on or before 31 March 20X1 Category 2—defective goods held on 31 March 20X1 Category 3—defective goods manufactured in 20X1-20X2 State the accounting treatment of the above categories in accordance with relevant Ind AS. (RTP May '21)

Answer 8

Category 1—defective goods sold on or before 31 March 20X1

If customer has the option to purchase warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In that case, entity shall account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation.



If a customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, unless it provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. If that is the case, then, the promised service is a performance obligation. Entity shall allocate the transaction price to the product and the service.

If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

Category 2—defective goods held on 31 March 20X1

At 31 March 20X1 the entity did not have a present obligation to make good the unsold defective goods that it held in inventories. Accordingly, at 31 March 20X1 the entity should not recognize a provision in respect of the defective inventories. However, the entity should test the inventories for impairment in accordance with Ind AS 36, Impairment of Assets.

For this category, the detection of the manufacturing defect in April 20X1 is an adjusting event after the end of the reporting period as per Ind AS 10, Events after the End of the Reporting Period. It provides evidence of a manufacturing defect in inventories held at 31 March 20X1.

Category 3—defective goods manufactured in 20X1-20X2

At 31 March 20X1 the entity did not have a present obligation to make good any defective goods that it might manufacture in the future. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective goods manufactured in 20X1-20X2.

For this category, the detection of the manufacturing defect in April 20X1 is a non-adjusting event after the end of the reporting period as per Ind AS 10, Events After the End of the Reporting Period.



Chapter 4.3

Ind AS 113: Fair Value Measurement

Question 1

- (i) A Ltd. owns 250 ordinary shares in XYZ Ltd., an unquoted company. XYZ Ltd. has a total share capital of 5,000 shares with nominal value of ₹ 10. XYZ Ltd.'s after-tax maintainable profits are estimated at ₹ 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). A Ltd.'s management estimates that the discount for the lack of marketability of XYZ Ltd.'s shares and restrictions on their transfer is 20%. A Ltd. values its holding in XYZ Ltd.'s shares based on earnings. Determine the fair value of A Ltd.'s investment in XYZ Ltd.'s shares.
- (ii) Based on the facts given in the aforementioned part (i), assume that A Ltd. estimates the fair value of the shares it owns in XYZ Ltd. using a net asset valuation technique. The fair value of XYZ Ltd.'s net assets including those recognised in its balance sheet and those that are not recognised is ₹ 8,50,000. Determine the fair value of A Ltd.'s investment in XYZ Ltd.'s shares. (MTP 5 Marks Oct '23)

Answer 1

- (i) An earnings-based valuation of A Ltd.'s holding of shares in XYZ Ltd. Could be calculated as follows:

Particulars	
XYZ Ltd.'s after-tax maintainable profits (A)	₹ 70,000
Price/Earnings ratio (B)	15
Adjusted discount factor (C) (1- 0.20)	0.80
Value of XYZ Ltd. (A) x (B) x (C)	₹ 8,40,000

Value of a share of XYZ Ltd. = ₹ 8,40,000 ÷ 5,000 shares = ₹ 168

The fair value of A Ltd.'s investment in XYZ Ltd.'s shares is estimated at ₹ 42,000 (that is, 250 shares × ₹ 168 per share).

- (ii) Share price = ₹ 8,50,000 ÷ 5,000 shares = ₹ 170 per share.

The fair value of A Ltd.'s investment in XYZ Ltd.'s shares is estimated to be ₹ 42,500 (250 shares × ₹ 170 per share).

Question 2

- (i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of ₹ 10. Entity XYZ's after-tax maintainable profits are estimated at ₹ 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.
- (ii) Based on the facts given in the aforementioned part (i), assume that, Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognized in its balance sheet and those that are not recognized is ₹ 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares. (MTP 6 Marks March '23) . (RTP Nov '21, Old & New SM)

Answer 2

- (i) An earnings-based valuation of Entity A's holding of shares in company XYZ could be calculated as follows:

Particulars	Unit
Entity XYZ's after-tax maintainable profits (A)	₹ 70,000



Price/Earnings ratio (B)	15
Adjusted discount factor (C) (1- 0.20)	0.80
Value of Company XYZ (A) x (B) x (C)	₹ 8,40,000

Value of a share of XYZ = ₹ 8,40,000 ÷ 5,000 shares = ₹ 168

The fair value of Entity A's investment in XYZ's shares is estimated at ₹ 42,000 (that is, 250 shares × ₹ 168 per share).

- (ii) Share price = ₹ 8,50,000 ÷ 5,000 shares = ₹ 170 per share.

The fair value of Entity A's investment in XYZ shares is estimated to be ₹ 42,500 (250 shares × ₹ 170 per share).

Question 3

Comment on the following by quoting references from appropriate Ind AS.

- (i) DS Limited holds some vacant land for which the use is not yet determined. the land is situated in a prominent area of the city where lot of commercial complexes are coming up and there is no legal restriction to convert the land into a commercial land. The company is not interested in developing the land to a commercial complex as it is not its business objective. Currently the land has been let out as a parking lot for the commercial complexes around. The Company has classified the above property as investment property. It has approached you, an expert in valuation, to obtain fair value of the land for the purpose of disclosure under Ind AS. On what basis will the land be fair valued under Ind AS?
- (ii) DS Limited holds equity shares of a private company. In order to determine the fair value' of the shares, the company used discounted cash flow method as there were no similar shares available in the market. Under which level of fair value hierarchy will the above inputs be classified? What will be your answer if the quoted price of similar companies were available and can be used for fair valuation of the shares? (RTP Nov '19, Old & New SM)

Answer 3

- (i) As per Ind AS 113, a fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

- A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (e.g. the location or size of a property).
- A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (e.g. the zoning regulations applicable to a property).
- A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximize the value of the asset.

To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use.



Nevertheless, the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.

In the given case, the highest best possible use of the land is to develop a commercial complex. Although developing a business complex is against the business objective of the entity, it does not affect the basis of fair valuation as Ind AS 113 does not consider an entity specific restriction for measuring the fair value.

Also, its current use as a parking lot is not the highest best use as the land has the potential of being used for building a commercial complex.

Therefore, the fair value of the land is the price that would be received when sold to a market participant who is interested in developing a commercial complex.

- (ii) As per Ind AS 113, unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. The unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

In the given case, DS Limited adopted discounted cash flow method, commonly used technique to value shares, to fair value the shares of the private company as there were no similar shares traded in the market. Hence, it falls under Level 3 of fair value hierarchy.

Level 2 inputs include the following:

- quoted prices for similar assets or liabilities in active markets.
- quoted prices for identical or similar assets or liabilities in markets that are not active.
- inputs other than quoted prices that are observable for the asset or liability.

If an entity can access quoted price in active markets for identical assets or liabilities of similar companies which can be used for fair valuation of the shares without any adjustment, at the measurement date, then it will be considered as observable input and would be considered as Level 2 inputs.

Question 4

On 1st January, 20X1, A Ltd assumes a decommissioning liability in a business combination. The reporting entity is legally required to dismantle and remove an offshore oil platform at the end of its useful life, which is estimated to be 10 years. The following information is relevant:

If A Ltd was contractually allowed to transfer its decommissioning liability to a market participant, it concludes that a market participant would use all of the following inputs, probability weighted as appropriate, when estimating the price, it would expect to receive:

a. Labour costs

Labour costs are developed based on current marketplace wages, adjusted for expectations of future wage increases, required to hire contractors to dismantle and remove offshore oil platforms. A Ltd. assigns probability to a range of cash flow estimates as follows:

Cash Flow Estimates:	100 Cr	125 Cr	175 Cr
Probability:	25%	50%	25%

b. Allocation of overhead costs:

Assigned at 80% of labour cost

c. The compensation that a market participant would require for undertaking the activity and for assuming the risk associated with the obligation to dismantle and remove the asset. Such compensation includes both of the following:

i. Profit on labour and overhead costs:

A profit mark-up of 20% is consistent with the rate that a market participant would require as



compensation for undertaking the activity

- ii. The risk that the actual cash outflows might differ from those expected, excluding inflation: A Ltd. estimates the amount of that premium to be 5% of the expected cash flows. The expected cash flows are 'real cash flows' / 'cash flows in terms of monetary value today'.

d. Effect of inflation on estimated costs and profits

A Ltd. assumes a rate of inflation of 4 percent over the 10 -year period based on available market data.

e. Time value of money, represented by the risk-free rate: 5%

f. Non-performance risk relating to the risk that Entity A will not fulfill the obligation, including A Ltd.'s own credit risk: 3.5%

A Ltd, concludes that its assumptions would be used by market participants. In addition, A Ltd. does not adjust its fair value measurement for the existence of a restriction preventing it from transferring the liability.

You are required to calculate the fair value of the asset retirement obligation. (RTP Nov '21, Old & New SM)

Answer 4

Particulars	Workings	Amount (In Cr)
Expected Labour Cost (Refer W.N.)		131.25
Allocated Overheads	(80% x 131.25 Cr)	105.00
Profit markup on Cost	(131.25 + 105) x 20%	47.25
Total Expected Cash Flows before inflation		283.50
Inflation factor for next 10 years (4%)	$(1.04)^{10} = 1.4802$	
Expected cash flows adjusted for inflation	283.50×1.4802	419.65
Risk adjustment - uncertainty relating to cash flows	(5% x 419.65)	20.98
Total Expected Cash Flows	(419.65+20.98)	440.63
Discount rate to be considered = risk-free rate + entity's non-performance risk	5% + 3.5%	8.5%
Expected present value at 8.5% for 10 years	$(440.63 / (1.085^{10}))$	194.88

Working Note: Expected labour

Cash Flows Estimates	Probability	Expected Cash Flows
100 Cr	25%	25.00 Cr
125 Cr	50%	62.50 Cr
175 Cr	25%	43.75 Cr
Total		131.25 Cr

Question 5

An asset is sold in 2 different active markets at different prices. An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

In Market A:

The price that would be received is Rs. 78, transaction costs in that market are Rs. 9 and the costs to transport the asset to that market are Rs. 6.

In Market B:



The price that would be received is Rs. 75, transaction costs in that market are Rs. 3 and the costs to transport the asset to that market are Rs. 6.

You are required to calculate:

- (i) The fair value of the asset, if market A is the principal market, and
- (ii) The fair value of the asset, if none of the markets is principal market. (PYP 5 Marks, Nov'18, Old & New SM)

Answer 5

(i) If Market A is the principal market

If Market A is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costs.

Fair Value of the asset will be

	Rs.
Price receivable	78
Less: Transportation cost	(6)
Fair value of the asset	<u>72</u>

(ii) If neither of the market is the principal market

If neither of the market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximizes the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (i.e., the net amount that would be received in the respective markets).

Determination of most advantageous market:

	Rs.	Rs.
	Market A	Market B
Price receivable	78	75
Less: Transaction cost	(9)	(3)
Less: Transportation cost	(6)	(6)
Fair value of the asset	<u>63</u>	<u>66</u>

Since the entity would maximize the net amount that would be received for the asset in Market B i.e. Rs. 66, the fair value of the asset would be measured using the price in Market B.

Fair value of the asset will be

	Rs.
Price receivable	75
Less: Transportation cost	(6)
Fair value of the asset	<u>69</u>

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A small number of the examinees were not able to calculate the fair value of the asset correctly. They got confused in the treatment of transportation cost and transaction cost.



Question 6

An asset is sold in two different active markets at different prices. Manor Ltd. enters into transactions in both markets and can access the price in those markets for the asset at the measurement date. In Mumbai market, the price that would be received is Rs. 290, transaction costs in that market are Rs. 40 and the costs to transport the asset to that market are Rs. 30. Thus, the net amount that would be received is Rs. 220. In Kolkata market the price that would be received is Rs. 280, transaction costs in that market are Rs. 20 and the costs to transport the asset to that market are Rs. 30. Thus, the net amount that would be received in Kolkata market is Rs. 230.

- (i) What should be the fair value of the asset if Mumbai Market is the principal market? What should be fair value if none of the markets is principle market?
- (ii) If the net realization after expenses is more in export market, say Rs. 280, but Government allows only 15% of the production to be exported out of India. Discuss what would be fair value in such case. (PYP 8 Marks, Nov'19)

Answer 6

(i)

(a) If Mumbai Market is the principal market

If Mumbai Market is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transportation costs. Fair value will be

	Rs.
Price receivable	290
Less: Transportation cost	(30)
Fair value of the asset	<u>260</u>

(b) If neither of the market is the principal market

If neither of the market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximizes the amount that would be received to sell the asset, after taking into account transaction costs and transportation costs (i.e., the net amount that would be received in the respective markets).

	Rs.	Rs.
	Mumbai Market	Kolkata Market
Fair value of the asset as per the question	<u>220</u>	<u>230</u>

Since the entity would maximise the net amount that would be received for the asset in Kolkata Market i.e. Rs. 230, the fair value of the asset would be measured using the price in Kolkata Market.

Fair value in such a case would be

	Rs.
Price receivable	280
Less: Transportation cost	(30)
Fair value of the asset	<u>250</u>

- (ii) Export prices are more than the prices in the principal market and it would give highest return comparing to the domestic market. Therefore, the export market would be considered as most advantageous market. But since the Government has capped the export, maximum upto 15% of total output, maximum sale activities are being done at domestic market only i.e. 85%. Since the highest level of activities with highest volume is being done at domestic market, principal market for asset would



be domestic market. Therefore, the prices received in domestic market would be used for fair valuation of assets.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Many examinees failed to calculate the fair value of the asset as required in last part of the question.

Question 7

Mr. Q has determined the valuation of Rhythm Ltd. by two approaches i.e., Market Approach and Income Approach and selected the highest as the final value but the management of Rhythm Ltd. is not satisfied and requests you to determine the fair value of shares of Rhythm Ltd. by assigning the weights to Market Approach and Income Approach in the ratio of 7:3.

Determine the Equity value on the basis of details given below:

Particulars	₹
Valuation as per Market Approach	35,82,380
Valuation as per Income Approach	21,99,930
Debt obligation as on measurement date	9,96,812
Surplus cash & cash equivalent	2,10,388
Fair value of surplus assets and liabilities	3,12,449
Number of shares of Rhythm Ltd.	1,06,680 shares

(PYP 4 Marks Dec '21)

Answer 7

Equity Valuation of Rhythm Ltd.

Particulars	Weights out of 10	(₹)
As per Market Approach	7	35,82,380
As per Income Approach	3	21,99,930
Enterprise Valuation based on weights (35,82,380 x 70%) + (21,99,930 x 30%)		31,67,645
Less: Debt obligation as on measurement date		(9,96,812)
Add: Surplus cash & cash equivalent		2,10,388
Add: Fair value of surplus assets and liabilities		3,12,449
Enterprise value of Rhythm Ltd.		26,93,670
No. of shares		1,06,680
Value per share		25.25

Question 8

Shravan Ltd. owns 6,800 ordinary shares in PQR Ltd., an unquoted company. PQR Ltd. has a total share capital of 2,00,000 shares with nominal value of ₹ 10. PQR Ltd.'s after tax maintainable profits are estimated at ₹ 28,00,000 per year. An appropriate price/earnings ratio determined from published industry data is 12 (before lack of marketability adjustment). Shravan Ltd.'s management estimates that the discount for the lack of marketability of PQR Ltd.'s shares and restrictions on their transfer is 18%.

Shravan Ltd. values its holding in PQR Ltd.'s shares based on earnings.

Determine the fair value of Shravan Ltd.'s investment in PQR Ltd.'s shares. (PP 5 Marks May '22)



Answer 8

Calculation of an earnings-based valuation of Shravan Ltd.'s holding of shares in PQR Ltd.:

Particulars	Unit
PQR Ltd.'s after-tax maintainable profits (A)	₹ 28,00,000
Price / Earnings ratio (B)	12
Adjusted discount factor (1- 0.18) (C)	0.82
Value of PQR Ltd. (A) x (B) x (C)	₹ 2,75,52,000

Value of a share of PQR Ltd. = ₹ 2,75,52,000 / 2,00,000 shares = ₹ 137.76

The fair value of Shravan Ltd.'s investment in PQR Ltd.'s shares is estimated at ₹ 9,36,768 (that is, 6,800 shares × ₹ 137.76 per share).

2022 Alternative way of presentation:

Particulars	
PQR Ltd.'s after-tax maintainable profits in ₹ (A)	28,00,000
PQR Ltd.'s number of outstanding shares (B)	2,00,000
PQR Ltd.'s EPS in ₹ (C = (A/B))	14.00
Industry PE ratio (given) (D)	12
Market price of PQR Ltd. per share in ₹ (E = (C x D))	168.00
Discount for lack of marketability @ 18% in ₹ (F = E x 18%)	30.24
Adjusted price per share of PQR Ltd. in ₹ (G = (E-F))	137.76
Shravan Ltd.'s holding (H)	6,800 shares
Fair value of Shravan's investment in PQR Ltd. (G x H)	9,36,768.00

Question 9

Silver Ltd. is in the process of acquiring shares of Blue Ltd. as a part of business reorganization plan. The projected free cash flow of Blue Ltd. for the next 5 years is as follows: (₹ in crores)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	280.65	281.40	182.70	403.50	518.20
Terminal value					5,945

The weighted average cost of capital of Blue Ltd. is 10%.

The total debt as on measurement date is ₹ 2,195 crore and the surplus cash and cash equivalent is ₹ 159.21 crore.

The total number of shares of Blue Ltd. as on the measurement date is 12.80 crore. You are required to determine the value per share of Blue Ltd. as per Income Approach of Ind AS 113. (Present value factor of 1 should be taken up to 4 decimals for the purpose of calculation) (PYP 5 Marks Nov 22) (Similar concept different figures- Old & New SM)

Answer 9

Determination of Equity Value of Blue Ltd.

(₹ in crore)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	280.65	281.40	182.70	403.50	518.20



Terminal value					5,945
	280.65	281.40	182.70	403.50	6,463.20
Discount rate @ 10%	0.9091	0.8264	0.7513	0.6830	0.6209
Free cashflow available to the firm	255.14	232.55	137.26	275.59	4,013.00
Total of all years					4,913.54
Less: Debt					(2,195.00)
Add: Cash & cash equivalent					159.21
Equity value of PT Ltd.					2,877.75
No. of shares (in crore)					12.80 Cr.
Per share value (₹ 2,877.75 Cr. / 12.80 Cr)					₹ 224.82



Chapter 5

Ind AS 115: Revenue from Contracts with Customers

Question 1

KK Ltd. runs a departmental store which awards 10 points for every purchase of Rs. 500 which can be discounted by the customers for further shopping with the same merchant. Unutilized points will lapse on expiry of two years from the date of credit. Value of each point is Rs. 0.50. During the accounting period 20X1-20X2, the entity awarded 1,00,00,000 points to various customers of which 18,00,000 points remained undiscounted. The management expects only 80% will be discounted in future of which normally 60-70% are redeemed during the next year.

The Company has approached your firm with the following queries and has asked you to suggest the accounting treatment (Journal Entries) under the applicable Ind AS for these award points:

(a)	How should the recognition be done for the sale of goods worth Rs. 10,00,000 on a particular day?
(b)	How should the redemption transaction be recorded in the year 20X1-20X2? The Company has requested you to present the sale of goods and redemption as independent transaction. Total sales of the entity is Rs. 5,000 lakhs.
(c)	How much of the deferred revenue should be recognised at the year-end (20X1-20X2) because of the estimation that only 80% of the outstanding points will be redeemed?
(d)	In the next year 20X2-20X3, 60% of the outstanding points were discounted Balance 40% of the outstanding points of 20X1-20X2 still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 20X2-20X3 and what will be the amount of balance deferred revenue?
(e)	How much revenue will the merchant recognized in the year 20X2-20X3, if 3,00,000 points are redeemed in the year 20X2-20X3?

(MTP 14 Marks Oct '19, 10 Marks Oct'20, RTP May '19)

Answer 1

- (a) Points earned on Rs. 10,00,000 @ 10 points on every Rs. 500 = $[(10,00,000/500) \times 10] = 20,000$ points.

Value of points = 20,000 points x Rs. 0.5 each point = Rs. 10,000

Revenue recognized for sale of goods	Rs. 9,90,099	$[10,00,000 \times (10,00,000/10,10,000)]$
Revenue for points deferred	Rs. 9,901	$[10,00,000 \times (10,000/10,10,000)]$

Journal Entry

		Rs.	Rs.
Bank A/c	Dr.	10,00,000	
To Sales A/c			9,90,099
To Liability under Customer Loyalty programme			9,901

- (b) Points earned on Rs. 50,00,00,000 @ 10 points on every Rs.500 = $[(50,00,00,000/500) \times 10] = 1,00,00,000$ points.

- (c) Value of points = 1,00,00,000 points x Rs. 0.5 each point = Rs. 50,00,000

Revenue recognized for sale of goods = Rs. 49,50,49,505 $[50,00,00,000 \times (50,00,00,000 / 50,50,00,000)]$

Revenue for points = Rs. 49,50,495 $[50,00,00,000 \times (50,00,000 / 50,50,00,000)]$

Journal Entry in the year 20X1

		Rs.	Rs.
Bank A/c	Dr.	50,00,00,000	
To Sales A/c			49,50,49,505

To Liability under Customer Loyalty programme			49,50,495
(On sale of Goods)			
Liability under Customer Loyalty programme	Dr.	42,11,002	
To Sales A/c			42,11,002
(On redemption of (100 lakhs -18 lakhs) points)			

Revenue for points to be recognized

Undiscounted points estimated to be recognized next year $18,00,000 \times 80\% = 14,40,000$ points

Total points to be redeemed within 2 years = $[(1,00,00,000 - 18,00,000) + 14,40,000] = 96,40,000$

Revenue to be recognized with respect to discounted point = $49,50,495 \times (82,00,000 / 96,40,000)$
 = 42,11,002

Revenue to be deferred with respect to undiscounted point in 20X1-20X2

$$= 49,50,495 - 42,11,002 = 7,39,493$$

- (d) In 20X2-20X3, KK Ltd. would recognize revenue for discounting of 60% of outstanding points as follows:

Outstanding points = $18,00,000 \times 60\% = 10,80,000$ points

Total points discounted till date = $82,00,000 + 10,80,000 = 92,80,000$ points Revenue to be recognized in the year 20X2-20X3

$$= [(49,50,495 \times (92,80,000 / 96,40,000)) - 42,11,002] = \text{Rs. } 5,54,620.$$

Liability under Customer Loyalty programme	Dr.	5,54,620	
To Sales A/c			5,54,620
(On redemption of further 10,80,000 points)			

The Liability under Customer Loyalty programme at the end of the year 20X2-20X3 will be
 Rs. $7,39,493 - 5,54,620 = 1,84,873$.

- (e) In the year 20X3-20X4, the merchant will recognize the balance revenue of Rs. 1,84,873 irrespective of the points redeemed as this is the last year for redeeming the points. Journal entry will be as follows:

Liability under Customer Loyalty programme	Dr.	1,84,873	
To Sales A/c			1,84,873
(On redemption of remaining points)			

Question 2

An entity enters into a contract with a customer for two intellectual property licences (Licences A and B), which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences A and B are Rs. 1,600,000 and Rs. 2,000,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.

Case A—Variable consideration allocated entirely to one performance obligation The price stated in the contract for Licence A is a fixed amount of Rs. 1,600,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B. For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be Rs. 2,000,000. Allocate the transaction price.

Case B—Variable consideration allocated on the basis of stand-alone selling prices



The price stated in the contract for Licence A is a fixed amount of Rs. 600,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (ie the variable consideration) is Rs. 3,000,000. Allocate the transaction price and determine the revenue to be recognized for each licence and the contract liability, if any. (MTP 8 Marks Mar '19 & Old & New SM)

Answer 2**Case A—Variable consideration allocated entirely to one performance obligation**

To allocate the transaction price, the entity considers the criteria in paragraph 85 and concludes that the variable consideration (i.e. the sales-based royalties) should be allocated entirely to Licence B. The entity concludes that the criteria are met for the following reasons:

- the variable payment relates specifically to an outcome from the performance obligation to transfer Licence B (i.e. the customer's subsequent sales of products that use Licence B).
- entity transfers Licence B at inception of the contract and transfers Licence A one month later. Upon the transfer of Licence B, the entity does not recognize revenue because the consideration allocated to Licence B is in the form allocating the expected royalty amounts of Rs. 2,000,000 entirely to Licence B is consistent with the allocation objective in paragraph 73 of Ind AS 115. This is because the entity's estimate of the amount of sales-based royalties (Rs. 2,000,000) approximates the stand-alone selling price of Licence B and the fixed amount of Rs. 1,600,000 approximates the stand-alone selling price of Licence A. The entity allocates Rs. 1,600,000 to Licence A. This is because, based on an assessment of the facts and circumstances relating to both licences, allocating to Licence B some of the fixed consideration in addition to all of the variable consideration would not meet the allocation objective in paragraph 73 of Ind AS 115.

The of a sales-based royalty. Therefore, the entity recognizes revenue for the sales-based royalty when those subsequent sales occur. When Licence A is transferred, the entity recognizes as revenue the Rs. 1,600,000 allocated to Licence A.

Case B—Variable consideration allocated on the basis of stand-alone selling prices

To allocate the transaction price, the entity applies the criteria in paragraph 85 of Ind AS 115 to determine whether to allocate the variable consideration (ie the sales-based royalties) entirely to Licence B.

In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B), allocating the variable consideration entirely to Licence B would be inconsistent with the principle for allocating the transaction price. Allocating Rs. 600,000 to Licence A and Rs. 3,000,000 to Licence B does not reflect a reasonable allocation of the transaction price on the basis of the stand-alone selling prices of Licences A and B of Rs. 1,600,000 and Rs. 2,000,000, respectively. Consequently, the entity applies the general allocation requirements of Ind AS 115.

The entity allocates the transaction price of Rs. 600,000 to Licences A and B on the basis of relative stand-alone selling prices of Rs. 1,600,000 and Rs. 2,000,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative stand-alone selling price basis. However, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognise revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).

Licence B is transferred to the customer at the inception of the contract and Licence A is transferred three months later. When Licence B is transferred, the entity recognises as revenue Rs. 333,333 $[(Rs. 2,000,000 \div Rs. 3,600,000) \times Rs. 600,000]$ allocated to Licence B. When Licence A is transferred, the entity recognises as revenue Rs. 266,667 $[(Rs. 1,600,000 \div Rs. 3,600,000) \times Rs. 600,000]$ allocated to Licence A.

In the first month, the royalty due from the customer's first month of sales is Rs. 400,000. Consequently, the entity recognises as revenue Rs. 222,222 $(Rs. 2,000,000 \div Rs. 3,600,000 \times Rs.$



400,000) allocated to Licence B (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognises a contract liability for the Rs. 177,778 ($\text{Rs. } 1,600,000 \div \text{Rs. } 3,600,000 \times \text{Rs. } 400,000$) allocated to Licence A. This is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

Question 3

An entity enters into 1,000 contracts with customers. Each contract includes the sale of one product for Rs. 50 (1,000 total products $\times$ Rs. 50 = Rs. 50,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is Rs. 30.

Since the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value. Using the expected value method, the entity estimates that 970 products will not be returned.

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Determine the amount of revenue, refund liability and the asset to be recognized by the entity for the said contracts. (MTP 4 Marks May '20, 6 Marks April '19, Old & New SM)

Answer 3

The entity considers the requirements in paragraphs 56–58 of Ind AS 115 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of Rs. 48,500 ($\text{Rs. } 50 \times 970$ products not expected to be returned) can be included in the transaction price.

The entity considers the factors in paragraph 57 of Ind AS 115 and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (i.e. the 30-day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognized (i.e. Rs. 48,500) will not occur as the uncertainty is resolved (i.e. over the return period).

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Upon transfer of control of the 1,000 products, the entity does not recognise revenue for the 30 products that it expects to be returned. Consequently, in accordance with paragraphs 55 and B21 of Ind AS 115, the entity recognises the following:

- (a) revenue of Rs. 48,500 ($\text{Rs. } 50 \times 970$ products not expected to be returned);
- (b) a refund liability of Rs. 1,500 ($\text{Rs. } 50 \text{ refund} \times 30$ products expected to be returned); and
- (c) an asset of Rs. 900 ($\text{Rs. } 30 \times 30$ products for its right to recover products from customers on settling the refund liability).

Question 4

An entity enters into a contract for the sale of Product A for Rs. 1,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to Rs. 1,000 in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.

The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase Rs. 500 of additional products.

Determine how many performance obligations does the entity have and their stand-alone selling price

and allocated transaction price? (MTP 5 Marks May '20, Old & New SM, PYP 4 Marks Nov '22)

Answer 4

Since all customers will receive a 10% discount on purchases during the next 30 days, the only additional discount that provides the customer with a material right is the incremental discount of 30% on the products purchased. The entity accounts for the promise to provide the incremental discount as a separate performance obligation in the contract for the sale of Product A.

The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase Rs. 500 of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is Rs. 120 (Rs. 500 average purchase price of additional products x 30% incremental discount x 80% like lihood of exercising the option). The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the Rs. 1,000 transaction price are as follows:

Performance obligations		Stand-alone selling price
Product A		Rs. 1,000
Discount voucher		Rs. 120
Total		Rs. 1,120
Performance obligations		Allocated transaction price (to nearest Rs.10)
Product A	$(Rs. 1000 \div Rs. 1120 \times Rs. 1000)$	Rs. 890
Discount voucher	$(Rs. 120 \div Rs. 1120 \times Rs. 1000)$	Rs. 110
Total		Rs. 1000

The entity allocates Rs. 890 to Product A and recognises revenue for Product A when control transfers. The entity allocates Rs. 110 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

Question 5

- (a) Entity I sells a piece of machinery to the customer for Rs. 2 million, payable in 90 days. Entity I is aware at contract inception that the customer might not pay the full contract price. Entity I estimates that the customer will pay atleast Rs. 1.75 million, which is sufficient to cover entity I's cost of sales (Rs. 1.5 million) and which entity I is willing to accept because it wants to grow its presence in this market. Entity I has granted similar price concessions in comparable contracts.

Entity I concludes that it is highly probable that it will collect Rs. 1.75 million, and such amount is not constrained under the variable consideration guidance.

What is the transaction price in this arrangement?

- (b) On 1 January 20X8, entity J enters into a one-year contract with a customer to deliver water treatment chemicals. The contract stipulates that the price per container will be adjusted retroactively once the customer reaches certain sales volume, defined, as follows:

Price per container	Cumulative sales volume
Rs. 100	1 - 1,000,000 containers
Rs. 90	1,000,001 - 3,000,000 containers
Rs. 85	3,000,001 containers and above

Volume is determined based on sales during the calendar year. There are no minimum purchase requirements. Entity J estimates that the total sales volume for the year will be 2.8 million containers, based on its experience with similar contracts and forecasted sales to the customer.



Entity J sells 700,000 containers to the customer during the first quarter ended 31 March 20X8 for a contract price of Rs. 100 per container.

How should entity J determine the transaction price?

- (c) Entity K sells electric razors to retailers for Rs. 50 per unit. A rebate coupon is included inside the electric razor package that can be redeemed by the end consumers for Rs. 10 per unit.

Entity K estimates that 20% to 25% of eligible rebates will be redeemed, based on its experience with similar programmes and rebate redemption rates available in the market for similar programmes. Entity K concludes that the transaction price should incorporate an assumption of 25% rebate redemption, as this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change.

How should entity K determine the transaction price?

- (d) A manufacturer enters into a contract to sell goods to a retailer for Rs. 1,000. The manufacturer also offers price protection, whereby it will reimburse the retailer for any difference between the sale price and the lowest price offered to any customer during the following six months. This clause is consistent with other price protection clauses offered in the past, and the manufacturer believes that it has experience which is predictive for this contract. Management expects that it will offer a price decrease of 5% during the price protection period. Management concludes that it is highly probable that a significant reversal of cumulative revenue will not occur if estimates change.

How should the manufacturer determine the transaction price? (MTP 12 Marks March '21, MTP 5 Marks Apr'23, Old & New SM & RTP May '20)

Answer 5

- (a) Entity I is likely to provide a price concession and accept an amount less than Rs. 2 million in exchange for the machinery. The consideration is therefore variable. The transaction price in this arrangement is Rs. 1.75 million, as this is the amount which entity I expects to receive after providing the concession and it is not constrained under the variable consideration guidance. Entity I can also conclude that the collectability threshold is met for Rs. 1.75 million and therefore contract exists.
- (b) The transaction price is Rs. 90 per container based on entity J's estimate of total sales volume for the year, since the estimated cumulative sales volume of 2.8 million containers would result in a price per container of Rs. 90. Entity J concludes that based on a transaction price of Rs. 90 per container, it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty is resolved. Revenue is therefore recognised at a selling price of Rs. 90 per container as each container is sold. Entity J will recognise a liability for cash received in excess of the transaction price for the first 1 million containers sold at Rs. 100 per container (that is, Rs. 10 per container) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced.

For the quarter ended 31st March, 20X8, entity J recognizes revenue of Rs. 63 million (700,000 containers x Rs. 90) and a liability of Rs. 7 million [700,000 containers x (Rs. 100 - Rs. 90)].

Entity J will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

- (c) Entity K records sales to the retailer at a transaction price of Rs. 47.50 (Rs. 50 less 25% of Rs. 10). The difference between the per unit cash selling price to the retailers and the transaction price is recorded as a liability for cash consideration expected to be paid to the end customer. Entity K will update its estimate of the rebate and the transaction price at each reporting date if estimates of redemption rates change.
- (d) The transaction price is Rs. 950, because the expected reimbursement is Rs. 50. The expected payment to the retailer is reflected in the transaction price at contract inception, as that is the amount of consideration to which the manufacturer expects to be entitled after the price protection. The manufacturer will recognise a liability for the difference between the invoice price and the transaction price, as this represents the cash that it expects to refund to the retailer.

The manufacturer will update its estimate of expected reimbursement at each reporting date until the uncertainty is resolved.

Question 6

Mercury Ltd. has sold goods to Mars Ltd. at a consideration of Rs. 10 lakhs, the receipt of which receivable in three equal installments of Rs. 3,33,333 over a two year period (receipts on 1st April, 20X1, 31st March, 20X2 and 31st March, 20X3).

The company is offering a discount of 5 % (i.e. Rs. 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

The total consideration to be received from such sale is at Rs. 10 Lakhs and hence, the management has recognised the revenue from sale of goods for Rs. 10 lakhs. Further, the management is of the view that there is no difference in this aspect between Indian GAAP and Ind AS.

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same. Also show its presentation in the company's profit & loss and balance sheet. (MTP 6 Marks March '21, MTP 8 Marks Oct'18)

Answer 6

The revenue from sale of goods shall be recognised at the fair value of the consideration received or receivable. The fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest where the receipt is deferred beyond normal credit terms. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue.

The fair value of consideration (cash price equivalent) of the sale of goods is calculated as follows:

Rs.			
Year	Consideration (Installment)	Present value factor	Present value of consideration
Time of sale	3,33,333	-	3,33,333
End of 1 st year	3,33,333	0.949	3,16,333
End of 2 nd year	3,33,334	0.901	3,00,334
	10,00,000		9,50,000

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

Initial recognition of sale of goods		Rs.	Rs.
Cash	Dr.	3,33,333	
Trade Receivable	Dr.	6,16,667	
To Sale			9,50,000
Recognition of interest expense and receipt of second installment			
Cash	Dr.	3,33,333	
To Interest Income			33,053
To Trade Receivable			3,00,280
Recognition of interest expense and payment of final installment			
Cash	Dr.	3,33,334	
To Interest Income (Balancing figure)			16,947
To Trade Receivable			3,16,387

Statement of Profit and Loss (extracts) for the year ended 31st March, 20X2 and 31st March, 20X3
Rs.

	As at 31 st March, 20X2	As at 31 st March, 20X3
Income		
Sale of Goods	9,50,000	-
Other Income (Finance income)	33,053	16,947

Balance Sheet (extracts) as at 31st March, 20X2 and 31st March, 20X3
Rs.

	As at 31 st March, 20X2	As at 31 st March, 20X3
Assets		
Current Assets		
<u>Financial Assets</u>		
Trade Receivables	3,16,387	-

Question 7

Buildings Limited with a financial year end of 31st March, entered into a contract with its customer, Radar Limited, to build a manufacturing facility. Buildings Limited determines that the contract contains one performance obligation satisfied over time. Construction is scheduled to be completed by the end of the 36th month for an agreed upon price of Rs. 25 crores. Buildings Limited has the opportunity to earn a performance bonus for early completion as follows:

- 15% bonus of the contract price if completed by the 30th months (25% likelihood).
- 10% bonus of the contract price if completed by the 32 nd months (40% likelihood).
- 5% bonus of the contract price if completed by the 34th months (15% likelihood).

In addition to the potential performance bonus for early completion, Buildings Limited is entitled to a quality bonus of Rs. 2 crores if a health and safety inspector assigns the facility a gold star rating as defined by Radar Limited in terms of the contract. Buildings Limited concludes that it is 60% likely that it will receive the quality bonus.

Analyze and determine the amount of variable consideration Building Limited should recognize in its contract with Radar Company Limited to build a manufacturing facility. (MTP 5 Marks April '21, Old & New SM)

Answer 7

In determining the transaction price, Buildings Limited separately estimates variable consideration for each element of variability i.e. the early completion bonus and the quality bonus. Buildings Limited decides to use the expected value method to estimate the variable consideration associated with the early completion bonus because there is a range of possible outcomes and the entity has experience with a large number of similar contracts that provide a reasonable basis to predict future outcomes. Therefore, the entity expects this method to best predict the amount of variable consideration associated with the early completion bonus. Buildings Ltd.'s best estimate of the early completion bonus is Rs. 2.125 crore, calculated as shown in the following table:

Bonus %	Amount of bonus (Rs. in crore)	Probability	Probability-weighted amount (Rs. in crore)
15%	3.75	25%	0.9375
10%	2.50	40%	1.00
5%	1.25	15%	0.1875

0%	-	20%	-
		100%	2.125

Buildings Limited decides to use the most likely amount to estimate the variable consideration associated with the potential quality bonus because there are only two possible outcomes (Rs. 2 crore or Rs. Nil) and this method would best predict the amount of consideration associated with the quality bonus. Buildings Limited believes the most likely amount of the quality bonus is Rs. 2 crore. Total variable consideration = 4.125 crore (2.125 crore + 2 crore).

Question 8

Entity AB Ltd. enters into a three-year service contract with a customer CD Ltd. for Rs. 4,50,000 (Rs.1,50,000 per year). The standalone selling price for one year of service at inception of the contract is Rs.1,50,000 per year. AB Ltd. accounts for the contract as a series of distinct services.

At the beginning of the third year, the parties agree to modify the contract as follows:

- (i) the fee for the third year is reduced to Rs.1,20,000; and**
- (ii) CD Ltd. agrees to extend the contract for another three years for Rs.3,00,000 (Rs.1,00,000 per year).**

The standalone selling price for one year of service at the time of modification is Rs. 1,20,000. How should AB Ltd. account for the modification? Analyze. (MTP 5 Marks April '21)

Answer 8

Paragraph 20 of Ind AS 115, inter alia, states that, “An entity shall account for a contract modification as a separate contract if both of the following conditions are present:

- (a) the scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with paragraphs 26–30); and
- (b) the price of the contract increases by an amount of consideration that reflects the entity’s stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract.

In accordance with the above, it may be noted that a contract modification should be accounted for prospectively if the additional promised goods or services are distinct and the pricing for those goods or services reflects their stand-alone selling price.

In the given case, even though the remaining services to be provided are distinct, the modification should not be accounted for as a separate contract because the price of the contract did not increase by an amount of consideration that reflects the standalone selling price of the additional services. The modification would be accounted for, from the date of the modification, as if the existing arrangement was terminated and a new contract created (i.e. on a prospective basis) because the remaining services to be provided are distinct.

AB Ltd. should reallocate the remaining consideration to all of the remaining services to be provided (i.e. the obligations remaining from the original contract and the new obligations). AB Ltd. will recognize a total of Rs.4,20,000 (Rs.1,20,000 + Rs.3,00,000) over the remaining four-year service period (one year remaining under the original contract plus three additional years) or Rs.1,05,000 per year.

Question 9

A construction services company enters into a contract with a customer to build a water purification plant. The company is responsible for all aspects of the plant including overall project management, engineering and design services, site preparation, physical construction of the plant, procurement of pumps and equipment for measuring and testing flow volumes and water quality, and the integration of all components.



Determine whether the company has a single or multiple performance obligations under the contract? (MTP 4 Marks April '21, Old & New SM)

Answer 9

Determining whether a good or service represents a performance obligation on its own or is required to be aggregated with other goods or services can have a significant impact on the timing of revenue recognition. While the customer may be able to benefit from each promised good or service on its own (or together with other readily available resources), they do not appear to be separately identifiable within the context of the contract. That is, the promised goods and services are subject to significant integration, and as a result will be treated as a single performance obligation.

This is consistent with a view that the customer is primarily interested in acquiring a single asset (a water purification plant) rather than a collection of related components and services.

Question 10

X Ltd. is engaged in manufacturing and selling of designer furniture. It sells goods on extended credit. X Ltd. sold furniture for Rs. 40,00,000 to a customer, the payment against which was receivable after 12 months with interest at the rate of 3% per annum. The market interest rate on the date of transaction was 8% per annum. Calculate the revenue to be recognized by X Ltd. for the above transactions. (MTP 6 Marks March '18)

Answer 10

X Ltd. should determine the fair value of revenue by calculating the present value of the cash flows receivable.

Total amount receivable	= Rs. 40,00,000 x 1.03 = Rs. 41,20,000. Present
Value of receivable (Revenue)	= Rs. 41,20,000/1.08 = Rs. 38,14,815. Interest
income	= Rs. 41,20,000 - Rs. 38,14,815 = Rs. 3,05,185.

Therefore, on transaction date, Rs. 38,14,815 will be recognized as revenue from sale of goods and Rs. 3,05,185 will be recognized as interest income receivable for the period in accordance with Ind AS 109.

Question 11

The Company has sold certain items to a customer with after sale service for a period of two years from the date of such sale i.e. 1st October, 2017 without any additional charges. The total amount payable by the customer is agreed as follows:

- Rs. 8,00,000, if paid by 31st January, 2018;
- Rs. 8,10,000, if paid by 28th February, 2018;
- Rs. 8,20,000, if paid by 31st March, 2018.

Based on past experience it is highly probable that the customer makes the payment before 28th February, 2018. The standalone selling price of the product is Rs. 7,00,000 and two years' services are offered to the customer at Rs. 1,40,000.

Answer the following:

- (1) How many transactions are included in the above arrangement as per applicable Ind AS
- (2) What is the amount of revenue to be considered for revenue recognition as per the applicable Ind AS?
- (3) What is the amount of revenue to be recognized under Ind AS towards sale of product as per the terms of the contract with the customer?
- (4) What is the amount of revenue to be recognized under Ind AS towards sale of service as

per the terms of the contract with the customer?

- (5) What is the portion of current and non-current liabilities to be presented in the financial statements as per Ind AS? (MTP 10 Marks Oct '18)

Answer 11

Two transactions are included in the above arrangement as per applicable Ind AS i.e. sale of item includes following transactions:

- (i) Selling price of item
- (ii) Two-years' after sale service

Revenue attributable to both the components is calculated as follows:

Total fair value of item and two years' service period

(7,00,000 + 1,40,000) 8,40,000

Less: Sale price of the item and two years' service period (8,10,000)

Discount 30,000

Discount and revenue attributable to each component of the transaction:

Proportionate discount attributable to sale of item 25,000

(30,000 x 7,00,000 / 8,40,000)

Revenue from sale of item (7,00,000 – 25,000) 6,75,000

Proportionate discount attributable to two years' service period 5,000 (30,000 x 1,40,000 / 8,40,000)

Revenue from two years' service period (1,40,000 – 5,000) 1,35,000

Revenue in respect of sale of item should be recognized immediately and revenue from two years' service period should be recognized over the 2-year period on monthly basis i.e on 31st March, 2017 revenue for two years' service period will be Rs. 5,625 (Rs. 1,35,000/24 months)

Amount of two years' service period due within 12 months from the reporting date = (1,35,000 / 24 months) x 12 months = Rs. 67,500 (Current).

Amount of two years' service period due after 12 months from the reporting date = (1,35,000 / 24 months) x 11 months = Rs. 61,875 (Non-current).

Question 12

Growth Ltd. enters into an arrangement with a customer for infrastructure outsourcing deal. Based on its experience, Growth Ltd. determines that customising the infrastructure will take approximately 200 hours in total to complete the project and charges ₹ 150 per hour. After incurring 100 hours of time, Growth Ltd. and the customer agree to change an aspect of the project and increases the estimate of labour hours by 50 hours at the rate of ₹ 100 per hour. Determine how contract modification will be accounted as per Ind AS 115? (MTP 5 Marks Oct 21)

Answer 12

Considering that the remaining goods or services are not distinct, the modification will be accounted for on a cumulative catch-up basis, as given below:

Particulars	Hours	Rate (₹)	Amount (₹)
Initial contract amount	200	150	30,000
Modification in contract	50	100	<u>5,000</u>
Contract amount after modification	250	140*	<u>35,000</u>

Revenue to be recognised	100	140	14,000
Revenue already booked	100	150	<u>15,000</u>
Adjustment in revenue			<u>(1,000)</u>

*₹ 35,000 / 250 hours = ₹ 140.

Question 13

Nivaan Limited commenced work on two long-term contracts during the financial year ended on 31st March, 20X2.

The first contract with A & Co. commences on 1st June, 20X1 and had a total sales value of ₹ 40 lakh. It was envisaged that the contract would run for two years and that the total expected costs would be ₹ 32 lakh. On 31st March, 20X2, Nivaan Limited revised its estimate of the total expected cost to ₹ 34 lakh on the basis of the additional rectification cost of ₹ 2 lakh incurred on the contract during the current financial year. An independent surveyor has estimated at 31st March, 20X2 that the contract is 30% complete. Nivaan Limited has incurred costs up to 31st March, 20X2 of ₹ 16 lakh and has received payments on account of ₹ 13 lakh.

The second contract with B & Co. commenced on 1st September, 20X1 and was for 18 months. The total sales value of contract was ₹ 30 lakh and the total expected cost is ₹ 24 lakh. Payments on account already received were ₹ 9.50 lakh and total costs incurred to date were ₹ 8 lakh. Nivaan Limited has insisted on a large deposit from B & Co. because the companies had not traded together prior to the contract. The independent surveyor estimated that on 31st March, 20X2 the contract was 20% complete.

The two contracts meet the requirement of Ind AS 115 'Revenue from Contracts with Customers' to recognize revenue over time as the performance obligations are satisfied over time.

The company also has several other contracts of between twelve and eighteen months in duration. Some of these contracts fall into two accounting periods and were not completed as at 31st March, 20X2. In absence of any financial date relating to the other contracts, you are advised to ignore these other contracts while preparing the financial statements of the company for the year ended 31st March, 20X2.

Prepare financial statement extracts for Nivaan Limited in respect of the two construction contracts for the year ending 31st March, 20X2. (MTP 12 Marks Nov 21, PYP 12 Marks Nov'19)

Answer 13

Extracts of Balance Sheet of Nivaan Ltd. as on 31st March, 20X2

	₹ in lakh
Current Assets	
Contract Assets- Work-in-progress (Refer W.N. 3)	9.0
Current Liabilities	
Contract Liabilities (Advance from customers) (Refer W.N. 2)	4.5

Extracts of Statement of Profit and Loss of Nivaan Ltd. as on 31st March, 20X2

	₹ in lakh
Revenue from contracts (Refer W.N. 1)	18
Cost of Revenue (Refer W.N. 1)	(15)
Net Profit on Contracts (Refer W.N. 1)	3

Working Notes:

- Table showing calculation of total revenue, expenses and profit or loss on contract for the year

	₹ in lakh		
	A & Co.	B & Co.	Total
Revenue from contracts	$(40 \times 30\%) = 12$	$(30 \times 20\%) = 6$	18
Expenses due for the year	$(34^* \times 30\%) = 10.2$	$(24 \times 20\%) = 4.8$	15
Profit or loss on contract	1.8	1.2	3

*Note: Additional rectification cost of ₹ 2 lakh has been treated as normal cost. Hence total expected cost has been considered as ₹ 34 lakh. Alternatively, in case this ₹ 2 lakh is treated as abnormal cost then expense due for the year would be ₹ 11.6 lakh (i.e. 30% of ₹ 32 lakh plus ₹ 2 lakh). Accordingly, with respect to A & Co., the profit for the year would be ₹ 0.4 lakh and work-in-progress recognized at the end of the year would be ₹ 4.4 lakh.

- Calculation of amount due from / (to) customers

	₹ in lakh		
	A & Co.	B & Co.	Total
Billing based on revenue recognised in the books	12	6	18
Payments received from the customers	(13)	(9.5)	(22.5)
Advance received from the customers	1	3.5	4.5

- Work in Progress recognized as part of contract asset at the end of the year

	₹ in lakh		
	A & Co.	B & Co.	Total
Total actual cost incurred during the year	16	8	24
Less: Cost recognized in the books for the year	(10.2)	(4.8)	(15)
31.3.20X2			
Work-in-progress recognized at the end of the year	5.8	3.2	9.0

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This part of the question was on application of Ind AS 115 'Revenue from contracts with the Customers'. A very small number of examinees attempted this question, but they erred either in the calculation of expenditure to be charged during the year or in calculation of amount due from / (to) customers or in recognising the correct 'Work in Progress recognised as part of contract asset at the end of the year'.

Question 14

Telco T Ltd. enters into a two-year contract for internet services with Customer C. C also buys a modem and a router from T Ltd. and obtains title to the equipment. T Ltd. does not require customers to purchase its modems and routers and will provide internet services to customers using other equipment that is compatible with T Ltd.'s network. There is a secondary market in which modems and routers can be bought or sold for amounts greater than scrap value. Determine how many performance obligations does the entity T Ltd. have? (MTP 6 Marks Oct 21 & April 22, Old & New SM)

**Answer 14**

T Ltd. concludes that the modem and router are each distinct and that the arrangement includes three performance obligations (the modem, the router and the internet services) based on the following evaluation:

Criterion 1: Capable of being distinct

- C can benefit from the modem and router on their own because they can be resold for more than scrap value.
- C can benefit from the internet services in conjunction with readily available resources – i.e. either the modem and router are already delivered at the time of contract set-up, they could be bought from alternative retail vendors or the internet service could be used with different equipment.

Criterion 2: Distinct within the context of the contract

- T Ltd. does not provide a significant integration service.
- The modem, router and internet services do not modify or customize one another.
- C could benefit from the internet services using routers and modems that are not sold by T Ltd.

Therefore, the modem, router and internet services are not highly dependent on or highly inter-related with each other.

Question 15

As a part of its sales promotion activities, MIL distributes office utility articles along with its product catalogues to medical practitioners to familiarize & encourage them to prescribe medicines manufactured by it. No conditions are attached with the items distributed. Whether the distribution of office utility articles to medical practitioners is covered by Ind AS 115 'Revenue from Contracts with Customers'? If not, how should the same be accounted by MIL? Give reasons. (MTP 4 Marks March '22)

Answer 15

The term 'contract' is defined in Ind AS 115 as an agreement between two or more parties that creates enforceable rights and obligations. In the given case:

- Gifts are distributed by MIL to doctors as a part of its sales promotion activities without there being an agreement between MIL and the doctors creating enforceable rights and obligations.
- The doctors to whom gifts are distributed are not 'customers' of MIL as they have not contracted with it to obtain goods or services in exchange for consideration.
- The items distributed as gifts are not an output of MIL ordinary activities.

In view of the above, the distribution of gifts to doctors does not fall under the scope of Ind AS 115.

As per Ind AS 38, sometimes expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods.

Examples of expenditure that is recognised as an expense when it is incurred include expenditure on advertising and promotional activities (including mail order catalogues).

Items acquired by MIL to be distributed as gifts as a part of sales promotion activities have no other purpose than to undertake those activities. In other words, the only benefit of those items for MIL is to develop or create brands or customer relationships, which in turn generate revenue. Ind AS 38 requires an entity to recognise expenditure on such items as an expense when the entity has a right to access those goods. Ind AS 38 states that an entity has a right to access goods when it owns them, or otherwise has a right to access them regardless of when it distributes the goods.

In view of the above, MIL should recognise the cost of the items to be distributed as gifts as an expense when it owns those items, or otherwise has a right to access them, regardless of when it distributes



the items to doctors.

Question 16

During 20X1-20X2, XYZ Ltd. completed a large contract to supply a customized equipment for one customer for a total consideration of ₹ 5,00,000 received fully in cash. As a special arrangement and in order to procure the customer's order, XYZ Ltd agreed to maintain the equipment for three years from the date of installation. Had there been no maintenance requirement, the sale would have been for an amount of ₹ 4,85,500. If maintenance alone was required, it would have cost the customer ₹ 12,500 per annum.

Explain the requirements of Ind AS in relation to the XYZ Ltd.'s supply of customized contract and the maintenance that has been agreed to be provided to the customer. Ignore discounting and calculate the amounts to be recognized in the financial statements as at 31 st March, 20X2. (MTP 4 Marks March '22)

Answer 16**As per para 81 of Ind AS 115**

- a customer receives a discount for purchasing a bundle of goods or services if the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract.
- except when an entity has observable evidence in accordance with paragraph 82 that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract.
- the proportionate allocation of the discount in those circumstances is a consequence of the entity allocating the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of the underlying distinct goods or services.

Amount to be recognised:

In this case, there are two separately identifiable performance obligations one being sale of the equipment and second being maintenance contract for three years.

For recognition of revenue, relative stand-alone selling price of the individual components may be taken and the consideration allocated in proportion of relative fair values, i.e. 4,85,500: 37,500* (i.e. 12,500 x 3). Hence, the sale of equipment should be recognised at ₹ 4,64,149 [$₹ 5,00,000 \times \{4,85,500 / (4,85,500 + 37,500)\}$] when all other conditions for sale of the equipment are fulfilled and the revenue from maintenance services of ₹ 35,851 [$₹ 5,00,000 \times \{37,500 / (4,85,500 + 37,500)\}$] should be the service revenue recognised over a period of three years as per its stage of completion.

Question 17

A contractor enters into a contract with a customer to build an asset for ₹ 1,00,000, with a performance bonus of ₹ 50,000 that will be paid based on the timing of completion. The amount of the performance bonus decreases by 10% per week for every week beyond the agreed-upon completion date. The contract requirements are similar to those of contracts that the contractor has performed previously, and management believes that such experience is predictive for this contract. The contractor concludes that the expected value method is most predictive in this case. The contractor estimates that there is a 60% probability that the contract will be completed by the agreed-upon completion date, a 30% probability that it will be completed one week late, and a 10% probability that it will be completed two weeks late. Determine the transaction price. (MTP 4 Marks April 22, RTP Nov '20)

Answer 17

The transaction price should include management's estimate of the amount of consideration to which the entity will be entitled for the work performed.

Probability-weighted	Consideration
₹ 1,50,000 (fixed fee plus full performance bonus) x 60%	₹ 90,000
₹ 1,45,000 (fixed fee plus 90% of performance bonus) x 30%	₹ 43,500
₹ 1,40,000 (fixed fee plus 80% of performance bonus) x 10%	₹ 14,000
Total probability-weighted consideration	₹ 1,47,500

Based on the probability-weighted estimate, the total transaction price is ₹ 1,47,500. The contractor have to update its estimate at each reporting date.

Question 18

Entity sells gym memberships for ₹ 7,500 per year to 100 customers, with an option to renew at a discount in 2nd and 3rd years at ₹ 6,000 per year. Entity estimates an annual attrition rate of 50% each year. Determine the amount of revenue to be recognized in the first year and the amount of contract liability against the option given to the customer for renewing the membership at discount. (MTP 5 Marks April 22, Old & New SM)

Answer 18

Allocated price per unit (year) is calculated as follows:

Total estimated memberships is 175 members (Year 1 = 100; Year 2 = 50; Year 3 = 25) = 175

Total consideration is ₹ 12,00,000 {(100 x 7,500) + (50 x 6,000) + (25 x 6,000)} Allocated

price per membership is ₹ 6,857 approx. (12,00,000 / 175)

Basis on above, it is to be noted that although entity has collected ₹ 7,500 but revenue can be recognized at ₹ 6,857 approx. per membership and remaining ₹ 643 should be recorded as contract liability against option given to customer for renewing their membership at discount.

Question 19

A Ltd. is a company which is in the business of manufacturing engineering machines and providing after sales services. The company entered into a contract with Mr. Anik to supply and install a machine, namely 'model pi' on 1st April 20X1 and to service this machine on 30th September 20X1 and 1st April 20X2. The cost of manufacturing the machine to A Ltd. was ₹ 1,60,000.

It is possible for a customer to purchase both the machine 'model pi' and the maintenance services separately. Mr. Anik is contractually obliged to pay A Ltd ₹ 4,00,000 on 1st April, 20X2.

The prevailing rate for one-year credit granted to trade customers in the industry is 5 percent per six-month period.

As per the experience, the servicing of the machine 'model pi' sold to Mr. Anik is expected to cost A Ltd. ₹ 30,000 to perform the first service and ₹ 50,000 to perform the second service. Assume actual costs equal expected costs. When A Ltd. provides machine services to customers in a separate transaction it earns a margin of 50% on cost. On 1 st April, 20X1, the cash selling price of the machine 'model pi' sold to Mr. Anik is ₹ 2,51,927.

The promised supply of machine 'model pi' and maintenance service obligations are satisfactorily carried out in time by the company.

You are required to:

- Segregate the components of the transaction that A Ltd. shall apply to the revenue recognition criteria separately as per Ind AS 115;
- Calculate the amount of revenue which A Ltd. must allocate to each component of the transaction;

(iii) Prepare journal entries to record the information set out above in the books of accounts of A Ltd. for the years ended 31st March-20X2 and 31st March 20X3; and
 Draft an extract showing how revenue could be presented and disclosed in the financial statements of A Ltd. for the year ended 31st March 20X2 and 31st March 20X3. (MTP 14 Marks Sep'22, PYP 12 Marks, Jan'21)

Answer 19

(i) As per para 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

- the customer can benefit from the good or service either on its own or together with other resources that are readily available to them. A readily available resource is a good or service that is sold separately (by the entity or another entity) or that the customer has already obtained from the entity or from other transactions or events; and
- the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Factors that indicate that two or more promises to transfer goods or services to a customer are separately identifiable include, but are not limited to, the following:

- significant integration services are not provided (i.e. the entity is not using the goods or services as inputs to produce or deliver the combined output called for in the contract)
- the goods or services does not significantly modify or customize other promised goods or services in the contract.
- the goods or services are not highly inter-dependent or highly interrelated with other promised goods or services in the contract Accordingly, on 1st April, 20X1, entity A entered into a single transaction with three identifiable separate components:
 - Sale of a good (i.e. engineering machine);
 - Rendering of services (i.e. engineering machine maintenance services on 30th September, 20X1 and 1st April, 20X2); and
 - Providing finance (i.e. sale of engineering machine and rendering of services on extended period credit).

(ii) Calculation and allocation of revenue to each component of the transaction

Date	Opening balance	Finance income	Goods	Services	Payment received	Closing balance
1st April, 20X1	–	–	2,51,927	–	–	2,51,927
30th September, 20X1	2,51,927	12,596 (Note 1)	–	45,000	–	3,09,523
31st March 20X2	3,09,523	15,477 (Note 2)	–	–	–	3,25,000
1st April, 20X2	3,25,000	–	–	75,000	(4,00,000)	

Notes:

- Calculation of finance income as on 30th September, 20X1 = $5\% \times 2,51,927 = ₹ 12,596$
- Calculation of finance income as on 31st March, 20X2 = $5\% \times 3,09,523 = ₹ 15,477$

(iii) Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
1st April, 20X1	Mr. Anik Dr.	2,51,927	
	To Revenue - sale of goods (Profit or loss A/c)		2,51,927
	(Being revenue recognised from the sale of the machine on credit)		

	Cost of goods sold (Profit or loss) Dr.	1,60,000	
	To Inventories		1,60,000
	(Being cost of goods sold recognised)		
30th September 20X1	Mr. Anik Dr.	12,596	
	To Finance Income (Profit or loss)		12,596
	(Being finance income recognised)		
	Mr. Anik Dr.	45,000	
	To Revenue- rendering of services (Profit or loss)		45,000
	(Being revenue from the rendering of maintenance services recognised)		
	Cost of services (Profit or loss) Dr.	30,000	
	To Cash/Bank or payables		30,000
	(Being the cost of performing maintenance services recognised)		
31st March 20X2	Mr. Anik Dr.	15,477	
	To Finance Income (Profit or loss)		15,477
	(Being finance income recognised)		
1st April, 20X2	Mr. Anik Dr.	75,000	
	To Revenue - rendering of services (Profit or loss)		75,000
	(Being revenue from the rendering of maintenance services recognised)		
	Cost of services (Profit or loss) Dr.	50,000	
	To Cash/Bank or payables		50,000
	(Being the cost of performing maintenance services recognised)		
	Cash/Bank Dr.	4,00,000	
	To Mr. Anik		4,00,000
	(Being the receipt of cash from the customer recognised)		

- (iv) Extract of Notes to the financial statements for the year ended 31 st March, 20X2 and 31st March, 20X3

Note on Revenue

	20X2-20X3	20X1-20X2
	₹	₹
Sale of goods	–	2,51,927
Rendering of machine - maintenance services	75,000	45,000
Finance income	–	28,073
	75,000	3,25,000



Question 20

On 1st April, 20X1, S Limited enters into a contract with Corp Limited to construct heavy-duty equipment for a promised consideration of ₹ 20,00,000 with a bonus of ₹ 2,50,000 if the equipment is completed within 24 months. At the inception of the contract, S Limited correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with Ind AS 115. At the inception of the contract, the Company expects the costs to be ₹ 11,00,000 and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will occur. Completion of the heavy-duty equipment is highly susceptible to factors outside of the Company's influence, mainly due to difficulties with the supply of components.

At 31st March, 20X2, S Limited has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained in accordance with Ind AS 115. However, on 4th June, 20X2, the contract is modified with the result that the fixed consideration and expected costs increase by ₹ 1,50,000 and ₹ 80,000 respectively. The time allowable for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that the bonus will be achieved and that the contract remains a single performance obligation.

S Limited wants your opinion on the accounting treatment of contract with Corp Limited in light of Ind AS 115, for the year 20X1-20X2 and 20X2-20X3. (12 Marks MTP Oct'22, 10 Marks MTP April '23, RTP May '22)

Answer 20

For the year 20X1-20X2

S Limited accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with Ind AS 115. At the inception of the contract,

S Limited expects the following:

Transaction price – ₹ 20,00,000
Expected costs – ₹ 11,00,000
Expected profit (45%) – ₹ 9,00,000

At contract inception, S Limited excludes the ₹ 2,50,000 bonus from the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Completion of the heavy-duty equipment is highly susceptible to factors outside the entity's influence.

By the end of the first year, the entity has satisfied 65% of its performance obligation on the basis of costs incurred to date. Costs incurred to date are therefore ₹ 7,15,000 and S Limited reassesses the variable consideration and concludes that the amount is still constrained. Therefore at 31st March, 20X2, the following would be recognized:

Revenue (A) – ₹ 13,00,000 (₹ 20,00,000 x 65%)
Costs (B) – ₹ 7,15,000 (₹ 11,00,000 x 65%)
Gross profit (C) i.e. (A-B) – ₹ 5,85,000

For the year 20X2-20X3

On 4th June, 20X2, the contract is modified. As a result, the fixed consideration and expected costs increase by ₹ 1,50,000 and ₹ 80,000, respectively.

The total potential consideration after the modification is ₹ 24,00,000 which is ₹ 21,50,000 fixed consideration + ₹ 2,50,000 completion bonus. In addition, the allowable time for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognized in accordance with Ind AS 115. Therefore, the bonus of ₹ 2,50,000 can be included in the transaction price.

S Limited also concludes that the contract remains a single performance obligation. Thus, S Limited accounts for the contract modification as if it were part of the original contract. Therefore, S Limited updates its estimates of costs and revenue as follows:

S Limited has satisfied 60.60% of its performance obligation (₹ 7,15,000 actual costs incurred compared to ₹ 11,80,000 total expected costs). The entity recognizes additional revenue of ₹ 1,54,400 [(60.60% of ₹ 24,00,000) – ₹ 13,00,000 revenue recognized to date] at the date of modification i.e. on 4th June, 20X2 as a cumulative catch-up adjustment.

Question 21

ST Limited enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (i.e. the performance obligation will be satisfied at a point in time). The contract includes two alternative payment options:

- (1) Payment of Rs. 5,000 in two years when the customer obtains control of the asset or**
- (2) Payment of Rs. 4,000 when the contract is signed. The customer elects to pay Rs. 4,000 when the contract is signed.**

ST Limited concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market.

The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the two alternative payment options economically equivalent. However, the entity determines that, the rate that should be used in adjusting the promised consideration is 6%, which is the entity's incremental borrowing rate.

Pass journal entries showing how the entity would account for the significant financing component. (MTP 5 Marks May '20, Old & New SM)

Answer 21

Journal Entries showing accounting for the significant financing component:

- (a) Recognise a contract liability for the Rs. 4,000 payment received at contract inception:

Cash	Dr.	Rs. 4,000
To Contract liability		Rs. 4,000

- (b) During the two years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration and accretes the contract liability by recognizing interest on Rs. 4,000 at 6% for two years:

Interest expense	Dr.	Rs. 494*
To Contract liability		Rs. 494

* Rs. 494 = Rs. 4,000 contract liability × (6% interest per year for two years).

- (c) Recognize revenue for the transfer of the asset:

Contract liability	Dr.	Rs. 4,494
To Revenue		Rs. 4,494

Question 22

NKT Limited sells a product to a customer for ₹ 1,21,000 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence. The cash selling price of the product is ₹ 1,00,000 which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is ₹ 80,000. The contract includes an implicit interest rate of 10 per cent.

Analyse the above transaction with respect to its financing component and compute the amount to be charged in each year as financing component. (MTP 5 Marks Oct '21, Old & New SM)

Answer 22

The contract includes a significant financing component. This is evident from the difference between the amount of promised consideration of ₹ 1,21,000 and the cash selling price of ₹ 1,00,000 at the date that the goods are transferred to the customer.

The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 1,21,000 to the cash selling price of ₹ 1,00,000). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.

Until the entity receives the cash payment from the customer, interest revenue would be recognised in accordance with Ind AS 109. In determining the effective interest rate in accordance with Ind AS 109, the entity would consider the remaining contractual term.

Calculation of interest income:

Year	Opening balance (a)	Interest @ 10% (b) = (a) x 10%	Payment (c)	Closing balance (d) = (a) + (b) -(c)
1	1,00,000	10,000	-	1,10,000
2	1,10,000	11,000	1,21,000	-

Hence, the interest revenue with respect to financing component of the transaction to be recognized in the Year 1 and Year 2 is ₹ 10,000 and ₹ 11,000 respectively.

Question 23

ABC Limited supplies plastic buckets to wholesaler customers. As per the contract entered into between ABC Limited and a customer for the financial year 20X1-20X2, the price per plastic bucket will decrease retrospectively as sales volume increases within the stipulated time of one year.

The price applicable for the entire sale will be based, on sales volume bracket during the year.

Price per unit (INR)	Sales volume
90	0 - 10,000 units
80	10,001 - 35,000 units
70	35,001 units & above

All transactions are made in cash.

- Suggest how revenue is to be recognized in the books of accounts of ABC Limited as per expected value method, considering a probability of 15%, 75% and 10% for sales volumes of 9,000 units, 28,000 units and 36,000 units respectively. For workings, assume that ABC Limited achieved the same number of units of sales to the customer during the year as initially estimated under expected value method for the financial year 20X1-20X2.
- In case ABC Limited decides to measure revenue, based on most likely method instead of expected value method, how will be the revenue recognised in the books of accounts of ABC Limited based on above available information? For workings, assume that ABC Limited achieved the same number of units of sales to the customer during the year as initially estimated under most likely value method for the financial year 20X1-20X2. Assume that the sales volume of 28,000 units given under the expected value method, with highest probability is the sales estimated under most likely method too.
- You are required to pass Journal entries in the books of ABC Limited if the revenue is accounted for as per expected value method for financial year 20X1-20X2. (MTP 14 Marks March '23, PYP 14 Marks, Nov 20) (MTP 14 Marks Oct '23)

Answer 23

- Determination of how revenue is to be recognized in the books of ABC Ltd. as per expected value method

Calculation of probability weighted sales volume

Sales volume (units)	Probability	Probability-weighted sales volume (units)
9,000	15%	1,350
28,000	75%	21,000
36,000	10%	3,600
		25,950

Calculation of probability weighted sales value

Sales volume (units)	Sales price per unit (₹)	Probability	Probability-weighted sales value (₹)
9,000	90	15%	1,21,500
28,000	80	75%	16,80,000
36,000	70	10%	2,52,000
			20,53,500

Average unit price = Probability weighted sales value/ Probability weighted sales volume = 20,53,500 / 25,950 = ₹ 79.13 per unit

Revenue is recognized at ₹ 79.13 for each unit sold. First 10,000 units sold will be booked at ₹ 90 per unit and liability is accrued for the difference price of ₹ 10.87 per unit (₹ 90 – ₹ 79.13), which will be reversed upon subsequent sales of 15,950 units (as the question states that ABC Ltd. achieved the same number of units of sales to the customer during the year as initially estimated under the expected value method for the financial year 20X1- 20X2). For, subsequent sale of 15,950 units, contract liability is accrued at 0.87 (80 – 79.13) per unit and revenue will be deferred.

(ii) Determination of how revenue is to be recognised in the books of ABC Ltd. as per most likely method

Transaction price will be:

28,000 units x ₹ 80 per unit = ₹ 22,40,000 Average

unit price applicable = ₹ 80

First 10,000 units sold will be booked at ₹ 90 per unit and liability of ₹ 1,00,000 is accrued for the difference price of ₹ 10 per unit (₹ 90 – ₹ 80), which will be reversed upon subsequent sales of 18,000 units (as question states that ABC Ltd. achieved the same number of units of sales to the customer during the year as initially estimated under the most likely method for the financial year 20X1-20X2).

(iii) Journal Entries in the books of ABC Ltd.

(when revenue is accounted for as per expected value method for financial year 20X1-20X2)

ft			₹	₹
1.	Bank A/c (10,000 x ₹ 90)	Dr.	9,00,000	
	To Revenue A/c (10,000 x ₹ 79.13)			7,91,300
	To Liability (10,000 x ₹ 10.87)			1,08,700
	(Revenue recognised on sale of first 10,000 units)			
2.	Bank A/c [(25,950 x ₹ 80) - 9,00,000]	Dr.	11,76,000	
	Liability	Dr.	86,124	
	To Revenue A/c (15,950 x ₹ 79.13)			12,62,124
	(Revenue recognised on sale of remaining 15,950 units (25,950 - 10,000). Amount paid by the customer will be the balance amount after adjusting the excess paid earlier since, the customer falls now in second slab)			



3.	Liability (1,08,700 – 86,124)	Dr.	22,576	
	To Revenue A/c [25,950 x (80-79.13)]			22,576
	(On reversal of liability at the end of the financial year 20X1-20X2 i.e. after completion of stipulated time)			

Alternatively, in place of first two entries, one consolidated entry may be passed as follows:

Bank A/c (25,950 x ₹ 80)	Dr.	20,76,000	
To Revenue A/c (25,950 x ₹ 79.13)			20,53,424
To Liability (25,950 x ₹ 0.87)			22,576
(Revenue recognized on sale of 25,950 units)			

Note: In 2nd journal entry, it is assumed that the customer had paid balance amount of ₹ 11,76,000 after adjusting excess ₹ 1,00,000 paid with first lot of sale of 10,000 unit. However, one can pass journal entry with total sales value of ₹ 12,76,000 (15,950 units x ₹ 80 per unit) and later on pass third entry for refund. In such a situation, alternatively, 2nd and 3rd entries would be as follows:

Bank A/c (15,950 x ₹ 80)	Dr.	12,76,000	
To Revenue A/c (15,950 x ₹ 79.13)			12,62,124
To Liability			13,876
(Revenue recognised on sale of remaining 15,950 units (25,950 - 10,000))			
Liability (1,08,700 + 13,876)	Dr.	1,22,576	
To Revenue A/c [25,950 x (80-79.13)]			22,576
To Bank			1,00,000
(On reversal of liability at the end of the financial year 20X1-20X2 i.e. after completion of stipulated time and excess amount refunded)			

Question 24

A Ltd. a telecommunication company, entered into an agreement with B Ltd. which is engaged in generation and supply of power. The agreement provided that A Ltd. will provide 1,00,000 minutes of talk time to employees of B Ltd. in exchange for getting power equivalent to 20,000 units. A Ltd. normally charges ₹ 0.50 per minute and B Ltd. charges ₹ 2.5 per unit. How should revenue be measured in this case? (MTP 6 Marks Sep '23)

Answer 24

Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

However, the current scenario will be covered under Ind AS 115 since the same is exchange of dissimilar goods or services.

As per paragraph 47 of Ind AS 115, an entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

On the basis of the above, revenue recognised by A Ltd. will be the consideration in the form of power units that it expects to be entitled for talk time sold, i.e. ₹ 50,000 (20,000 units x ₹ 2.5). The revenue recognised by B Ltd. will be the consideration in the form of talk time that it expects to be entitled for the power units sold, i.e., ₹ 50,000 (1,00,000 minutes x ₹ 0.50).

Question 25

An entity enters into a contract with a customer on 1st April, 20X1 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years. Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31st March, 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

How will the Company recognise revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods? (MTP 8 Marks Sep '23)

Answer 25

The entity has made sale of two goods – machine and space parts, whose control is transferred at a point in time. Additionally, company agrees to hold the spare parts for the customer for a period of 2 - 4 years, which is a separate performance obligation. Therefore, total transaction price shall be divided amongst 3 performance obligations:

- (i) Sale of machinery
- (ii) Sale of spare parts
- (iii) Custodial services for storing spare parts.

Recognition of revenue for each of the three performance obligations shall occur as follows:

- Sale of machinery: Machine has been sold to the customer and physical possession as well as legal title passed to the customer on 31st March, 20X3. Accordingly, revenue for sale of machinery shall be recognised on 31st March, 20X3.
- Sale of spare parts: The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill-and-hold basis if all below criteria are met:

(a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement)	The customer has specifically requested for entity to store goods in their warehouse, owing to close proximity to customer's factory
(b) the product must be identified separately as belonging to the customer	The spare parts have been specifically identified and inspected by the customer
(c) the product currently must be ready for physical transfer to the (d) customer	The spares are identified and segregated, therefore, ready for delivery
(d) the entity cannot have the ability to use the product or to direct it to another customer	Spares have been segregated and cannot be redirected to any other customer



Therefore, all conditions of bill-and-hold are met and hence, company can recognize revenue for sale of spare parts on 31st March, 20X3.

- Custodial services: Such services shall be given for a period of 2 to 4 years from 31st March, 20X3. Where services are given uniformly and customer receives and consumes benefits simultaneously, revenue for such service shall be recognized on a straight-line basis over a period of time.

Question 26

An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for Rs.20,00,000. P Ltd. intends to use the said machinery to start a food processing unit. The food processing industry is highly competitive and P Ltd. has very little experience in the said industry. P Ltd. pays a non-refundable deposit of Rs.1,00,000 at inception of the contract and enters into a long-term financing agreement with G Ltd. for the remaining 95 per cent of the agreed consideration which it intends to pay primarily from income derived from its food processing unit as it lacks any other major source of income. The financing arrangement is provided on a non-recourse basis, which means that if P Ltd. defaults then G Ltd. can repossess the machinery but cannot seek further compensation from P Ltd., even if the full value of the amount owed is not recovered from the machinery. The cost of the machinery for G Ltd. is Rs. 12,00,000. P Ltd. obtains control of the machinery at contract inception.

When should G Ltd. recognize revenue from sale of machinery to P Ltd. in accordance with Ind AS 115? (RTP Nov'19, Old & New SM)

Answer 26

As per paragraph 9 of Ind AS 115, "An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met: the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;

- (a) the entity can identify each party's rights regarding the goods or services to be transferred;
- (b) the entity can identify the payment terms for the goods or services to be transferred;
- (c) the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession".

Paragraph 9(e) above, requires that for revenue to be recognized, it should be probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In the given case, it is not probable that G Ltd. will collect the consideration to which it is entitled in exchange for the transfer of the machinery. P Ltd.'s ability to pay may be uncertain due to the following reasons:

- (a) P Ltd. intends to pay the remaining consideration (which has a significant balance) primarily from income derived from its food processing unit (which is a business involving significant risk because of high competition in the said industry and P Ltd.'s little experience);
- (b) P Ltd. lacks sources of other income or assets that could be used to repay the balance consideration; and
- (c) P Ltd.'s liability is limited because the financing arrangement is provided on a non-recourse basis.

In accordance with the above, the criteria in paragraph 9 of Ind AS 115 are not met.

Further, para 15 states that when a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognize the consideration received as revenue only when either of the following events has occurred:

- (a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
- (b) the contract has been terminated and the consideration received from the customer is non-refundable.

Para 16 states that an entity shall recognize the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met. Depending on the facts and circumstances relating to the contract, the liability recognized represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

In accordance with the above, in the given case G Ltd. should account for the non-refundable deposit of Rs.1,00,000 payment as a deposit liability as none of the events described in paragraph 15 have occurred—that is, neither the entity has received substantially all of the consideration nor it has terminated the contract. Consequently, in accordance with paragraph 16, G Ltd. Will continue to account for the initial deposit as well as any future payments of principal and interest as a deposit liability until the criteria in paragraph 9 are met (i.e. the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. Further, G Ltd. will continue to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

Question 27 (Includes concepts of Ind AS 37 & Ind AS 10)

A manufacturer gives warranties to the purchasers of its goods. Under the terms of the warranty, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale to the purchasers.

On 30 April 20X1, a manufacturing defect was detected in the goods manufactured by the entity between 1 March 20X1 and 30 April 20X1. At 31 March 20X1 (the entity's reporting date), the entity held approximately one week's sales in inventories.

The entity's financial statements for the year ended 31 March 20X1 have not yet been finalized.

Three separate categories of goods require separate consideration: Category 1—defective goods sold on or before 31 March 20X1 Category 2—defective goods held on 31 March 20X1 Category 3—defective goods manufactured in 20Xb1-20X2 State the accounting treatment of the above categories in accordance with relevant Ind AS. (RTP May '21)

Answer 27

Category 1—defective goods sold on or before 31 March 20X1

If customer has the option to purchase warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In that case, entity shall account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation.

If a customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, unless it provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. If that is the case, then, the promised service is a performance obligation. Entity shall allocate the transaction price to the product and the service.

If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

Category 2—defective goods held on 31 March 20X1



At 31 March 20X1 the entity did not have a present obligation to make good the unsold defective goods that it held in inventories. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective inventories. However, the entity should test the inventories for impairment in accordance with Ind AS 36, Impairment of Assets.

For this category, the detection of the manufacturing defect in April 20X1 is an adjusting event after the end of the reporting period as per Ind AS 10, Events after the End of the Reporting Period. It provides evidence of a manufacturing defect in inventories held at 31 March 20X1.

Category 3—defective goods manufactured in 20X1-20X2

At 31 March 20X1 the entity did not have a present obligation to make good any defective goods that it might manufacture in the future. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective goods manufactured in 20X1-20X2.

For this category, the detection of the manufacturing defect in April 20X1 is a non-adjusting event after the end of the reporting period as per Ind AS 10, Events After the End of the Reporting Period.

Question 28

A property sale contract includes the following:

- (a) Common areas
- (b) Construction services and building material
- (c) Property management services
- (d) Golf membership
- (e) Car park
- (f) Land entitlement

Analyze whether the above items can be considered as separate performance obligations as per the requirements of Ind AS 115? (RTP May 21)

Answer 28

Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

- a good or service (or a bundle of goods or services) that is distinct; and
- series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

As per paragraph 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

Each performance obligation is required to be accounted for separately.

Based on the above guidance, the following table discusses whether the common goods and services in property sale contract should be considered as separate performance obligation or not:

Goods/Service	Whether a separate Performance obligation (PO) or not	Reason
Common areas	Unlikely to be separate PO	Common areas are unlikely to be a separate performance obligation because the interests received in common areas are typically undivided interests that are not separable from the property itself. However, if the common areas were sold separately by the developer, then they could be considered as a separate performance obligation provided that it is distinct in the context of the contract.
Construction services and building material	Unlikely to be separate PO	Construction services and building materials can meet the first criterion as they are items that can be used in conjunction with other readily available goods or services. However, the developer would be considered to be providing a significant integration service as it is bringing together all the separate elements to deliver a complete building.
Property management services and Golf membership	Likely to be separate PO	Property management services and golf membership are likely to be separate performance obligations as they may be used in isolation or with the property already acquired, i.e., management services can be used with the property. These types of services are not significantly customised, integrated with, or dependent on the property. This is because there is no change in their function with or without the property. Also, a property management service could be undertaken by a third party.
Car park and Land entitlement	Analysis required	Items such as car parks and land entitlements generally meet the first criterion – i.e., capable of being distinct – as the buyer benefits from them on their own. Whether the second criterion is met depends on the facts and circumstances. For example, if the land entitlement can be sold separately or pledged as security as a separate item, it may indicate that it is not highly dependent on, or integrated with, other rights received in the contract. In an apartment scenario, the customer can receive an undivided interest in the land on which the apartment block sits. This type of right is generally considered as highly inter-related with the apartment itself.*

* However, if title to the land is transferred to the buyer separately – for example in a single party development – then the separately identifiable criterion may be met.

PS: Other facts and circumstances of each contract should also be carefully examined to determine performance obligations.

Question 29

Prime Ltd. is a technology company and regularly sells Software S, Hardware H and Accessory A. The stand-alone selling prices for these items are stated below:

Software S – ₹ 50,000 Hardware H – ₹1,00,000 and Accessory A – ₹ 20,000.

Since the demand for Hardware H and Accessory A is low, Prime Ltd. sells H and A together at ₹ 100,000. Prime Ltd. enters into a contract with Zeta Ltd. to sell all the three items for a consideration of ₹1,50,000.

What will be the accounting treatment for the discount in the financial statements of Prime Ltd., considering that the three items are three different performance obligations which are satisfied at different points in time? Further, what will be the accounting treatment if Prime Ltd. would have transferred the control of Hardware H and Accessory A at the same point in time. (RTP Nov '21)

Answer 29

Paragraph 82 of Ind AS 115 states that, “An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

- the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;
- the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and
- the discount attributable to each bundle of goods or services described in paragraph 82(b) is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs”.
- In the given case, the contract includes a discount of ₹ 20,000 on the overall transaction, which should have been allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method (in accordance with paragraph 81 of Ind AS 115). However, as Prime Ltd. meets all the criteria specified in paragraph 82 above, i.e., it regularly sells Hardware H and Accessory A together for ₹ 1,00,000 and Software S for ₹ 50,000, accordingly, it is evident that the entire discount should be allocated to the promises to transfer Hardware H and Accessory A.
- In the given case, since the contract requires the entity to transfer control of Hardware H and Accessory A at different points in time, then the allocated amount of ₹ 1,00,000 should be individually allocated to the promises to transfer Hardware H (stand-alone selling price of ₹ 1,00,000) and Accessory A (stand-alone selling price of ₹20,000)

Product	Allocated transaction price (₹)
Hardware H	83,333 $(1,00,000 / 120,000 \times 100,000)$
Accessory A	<u>16,667</u> $(20,000 / 120,000 \times 100,000)$
Total	<u>1,00,000</u>

- However, if Prime Ltd. would have transferred the control of Hardware H and Accessory A at the same point in time, then the Prime Ltd. could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, Prime Ltd. could allocate ₹ 1,00,000 of the transaction price to the single performance obligation and recognise revenue of ₹ 1,00,000 when Hardware H and Accessory A simultaneously transfer to Zeta Ltd.

Question 30

XYZ Ltd. sells goods to its customer with a promise to give discount of 5% on list price of the goods provided that the payments are received from customer within 15 days. XYZ Ltd. sold goods of ₹ 5 lakhs to ABC Ltd. between 17 th March, 20X1 and 31st March, 20X1. ABC Ltd. paid the dues by 15th April,



20X1 with respect to sales made between 17th March, 20X1 and 31st March, 20X1. Financial statements were approved for issue by Board of Directors on 31st May, 20X1. State whether discount will be adjusted from the sales at the end of the reporting period. (RTP May '22)

Answer 30

As per Ind AS 115, if the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

In the instant case, the condition that sales have been made exists at the end of the reporting period and the receipt of payment within 15 days' time after the end of the reporting period and before the approval of the financial statements confirms that the discount is to be provided on those sales. Therefore, it is an adjusting event.

Accordingly, XYZ Ltd. should adjust the sales made to ABC Ltd. With respect to discount of 5% on the list price of the goods.

Question 31

A Ltd. owns 20 resorts across India. Every customer who stays in any of the resorts owned by A Ltd. is entitled to get points on the basis of total amount paid by him. Under this scheme, 1 point is granted for every ₹ 100 spent for stay in the resort. As per the past experience of A Ltd., the likelihood of exercise of the points is 100% and the standalone price of each such point is ₹ 5. Customer X spends ₹ 10,000 in one of the resorts of A Ltd. What is the accounting treatment for the points granted by A Ltd.? (RTP Nov'22)

Answer 31

Paragraph B40 of Ind AS 115, inter alia, states that, "if in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a separate performance obligation only if the option provides a material right to the customer that it would not receive without entering into that contract".

Further, paragraph B41 states that if a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services.

In the given case, the customer does get a material right by way of a discount of ₹ 500 for every 100 points that he would not receive without the previous stay in that resort. Thus, the customer in effect pays the entity in advance for future goods and the entity recognises revenue when the goods are transferred.

According to paragraph B42, paragraph 74 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the standalone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it on the basis of percentage discount the customer may obtain upon exercising the option and the likelihood of the option getting exercised.

In accordance with above, an entity shall account for award credit as a separate performance obligation of the sales transactions in which they are initially granted. The value of the consideration the entity expects to be entitled in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

In the current case, the standalone selling price of the 100 points is ₹ 500. A Ltd. should allocate the fair value of the consideration (i.e. ₹ 10,000) between the points and the other components of the sale as ₹ 476 ($500/10,500 \times 10,000$) and ₹ 9,524 ($10,000/10,500 \times 10,000$) respectively in proportion of their standalone selling price. Since A Ltd. supplies the awards itself (i.e. it acts as a principal), it should recognise ₹ 476 as revenue when points are redeemed.

Question 32

Company X enters into an agreement on 1st January, 20X1 with a customer for renovation of hospital and install new air-conditioners for total consideration of ₹ 50,00,000. The promised renovation service, including the installation of new air - conditioners is a single performance obligation satisfied over time. Total expected costs are ₹ 40,00,000 including ₹ 10,00,000 for the air-conditioners. Company X determines that it acts as a principal in accordance with Ind AS 115 because it obtains control of the air conditioners before they are transferred to the customer. The customer obtains control of the air conditioners when they are delivered to the hospital premises.

Company X uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation.

As at 31st March, 20X1, other costs incurred excluding the air conditioners are ₹ 6,00,000.

Whether Company X should include cost of the air conditioners in measure of its progress of performance obligation? How should revenue be recognized for the year ended 31st March, 20X1? (RTP May '23, Old & New SM)

Answer 32

Paragraph B19 of Ind AS 115 inter alia, states that, “an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 39, do not depict the entity’s performance in transferring control of goods or services to the customer”.

In accordance with the above, Company X assesses whether the costs incurred to procure the air conditioners are proportionate to the entity’s progress in satisfying the performance obligation. The costs incurred to procure the air conditioners i.e ₹ 10,00,000 are significantly relative to the total costs to completely satisfy the performance obligation i.e. ₹ 40,00,000. Also, Company X is not involved in manufacturing or designing of air conditioners.

Company X concludes that including the costs to procure the air conditioners in the measure of progress would overstate the extent of the entity’s performance. Consequently, in accordance with paragraph B19 of Ind AS 115, the entity adjusts its measure of progress to exclude the costs to procure the air conditioners from the measure of costs incurred and from the transaction price. The entity recognises revenue for the transfer of the air conditioners at an amount equal to the costs to procure the air conditioners (i.e., at a zero margin). Accordingly, the total revenue on account of renovation would be ₹ 50,00,000 – ₹ 10,00,000 = ₹ 40,00,000.

Company X assesses that as at 31st March, 20X1, the performance is 20% complete (i.e., ₹ 6,00,000 ₹ 30,00,000).

Total revenue from renovation work would be = ₹ 50,00,000 – ₹ 10,00,000 = ₹ 40,00,000.

Consequently, as at 31st March, 20X1, Company X recognizes the following:

		₹
Revenue	[(₹ 40,00,000 × 20%) + ₹ 10,00,000]	18,00,000
Less: Cost of goods sold	(₹ 6,00,000 of costs incurred + ₹ 10,00,000 costs of air conditioners)	(16,00,000)
Profit		2,00,000

Question 33

On 1st April, 20X1, Entity X enters into a contract with Entity Y to sell mobile chargers for ₹ 100 per charger. As per the terms of the contract, if Entity Y purchases more than 1,000 chargers till March 20X2, the price per charger will be retrospectively reduced to ₹ 90 per unit. Till September 20X1, Entity X sold 95 chargers to Entity Y. Entity X estimates that Entity Y’s purchases by March 20X2 will not exceed the required threshold of 1,000 chargers.

In October 20X1, Entity Y acquires another Entity C and from October 20X1 to December 20X1, Entity X

sells an additional 600 chargers to Entity Y. Due to these developments, Entity X estimates that purchases of Entity Y will exceed the 1,000 chargers threshold for the period and therefore, it will be required to retrospectively reduce the price per charger to ₹ 90. Analyse the above scenario in light of Ind AS 115 and state how the revenue should be recognised in such a situation. (RTP Nov '23)

Answer 33

Paragraph 56 of Ind AS 115 states that an entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

Further, paragraph 57 of Ind AS 115 state that in assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

- the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.
- the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.
- the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- the contract has a large number and broad range of possible consideration amounts.

Entity X estimates that the consideration in the above contract is variable. Therefore, in accordance with paragraphs 56 and 57 of Ind AS 115, Entity X is required to consider the constraints in estimating variable consideration. Entity X determines that it has significant experience with this product and with the purchasing pattern of the Entity Y. Thus, if Entity X concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ₹ 100 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known), then the Entity X will recognise revenue of ₹ 9,500 (95 chargers x ₹ 100 per charger) for the half year ended 30th September, 20X1.

Further, paragraphs 87 and 88 of Ind AS 115 that after contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes."

In accordance with the above, in the month of October 20X1, due to change in circumstances on account of Entity Y acquiring Entity C and consequential increase in sale of chargers to Entity Y, Entity X estimates that Entity Y's purchases will exceed the 1,000 chargers threshold till March 20X2 for the period and therefore, it will be required to retrospectively reduce the price per charger to ₹ 90.

Consequently, the Entity X will recognise revenue of ₹ 53,050 for the quarter ended December 20X1 which is calculated as follows:

Particulars	Amount in ₹

Sale of 600 chargers (600 chargers x ₹ 90 per charger)	54,000
Less: Change in transaction price (95 chargers x ₹ 10 price reduction) for the reduction of revenue relating to units sold till September 20X1.	<u>(950)</u>
Revenue recognised for the quarter ended December 20X1	<u>53,050</u>

Question 34

Royal Silks, a textile chain operates a customer loyalty programme. It grants programme members loyalty points when they purchase textiles for a specified amount. Programme members can redeem the points for further purchase of textiles. The points have no expiry date. In one period, the entity grants 10,000 points. Management estimates the fair value of textiles for which each loyalty point can be redeemed as Rs. 125. This amount takes into account an estimate of the discount that management expects would otherwise be offered to customers who have not earned award credits from an initial sale. In addition, management expects only 8,000 of these points to be redeemed. At the end of the first year, 4,000 of the points have been redeemed in exchange for textiles, i.e. half of those expected to be redeemed. In the second year, management revises its expectations. It now expects 9,000 points to be redeemed altogether. During the second year, 4,100 points are redeemed. In the third year, a further 900 points are redeemed, i.e. that no more points will be redeemed after the third year. How would the Royal Silks account for the customer loyalty programme? (PYP 4 Marks, May' 18)

Answer 34

The fair value of textiles for which each loyalty point can be redeemed as Rs. 125. Since management expects that only 8,000 points to be reimbursed, the revenue that should be deferred is of Rs. 10,00,000 (8,000 x 125).

Year 1

At the end of the first year, 4,000 of the points have been redeemed in exchange for textiles, i.e., half of those expected to be redeemed. The entity recognises revenue of (4,000 points / 8,000 points) x Rs. 10,00,000 = Rs. 5,00,000.

Year 2

During the second year, 4,100 points are redeemed, bringing the total number redeemed to 4,000 + 4,100 = 8,100 points. The cumulative revenue that the entity recognises is (8,100 points / 9,000 points) x Rs. 10,00,000 = Rs. 9,00,000. The entity has recognised revenue of Rs. 5,00,000 in the first year, so it recognises Rs. 4,00,000 in the second year.

Year 3

In the third year, a further nine hundred points are redeemed, taking the total number of points redeemed to 8,100 + 900 = 9,000. Management continues to expect that only 9,000 points will ever be redeemed, i.e., that no more points will be redeemed after the third year. So the cumulative revenue to date is (9,000 points / 9,000 points) x Rs. 10,00,000 = Rs. 10,00,000. The entity has already recognised Rs. 9,00,000 of revenue (Rs. 5,00,000 in the first year and Rs. 4,00,000 in the second year). So it recognises the remaining Rs. 1,00,000 in the third year. All of the revenue initially deferred has now been recognized.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A few examinees calculated deferred income on the basis of 10,000 points instead of 8000 points.

Question 35

Deluxe bike manufactured by Zed Limited is sold with an extended warranty of 2 years for Rs. 87,300 while an identical Deluxe bike without the extended warranty is sold in the market for Rs. 80,000 and equivalent warranty is given in the market for Rs. 10,000. How should Zed Limited recognize and



measure revenue in the books on the sale of the bikes and warranty? (PYP 5 Marks, Nov'18)

Answer 35

Zed Ltd. has sold two products viz Deluxe bike and the extended warranty. Revenue earned on sale of each product should be recognised separately.

Calculation of Revenue attributable to both the components:

Total fair value of Deluxe bike and extended warranty (80,000+10,000)	Rs. 90,000
Less: Sale price of the Deluxe bike with extended warranty	<u>(Rs. 87,300)</u>
Discount	<u>Rs. 2,700</u>

Discount and revenue attributable to each component of the transaction: Proportionate

discount attributable to sale of Deluxe bike Rs. 2,400
(2,700 x 80,000 / 90,000)

Revenue from sale of Deluxe bike (80,000 – 2,400)	Rs. 77,600
Proportionate discount attributable to extended warranty	Rs. 300 (2,700 x 10,000 / 90,000)

Revenue from extended warranty (10,000 - 300)	Rs. 9,700

Revenue in respect of sale of Deluxe bike of Rs. 77,600 should be recognised immediately and revenue from warranty of Rs. 9,700 should be recognised over the period of warranty i.e. 2 years.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees were not able to bifurcate the discount, revenue from sale of bike and revenue from warranty correctly.

Question 36

Orange Ltd. contracts to renovate a five-star hotel including the installation of new elevators on 01.10.2017. Orange Ltd. estimates the transaction price of Rs. 480 lakhs. The expected cost of elevators is Rs. 144 lakhs and expected other costs is Rs. 240 lakhs. Orange Ltd. purchases elevators and they are delivered to the site six months before they will be installed. Orange Ltd. uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of Rs. 48 lakhs by 31.03.2018. How much revenue will be recognised as per relevant Ind AS 115 for the year ended 31st March, 2018, if performance obligation is met over a period of time? (PYP 5 Marks, May 19)

Answer 36

Cost to be incurred comprises two major components – cost for elevators and cost of construction service.

- The elevators are part of the overall construction project and are not a distinct performance obligation
- The cost of elevators is substantial to the overall project and are incurred well in advance.
- Upon delivery at site, customer acquires control of such elevators.
- There is no modification done to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method –

- The measure of progress should be based on percentage of costs incurred relative to the total budgeted costs.
- The cost of elevators should be excluded when measuring such progress and revenue for

such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	Amount (Rs. in lakh)
Transaction price	480
Costs incurred:	
(a) Cost of elevators	144
(b) Other costs	48
Measure of progress	48 / 240 = 20%

Revenue to be recognised: (Rs. in lakh)

(a) For costs incurred (other than elevators)	Total attributable revenue = 480 - 144 = 336 % of work completed = 20% Revenue to be recognised = 67.20
(b) Revenue for elevators	(equal to costs incurred) 144
Total revenue to be recognized	144 + 67.2 = 211.20

Therefore, for the year ended 31st March, 2018, the company shall recognize revenue of Rs. 211.20 lakhs on the project.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees made mistake in calculating the amount of revenue to be recognised while some failed to properly explain the basis for the treatment done. A few examinees erroneously included the cost of elevator in the total cost and revenue.

Question 37

An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and will pay for those tickets even if it is not able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance. The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are sold; therefore, there is no credit risk to the entity.

The entity also assists the customers in resolving complaints with the service provided by airlines.

However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

Determine whether the entity is a principal or an agent with suitable explanation in light with the provisions given in the relevant standard. (PYP 4 Marks, Nov'20, Old & New SM)

Answer 37

To determine whether the entity's performance obligation is to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for another party to provide those goods or services (i.e. the entity is an agent), the entity considers the nature of its promise as per Ind AS 115.

The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. The entity considers the following indicators for assessment as principal or agent under the contract with the customers:

- (a) the entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.

- (b) the entity has inventory risk for the tickets because they are purchased before they are sold to the

entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.

- (c) the entity has discretion in setting the sales prices for tickets to its customers.

The entity concludes that its promise is to provide a ticket (i.e. a right to fly) to the customer. On the basis of the indicators, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognizes revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.

Question 38

GTM Limited has provided the following 4 independent scenarios. You are advised to respond to the queries mentioned at the end of each scenario. Support your answer with the relevant extracts of the applicable Ind AS.

Scenario 1

GTM Limited enters into a contract with a customer to sell product G, T and M in exchange for ₹ 1,90,000. GTM Limited will satisfy the performance obligations for each of the product at different points in time. GTM Limited regularly sells product G separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of product T and M are not directly observable. Because the stand-alone selling prices for Product T and M are not directly observable, the Company has to estimate them. To estimate the stand-alone selling prices, the Company uses the adjusted market assessment approach for product T and the expected cost plus a margin approach for product M. In making these estimates, the Company maximizes the use of observable inputs.

The entity estimated the stand-alone selling prices as follows:

Product	Stand-alone selling price (₹)
Product G	90,000
Product T	44,000
Product M	66,000
Total	2,00,000

Determine the transaction price allocated to each Product.

Scenario 2

GTM Limited regularly sells Products G, T and M individually. The standalone selling prices are as under:

Product	Stand-alone selling price (₹)
Product G	90,000
Product T	44,000
Product M	66,000
Total	2,00,000

In addition, the Company regularly sells Products T and M together for ₹ 1,00,000. The Company enters into a contract with another customer to sell Products G, T and M in exchange for ₹ 1,90,000. GTM Limited will satisfy the performance obligations for each of the products at different points in time; or Product T and M at same point in time.

Determine the allocation of transaction price to Product T and M.

Scenario 3

GTM Limited enters into a contract with a customer to sell products G, T and M as described in scenario 2. The contract also includes a promise to transfer product 'Hope'. Total consideration in the contract is ₹ 2,40,000. The stand-alone selling price for product 'Hope' is highly variable because the company sells Product 'Hope' to different customers for a broad range of amounts (₹ 40,000 to ₹ 65,000). Determine the selling price of Products G, T, M and Hope using the residual approach.

Scenario 4

The same facts as in scenario 3 applies to scenario 4 except that the transaction price is ₹ 2,25,000 instead of ₹ 2,40,000. Discuss how the transaction price should be allocated. (PYP 12 Marks July 21, Old & New SM)

Answer 38

Scenario 1

The customer receives a discount for purchasing the bundle of goods because the sum of the stand-alone selling prices (₹ 2,00,000) exceeds the promised consideration (₹ 1,90,000). The entity considers that there is no observable evidence about the performance obligation to which the entire discount belongs. The discount is allocated proportionately across Products G, T and M. The discount, and therefore the transaction price, is allocated as follows:

Product	Allocated transaction price	
	₹	
Product G	85,500	(₹ 90,000 ÷ ₹ 2,00,000 × ₹ 1,90,000)
Product T	41,800	(₹ 44,000 ÷ ₹ 2,00,000 × ₹ 1,90,000)
Product M	62,700	(₹ 66,000 ÷ ₹ 2,00,000 × ₹ 1,90,000)
Total	1,90,000	

Scenario 2

The contract includes a discount of ₹ 10,000 on the overall transaction, which would be allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method.

However, because the entity regularly sells Products T and M together for ₹ 1,00,000 and Product G for ₹ 90,000, it has evidence that the entire discount of ₹ 10,000 should be allocated to the promises to transfer Products T and M in accordance with paragraph 82 of Ind AS 115.

If the entity transfers control of Products T and M at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate ₹ 90,000 of the transaction prices to the single performance obligation of G and recognise revenue of ₹ 1,00,000 when Products T and M simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Products T and M at different points in time, then the allocated amount of ₹ 1,00,000 is individually allocated to the promises to transfer Product T (stand-alone selling price of ₹ 44,000) and Product M (stand-alone selling price of ₹ 66,000) as follows:

Product	Allocated transaction price	
	₹	
Product T	40,000	(₹ 44,000 ÷ ₹ 1,10,000 total stand-alone selling price × ₹ 1,00,000)
Product M	60,000	(₹ 66,000 ÷ ₹ 1,10,000 total stand-alone selling price × ₹ 1,00,000)
Total	1,00,000	

Scenario 3

Before estimating the stand-alone selling price of Product Hope using the residual approach, the entity determines whether any discount should be allocated to the other performance obligations in the contract. As in Scenario 2, because the entity regularly sells Products T and M together for ₹ 1,00,000 and Product G for ₹ 90,000, it has observable evidence that ₹ 1,90,000 should be allocated to those three products and ₹ 10,000 discount should be allocated to the promises to transfer Products T and M in accordance with paragraph 82 of Ind AS 115. Using the residual approach, the entity estimates the stand-alone selling price of Product Hope to be ₹ 50,000 as follows:

Product	Stand-alone selling price	Method
	₹	
Product G	90,000	Directly observable
Products T and M	1,00,000	Directly observable with discount
Product Hope	50,000	Residual approach
Total	2,40,000	

The entity observes that the resulting ₹ 50,000 allocated to Product Hope is within the range of its observable selling prices (₹ 40,000 to ₹ 65,000).

Scenario 4

The same facts as in Scenario 3 apply to Scenario 4 except the transaction price is ₹ 2,25,000 instead of ₹ 2,40,000. Consequently, the application of the residual approach would result in a stand-alone selling price of ₹ 35,000 for Product Hope (₹ 2,25,000 transaction price less ₹ 1,90,000 allocated to Products G, T and M).

The entity concludes that ₹ 35,000 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product Hope, because ₹ 35,000 does not approximate the stand-alone selling price of Product Hope, which ranges from ₹ 40,000 to ₹ 65,000.

Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product Hope using another suitable method. The entity allocates the transaction price of ₹ 2,25,000 to Products G, T, M and Hope using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of Ind AS 115.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Most of the examinees were able to compute the value of each product in all the scenarios but lacked in explaining the reason for the same. Further, in scenario 4, a few of the examinees considered the minimum price of the product Hope as ₹ 40,000 (instead of ₹ 35,000) and done the allocation accordingly.

Question 39

An entity has a fixed fee contract for ₹ 22,00,000 to develop a product that meets specified performance criteria. Estimated cost to complete the contract is ₹ 20,00,000. The entity will transfer control of the product over five years and the entity uses the cost-to-cost input method to measure progress on the contract. An incentive award is available if the product meets the following weight criteria:

Weight (Kg)	Award % of Fixed Fee	Incentive Fee (₹)
951 or greater	0%	Nil
701 - 950	10%	2,20,000
700 or less	25%	5,50,000

The entity has extensive experience creating products that meet the specific performance criteria. Based on its experience, the entity has identified five engineering alternatives that will achieve the 10% incentive and two that will achieve the 25% incentive. In this case, the entity determined that it has 90% confidence that it will achieve the 10% incentive and 10% confidence that it will achieve 25% incentive. Based on this analysis, the entity believes 10% to be the most likely amount when estimating the transaction price. Therefore, the entity includes only the 10% award in the transaction price when calculating revenue because the entity has concluded it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved due to its 90% confidence in achieving the 10% award.

The entity reassesses its production status quarterly to determine whether it is on track to meet the criteria for the incentive award. At the end of the year four, it becomes apparent that this contract will fully achieve the weight-based criteria. Therefore, the entity revises its estimate of variable consideration to include the entire 25% incentive fee in the year four because, at this point, it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when including the entire variable consideration in the transaction price. Analyze the impact of changes in variable consideration when cost incurred is as follows:

Year	₹
1	1,20,000
2	3,70,000
3	8,20,000
4	5,70,000
5	1,20,000

Calculate yearly Revenue, Operating Profit and Margin (%). For simplification purposes, calculate revenue for the year independently based on costs incurred during the year divided by total expected costs, with the assumption that total expected costs do not change. (PYP 10 Marks Dec '21)

Answer 39

Table showing Yearly Revenue, Operating Profit and Margin (%)

Fixed consideration	A	22,00,000				
Estimated costs to complete	B	20,00,000				
		Year 1	Year 2	Year 3	Year 4	Year 5
Total estimated variable consideration	C	2,20,000	2,20,000	2,20,000	5,50,000	5,50,000
Fixed revenue	$D=A \times H/B$	1,32,000	4,07,000	9,02,000	6,27,000	1,32,000
Variable revenue	$E=C \times H/B$	13,200	40,700	90,200	1,56,750	33,000
Cumulative revenue adjustment	F (see below)	—	—	—	2,16,150	—
Total revenue	$G=D+E+F$	1,45,200	4,47,700	9,92,200	9,99,900	1,65,000
Costs	H	1,20,000	3,70,000	8,20,000	5,70,000	1,20,000
Operating profit	$I=G-H$	25,200	77,700	1,72,200	4,29,900	45,000
Margin (rounded off)	$J=I/G$	17.36%	17.36%	17.36%	42.99%	27.27%

In practice, under the cost-to-cost measure of progress, total revenue for each period is determined by multiplying the total transaction price (fixed and variable) by the ratio of cumulative cost incurred to total estimated costs to complete, less revenue recognized to date.

Calculation of cumulative catch-up adjustment:			
Updated variable consideration	L		5,50,000
Cumulative costs through Year 4	M	18,80,000	
Estimated costs to complete	N	20,00,000	
Percent complete in Year 4: (rounded off)	$O=M/N$		94%
Cumulative variable revenue through Year 4:	P		3,00,850
Cumulative catch-up adjustment	$F=[(L \times O) - P]$		2,16,150

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question required to calculate yearly revenue, operating profit and percentage of margin by applying the provisions of Ind AS 115. Many examinees erred in the calculation of cumulative catch-up adjustment in year 4 because of which operating profit margin also went

Question 40

ANANDAM Ltd. enters into a contract with a customer on 1st April, 2019 for sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is 3 years.

On completion of manufacturing, ANANDAM Ltd. demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations each of which will be satisfied at a point in time.

On 31st March, 2022, the customer pays for the machine and spare parts, but only takes the physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at ANANDAM Ltd.'s warehouse because of its close proximity to the customer's factory.

The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. ANANDAM Ltd. stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. ANANDAM Ltd. expects to hold the spare parts for one to three years and does not have the authority to use the spare parts or direct them to another customer.

Determine how the revenue will be recognized by ANANDAM Ltd. for the different performance obligations as per Ind AS 115? (PYP 6 Marks May '22, Old & New SM)

Answer 40
IDENTIFICATION OF OBLIGATIONS:

ANANDAM Ltd. has made sale of two goods – machine and spare parts, whose control is transferred at a point in time. Additionally, company agrees to hold the spare parts for the customer for a period of 1-3 years, which is a separate performance obligation. Therefore, total transaction price shall be allocated amongst 3 performance obligations viz

- (i) Sale of machinery
- (ii) Sale of spare parts
- (iii) Custodial services for storing spare parts.

RECOGNITION OF REVENUE:

Recognition of revenue for each of the three performance obligations shall occur as follows:

- (i) **Sale of machinery:** Machine has been sold to the customer and physical possession as well as legal title passed to the customer on 31st March, 2022. Accordingly, revenue for sale of machinery shall be recognised on 31st March, 2022.
- (ii) **Sale of spare parts:** The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill-and-hold basis if all below criteria are met:

(a) The reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);	The customer has specifically requested the entity to store goods in their warehouse, owing to proximity to customer's factory.
(b) The product must be identified separately as belonging to the customer;	The spare parts have been specifically identified and inspected by the customer.
(c) The product currently must be ready for physical transfer to the customer; and	The spares are identified and segregated, therefore, ready for delivery any time.
(d) The entity cannot have the ability to use the product or to direct it to another customer	Spares have been segregated and cannot be redirected to any other customer.

Therefore, all the above conditions of bill-and-hold are met and hence, company can recognize

- (iii) **Custodial services:** Such services shall be given for a period of 1 to 3 years from 31st March, 2022. Where services are given uniformly and customer receives & consumes benefits simultaneously, revenue for such service shall be recognized on a straight-line basis over a period of time.

Question 41

Card Ltd. is engaged in the business of manufacturing of car locks and nut bolts.

Car Locks: Typically, a contract is entered into for sale of car locks and consideration is received in the event of delivery of goods to the customer place. The cost of each car lock is ₹ 1,500 and the selling price is ₹ 1,800. The terms of the contract entitle the customer to return any unused car locks within 30 days and receive a full refund. The Company estimates that the costs of recovering the car lock will be immaterial and expects that the returned car locks can be resold at a profit. The Company has sold a total of 20,000 car locks during the month ended 31st March, 2022. From past experience, Card Ltd. expects that 4% of the car locks will be returned in the financial year 2022 - 2023.

Nut Bolts: On 1st April, 2021, Card Ltd. enters into a one-year contract with a customer to deliver nut bolts. The contract stipulates that the price per piece will be adjusted retrospectively once the customer reaches certain sales volume, defined, as follows:

Price per piece	Cumulative sales volume
₹ 200	1 – 50,000
₹ 190	50,001 – 1,00,000
₹ 180	1,00,001 & above

Volume is determined based on sales during the financial year. There are no minimum purchase requirements. Card Ltd. estimates that the total sales volume for the year will be 90,000 based on its experience with similar contracts and forecasted sales to the customer.

Card Ltd. sells 24,000 pieces to the customer during the first quarter of the financial year 2021-2022 for a contract price of ₹ 200 per piece.

You are required to:

- Analyze the terms of the revenue contracts with customers for sale of car locks as per Ind AS 115. Determine the amount of revenue, refund liability and the asset to be recognized by Card Ltd. for the said contracts of car locks.
- Determine the transaction price, revenue and liability, if any, for nut bolts as per Ind AS 115 at the end of first quarter of the financial year 2021-2022. (PYP 8 Marks May '22)

Answer 41

Analysis:

(i)

(a) Nature of consideration received:

Card Ltd. applies the requirements in Ind AS 115 to the portfolio of 20,000 car locks because it reasonably expects that the effects on the financial statements from applying the requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable.

(b) Probability of significant reversal of cumulative revenue:

Card Ltd. considers on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of ₹ 3,45,60,000 (₹ 1,800 x 19,200 car locks not expected to be returned) can be included in the transaction price. Card Ltd. determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame i.e. the 30 -day return period. Thus, Card Ltd. concludes that it is highly probable that a significant reversal in the cumulative amount of revenue

recognized (i.e. ₹ 3,45,60,000) will not occur as the uncertainty will be resolved (i.e. over the return period).

Card Ltd. estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Upon transfer of control of the 20,000 car locks, Card Ltd. does not recognise revenue for 800 car locks that it expects to be returned. Consequently, it recognises the following:

- a. revenue of ₹ 3,45,60,000 (₹ 1,800 x 19,200 products not expected to be returned);
- b. a refund liability of ₹ 14,40,000 (₹ 1,800 refund x 800 products expected to be returned); and
- c. an asset of ₹ 12,00,000 (₹ 1,500 x 800 products for its right to recover products from customers on settling the refund liability).

(ii)

(a) Transaction Price:

The transaction price will be based on Card Ltd.'s estimate of total sales volume for the year. Since Card Ltd. estimates cumulative sales volume of 90,000 nut bolts during the year, transaction price per nut bolt will be ₹ 190. Card Ltd. will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

(b) Determination of Revenue:

Card Ltd. concludes that based on a transaction price of ₹ 190 per nut bolt, it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty is resolved. Revenue is therefore recognised at a selling price of ₹ 190 per nut bolt as each nut bolt is sold. Accordingly, for the first quarter of the financial year 2021-2022, Card Ltd. recognizes revenue of ₹ 45,60,000 (24,000 nut bolts x ₹ 190).

(c) Determination of Liability:

Card Ltd. will recognise a liability for cash received in excess of the transaction price for the first 50,000 nut bolts sold at ₹ 200 per nut bolt (that is, ₹ 10 per nut bolt) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced. Accordingly, for the first quarter of the financial year 2021-2022, Card Ltd. recognizes liability of ₹ 2,40,000 (24,000 nut bolts x (₹ 200 – ₹ 190)).

Question 42

On 1st April, 2021, Z Limited enters into a contract to construct a manufacturing facility for Mint Limited at a fixed consideration of ₹ 30.00 lakhs. Z Limited can earn an incentive of ₹ 3.75 lakhs if the construction is completed within 24 months. Z Limited expects the costs to be ₹ 16.50 lakhs. At the inception of the contract, Z Limited determines that the contract contains single performance obligation satisfied over time. Z Limited also concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will occur as the completion of the manufacturing facility is highly susceptible to factors outside of the Company's influence, due to exceptionally high rainfall in the region.

At 31st March, 2022, Z Limited has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained due to uncertain weather conditions.

However, on 15th April, 2022, the contract is modified. The fixed consideration is enhanced by ₹ 2.25 lakhs and the expected costs increases by ₹ 1.20 lakhs. The contract period is also extended by 6 months. Z Limited now concludes that it is highly probable that the incentive award will be achieved. The contract remains a single performance obligation.

Compute, as per applicable Ind AS: (i) For financial year 2022-2023, revenue from the contract, contract costs & resultant profit, (ii) Additional revenue (catch up adjustment) as on the date of modification of the contract i.e. 15th April, 2022. (PYP 6 Marks May '23)

Answer 42
Year 1 i.e. financial year 2021-2022

In the given case, at contract inception, Z Ltd. will exclude the performance bonus of ₹ 3,75,000 from the transaction price because it is concluded that there is high probability that a significant reversal in the amount of cumulative revenue recognised will occur as the completion of the manufacturing facility is highly susceptible to factors outside the entity's influence i.e. exceptionally high rainfall in the region.

Therefore, at the inception of the contract, for Z Ltd:

	₹
Transaction Price	30,00,000
Expected costs	(16,50,000)
Expected profit (45%)	13,50,000

As at the year end, 31st March, 2022, Z Ltd. reassessed the variable consideration (i.e. performance bonus) and has concluded that the amount is still uncertain in accordance with paragraphs 56–58 of Ind AS 115. Therefore, the cumulative revenue and costs recognised for the year ended March, 2022 will be as follows:

	₹
Revenue from the contract (65%)	19,50,000
Contract costs	(10,72,500)
Resultant profit	8,77,500

Year 2 i.e. financial year 2022-2023

On 15th April, 2022, Z Ltd. and Mint Ltd. agreed to modified the contract. As a result, the fixed consideration and expected costs increased by ₹ 2,25,000 and ₹ 1,20,000 respectively.

At the date of the modification, since Z Ltd. concluded that it is highly probable that incentive amount will be achieved, it has to include incentive amount of ₹ 3,75,000 in the transaction price. Therefore, the total potential consideration after the modification is ₹ 36,00,000 (₹ 32,25,000 fixed consideration + ₹ 3,75,000 performance bonus) and total estimated cost is ₹ 17,70,000 (₹ 16,50,000 + ₹ 1,20,000).

Further, since the modified contract remains a single performance obligation, Z Ltd. will account for the contract modification, as if it were part of the original contract in accordance with paragraph 21(b) of Ind

Z Ltd. will update its measure of progress and estimates at the date of the modification as a cumulative catch-up adjustment as follows:

Calculation of cumulative catch-up adjustment:		₹
Total potential consideration after the modification	A	36,00,000
Actual costs incurred	B	10,72,500
Total expected costs to complete	C	17,70,000
Percent completion of performance obligation (rounded off)	D = B/C	60.6%
Revenue recognised till date	E	19,50,000
Additional revenue to recognised	F = (A x D) - E	2,31,600

Question 43

On 1st January, 2023, Z Limited enters into an agreement with a college for renovation of building including installation of new air conditioners at a transaction price of ₹ 40.00 lakhs. The expected cost of air conditioners is ₹ 12.00 lakhs. The other expected cost is ₹ 20.00 lakhs. Z Limited purchases the air conditioners and they are delivered to the site before 31st March, 2023. Z Limited uses an input method based on cost to measure progress towards completion of the contract.

Z Limited has incurred actual other costs (excluding the air conditioners) of ₹ 4.00 lakhs by 31st March, 2023.

Determine the revenue to be recognized as per applicable Ind AS for the year ended 31st March, 2023, if performance obligation is met over a period of time. (PYP 6 Marks May '23)

Answer 43

Costs to be incurred comprise two major components – air conditioners and cost of construction service.

- The air conditioners are part of the overall construction project and are not a distinct performance obligation.
- The cost of air conditioners is substantial to the overall project and are incurred well in advance.
- Upon delivery at site, customer acquires control of such air conditioners.
- And there is no modification done to the air conditioners, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such air conditioners also.

Therefore, applying the guidance on Input method –

- The measure of progress should be made based on the percentage of costs incurred relative to the total budgeted costs.
- The cost of air conditioners should be excluded when measuring such progress and revenue for such air conditioners should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	Amount (₹)
Transaction price	40,00,000
Costs incurred:	
(a) Cost of air conditioners	12,00,000
(b) Other costs	4,00,000
Measure of progress:	4,00,000 / 20,00,000 = 20%

Revenue to be recognised:	
(a) For costs incurred (other than air conditioners)	Total attributable revenue = 28,00,000 % of work completed = 20% Revenue to be recognised = 5,60,000
(b) Revenue for air conditioners	12,00,000 (equal to costs incurred)
Total revenue to be recognised	12,00,000 + 5,60,000 = 17,60,000

Therefore, for the year ended 31st March, 2023, the Company shall recognize revenue of ₹ 17,60,000 on the project.

Question 44

A Ltd. is in the business of infrastructure and has two divisions. The brief details of its business and underlying project details are as follows:

Project 1: Ludhiana - Chandigarh Expressway Toll Project

The Company has commenced the construction of the project in the current year. The brief details of the Concession Agreement are given below:

- Total expenses incurred ₹ 100 crore as on 31st March, 2022.
- Under IGAAP, the company has recorded such expenses as intangible assets in the books of account. Total expenses estimated to be incurred on the project are ₹ 200 crore;
- Fair value of the construction service is ₹ 220 crore;
- Total cash flow guaranteed by the government under the concession agreement is ₹ 350 crore;
- Finance revenue over the period of operation phase is ₹ 30 crore;
- Other income relates to the services provided during the operation phase.

Project 2: Bengaluru - Chennai Expressway Toll Project

The Company has also entered into another Concession Agreement with Government of Karnataka in the current year. The said concession agreement is Toll Based Project and the Company needs to collect the toll from the users of the expressway. The construction cost for the said project will be ₹ 150 crore. The fair value of such construction cost is approximately ₹ 200 crore. Under IGAAP, the company has recorded the expenses incurred on the said project as an intangible asset.

You are required to answer the following:

- What would be the classification of Ludhiana - Chandigarh Expressway Toll Project as per applicable Ind AS? Give brief reasoning.
- What would be the classification of Bengaluru – Chennai Expressway Toll Project as per applicable Ind AS? Give brief reasoning.
- What should be the accounting entries for the preparation of financial statements as per relevant Ind AS for the above 2 projects? (PYP 10 Marks Nov 22) (Same concept different figures- Old & New SM)

Answer 44

(i) Project 1 : Ludhiana - Chandigarh Expressway Toll Project

Here the operator has a contractual right to receive cash from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, the operator recognizes a financial asset to the extent it has a contractual right to receive cash.

(ii) Project 2 : Bengaluru - Chennai Expressway Toll Project

Here the operator has a contractual right to charge users of the public services. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are

contingent on the extent that the public uses the service. Therefore, the operator shall recognise an intangible asset to the extent it receives a right (a license) to charge users of the public service.

(iii) Accounting Entries for preparation of financial statements

Ludhiana-Chandigarh Expressway Toll Project

Journal Entries

	Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
	During construction:		
1	Financial asset A/c Dr.	220	
	To Construction revenue		220
	(To recognise revenue relating to construction services, to be settled in cash)		
2	Cost of construction (profit or loss) Dr.	200	
	To Bank A/c (As and when incurred)		200
	(To recognise costs relating to construction services)		
	During the operation phase:		
3	Financial asset Dr.	30	
	To Finance revenue (As and when received or due to receive)		30
	(To recognise interest income under the financial asset model)		
4	Financial asset Dr.	100	
	To Revenue [(350-220) – 30]		100
	(To recognise revenue relating to the operation phase)		
5	Bank A/c Dr.	350	
	To Financial asset		350
	(To recognise cash received from the grantor)		

Bengaluru-Chennai Expressway Toll Project

Journal Entries

	Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
	During construction:		
1	Cost of construction (profit or loss) Dr.	150	
	To Bank A/c (As and when incurred)		150
	(To recognise costs relating to construction services)		
2	Intangible asset Dr.	200	
	To Revenue		200
	(To recognise revenue relating to construction services provided for non-cash consideration)		
	During the operation phase:		
3	Amortisation expense Dr.	200	
	To Intangible asset (accumulated amortisation)		200



	(To recognise amortisation expense relating to the operation phase over the period of operation)		
4	Bank A/c Dr.	?	
	To Revenue		?
	(To recognise revenue relating to the operation phase)		

Note: Amount in entry 4 is kept blank as no information in this regard is given in the question.





Chapter 6.1

Ind AS 2: Inventories

Question 1

State the major changes in Ind AS 2 vis-a-vis AS 2 in respect of the following namely:

- (i) **Machinery Spares**
- (ii) **Subsequent assessment of Net Realizable value**
- (iii) **Cost Formulae (MTP 4 Marks April '21)**

Answer 1

The major changes in Ind AS 2 vis-à-vis AS 2 with respect to following are as follows:

- (i) **Machinery Spares:** AS 2 explains that inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, Property, Plant and Equipment. Such items are accounted for in accordance with AS 10. Ind AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under Ind AS 16.
- (ii) **Subsequent Assessment of Net Realisable Value (NRV):** Ind AS 2 provides detailed guidance in case of subsequent assessment of net realisable value. It also deals with the reversal of the write-down of inventories to net realisable value to the extent of the amount of original write-down, and the recognition and disclosure thereof in the financial statements. AS 2 does not deal with such reversal.
- (iii) **Cost Formulae:** AS 2 specifically provides that the formula used in determining the cost of an item of inventory should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition whereas Ind AS 2 does not specifically state so and requires the use of consistent cost formulas for all inventories having a similar nature and use to the entity.

Question 2

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 debtors? (MTP 2 Marks March '22)**

Answer 2

- (a) **Calculation of operating cycle**

	Month
Period of manufacturing the aircraft	9
Credit period for settlement of delivery amount	<u>7</u>
	<u>16</u>

Hence, the length of the operating cycle will be 16 month.

- (b) Since the inventory and debtors will be realised within normal operating cycle, i.e., 16 months, both the inventory as well as debtors should be classified as current.

Question 3

On 1st January, 20X1 an entity accepted an order for 7,000 custom-made corporate gifts.

On 3rd January, 20X1 the entity purchased raw materials to be consumed in the production process for ₹ 5,50,000, including ₹ 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ₹ 5,55,000 (including ₹ 5,000 loan-raising fees). The loan is secured by the inventories.



During January 20X1 the entity designed the corporate gifts for the customer. Design costs included:

- cost of external designer = ₹ 7,000; and
- labour = ₹ 3,000.

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

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

During February 20X1, the entity incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = ₹ 55,000;
- labour = ₹ 65,000; and
- depreciation of plant used to manufacture the customised corporate gifts = ₹ 15,000.

The customised corporate gifts were ready for sale on 1st March, 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.

Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required. (MTP 6 Marks Sep'22, RTP May'21, Old & New SM)

Answer 3

Statement showing computation of inventory cost

Particulars	Amount (₹)	Remarks
Costs of purchase	5,00,000	Purchase price of raw material [purchase price (₹ 5,50,000) less refundable purchase taxes (₹ 50,000)]
Loan-raising fee	—	Included in the measurement of the liability
Costs of purchase	55,000	Purchase price of consumable stores
Costs of conversion	65,000	Direct costs—labour
Production overheads	15,000	Fixed costs—depreciation
Production overheads	10,000	Product design costs and labour cost for specific customer
Other costs	37,000	Refer working note
Borrowing costs	—	Recognised as an expense in profit or loss
Total cost of inventories	6,82,000	

Working Note:

Costs of testing product designed for specific customer:

₹ 21,000 material (ie net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation = ₹ 37,000

Question 4

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

	Cost	Estimated Sales price	₹ Selling costs
Inventory item A1	8,000	7,800	500
Inventory item A2	14,000	18,000	200
Inventory item B1	16,000	17,000	200
Inventory item C1	6,000	7,500	150



Determine the value of closing inventory in the financial statements of a business. (MTP 4 Marks April '23, Old & New SM)

Answer 4

The value of closing inventory in the financial statements:

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

Question 5

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

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

What will be the value inventory at the following dates:

(a) 31st March 20X1

(b) 31st March 20X2 (RTP May '18, Old & New SM)(MTP 4 Marks Sep '23)

Answer 5

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

- In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be Rs. 10 million and net realisable value would be Rs. 7.5 million (i.e. Expected selling price Rs. 8 million- estimated selling expenses Rs. 0.5 million). Accordingly, inventory shall be measured at Rs. 7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of Rs. 2.5 million would be recorded in income statement of that year.
- As per para 33 of Ind AS 2, a new assessment is made of net realizable value in each subsequent period. It Inter alia states that if there is increase in net realizable value because of changed economic circumstances, the amount of write down is reversed so that new carrying amount is the lower of the cost and the revised net realizable value. Accordingly, as at 31 March 20X2, again inventory would be valued at cost or net realisable value whichever is lower. In the present case, cost is Rs. 10 million and net realisable value would be Rs. 10.5 million (i.e. expected selling price Rs. 11 million – estimated selling expense Rs. 0.5 million). Accordingly, inventory would be recorded at Rs. 10 million and inventory write down carried out in previous year for Rs. 2.5 million shall be reversed.



Question 6

The following is relevant information for an entity:

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

How overhead costs are to be allocated to cost of goods sold and closing inventory (RTP May '20, Old & New SM)

Answer 6

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

Fixed production overhead absorption rate:

= Fixed production overhead / labour hours for normal capacity

= Rs. 1,500 / 7,500

= Rs. 0.2 per hour

Management should allocate fixed overhead costs to units produced at a rate of Rs. 0.2 per hour.

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

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

The amount of fixed overhead allocated to inventory is not increased as a result of low production by using normal capacity to allocate fixed overhead.

Variable production overhead absorption rate:

= Variable production overhead/actual hours for current period

= Rs. 2,600 / 6,500 hours = Rs. 0.4 per hour

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

The above rate results in the allocation of all variable overheads to units produced during the year.

Closing inventory = Opening inventory + Units produced during year – Units sold during year

= 2,500 + 6,500 – 6,700 = 2,300 units

As each unit has taken one hour to produce (6,500 hours / 6,500 units produced), total fixed and variable production overhead recognized as part of cost of inventory:

= Number of units of closing inventory x Number of hours to produce each unit x (Fixed production overhead absorption rate + Variable production overhead absorption rate)

= 2,300 units x 1 hour x (Rs. 0.2 + Rs. 0.4) = **Rs. 1,380**

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

Absorbed in cost of goods sold (FIFO basis) (6,500 – 2,300) = 4,200 x 0.6 = 2,520



Unabsorbed fixed overheads, not included in the cost of goods sold

200

Total **2,720**

Question 7

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

Material = Rs. 200 per unit;

Labour = Rs.100 per unit;

Variable manufacturing overhead = Rs. 100 per unit;

Fixed factory production overhead =Rs. 1,00,00,000;

Fixed factory selling overhead = Rs. 50,00,000;

Variable factory selling overhead = Rs. 150 per unit.

Calculate the value of inventory per unit in accordance with Ind AS 2. What will be the treatment of fixed manufacturing overhead? (RTP Nov '20)

Answer 7

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

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

Fixed overheads are absorbed based on normally capacity level, i.e.; 1,00,000 units, rather than on the basis of actual production, i.e.; 50,000 units. Therefore, fixed manufacturing overhead on 50,000 units, will be absorbed as inventory value. The remaining fixed manufacturing overhead Rs. 50,00,000 (1,00,00,000 - 50,00,000) will be charged to P&L.

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

Question 8

Whether the following costs should be considered while determining the Net Realisable Value (NRV) of the inventories?

- (a) Costs of completion of work-in-progress;
- (b) Trade discounts expected to be allowed on sale; and
- (c) Cash discounts expected to be allowed for prompt payment (RTP Nov '21, Old & New SM)

Answer 8

Ind AS 2 defines Net Realisable Value as the “estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.”

Costs of completion of work-in-progress are incurred to convert the work-in progress into finished goods. Since these costs are in the nature of completion costs, in accordance with the above definition, the same should be deducted from the estimated selling price to determine the NRV of work-in-progress.

The Guidance Note on Terms Used in Financial Statements defines Trade Discount as “A reduction granted by a supplier from the list price of goods or services on business considerations other than for



prompt payment”.

Trade discount is allowed either expressly through an agreement or through prevalent commercial practices in the terms of the trade and the same is adjusted in arriving at the selling price. Accordingly, the trade discount expected to be allowed should be deducted to determine the estimated selling price.

The Guidance Note on Terms Used in Financial Statements defines Cash Discount as “A reduction granted by a supplier from the invoiced price in consideration of immediate payment or payment within a stipulated period.”

These types of costs are incurred to recover the sale proceeds immediately or before the end of the specified period or credit period allowed to the customer. In other words, these costs are not incurred to make the sale, therefore, the same should not be considered while determining NRV.

Question 9

A retailer company imported goods at a cost of ₹ 1,30,000 including ₹ 20,000 non-refundable import duties and ₹ 10,000 refundable purchase taxes. The risks and rewards of ownership of the imported goods were transferred to the retailer company upon collection of the goods from the harbour warehouse. The retailer company was required to pay for the goods upon collection. The retailer company incurred ₹ 5,000 to transport the goods to its retail outlet and a further ₹ 2,000 in delivering the goods to its customer. Further selling costs of ₹ 3,000 were incurred in selling the goods.

State whether delivery charges and selling expenses will form part of the cost of inventory. If not, then why? Also calculate the cost of inventory. (RTP Nov '22)

Answer 9

Calculation of Inventory cost:

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

Note: The cost of purchase excludes the refundable purchase taxes paid on acquisition of the goods as the ₹ 10,000 paid will be refunded to the retailer.

Ind AS 2 specifically exclude selling cost from forming part of cost of inventory. However, selling and distribution costs are generally used as single term because both are related, as selling costs are incurred to effect the sale and the distribution costs are incurred by the seller to complete a sale transaction by making the goods available to the buyer from the point of sale to the point at which the buyer takes possession. Since these costs are not related to bringing the goods to their present location and condition, the same are not included in the cost of inventories. Accordingly, though the word ‘distribution costs’ is not specifically mentioned in Ind AS 2, these costs would continue to be excluded from the cost of inventories. Therefore, it excludes the selling expenses incurred (i.e., ₹ 2,000 delivery costs and ₹ 3,000 other selling costs).

Paragraph 16 of Ind AS 16, Property, Plant and Equipment, inter alia states that the cost of an item of property, plant and equipment comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Further, paragraph 18 of Ind AS 16 states that an entity applies Ind AS 2 to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with Ind AS 2 or Ind AS 16 are recognised and measured in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.



Question 10

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

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

Applying the retail method, compute the following:

- Percentage of cost price over retail price;
- Cost of closing inventory;
- Value of cost of sales (at cost); and
- Revenue earned during the year on sale of inventory

Ignore the impact of mark-ups or mark-downs on the selling price. (RTP May '23)

Answer 10

Table showing application of Retail method for calculation of the goods sold during the year and unsold inventory

S. No.	Particulars		₹
	Cost price of goods	6,250 + 19,500	25,750
	Retail price of goods	8,000 + 34,000	42,000
(a)	Cost percentage of retail price	25,750 / 42,000	61%
(b)	Closing inventory (at cost)	23,000 × 61%	14,030
(c)	Cost of sales for the period	[(6,250 + 19,500) - 14,030]	11,720
	Sales for the period		19,000
(d)	Revenue earned on sale of goods during the year	19,000 – 11,720	7,280

Question 11

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

- Purchase price of the raw materials = ₹ 30,000;
- Import duty and other non-refundable purchase taxes = ₹ 8,000;
- Refundable purchase taxes = ₹ 1,000;
- Freight costs for bringing the goods from the supplier to the factory's storeroom for raw materials = ₹ 3,000;
- Costs of unloading the materials into the storeroom for raw materials = ₹ 20; and
- Packaging = ₹ 2,000.

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

A Ltd. incurred the following additional costs in the production run:

- Salary of the machine workers in the factory = ₹ 5,000;
- Salary of factory supervisor = ₹ 3,000;
- Depreciation of the factory building and equipment used for production process = ₹ 600;
- Consumables used in the production process = ₹ 200;
- Depreciation of vehicle used to transport the goods from the storeroom for raw materials to the



machine floor = ₹ 400;

vi. Factory electricity usage = ₹ 300;

vii. Factory rental = ₹ 1,000; and

viii. Depreciation of the entity's vehicle used by the factory supervisor is ₹ 200. During 20X1-20X2, A Ltd.

incurred the following administrative expenses:

1. Depreciation of the administration building = ₹ 500;

2. Depreciation and maintenance of vehicles used by the administrative staff = ₹ 150; and

3. Salaries of the administrative personnel = ₹ 3,050.

Of the administrative expenses, 20% is attributable to administering the factory. Remaining expenses are attributable, in equal proportion, to the sales and other non- production operations (eg financing, tax and corporate secretarial functions).

In 20X1-20X2, A Ltd. incurred the following selling expenses:

a) Advertising costs = ₹ 300;

b) Depreciation and maintenance of vehicles used by the sales staff = ₹ 100; and

c) Salaries of the administrative personnel = ₹ 6,000.

Pass necessary journal entries to record the cost of inventory in the books of A Ltd. (RTP Nov '23)

Answer 11

Journal Entries for the year 20X1-20X2

		₹	₹
Inventory A/c (W.N.1)	Dr.	42,490	
To Cash/Bank A/c			42,490
(To recognise the cost of raw materials purchased)			
Inventory A/c (W.N.2)	Dr.	11,240	
To Cash/Bank A/c (cost of direct labour)			5,000
To Property, plant and equipment (accumulated depreciation-factory equipment)			600
To Property, plant and equipment (accumulated depreciation-raw-materials delivery vehicle)			400
To Cash/Bank A/c (cost of electricity used)			300
To Property, plant and equipment (accumulated depreciation-factory supervisor's vehicle)			200
To Cash/Bank A/c (factory management's salaries)			3,000
To Cash/Bank A/c (factory rental)			1,000
To Cash/Bank A/c (administrative salaries attributable to the factory)			610
To Property, plant and equipment (attributable portion of accumulated depreciation- administration building)			100



To Property, plant and equipment (attributable portion of accumulated depreciation- administration vehicles)			30
(To recognise the costs of conversion)	Dr.	200	
Inventory A/c (W.N.2)			
To Inventory A/c (consumable stores) (To recognise the costs of consumable stores inventory consumed)			200

The total cost of inventories = Costs of purchase + Costs of conversion

$$= ₹ 42,490 + ₹ 11,240 + ₹ 200$$

$$= ₹ 53,930$$

Working Notes:

1. Computation of costs of purchase

Description	₹
Purchase price	30,000
Import duty and other non-refundable purchase taxes	8,000
Freight costs for bringing the goods to the factory storeroom	3,000
Cost of unloading the raw materials into the storeroom	20
Packaging	2,000
Less: Trade discounts, rebates and subsidies	<u>(530)</u>
Cost of purchase	<u>42,490</u>

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

2. Computation of costs of conversion

Description	
Direct labour	5,000
Fixed production overheads	
Depreciation and maintenance of factory equipment	600
Depreciation of vehicle used for transporting the goods	400
Depreciation of vehicle used by factory supervisor	200
Factory electricity usage	300
Factory management	3,000
Factory rental	1,000
Other costs of administering the factory	
20% of depreciation of administration building	100
20% of depreciation of administration vehicles	30
20% of administrative staff costs	610



Variable production overheads	
Indirect material—consumables	200
Cost of conversion	11,440

Question 12

XYZ Limited has a plant with the normal capacity to produce 10,00,000 units of a product per annum and the expected fixed overhead is Rs. 30,00,000, Fixed overhead, therefore based on normal capacity is Rs. 3 per unit. Determine Fixed overhead as per Ind AS 2 'Inventories' if

- Actual production is 7,50,000 units.
- Actual production is 15,00,000 units. (PYP 8 Marks, May' 18)

Answer 12

- Actual production is 7,50,000 units: Fixed overhead is not going to change with the change in output and will remain constant at Rs. 30,00,000, therefore, overheads on actual basis is Rs. 4 per unit (30,00,000 / 7,50,000).

Hence, by valuing inventory at Rs. 4 each for fixed overhead purpose, it will be overvalued and the losses of Rs. 7,50,000 will also be included in closing inventory leading to a higher gross profit than actually earned.

Therefore, it is advisable to include fixed overhead per unit on normal capacity to actual production (7,50,000 x 3) Rs. 22,50,000 and balance Rs. 7,50,000 shall be transferred to Profit & Loss Account.

- Actual production is 15,00,000 units: Fixed overhead is not going to change with the change in output and will remain constant at Rs. 30,00,000, therefore, overheads on actual basis is Rs. 2 (30,00,000 / 15,00,000).

Hence by valuing inventory at Rs. 3 each for fixed overhead purpose, we will be adding the element of cost to inventory which actually has not been incurred. At

Rs. 3 per unit, total fixed overhead comes to Rs. 45,00,000 whereas, actual fixed overhead expense is only Rs. 30,00,000. Therefore, it is advisable to include fixed overhead on actual basis (15,00,000 x 2) Rs. 30,00,000.

Note:

Various issues related to the applicability of Ind AS / implementation under Companies (Indian Accounting Standards) Rules, 2015, are being raised by preparers, users and other stakeholders. Although many clarifications have been issued by way of ITFG Bulletins or EAC Opinion, still issues are arising on account of varying interpretations on several of its guidance. Therefore, alternate answers may be possible for the above questions based on standards, depending upon the view taken.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees calculated fixed overhead per unit but had not explained the reason for its calculation.

Question 13

In a manufacturing process of Saturn Limited, one by-product BP emerges besides two main products MP1 and MP2 and scrap. Details of cost of production process for financial year 2020-2021 are here under:

Item	Amount (₹)	Output (Units)	Closing Stock 31.3.2021
Raw Material	6,00,000	MP1- 20,000	1,000
Wages	3,60,000	MP2- 16,000	400
Fixed Overhead	2,60,000	BP- 8,000	
Variable Overhead	2,00,000		



Average Market Price of MP1 and MP2 is ₹ 45.00 per unit and ₹ 37.50 per unit respectively. Average Market Price of by-product BP is ₹ 10 per unit. All the units of by-product BP sold after incurring separate processing charges of ₹ 32,000 and packing charges of ₹ 8,000. ₹ 20,000 was realised from sale of scrap.

Calculate the value of closing stock of MP1 and MP2 as on 31.3.2021. Allocate Joint Cost based on the relative sales value of each product. (PYP 5 Marks Dec '21)(Same concept but different figures- Old & New SM, MTP 8 Marks Oct '18)

Answer 13

Calculation of NRV of By-product BP

		₹
Selling price of by-product	8,000 units x 10 per unit	80,000
Less: Separate processing charges of by-product BP		(32,000)
Packing charges		(8,000)
Net realizable value of by-product BP		40,000

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

		₹
Raw material		6,00,000
Wages		3,60,000
Fixed overhead		2,60,000
Variable overhead		2,00,000
		14,20,000
Less: NRV of by-product BP (See calculation 1)	40,000	
Sale value of scrap	20,000	(60,000)
Joint cost to be allocated between MP1 and MP2		13,60,000

Determination of "basis for allocation" and allocation of joint cost to MP1 and

MP2

	MP1	MP2
Output in units (a)	20,000	16,000
Sales price per unit (b)	₹ 45.00	₹ 37.50
Sales value (a x b)	9,00,000	6,00,000
Ratio of allocation	3	2
Joint cost of ₹ 13,60,000 allocated in the ratio of 3:2 (c)	₹ 8,16,000	₹ 5,44,000
Cost per unit [c/a]	₹ 40.80	₹ 34.00

Determination of value of closing stock of MP1 and MP2

Particulars	MP1	MP2
Closing stock in units	1,000 units	400 units
Cost per unit	₹ 40.80	₹ 34.00
Value of closing stock	₹ 40,800	₹ 13,600

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question required determination of cost allocated to the joint products manufactured during the process. A few of the examinees added the cost of by-product to the cost of joint product. While some of the examinees did not subtract the sale value of the scrap to arrive at the joint cost to be allocated to both the joint products.



Question 14

Summer Solutions Limited is engaged in the manufacturing of customized gifts for its corporate customers. On 1st December, 2022, the company received an order from Rain Limited for the supply of 15,000 customized corporate gifts. On 4th December, 2022, to meet the order, Summer Solutions Limited purchased 20,000 kg of certain material at ₹ 110 per kg. The purchase price includes GST of ₹ 10 per kg in respect of which full GST credit is admissible. Freight incurred amounted to ₹ 1,00,000.

During January, 2023, the company incurred the following expenses to design the corporate gift for Rain Limited:

- Fee to external designer ₹ 20,000
- Labour ₹ 8,000

After checking the sample of gift, the management of Rain Limited did not approve the design of gift and suggested some modifications. Consequently, the production team of Summer Solutions Limited made modifications to bring the inventories as per the conditions specified in the order.

Following costs were incurred during testing phase:

- Materials ₹ 45,000
- Labour ₹ 20,000
- Depreciation of plant used during testing phase ₹ 7,000

Some of the materials used during testing phase was scrapped and sold for ₹ 5,000.

During February, 2023, Summer Solutions Limited incurred the following additional costs in the manufacturing of customized corporate gifts:

- Consumable stores ₹ 1,25,000
- Labour ₹ 1,42,000
- Depreciation of plant used in manufacturing of customized corporate gifts: ₹ 38,000

On 15th March, 2023, the customized gifts were ready for delivery. There was no abnormal loss during the manufacturing process.

You are required to compute the cost of customized gifts. Your answer should be supported by appropriate reasons and calculations wherever necessary. (PYP 5 Marks May '23)

Answer 14

Statement showing computation of inventory cost

Particulars	₹	Reasons
Costs of purchase of raw material	21,00,000	Purchase price of raw material net of GST plus freight $[(20,000 \times (110-10)) + 1,00,000]$
Costs of purchase of consumable stores	1,25,000	Purchase price of consumable stores
Costs of conversion	1,42,000	Direct costs — labour
Production overheads	38,000	Fixed costs — depreciation
Production overheads	28,000	Product design costs and labour cost for specific customer
Other costs	67,000	Refer working note
Total cost of inventories	25,00,000	

Working Note:

Costs of testing product designed for specific customer:

₹ 40,000 material (net of ₹ 5,000 recovered from the sale of scrapped output) + ₹ 20,000 labour + ₹ 7,000 depreciation = ₹ 67,000

**Question 15**

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

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31.3.20X3 are as follows:

Solar power panel (WIP) ₹ 85 lakhs

Solar power panel (finished products) ₹ 55 lakhs

Sundry Debtor (solar power panel) ₹ 65 lakhs

The petition for winding up against the customer has been filed during 20X2-20X3 by Sun Ltd. Comment with explanation on provision to be made of ₹ 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 20X2-20X3. (Old & New SM) (Same concept different figures PYP 4 Marks, Nov' 20)

Answer 15

From the fact given in the question it is obvious that Sun Ltd. is a manufacturer of solar power panel. As per Ind AS 2 'Inventories', inventories are assets (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. Therefore, solar power panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year are to be valued at lower of cost or NRV.

As the customer has postponed the delivery schedule due to liquidity crunch the entire cost incurred for solar power panel which were to be supplied has been shown in Inventory. The solar power panel are in the possession of the Company which can be sold in the market. Hence company should value such inventory as per principle laid down in Ind AS 2 i.e. lower of Cost or NRV. Though, the goods were produced as per specifications of buyer the Company should determine the NRV of these goods in the market and value the goods accordingly. Change in value of such solar power panel should be provided for in the books. In the absence of the NRV of WIP and Finished product given in the question, assuming that cost is lower, the company shall value its inventory as per Ind AS 2 for ₹ 140 lakhs [i.e solar power panel (WIP) ₹ 85 lakhs + solar power panel (finished products) ₹ 55 lakhs].

Alternatively, if it is assumed that there is no buyer for such fabricated solar power panel, then the NRV will be Nil. In such a case, full value of finished goods and WIP will be provided for in the books.

As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 20X2-20X3, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for ₹ 65 lakhs shall be made in the books against the debtor's amount.



Chapter 6.2

Ind AS 16: Property, Plant and Equipment

Question 1

An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1st April, 20X1. The plant has a useful life of 40 years. Its initial cost was ₹ 1,20,000. This included an amount for decommissioning costs of ₹ 10,000, which represented ₹ 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31st March. Assume that a market-based discounted cash flow valuation of ₹ 1,15,000 is obtained at 31st March, 20X4. This valuation is after deduction of an allowance of ₹ 11,600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. On 31st March, 20X5, the entity estimates that, as a result of technological advances, the present value of the decommissioning liability has decreased by ₹ 5,000. The entity decides that a full valuation of the asset is needed at 31st March, 20X5, in order to ensure that the carrying amount does not differ materially from fair value. The asset is now valued at ₹ 1,07,000, which is net of an allowance for the reduced decommissioning obligation.

How the entity will account for the above changes in decommissioning liability if it adopts revaluation model? (MTP 8 Marks Oct '19, 10 Marks May'19, Old & New SM)

Answer 1

At 31st March, 20X4:

	₹
Asset at valuation (1)	1,26,600
Accumulated depreciation	Nil
Decommissioning liability	(11,600)
Net assets	1,15,000
Retained earnings (2)	(10,600)
Revaluation surplus (3)	5,600

Notes:

(1) When accounting for revalued assets to which decommissioning liabilities attach, it is important to understand the basis of the valuation obtained. For example:

- if an asset is valued on a discounted cash flow basis, some valuers may value the asset without deducting any allowance for decommissioning costs (a 'gross' valuation), whereas others may value the asset after deducting an allowance for decommissioning costs (a 'net' valuation), because an entity acquiring the asset will generally also assume the decommissioning obligation. For financial reporting purposes, the decommissioning obligation is recognised as a separate liability, and is not deducted from the asset. Accordingly, if the asset is valued on a net basis, it is necessary to adjust the valuation obtained by adding back the allowance for the liability, so that the liability is not counted twice.
- if an asset is valued on a depreciated replacement cost basis, the valuation obtained may not include an amount for the decommissioning component of the asset. If it does not, an appropriate amount will need to be added to the valuation to reflect the depreciated replacement cost of that component.

Since, the asset is valued on a net basis, it is necessary to adjust the valuation obtained by adding back the allowance for the liability. Valuation obtained of ₹ 1,15,000 plus decommissioning costs of ₹ 11,600, allowed for in the valuation but recognised as a separate liability = ₹ 1,26,600.

- Three years' depreciation on original cost ₹ 1,20,000 $\times$ 3/40 = ₹ 9,000 plus cumulative discount on ₹ 10,000 at 5 per cent compound = ₹ 1,600; total ₹ 10,600.



- (3) Revalued amount ₹ 1,26,600 less previous net book value of ₹ 1,11,000 (cost ₹ 120,000 less accumulated depreciation ₹ 9,000).

The depreciation expense for 20X4-20X5 is therefore ₹ 3,420 ($₹ 1,26,600 \times 1 / 37$) and the discount expense for 20X5 is ₹ 600. On 31st March, 20X5, the decommissioning liability (before any adjustment) is ₹ 12,200. However, as per estimate of the entity, the present value of the decommissioning liability has decreased by ₹ 5,000. Accordingly, the entity adjusts the decommissioning liability from ₹ 12,200 to ₹ 7,200.

The whole of this adjustment is taken to revaluation surplus, because it does not exceed the carrying amount that would have been recognised had the asset been carried under the cost model. If it had done, the excess would have been taken to profit or loss. The entity makes the following journal entry to reflect the change:

₹Provision for decommissioning liability	Dr.	5,000	
To Revaluation surplus			5,000

As at 31st March, 20X5, the entity revalued its asset at ₹ 1,07,000, which is net of an allowance of ₹ 7,200 for the reduced decommissioning obligation that should be recognized as a separate liability. The valuation of the asset for financial reporting purposes, before deducting this allowance, is therefore ₹ 1,14,200. The following additional journal entry is needed:

Notes:

		₹	₹
Accumulated depreciation (1) To Asset at valuation	Dr.	3,420	3,420
Revaluation surplus (2) To Asset at valuation (3)	Dr.	8,980	8,980

- (1) Eliminating accumulated depreciation of ₹ 3,420 in accordance with the entity's accounting policy.
- (2) The debit is to revaluation surplus because the deficit arising on the revaluation does not exceed the credit balance existing in the revaluation surplus in respect of the asset.
- (3) Previous valuation (before allowance for decommissioning costs) ₹ 1,26,600, less cumulative depreciation ₹ 3,420, less new valuation (before allowance for decommissioning costs) ₹ 1,14,200.

Following this valuation, the amounts included in the balance sheet are:

Asset at valuation	1,14,200
Accumulated depreciation	Nil
Decommissioning liability	(7,200)
Net assets	1,07,000
Retained earnings (1)	(14,620)
Revaluation surplus (2)	11,620

Notes:

- (1) ₹ 10,600 at 31st March, 20X4, plus depreciation expense of ₹ 3,420 and discount expense of ₹ 600 = ₹ 14,620.
- (2) ₹ 15,600 at 31st March, 20X4, plus ₹ 5,000 arising on the decrease in the liability, less ₹ 8,980 deficit on revaluation = ₹ 11,620.

Following this valuation, the amounts included in the balance sheet are:



Asset at valuation	1,14,200
Accumulated depreciation Decommissioning liability	Nil (7,200)
Net assets	1,07,000
Retained earnings (1)	(14,620)
Revaluation surplus (2)	11,620

Notes:

- (1) ₹ 10,600 at 31st March, 20X4, plus depreciation expense of ₹ 3,420 and discount expense of ₹ 600 = ₹ 14,620.
- (2) ₹ 15,600 at 31st March, 20X4, plus ₹ 5,000 arising on the decrease in the liability, less ₹ 8,980 deficit on revaluation = ₹ 11,620.

Question 2

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

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

Costs relating to the production line are as follows:

Details	Amount Rs.'000
Costs of the basic materials (list price Rs.12.5 million less a 20% trade discount)	10,000
Recoverable goods and services taxes incurred not included in the purchase cost	1,000
Employment costs of the construction staff for the three months to 30 June 20X1	1,200
Other overheads directly related to the construction	900
Payments to external advisors relating to the construction	500
Expected dismantling and restoration costs	2,000

Additional Information

The construction staff was engaged in the production line, which took two months to make ready for use and was brought into use on 31 May 20X1. The other overheads were incurred in the two months period ended on 31 May 20X1. They included an abnormal cost of Rs.3,00,000 caused by a major electrical fault.

The production line is expected to have a useful economic life of eight years. At the end of that time Flywing Airways Ltd is legally required to dismantle the plant in a specified manner and restore its location to an acceptable standard. The amount of Rs.2 million mentioned above is the amount that is expected to be incurred at the end of the useful life of the production line. The appropriate rate to use in any discounting calculations is 5%. The present value of Re.1 payable in eight years at a discount rate of 5% is approximately Re.0.68.

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

The Company computes its depreciation charge on a monthly basis. No impairment of the plant had occurred by 31 March 20X2. Analyze the accounting implications of costs related to production line to be recognized in the balance sheet and profit and loss for the year ended 31 March, 20X2. (MTP 12 Marks May '20)



Answer 2

Statement showing Cost of production line:

Particulars	Amount Rs.'000
Purchase cost	10,000
Goods and services tax – recoverable goods and services tax not included	-
Employment costs during the period of getting the production line ready for use (1,200 x 2 months / 3 months)	800
Other overheads – abnormal costs	600
Payment to external advisors – directly attributable cost	500
Dismantling costs – recognized at present value where an obligation exists (2,000 x 0.68)	1,360
Total	13,260

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

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

Provision for dismantling cost:

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

Extract of Statement of Profit & Loss

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

Extract of Balance Sheet

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

Working Notes:
1. Calculation of depreciation charge

Particulars	Amount Rs. '000
In accordance with Ind AS 16 the asset is split into two depreciable components: Out of the total capitalization amount of 13,260, Depreciation for 3,000 with a useful economic life (UEL) of four years ($3,000 \times \frac{1}{4} \times 10/12$). This is related to a major overhaul to ensure that it generates economic benefits for the second half of its useful life	625
For balance amount, depreciation for 10,260 with an useful economic life (UEL) of eight years will be : $10,260 \times \frac{1}{8} \times 10/12$	1,069
Total (To Statement of Profit & Loss for the year ended 31 st March 20X2)	1,694

2. Finance costs

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

Question 3

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

- Preparation and levelling of the land – ₹ 3,00,000.
- Purchase of materials for the construction – ₹ 6.08 million in total.
- Employment costs of the construction workers – ₹ 2,00,000 per month.
- Overhead costs incurred directly on the construction of the factory – ₹ 1,00,000 per month.
- Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – ₹ 50,000 per month.
- Income received during the temporary use of the factory premises as a car park during the construction period – ₹ 50,000.
- Costs of relocating employees to work at the new factory – ₹ 300,000.
- Costs of the opening ceremony on 31st January, 20X2 – ₹ 150,000.

The factory was completed on 30th November, 20X1 (which is considered as substantial period of time as per Ind AS 23) and production began on 1st February, 20X2. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

At the end of the 40-year period, Sun Ltd has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be ₹ 20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of ₹ 1 payable in 40 years' time at an annual discount rate of 8% is ₹ 0.046.

The construction of the factory was partly financed by a loan of ₹ 17.5 million taken out on



1st April, 20X1. The loan was at an annual rate of interest of 6%. Sun Ltd received investment income of ₹ 100,000 on the temporary investment of the proceeds.

Required: Compute the carrying amount of the factory in the Balance Sheet of Sun Ltd at 31st March, 20X2. You should explain your treatment of all the amounts referred to in this part in your answer. (MTP 10 Marks Nov 21, Old & New SM) (Same concept different figures PYP 5 Marks Nov'18)

Answer 3

Computation of the cost of the factory

Description	Included in P.P.E. ₹ '000	Explanation
Purchase of land	10,000	Both the purchase of the land and the associated legal costs are direct costs of constructing the factory.
Preparation and levelling	300	A direct cost of constructing the factory
Materials	6,080	A direct cost of constructing the factory
Employment costs of construction workers	1,400	A direct cost of constructing the factory for a seven-month period
Direct overhead costs	700	A direct cost of constructing the factory for a seven-month period
Allocated overhead costs	Nil	Not a direct cost of construction
Income from use as a car park	Nil	Not essential to the construction so recognised directly in profit or loss
Relocation costs	Nil	Not a direct cost of construction
Opening ceremony	Nil	Not a direct cost of construction
Finance costs	612.50	Capitalise the interest cost incurred in a seven-month period (purchase of land would not trigger off capitalisation since land is not a qualifying asset. Infact, the construction started from 1 st May, 20X1)
Investment income on temporary investment of the loan proceeds	(100)	offset against the amount capitalised
Demolition cost recognised as a provision	920	Where an obligation must recognise as part of the initial cost
Total	19,912.50	

Computation of accumulated depreciation

Total depreciable amount	9,912.50	All of the net finance cost of 512.50 (612.50 – 100) has been allocated to the depreciable amount.
Depreciation must be in two parts: Depreciation of roof		



component Depreciation of remainder	49.56	$9,912.50 \times 30\% \times 1/20 \times 4/12$
	57.82	$9,912.50 \times 70\% \times 1/40 \times 4/12$
Total depreciation	107.38	
Computation of carrying amount	19,805.12	$19,912.50 - 107.38$

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees erred in the calculation of cost of the factory. Whereas others made mistake in the calculation of depreciation and finance cost and also the carrying amount of factory and land separately.

Question 4

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

	Amount ('000)
Gross carrying amount	Rs. 200
Accumulated depreciation (straight-line method)	(Rs. 80)
Net carrying amount	Rs. 120
Fair value	Rs. 150

The useful life of the machinery is 10 years and the company uses Straight line method of depreciation. The revaluation was performed at the end of 4 years. How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? Support your answer with journal entries.(MTP 6 Marks March '21) (RTP May '19 & May '20, Old & New SM)

Answer 4

According to paragraph 35 of Ind AS 16, when an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

- (a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses.

In such a situation, the revised carrying amount of the machinery will be as follows:

Gross carrying amount	Rs. 250	$[(200/120) \times 150]$
Net carrying amount	Rs. 150	
Accumulated depreciation	Rs. 100	$(Rs. 250 - Rs. 150)$

Journal entry

Plant and Machinery (Gross Block)	Dr. Rs. 50
To Accumulated Depreciation	Rs. 20
To Revaluation Reserve	Rs. 30

Depreciation subsequent to revaluation

Since the Gross Block has been restated, the depreciation charge will be Rs. 25 per annum (Rs. 250/10 years).



Journal entry

Accumulated Depreciation	Dr.	Rs. 25 p.a.	
To Plant and Machinery (Gross Block)			Rs. 25 p.a.

- (b) The accumulated depreciation is eliminated against the gross carrying amount of the asset. The amount of the adjustment of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with the paragraphs 39 and 40 of Ind AS 16.

In this case, the gross carrying amount is restated to Rs. 150 to reflect the fair value and accumulated depreciation is set at zero.

Journal entry

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

Depreciation subsequent to revaluation

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

Journal entry

Accumulated Depreciation	Dr.	Rs. 25 p.a.	
To Plant and Machinery (Gross Block)			Rs. 25 p.a.

Question 5

On 1st April 2017, A Ltd. assumes a decommissioning liability in a business combination. The entity is legally required to dismantle and remove an offshore oil platform at the end of its useful life, which is estimated to be 10 years. A Ltd. uses the expected present value technique to measure the fair value of the decommissioning liability. If A Ltd. was contractually allowed to transfer its decommissioning liability to a market participant, it concludes that a market participant would use the following inputs, probability-weighted as appropriate, when estimating the price, it would expect to receive:

- (i) Labour costs are developed on the basis of current market place wages, adjusted for expectations of future wage increases, required to hire contractors to dismantle and remove offshore oil platforms. A Ltd. assigns probability assessments (based A Ltd.'s experience with fulfilling obligations of this type and its knowledge of the market) to a range of cash flow estimates as follows:

Cash flow estimate (Rs.)	Probability assessment
50,000	25%
62,500	50%
87,500	25%

- (ii) A Ltd. estimates allocated overhead and equipment operating costs to be 80% of expected labour costs in consistent with the cost structure of market participants.
- (iii) A Ltd. estimates the compensation that a market participant would require for undertaking the activity and for assuming the risk associated with the obligation to dismantle and remove the asset as follows:



1. A third-party contractor typically adds 20% mark-up on labour and allocated internal costs to provide a profit margin on the job.
 2. A Ltd. estimates 5% premium of the expected cash flows, including the effect of inflation for uncertainty inherent in locking in today's price for a project that will not occur for 10 years.
- (iv) Entity A assumes a rate of inflation of 4% over the 10-year period on the basis of available market data.
- (v) The risk-free rate of interest for a 10-year maturity on 1st April, 2017 is 5 %. A Ltd. adjusts that rate by 3.5 per cent to reflect its risk of non-performance (ie the risk that it will not fulfil the obligation), including its credit risk.
- (vi) A Ltd. concludes that its assumptions would be used by market participants. In addition, A Ltd. does not adjust its fair value measurement for the existence of a restriction preventing it from transferring the liability.
- (vii) Measure the fair value of its decommissioning liability. Discount factor:

@ 5% for 10 th year	0.6139
@ 3.5% for 10 th year	0.7089
@ 8.5% for 10 th year	0.4423

(MTP 10 Marks April '18)

Answer 5

(a) Measurement of the fair value of its decommissioning liability

	Expected cash flows (Rs.) 1st April 2017
Expected labour costs (Refer W.N.)	65,625
Allocated overhead and equipment costs (0.80 × Rs. 65,625)	52,500
Contractor's profit mark-up [0.20 × (Rs. 65,625 + Rs. 52,500)]	23,625
Expected cash flows before inflation adjustment	1,41,750
Inflation factor (4% for 10 years) on compounding	1.4802
Expected cash flows adjusted for inflation	2,09,818
Market risk premium (Rs. 2,09,818 × 5%)	10,491
Expected cash flows adjusted for market risk	2,20,309
Expected present value using discount rate of (5 +3.5) 8.5% for 10 years	97,443

Working Note:

Cash flow estimate (Rs.)	Probability assessment	Expected cash flows (Rs.)
50,000	25%	12,500
62,500	50%	31,250
87,500	25%	21,875
		65,625

Question 6



G Ltd. has four assets, each in a different class under property, plant & equipment. Assets 1 and 2 are revalued under previous GAAP (AS). Assets 3 and 4 are not. Under previous GAAP, at 31st March 20X1, immediately prior to the entity's date of transition to Ind AS, its Balance Sheet (extract) is as follows:

	Asset 1	Asset 2	Asset 3	Asset 4	Total
	Valuation	Valuation	Cost	Cost	
	₹	₹	₹	₹	₹
Cost or revaluation	5,000	2,000	4,000	4,500	15,500
Accumulated depreciation	(1,000)	(500)	(2,000)	(1,700)	(5,200)
Net book value	4,000	1,500	2,000	2,800	10,300
Revaluation surplus	2,500	500	-	-	3,000

On adoption of Ind AS, its management decides that, under Ind AS, it will:

- Continue to revalue asset 1. The fair value of asset 1 at the date of transition is not materially different from its carrying value under previous GAAP;
- Use the previous valuation of asset 2 as deemed cost, and adopt a policy of cost less depreciation under Ind AS;
- Adopt a policy of revaluation for asset 3. The fair value of asset 3 at the entity's date of transition is ₹ 5,000;
- Continue to use a policy of cost less depreciation for asset 4.

All depreciation methods are already in accordance with those required by Ind AS 16. Discuss the treatment under Ind AS of valuation of assets 1, 2, 3 & 4, being part of property, plant & equipment? (MTP 8 Marks March '22)

Answer 6

Measurement basis for valuation of PPE:

An entity has the following options with respect to measurement of its property, plant and equipment (Ind AS 16) in the opening Ind AS Balance Sheet:

- ◆ Measurement basis as per the respective standards applied retrospectively. This measurement option can be applied on an item-by-item basis. For example, Plant A can be measured applying Ind AS 16 retrospectively and Plant B can be measured applying the “fair value” or “revaluation” options mentioned below.
- ◆ Fair value at the date of transition to Ind AS. This measurement option can be applied on an item-by-item basis in similar fashion as explained above.
- ◆ Previous GAAP revaluation, if such revaluation was, at the date of revaluation, broadly comparable to (a) fair value or (b) cost or depreciated cost in accordance with other Ind AS adjusted to reflect changes in general or specific price index. This measurement option can be applied on an item-by-item basis in similar fashion as explained above.

Analysis of given case:

	Asset 1	Asset 2	Asset 3	Asset 4
Basis used in previous GAAP	Revaluation Model	Revaluation Model	Cost Model	Cost Model
Intent of G Ltd. on transition	To continue with Revaluation model	Use previous valuation as deemed cost	Adopt a policy of revaluation	Continue to use a policy of cost less depreciation
Treatment at	Since fair value at	An entity may	Fair value at	The entity is not



the Time of transition to Ind AS	the transition date is not materially different from its carrying value under previous GAAP, G Ltd. can carry forward with revalued carrying value ₹4,000 as per previous GAAP in Ind AS books and continue to disclose a revaluation surplus of ₹ 2,500.	elect to measure an item of property, plant and equipment at the date of transition to Ind AS at its fair value and use that fair value as its deemed cost at that date. In Ind AS financial statements, asset will be carried forward at ₹ 1,500 and previously disclosed revaluation surplus is transferred to retained earnings or another component of equity.	the date of transition to Ind AS is materially different from its carrying value under previous GAAP. The asset should be revalued and stated at its fair value of ₹ 5,000 on the date of transition to Ind AS. A revaluation surplus of ₹ 3,000 (5,000 – 2,000) will be transferred to revaluation reserve.	availing any exemption given in Ind AS 101. The entity can measure applying Ind AS 16 retrospectively. It is assumed that measurement bases for cost of asset as per previous GAAP and Ind AS are same so asset will be shown in the Ind AS financial statements at ₹ 2,800.

Question 7

On 1st April, 20X1, an entity purchased an office block (building) for ₹ 50,00,000 and paid a non-refundable property transfer tax and direct legal cost of ₹ 2,50,000 and ₹ 50,000 respectively while acquiring the building. During 20X1, the entity redeveloped the building into two-story building. Expenditures on re-development were:

- ₹ 1,00,000 on Building plan approval;
- ₹ 10,00,000 on construction costs (including ₹ 60,000 refundable purchase taxes); and
- ₹ 40,000 was due to abnormal wastage of material and labour.

When the re-development of the building was completed on 1st October, 20X1, the entity rents out Ground Floor of the building to its subsidiary under an operating lease in return for rental payment. The subsidiary uses the building as a retail outlet for its products. The entity kept first floor for its own administration and maintenance staff usage. Equal value can be attributed to each floor. How will the entity account for all the above mentioned expenses in the books of account as on 1st October, 20X1? Also, discuss how the above building will be shown in the consolidated financial statements of the entity as a group and in its separate financial statements as per relevant Ind AS. (MTP 6 Marks April 22)

Answer 7

In accordance with Ind AS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalised. Therefore, the initial purchase price of the building would be:

Particulars	(₹)
Purchase amount	50,00,000
Non-refundable property tax	2,50,000
Direct legal cost	50,000



Expenditures on redevelopment:	53,00,000
Building plan approval	1,00,000
Construction costs (10,00,000 – 60,000)	9,40,000
Total amount to be capitalised at 1st October, 20X1	63,40,000

Treatment of abnormal wastage of material and labour:

As per Ind AS 16, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. It will be charged to Profit and Loss in the year it is incurred. Hence, abnormal wastage of ₹ 40,000 will be expensed off in Profit & Loss in the financial year 20X1-20X2.

Accounting of property- Building

When the property is used as an administrative centre, it is not an investment property, rather it is an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

When the property (land and/or buildings) is held to earn rentals or for capital appreciation (or both), it is an Investment Property. Ind AS 40 prescribes the cost model for accounting of such investment property.

Since equal value can be attributed to each floor, Ground Floor of the building will be considered as Investment Property and accounted for as per Ind AS 40 and First Floor would be considered as Property, Plant and Equipment and accounted for as per Ind AS 16.

Cost of each floor = ₹ 63,40,000 / 2 = ₹ 31,70,000

As on 1st October, 20X1, the carrying value of building vis-à-vis its classification would be as follows:

- (i) In the Separate Financial Statements: The Ground Floor of the building will be classified as investment property for ₹ 31,70,000, as it is property held to earn rentals. While First Floor of the building will be classified as item of property, plant and equipment for ₹ 31,70,000.
- (ii) In the Consolidated Financial Statements: The consolidated financial statements present the parent and its subsidiary as a single entity. The consolidated entity uses the building for the supply of goods. Therefore, the leased-out property to a subsidiary does not qualify as investment property in the consolidated financial statements. Hence, the whole building will be classified as an item of Property, Plant and Equipment for ₹ 63,40,000.

Question 8

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

Advise a per Ind AS whether the cost of the new turbine be recognized as an asset, and, if so, what treatment should be used. Also calculate the revised carrying amount of the machinery? Consider the discount rate of 5% per annum. (MTP 8 Marks March '18, 7 Marks Oct '23 , Old & New SM)

Answer 8

The new turbine will produce economic benefits to MS Ltd., and the cost is measurable. Hence, the item should be recognized as an asset. The original invoice for the machine did not specify the cost of the turbine; however, the cost of the replacement (Rs. 45,00,000) can be used as an indication (usually by discounting) of the likely cost, six years previously.

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

The current carrying amount of the turbine which is required to be replaced of Rs. 13,43,160 would be



derecognized from the books of account, (i.e., Original Cost Rs. 33,57,900 as reduced by accumulated depreciation for past 6 years Rs. 20,14,740, assuming depreciation is charged on straight-line basis.)

The cost of the new turbine, Rs. 45,00,000 would be added to the cost of machine, resulting in a revision of carrying amount of machine to Rs. 71,56,840. (i.e., Rs. 40,00,000* – Rs. 13,43,160 + Rs. 45,00,000).

*Original cost of machine Rs. 1,00,00,000 reduced by accumulated depreciation (till the end of 6 years) Rs. 60,00,000.

Question 9

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

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

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

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

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

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

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

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

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

What is the cost of the equipment at initial recognition? Also show the calculation or reason for underlying treatment. (MTP 10 Marks March '23, RTP May'22)

Answer 9

Description	Calculation or reason	₹
Purchase price	₹ 600,000 purchase price minus ₹ 50,000 refundable purchase taxes	550,000
Loan raising fee	Offset against the measurement of the liability	-
Transport cost	Directly attributable expenditure	20,000
Installation costs	Directly attributable expenditure	100,000
Environmental restoration costs	The obligation to dismantle and restore the environment arose from the installation of the equipment	100,000



Preparation costs	₹ 55,000 materials + ₹ 65,000 labour + ₹ 15,000 depreciation	135,000
Training costs	Recognised as expenses in profit and loss account. The equipment was capable of operating in the manner intended by management without incurring the training costs.	-
Cost of testing	₹ 21,000 materials (ie net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 16,000 labour	37,000
Operating loss	Recognised as expenses in profit and loss account	-
Borrowing costs	Recognised as expenses in profit and loss account	-
Cost of equipment		9,42,000

Question 10

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director for approval. Mr. Y, who is not an accountant, had raised following queries from Mr. X after going through the draft financial statements:

The notes to the financial statements say that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts. Elucidate how all these treatments comply with the relevant Ind AS. (RTP Nov '18, Old & New SM)

Answer 10

Ongoing through the queries raised by the Managing Director

Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

The accounting treatment of the majority of tangible non-current assets is governed by Ind AS 16 'Property, Plant and Equipment'. Ind AS 16 states that the accounting treatment of PPE is determined on a class by class basis. For this purpose, property and plant would be regarded as separate classes. Ind AS 16 requires that PPE is measured using either the cost model or the revaluation model. This model is applied on a class by class basis and must be applied consistently within a class. Ind AS 16 states that when the revaluation model applies, surpluses are recorded in other comprehensive income, unless they are cancelling out a deficit which has previously been reported in profit or loss, in which case it is reported in profit or loss. Where the revaluation results in a deficit, then such deficits are reported in profit or loss, unless they are cancelling out a surplus which has previously been reported in other comprehensive income, in which case they are reported in other comprehensive income.

According to Ind AS 16, all assets having a finite useful life should be depreciated over that life. Where property is concerned, the only depreciable element of the property is the buildings element, since land normally has an indefinite life. The estimated useful life of a building tends to be much longer than for plant. These two reasons together explain why the depreciation charge of a property as a percentage of its carrying amount tends to be much lower than for plant. Properties which are held for investment purposes are not accounted for under Ind AS 16, but under Ind AS 40 'Investment Property'. As per Ind AS 40, investment properties should be accounted for under a cost model. ABC Ltd. had applied the cost model and thus our investment properties are treated differently from the owner occupied property which is annually to fair value.

**Question 11**

Entity X has a warehouse which is closer to factory of Entity Y and vice versa. The factories are located in the same vicinity. Entity X and Entity Y agree to exchange their warehouses. The carrying value of warehouse of Entity X is Rs. 1,00,000 and its fair value is Rs. 1,25,000. It exchanges its warehouse with that of Entity Y, the fair value of which is Rs. 1,20,000. It also receives cash amounting to Rs. 5,000. How should Entity X account for the exchange of warehouses? (RTP Nov'20)

Answer 11

Paragraph 24 of Ind AS 16, inter alia, provides that when an item of property, plant and equipment is acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Further as per paragraph 25 of Ind AS 16, an entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

- (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
- (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
- (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

In the given case, the transaction lacks commercial substance as the company's cash flows are not expected to significantly change as a result of the exchange because the factories are located in the same vicinity i.e. it is in the same position as it was before the transaction.

Hence, Entity X will have to recognize the assets received at the carrying amount of asset given up, i.e., Rs. 1,00,000 being carrying amount of existing warehouse of Entity X and Rs. 5,000 received will be deducted from the cost of property, plant and equipment. Therefore, the warehouse of Entity Y is recognised as property, plant and equipment with a carrying value of Rs. 95,000 in the books of Entity X.

Question 12

An entity has the following items of property, plant and equipment:

- **Property A — a vacant plot of land on which it intends to construct its new administration headquarters;**
- **Property B — a plot of land that it operates as a landfill site;**
- **Property C — a plot of land on which its existing administration headquarters are built;**
- **Property D — a plot of land on which its direct sales office is built;**
- **Properties E1–E10 — ten separate retail outlets and the land on which they are built;**
- **Equipment A — computer systems at its headquarters and direct sales office that are integrated with the point of sale computer systems in the retail outlets;**
- **Equipment B — point of sale computer systems in each of its retail outlets;**
- **Furniture and fittings in its administrative headquarters and its sales office;**
- **Shop fixtures and fittings in its retail outlets.**

How many classes of property, plant and equipment must the entity disclose? (RTP May '21, Old & New SM)

Answer 12

To answer this question one must make a materiality judgement.



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

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

Consequently, land without a building is a separate class of asset from land and buildings. Furthermore, the nature and use of land operated as a landfill site is different from vacant land. Hence, the entity should disclose Property A separately. The entity must apply judgement to determine whether the entity's retail outlets are sufficiently different in nature and use from its office buildings, and thus constitute a separate class of land and buildings.

The computer equipment is integrated across the organization and would probably be classified as a single separate class of asset.

Furniture and fittings used for administrative purposes could be sufficiently different to shop fixtures and fittings in retail outlets. Hence, they should be classified in two separate classes of assets.

Question 13

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

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

Prepare machinery account in the books of Heaven Ltd. over its useful life to record the above transactions. (RTP Nov '21, Old & New SM)

Answer 13

In the books of Heaven Ltd.

Machinery A/c

Date	Particulars	Amount	Date	Particulars	Amount
1.4.2X01	To Bank / Vendor	30,00,000	31.3.2X02	By Depreciation (W.N.1)	2,50,000
			31.3.2X02	By Balance c/d	27,50,000
		30,00,000			30,00,000
1.4.2X02	To Balance b/d	27,50,000	31.3.2X03	By Depreciation	2,50,000
			31.3.2X03	By Balance c/d	25,00,000
		27,50,000			27,50,000
1.4.2X03	To Balance b/d	25,00,000	31.3.2X04	By Depreciation	2,50,000
			31.3.2X04	By Balance c/d	22,50,000
		25,00,000			25,00,000
1.4.2X04	To Balance b/d	22,50,000	31.3.2X05	By Depreciation	2,50,000
			31.3.2X05	By Balance c/d	20,00,000
		22,50,000			22,50,000
1.4.2X05	To Balance b/d	20,00,000	31.3.2X06	By Depreciation	2,50,000
			31.3.2X06	By Balance c/d	17,50,000



		20,00,000			20,00,000
1.4.2X06	To Balance b/d	17,50,000	31.3.2X07	By Depreciation (W.N.2)	2,75,000
1.4.2X06	To Revaluation Reserve @ 10%	1,75,000	31.3.2X07	By Balance c/d	16,50,000
		19,25,000			19,25,000
1.4.2X07	To Balance b/d	16,50,000	31.3.2X08	By Depreciation	2,75,000
			31.3.2X08	By Balance c/d	13,75,000
		16,50,000			16,50,000
1.4.2X08	To Balance b/d	13,75,000	1.4.2X08	By Revaluation Reserve (W.N.4)	1,25,000
			31.3.2X09	By Profit and Loss A/c (W.N.5)	81,250
			31.3.2X09	By Depreciation (W.N.3)	1,46,094
			31.3.2X09	By Balance c/d	10,22,656
		13,75,000			13,75,000
1.4.2X09	To Balance b/d	10,22,656	31.3.2X10	By Depreciation	1,46,094
31.3.2X10	To Profit and Loss A/c (balancing figure)	58,438*	31.3.2X10	By Bank A/c	9,35,000
		10,81,094			10,81,094

Working Notes:
1. Calculation of useful life of machinery on 1.4.2X01

Depreciation charge in 5 years = $(30,00,000 - 17,50,000) = ₹ 12,50,000$ Depreciation per year as per Straight Line method = $12,50,000 / 5$ years
 $= ₹ 2,50,000$

Remaining useful life = $₹ 17,50,000 / ₹ 2,50,000 = 7$ years Total useful life = 5 years + 7 years = 12 years

2. Depreciation after upward revaluation as on 31.3.2X06 ₹

Book value as on 1.4.2X06 17,50,000
 Add: 10% upward revaluation 1,75,000
 Revalued amount 19,25,000

Remaining useful life 7 years (Refer W.N.1)

Depreciation on revalued amount = $19,25,000 / 7$ years = ₹ 2,75,000 lakh

3. Depreciation after downward revaluation as on 31.3.2X08 ₹

Book value as on 1.4.2X08 13,75,000
 Less: 15% Downward revaluation (2,06,250)



Revalued amount 11,68,750

Revised useful life 8 years

Depreciation on revalued amount = $11,68,750 / 8 \text{ years} = ₹ 1,46,094$

4. Amount transferred from revaluation reserve

Revaluation reserve on 1.4.2X06 (A) ₹ 1,75,000

Remaining useful life 7 years

Amount transferred every year ($1,75,000 / 7$) ₹ 25,000

Amount transferred in 2 years ($25,000 \times 2$) (B) ₹ 50,000
Balance of revaluation reserve on 1.4.2X08 (A-B) ₹ 1,25,000

5. Amount of downward revaluation to be charged to Profit and Loss Account

Downward revaluation as on 1.4.2X08 (W.N.3) ₹ 2,06,250

Less: Adjusted from Revaluation reserve (W.N.4) (₹1,25,000) Amount
transferred to Profit and Loss Account ₹ 81,250

Question 14

Company A incurred ₹ 20,000 as cost for restoring the site on which the item of PPE was located. This item was used for manufacturing of goods and the requirement for restoring will arise due to manufacturing of goods.

What will the treatment of this ₹ 20,000 in the books of Company A? Analyse on the basis of the provisions of relevant Ind AS. (RTP Nov'22)

Answer 14

Paragraph 16 of Ind AS 16 clarifies that decommissioning costs that meet the recognition criteria under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, for a provision are added to the cost of an item of property, plant and equipment if such costs are not incurred through the asset's use to produce inventories. Paragraph 18 fills the gap by clarifying where such costs are incurred through the asset's use to produce inventories, they are added to the cost of inventories.

Where the obligation to restore the asset arises due to the use of the asset to produce inventories but not due to the asset's installation, construction or acquisition, the costs are added to the costs of inventories. Based on the above provisions and discussion, cost of restoring the site ₹ 20,000 incurred during the period of production as a consequence of having used the item to produce inventories during that period should be added to the cost of inventories. However, later the inventories are measured at the lower of cost and net realisable value in accordance with paragraph 9 of Ind AS 2.

Question 15

A Ltd. purchased some Property, Plant and Equipment on 1st April, 20X1, and estimated their useful lives for the purpose of financial statements prepared on the basis of Ind AS: Following were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 20X1:

Property, Plant and Equipment	Original Cost	Estimated useful life
Buildings	Rs. 15,000,000	15 years
Plant and machinery	Rs. 10,000,000	10 years
Furniture and fixtures	Rs. 3,500,000	7 years

A Ltd. uses the straight-line method of depreciation. On 1st April, 20X4, the entity reviewed the



following useful lives of the property, plant, and equipment through an external valuation expert:

Buildings	10 years
Plant and machinery	7 years
Furniture and fixtures	5 years

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised.

Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X4. (RTP May '18, Old & New SM)

Answer 15

The annual depreciation charges prior to the change in useful life were

Buildings	Rs. 1,50,00,000/15 =	Rs. 10,00,000
Plant and machinery	Rs. 1,00,00,000/10 =	Rs. 10,00,000
Furniture and fixtures	Rs. 35,00,000/7 =	Rs. 5,00,000
Total =		Rs. 25,00,000 (A)

The revised annual depreciation for the year ending 31st March, 20X4, would be

Buildings	$[\text{Rs. } 1,50,00,000 - (\text{Rs. } 10,00,000 \times 3)] / 10$	Rs. 12,00,000
Plant and machinery	$[\text{Rs. } 1,00,00,000 - (\text{Rs. } 10,00,000 \times 3)] / 7$	Rs. 10,00,000
Furniture and fixtures	$[\text{Rs. } 35,00,000 - (\text{Rs. } 5,00,000 \times 3)] / 5$	Rs. 4,00,000
Total		Rs. 26,00,000 (B)

The impact on Statement of Profit and Loss for the year ending 31st March, 20X4

= Rs. 26,00,000 – Rs. 25,00,000 = Rs. 1,00,000

This is a change in accounting estimate which is adjusted prospectively in the period in which the estimate is amended and, if relevant, to future periods if they are also affected. Accordingly, from 20X4-20X5 onward, excess of Rs. 1,00,000 will be charged in the Statement of Profit and Loss every year till the time there is any further revision.

Question 16

On 1st October, 2017, A Ltd. completed the construction of a power generating facility. The total construction cost was Rs. 2,00,00,000. The facility was capable of being used from 1st October, 2017 but A Ltd. did not bring the facility into use until 1st January, 2018. The estimated useful life of the facility at 1st October, 2017 was 40 years. Under legal regulations in the jurisdiction in which A Ltd. operates, there are no requirements to restore the land on which power generating facilities stand to its original state at the end of the useful life of the facility. However, A Ltd. has a reputation for conducting its business in an environmentally friendly way and has previously chosen to restore similar land even in the absence of such legal requirements. The directors of A Ltd. estimated that the cost of restoring the land in 40 years' time (based on prices prevailing at that time) would be

Rs. 1,00,00,000. A relevant annual discount rate to use in any discounting calculations is 5%. When the annual discount rate is 5%, the present value of Rs. 1 receivable in 40 years' time is approximately 0.142.

Analyze and present how the above events would be reported in the financial statements of A Ltd. for the year ended 31st March, 2018 as per Ind AS. (RTP Nov '18)

Answer 16

All figures are Rs. in '000.

The power generating facility should be depreciated from the date it is ready for use, rather than when it



would actually start being used. In this case, then, the facility should be depreciated from 1st October, 2017.

Although A Ltd. has no legal obligation to restore the piece of land, it does have a constructive obligation, based on its past practice and policies.

The amount of the obligation will be 1,420, being the present value of the anticipated future restoration expenditure ($10,000 \times 0.142$).

This will be recognised as a provision under non-current liabilities in the Balance Sheet of A Ltd. at 31st March, 2018.

As time passes the discounted amount unwinds. The unwinding of the discount for the year ended 31st March, 2018 will be 35.5 ($1,420 \times 5\% \times 6/12$).

The unwinding of the discount will be shown as a finance cost in the statement of profit or loss and the closing provision will be 1,455.50 ($1,420 + 35.5$).

The initial amount of the provision is included in the carrying amount of the non-current asset, which becomes 21,420 ($20,000 + 1,420$).

The depreciation charge in profit or loss for the year ended 31st March, 2018 is 267.75 ($21,420 \times 1/40 \times 6/12$). The closing balance included in non-current assets will be 21,152.25 ($21,420 - 267.75$).

Question 17

Company X built a new plant that was brought into use on 1st April, 20X1. The cost to construct the plant was ₹ 1.5 crore. The estimated useful life of the plant is 20 years and Company X accounts for the plant using the cost model.

The initial carrying amount of the plant included an amount of ₹ 10 lakh for decommissioning, which was determined using a discount rate of 10%. On 31st March, 20X2, Company X remeasures the provision for decommissioning to ₹ 13 lakh.

Provide necessary journal entries at the end of the year i.e. 31 st March, 20X2 for recording of depreciation and decommissioning provision.(RTP May '23)

Answer 17

Journal Entries in the books of Company X for the year ending ended 31st March, 20X2

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

Question 18

Besides manufacturing plants, A Ltd. has various other assets, not used for operational activities, e.g., freehold land, townships in different locations, excess of office space rented to ABC, etc. Also, A Ltd. has



some land, which are kept vacant as per the government regulations which require that a specified area around the plant should be kept vacant.

The details of these assets are as under:

Property	Details
A Ltd.'s office building (registered office)	A Ltd.'s registered office in Delhi, is a 15 storey building, of which only 3 floors are occupied by A Ltd., whereas remaining floors are given on rent to other companies. These agreements are usually for a period of 3 years. According to A Ltd., such excess office space will continue to be let out on lease to external parties and have no plans to occupy it, at least in near future.
Flats in Township located in location 1	As regards township in Location 1, there are approximately 2,000 flats in the said township. It was built primarily for A Ltd.'s employees, hence, approximately 80% of the flats are allotted to employees and remaining flats are either kept vacant or given on rent to other external parties. A lease agreement is signed between A Ltd. and an individual party for every 12 months being 1st April to 31st March. The lease entered is a cancellable lease (cancellable at the option of any of the parties). Also, besides monthly rent, additional charges are levied by A Ltd. on account of electricity, water, cable connection, etc. According to A Ltd., there is no intention of selling such excess flats or allotting it to its employees.
Flats in township located in location 2	There are 1,000 flats in location 2 township, of which: • 400 flats are given to employees for their own accommodation. • 350 flats are given on rent to Central Government and State Government for accommodation of their employees. Average lease period being 12 months with cancellable clause in lease agreements. • 250 flats are kept vacant.
Hostel located in location 1	60 rooms in the hostel have been let out to G Ltd., to give accommodation to their personnel. Lease agreement is prepared for every 11 months and renewed thereafter. Besides the monthly rent amount, some charges are levied towards water, electricity and other amenities, e.g., cable connection, etc.
Land in location 1	In 20X4, A Ltd. purchased a plot of land on the outskirts of a major city. The area has mainly low-cost public housing and very limited public transport facilities. The government has plans to develop the area as an industrial park in 5 years' time and the land is expected to greatly appreciate in value if the government proceeds with the plan. A Ltd. has not decided what to do with the property.
Land in location 1	A portion of land has been leased out to C Ltd. for its manufacturing operations. Land has been given on lease on a lease rental of ₹ 10 lacs p.a. with a lease term of 25 years.
Land in location 2	A portion of the land has been given on rent to D Ltd. which has constructed a petrol pump on such land. It has been leased for a period of 40 years and renewed for a further period of 40 years.

Determine the classification of properties which are not held for operational purposes, with suitable reasoning in the financial statements of A Ltd. (RTP Nov '23)



Answer 18

Property	Classification of properties not held for operational purpose
A Ltd.'s office building (registered office)	Excess portion of office space has been given on lease to earn rental income. Out of 15 storey building, only 3 floors are occupied by A Ltd. Such excess office space was constructed for the purpose of letting it out. According to A Ltd., such excess office space will continue to be let out on lease to external parties and have no plans to occupy it, at least in near future. Further, office space given on rent, although in same building, is separately identifiable from another owner-occupied portion and hence can be sold separately (if required). Hence, the excess space will qualify to be an investment property.
Flats in Township located in location 1	Excess flats have been given on lease to earn rental income. According to A Ltd., there is no intention of selling such excess flats or allotting it to its employees. Further, flats given on rent, can be sold separately from flats occupied by A Ltd.'s employees as they are separately identifiable. A Ltd. also charges its lessees on account of ancillary services, i.e., water, electricity, cable connection, etc., but the monthly charges in such cases are generally not significant as compared to rental payments. Hence, flats given on rent should qualify to be an 'investment property'. With regards to the flats kept vacant, A Ltd. has to evaluate the purpose of holding these flats, i.e., whether these would be kept for earning rentals or will it be allotted to its future employees. In case they are held for earning rentals, it would be classified as an investment property; and if they are held for allotment to future employees, it would form part of property, plant and equipment.
Flats in township located in location 2	be kept for earning rentals or will it be allotted to its future employees. In case they are held for earning rentals, it would be classified as an investment property; and if they are held for allotment to future employees, it would form part of property, plant and equipment.
Hostel located in location 1	Rooms in a hostel have been let out to G Ltd. to be used by its personnel. A Ltd. also charges G Ltd. on account of ancillary services, i.e., water, electricity, cable connection, etc., but the monthly charges in such cases are generally not significant as compared to rental payments. Hence, it should be classified as an 'Investment property'.
Land in location 1	Although management has not determined use for property after the development of park, yet in the medium-term the land is held for capital appreciation. As per Ind AS 40, if an entity has not determined that it will use the land either as owner-occupied property or for short term sale in the ordinary course of business, then it will be considered as land held for capital appreciation. Therefore, management should classify the property as an investment property.
Land in location 1	Since the land is held with an intention of giving it on lease and earning capital appreciation over a period, it should be classified as an 'Investment property'.
Land in location 2	Since the land is held with an intention of giving it on lease and earning capital appreciation over a period, it should be classified as 'Investment property'.

**Question 19**

M Ltd. is setting up a new factory outside the Delhi city limits. In order to facilitate the construction of the factory and its operations, M Ltd. is required to incur expenditure on the construction/development of electric-substation. Though M Ltd. incurs (or contributes to) the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether M Ltd. can capitalise expenditure incurred on these items as property, plant and equipment (PPE)? If yes, then how should these items be depreciated and presented in the financial statements of M Ltd. as per Ind AS? (PYP 8 Marks, Nov'19, RTP Nov'18)

Answer 19

As per Ind AS 16, the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and
- (b) the cost of the item can be measured reliably.

Further, Ind AS 16 does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances.

Ind AS 16, further, states that the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, electric- substation is required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

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

From this, it can be concluded that, in the extant case the expenditure incurred on electric- substation should be considered as the cost of constructing the factory and accordingly, expenditure incurred on electric-substation should be allocated and capitalized as part of the items of property, plant and equipment of the factory.

Depreciation

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

Further, Ind AS 16 provides that, if these assets have a useful life which is different from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. Nevertheless, if it has been included in the cost of property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment.

The useful lives of electric-substation should not exceed that of the asset to which it relates.

Presentation



Electric-substation should be presented within the class of asset to which they relate ie factory.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This part of the question is related with Ind AS 16 'Property, Plant and Equipment'. Most of the examinees failed to express correctly the treatment of expenditure incurred for development of electric substation. Some examinees concluded correctly but were not able to substantiate their conclusion with proper reasoning.

Question 20

On 1st May, 2022, Sanskar Limited purchased ₹ 42,00,000 worth of land for construction of a new warehouse for stocking new products.

The land purchased had an old temporary structure which was to be demolished for the purpose of construction of warehouse. The salvaged material from the demolition was to be sold as scrap. The company started the construction work of the warehouse on 1st June, 2022. Following costs were incurred by the company with regard to purchase of land and construction of warehouse:

Particulars	Amount (₹)
Legal fees for purchase contract of land and recording ownership	1,50,000
Architect and consultant's fee	2,70,000
Cost of demolishing existing structure on the purchased land	1,35,000
Site preparation charges for the warehouse	1,00,000
Purchase of cement and other materials for the construction (including GST of ₹ 1,00,000 and GST credit is 50% of the payment)	15,00,000
Employment costs of the construction workers	8,00,000
General overhead costs allocated to the construction work	30,000 per month
Overhead costs incurred directly on the construction of warehouse	35,000 per month
Income received from land used as temporary parking during construction phase	80,000

Additional Information:

- Receipt of ₹ 35,000 being proceeds from sale of salvaged and scrapped materials from demolition of existing structure.
- Materials costing ₹ 40,000 was wasted and further ₹ 1,20,000 was spent to rectify the wrong design work.
- The employment costs are for 10 months i.e. from 1st June 2022 till 31st March, 2023.
- The construction of factory was completed on 28th February, 2023 (which is considered as substantial period of time as per Ind AS 23)
- The use of warehouse commenced on 1st March, 2023.
- The overall useful life of factory building was estimated at 25 years from the date of completion; however, it is estimated that the roof of the warehouse will need to be replaced 15 years after the date of completion and that the cost of replacing the roof at current prices would be 25% of the total cost of the building.
- At the end of the 25-year period, Sanskar Limited is legally bound to demolish the factory and restore the site to its original condition. The directors of the company estimate that the cost of demolition in 25 years' time (based on prices prevailing at that time) will be ₹ 80,00,000. An annual risk adjusted discount rate which is appropriate to this project is 10% per annum. The present value of ₹ 1 payable in 25 years' time at an annual discount rate of 10% per annum is ₹ 0.092.



- Sanskar Limited raised a loan of ₹ 60 lakhs @ 10% per annum rate of interest on 1st June, 2022. The building of warehouse meets the definition of a qualifying asset in accordance with Ind AS 23 Borrowing Costs. Sanskar Limited received an investment income of ₹ 25,000 on the temporary investment of the proceeds.
- Assume that cost of demolition of old structure is directly attributable to the cost of land.
- The company follows straight line method of depreciation.

You are required to compute:

- Cost of construction of the warehouse
- Depreciation charge for the year ended 31st March, 2023
- Carrying value of warehouse to be taken to Balance Sheet of the Company on 31st March, 2023.

You should explain your treatment of all the amounts referred to in this question as part of your answer. (PYP 8 Marks May '23)

Answer 20

i) Computation of the cost of construction of the warehouse

Description	Included in P.P.E. ₹	Explanation
Purchase of land	42,00,000	Separately capitalised as cost of land and do not form part of cost of construction of warehouse
Legal fee for purchase of contract of land	1,50,000	Associated legal costs are direct costs for purchasing the land. Hence, separately capitalised as cost of land and do not form part of cost of construction of warehouse
Net cost of demolishing the existing structure	1,00,000	Given in the question to assume it as directly attributable to the cost of land. However, it will be adjusted with the proceeds from sale of salvaged material from demolition (1,35,000 – 35,000). Further, it will be separately capitalised as cost of land and do not form part of cost of construction of warehouse.
Total cost of land	44,50,000	
Architect and consultant's fee	2,70,000	A direct cost of constructing the warehouse
Site preparation charges	1,00,000	A direct cost of constructing the warehouse
Cement and other materials	14,10,000*	A direct cost of constructing the warehouse net GST credit and wastage (15,00,000 – 50,000 – 40,000)
Expense to rectify the wrong design work	Nil	Assumed to be abnormal cost
Employment costs of the construction workers	7,20,000	A direct cost of constructing the warehouse for a nine-month period till 28th February, 2023 [(8,00,000/10) x 9]
Direct overhead costs	3,15,000	A direct cost of constructing the warehouse for a nine-month period (35,000 x 9)
Allocated overhead costs	Nil	Not a direct cost of construction



Income from temporary use of land as car parking area	Nil	Not essential to the construction so recognised directly in profit or loss
Finance costs	4,50,000	Capitalise the interest cost incurred in a nine-month period (from 1st June, 2022 to 28th February, 2023)
Investment income on temporary investment of the loan proceeds	(25,000)	Offset against the interest amount capitalised
Demolition cost recognised as a provision	7,36,000	Recognised as part of the initial cost at present value (i.e 80,00,000 x 0.092)
Total cost of construction of a warehouse	39,76,000	

ii) **Computation of depreciation charges for the year ended 31st March, 2023**

Note: Land is not depreciated as per Ind AS 16. Hence, only cost of warehouse is subject to depreciation.

Total depreciable amount as on 1st March, 2023	39,76,000	
Depreciation for 1 month must be in two parts:		
(a) Depreciation on roof component	5,522	$39,76,000 \times 25\% \times \frac{1}{15} \times \frac{1}{12}$ $39,76,000 \times 75\% \times \frac{1}{25} \times \frac{1}{12}$
(b) Depreciation of remaining item	9,940	
Total depreciation for the year 2022-2023	15,462	

iii) **Computation of carrying value of the warehouse on 31st March, 2023**

₹

Cost of the warehouse as on 1st March, 2023 [computed in (i) above]	39,76,000
Less: Depreciation for 1 month as computed in (ii) above	(15,462)
Carrying value of the warehouse as on 31st March, 2023	39,60,538

***Note:** In the above solution, it has been assumed that amount spent for rectifying the faulty design is not included in the cement and other material cost. However, alternatively, it may be considered as part of gross cement and material cost and in such a case, the cost of material will further be reduced with the amount of rectifying the faulty design as follows:

i) **Computation of the cost of construction of the warehouse**

Description	Included in P.P.E. ₹	Explanation
Purchase of land	42,00,000	Separately capitalised as cost of land and do not form part of cost of construction of warehouse
Legal fee for purchase of contract of land	1,50,000	Associated legal costs are direct costs for purchasing the land. Hence, separately capitalised as cost of land and do not form part of cost of construction of warehouse



Net cost of demolishing the existing structure	1,00,000	Given in the question to assume it as directly attributable to the cost of land. However, it will be adjusted with the proceeds from sale of salvaged material from demolition (1,35,000 – 35,000). Further, it will be separately capitalised as cost of land and do not form part of cost of construction of warehouse.
Total cost of land	44,50,000	
Architect and consultant's fee	2,70,000	A direct cost of constructing the warehouse
Site preparation charges	1,00,000	A direct cost of constructing the warehouse
Cement and other materials	12,90,000*	A direct cost of constructing the warehouse net GST credit, wastage and rectification cost (15,00,000 – 50,000 – 40,000 – 1,20,000)
Employment costs of the construction workers	7,20,000	A direct cost of constructing the warehouse for a nine-month period till 28th February, 2023 [(8,00,000/10) x 9]
Direct overhead costs	3,15,000	A direct cost of constructing the warehouse for a nine-month period (35,000 x 9)
Allocated overhead costs	Nil	Not a direct cost of construction
Income from temporary use of land as car parking area	Nil	Not essential to the construction so recognised directly in profit or loss
Finance costs	4,50,000	Capitalise the interest cost incurred in a nine-month period (from 1st June, 2022 to 28th February, 2023)
Investment income on temporary investment of the loan proceeds	(25,000)	Offset against the interest amount capitalised
Demolition cost recognised as a provision	7,36,000	Recognised as part of the initial cost at present value (i.e 80,00,000 x 0.092)
Total cost of construction of a warehouse	38,56,000	

ii) Computation of depreciation charges for the year ended 31st March, 2023

Note: Land is not depreciated as per Ind AS 16. Hence, only cost of warehouse is subject to depreciation.

Total depreciable amount as on 1st March, 2023	38,56,000	
Depreciation for 1 month must be in two parts:		
(a) Depreciation on roof component	5,356	$38,56,000 \times 25\% \times 1/15 \times 1/12$
(b) Depreciation of remaining item	9,640	$38,56,000 \times 75\% \times 1/25 \times 1/12$



Total depreciation for the year 2022-2023	14,996	

iii) **Computation of carrying value of the warehouse on 31st March, 2023**

₹

Cost of the warehouse as on 1st March, 2023 [computed in (i) above]	38,56,000
Less: Depreciation for 1 month as computed in (ii) above	(14,996)
Carrying value of the warehouse as on 31st March, 2023	38,41,004



Chapter 6.3

Ind AS 23: Borrowing Costs

Question 1

On 1 April 2019, entity A contracted for the construction of a building for Rs. 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying asset. The building was completed at the end of March, 2020, and during the period the following payments were made to the contractor:

Payment date	Amount (Rs.)
1 April 2019	2,00,000
30 June 2019	6,00,000
31 December 2019	12,00,000
31 March 2020	2,00,000
Total	22,00,000

Entity A's borrowings at its year end of 31 March 2020 were as follows:

- 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31 March 2020 amounted to Rs. 7,00,000. Interest of Rs. 65,000 was incurred on these borrowings during the year, and interest income of Rs. 20,000 was earned on these funds while they were held in anticipation of payments.
- 12.5% 10-year note with simple interest payable annually; debt outstanding at 1 April 2019 amounted to Rs. 10,00,000 and remained unchanged during the year; and
- 10% 10-year note with simple interest payable annually; debt outstanding at 1 April 2019 amounted to Rs. 15,00,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS? (MTP 6 Marks Oct '20, RTP Nov'19, Old & New SM)

Answer 1

As per Ind AS 23, when an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity should determine the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

The amount of borrowing costs eligible for capitalization, in cases where the funds are borrowed generally, should be determined based on the expenditure incurred in obtaining a qualifying asset. The costs incurred should first be allocated to the specific borrowings.

Analysis of expenditure:

Date	Expenditure (Rs.)	Amount allocated in general borrowings (Rs.)	Weighted for period outstanding (Rs.)
1 April 2019	2,00,000	0	0
30 June 2019	6,00,000	1,00,000*	$1,00,000 \times 9/12 = 75,000$
31 Dec 2019	12,00,000	12,00,000	$12,00,000 \times 3/12 = 3,00,000$
31 March 2020	2,00,000	2,00,000	$2,00,000 \times 0/12 = 0$
Total	22,00,000		3,75,000

*Specific borrowings of Rs. 7,00,000 fully utilized on 1 April & on 30 June to the extent of Rs. 5,00,000 hence remaining expenditure of Rs. 1,00,000 allocated to general borrowings.

The expenditure rate relating to general borrowings should be the weighted average of the borrowing costs applicable to the entity's borrowings that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Capitalization rate = $(10,00,000 \times 12.5\%) + (15,00,000 \times 10\%) = 11\%$



10,00,000 + 15,00,000

Borrowing cost to be capitalized:	Amount
	(Rs.)
On specific loan	65,000
On General borrowing (Rs. 3,75,000 × 11%)	41,250
Total	1,06,250
Less: Interest income on specific borrowings	(20,000)
Amount eligible for capitalization	
Therefore, the borrowing costs to be capitalized are Rs. 86,250.	86,250

Question 2

An entity constructs a new office building commencing on 1st September, 20X1, which continues till 31st December, 20X1 (and is expected to go beyond a year). Directly attributable expenditure at the beginning of the month on this asset are Rs. 2 lakh in September 20X1 and Rs. 4 lakh in each of the months of October to December 20X1.

The entity has not taken any specific borrowings to finance the construction of the building but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 9% debentures with a face value of Rs. 30 lakh and had an overdraft of Rs. 4 lakh, which increased to Rs. 8 lakh in December 20X1. Interest was paid on the overdraft at 12% until 1st October, 20X1 and then the rate was increased to 15%. Calculate the capitalization rate for computation of borrowing cost for the period ending 31st December 20X1, in accordance with Ind AS 23 'Borrowing Cost'. (MTP 5 Marks March '21, PYP 8 Marks Nov '19)

Answer 2

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding balance	Amount of loan (Rs.)	Rate of interest p.a.	Weighted average amount of interest (Rs.)
	a	b	c	d = [(b x c) x (a/12)]
9% Debentures	12 months	30,00,000	9%	2,70,000
Bank overdraft	9 months	4,00,000	12%	36,000
	2 months	4,00,000	15%	10,000
	1 month	8,00,000	15%	10,000
		46,00,000		3,26,000

Weighted average cost of borrowings

$$= \{30,00,000 \times (12/12)\} + \{4,00,000 \times (11/12)\} + \{8,00,000 \times (1/12)\}$$

$$= 34,33,334$$

$$\text{Capitalization rate} = (\text{Weighted average amount of interest} / \text{Weighted average of general borrowings}) \times 100$$

$$= (3,26,000 / 34,33,334) \times 100 = 9.50\% \text{ p.a.}$$

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some examinees correctly calculated the amount of finance cost but failed to calculate the weighted average capital. Due to this they arrived into wrong capitalisation rate.



Question 3

ABC Ltd. has taken a loan of USD 20,000 on April 1, 20X1 for constructing a plant at an interest rate of 5 % per annum payable on annual basis.

On April 1, 20X1, the exchange rate between the currencies i.e. USD vs Rupees was Rs. 45 per USD. The exchange rate on the reporting date i.e. March 31, 20X2 is Rs. 48 per USD.

The corresponding amount could have been borrowed by ABC Ltd. from State bank of India in local currency at an interest rate of 11% per annum as on April 1, 20X1.

Compute the borrowing cost to be capitalized for the construction of plant by ABC Ltd. (MTP 8 Marks April '19 & April '22, Old & New SM)

Answer 3

In the above situation, the Borrowing cost needs to determine for interest cost on such foreign currency loan and eligible exchange loss difference if any.

- (a) Interest on Foreign currency loan for the period:

$$\text{USD } 20,000 \times 5\% = \text{USD } 1,000$$

$$\text{Converted in Rs. : } \text{USD } 1,000 \times \text{Rs. } 48/\text{USD} = \text{Rs. } 48,000$$

Increase in liability due to change in exchange difference:

$$\text{USD } 20,000 \times (48 - 45) = \text{Rs. } 60,000$$

- (b) Interest that would have resulted if the loan was taken in Indian Currency:

$$\text{USD } 20,000 \times \text{Rs. } 45/\text{USD} \times 11\% = \text{Rs. } 99,000$$

- (c) Difference between Interest on Foreign Currency borrowing and local Currency borrowing

$$\text{Rs. } 99,000 - 48,000 = \text{Rs. } 51,000$$

Hence, out of Exchange loss of Rs. 60,000 on principal amount of foreign currency loan, only exchange loss to the extent of Rs. 51,000 is considered as borrowing costs.

Total borrowing cost to be capitalized is as under :

Interest cost on borrowing	Rs. 48,000
(a) Exchange difference to the extent considered as an adjustment to Interest cost	Rs. 51,000
	Rs. 99,000

The exchange difference of Rs. 51,000 has been capitalized as borrowing cost and the remaining Rs. 9,000 will be expensed off in the Statement of Profit and loss.

Question 4

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

The company has paid total interest of ₹ 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will



your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 20X2? (MTP 6 Marks March '23, RTP Nov '21, Old & New SM)

Answer 4

As per Ind AS 23, Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

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

Accordingly, the treatment of Interest of ₹ 68.20 lacs occurred during the year 20X1-20X2 would be as follows:

(i) When construction of asset completed on 30th April, 20X2

The treatment for total borrowing cost of ₹ 68.20 lakh will be as follows:

Purpose	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
		₹ in lakh	₹ in lakh
Modernization and renovation of plant and machinery	Qualifying asset	$[68.20 \times (510/620)] = 56.10$	
Advance to suppliers for additional assets	Qualifying asset	$[68.20 \times (54/620)] = 5.94$	
Working Capital	Not a qualifying asset		$[68.20 \times (56/620)] = 6.16$
		62.04	6.16

(ii) When construction of assets is completed by 28th February, 20X2

When the process of renovation gets completed in less than 12 months, the plant and machinery and the additional assets will not be considered as qualifying assets (until and unless the entity specifically considers that the assets took substantial period of time for completing their construction). Accordingly, the whole of interest will be required to be charged off / expensed off to Profit and loss account.

Question 5

An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1. Directly attributable expenditure at the beginning of the month on this asset are Rs. 100,000 in September 20X1 and Rs. 250,000 in each of the months of October to December 20X1. The entity has not taken any specific borrowings to finance the construction of the asset, but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 10% debentures with a face value of Rs. 20 lacs and had an overdraft of Rs. 500,000, which increased to Rs. 750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%. Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'. (RTP May '18, Old & New SM)

Answer 5

Since the entity has only general borrowing hence first step will be to compute the capitalization rate. The capitalization rate of the general borrowings of the entity during the period of construction is calculated as follows:



Finance cost on Rs. 20 lacs 10% debentures during September – December 20X1	Rs. 66,667
Interest @ 15% on overdraft of Rs. 5,00,000 in September 20X1	Rs. 6,250
Interest @ 16% on overdraft of Rs. 5,00,000 in October and November 20X1	Rs. 13,333
Interest @ 16% on overdraft of Rs. 750,000 in December 20X1	Rs. 10,000
Total finance costs in September – December 20X1	Rs. 96,250

Weighted average borrowings during period

$$\frac{(20,00,000 \times 4) + (500,000 \times 3) + (750,000 \times 1)}{4} = \text{Rs. } 25,62,500$$

Capitalization rate = Total finance costs during the construction period / Weighted average borrowings during the construction period

$$= 96,250 / 25,62,500 = 3.75\%$$

Question 6

K Ltd. began construction of a new building at an estimated cost of Rs. 7 lakh on 1st April, 2017. To finance construction of the building it obtained a specific loan of Rs. 2 lakh from a financial institution at an interest rate of 9% per annum.

The company's other outstanding loans were:

Amount	Rate of Interest per annum
Rs. 7,00,000	12%
Rs. 9,00,000	11%

The expenditure incurred on the construction was:

April, 2017	Rs. 1,50,000
August, 2017	Rs. 2,00,000
October, 2017	Rs. 3,50,000
January, 2018	Rs. 1,00,000

The construction of building was completed by 31st January, 2018. Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entry for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 2018. (RTP Nov '18, Old & New SM)

Answer 6

(i) Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (Rs.)
7,00,000	12%	= 84,000
9,00,000	11%	= 99,000
16,00,000		1,83,000
Weighted average rate of interest (1,83,000/16,00,000) x 100		= 11.4375%



(ii) **Computation of borrowing cost to be capitalized for specific borrowings and general borrowings based on weighted average accumulated expenses**

Date of incurrence expenditure	Amount of spent	Financed through	Calculation	Rs.
1 st April, 2017	1,50,000	Specific borrowing	$1,50,000 \times 9\% \times 10/12$	11,250
1 st August, 2017	2,00,000	Specific borrowing	$50,000 \times 9\% \times 10/12$	3,750
		General borrowing	$1,50,000 \times 11.4375\% \times 6/12$	8,578.125
1 st October, 2017	3,50,000	General borrowing	$3,50,000 \times 11.4375\% \times 4/12$	13,343.75
1 st January, 2018	1,00,000	General borrowing	$1,00,000 \times 11.4375\% \times 1/12$	953.125
				-37,875

Note: Since construction of building started on 1st April, 2017, it is presumed that all the later expenditures on construction of building had been incurred at the beginning of the respective month.

(i) **Total expenses to be capitalized for building**

	Rs.
Cost of building Rs. (1,50,000 + 2,00,000 + 3,50,000 + 11,00,000)	8,00,000
Add: Amount of interest to be capitalized	37,875
	8,37,875

(ii) **Journal Entry**

Date	Particulars		Rs.	Rs.
31.1.2018	Building account	Dr.	8,37,87	
	To Bank account			8,00,0000
	To Interest payable (borrowing cost)			37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Note: In the above journal entry, it is assumed that interest amount will be paid at the year end. Hence, entry for interest payable has been passed on 31.1.2018.

Alternatively, following journal entry may be passed if interest is paid on the date of capitalization

Date	Particulars		Rs.	Rs.
31.1.2018	Building account	Dr.	8,37,875	
	To Bank account			8,37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			



Question 7

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

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of Rs. 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2. Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR. (RTP May '21)

Answer 7

Capitalization Method As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalization of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Thus, only that portion of the amortized discount should be capitalized as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Capitalization of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalized and the borrowing cost relating to year 3 & 4 should be expensed.

Quantum of Borrowing

The value of the bond to Y Ltd. is the transaction price ie Rs. 1,80,000 (2,00,000 – 20,000) Therefore, Y Ltd will recognize the borrowing at Rs. 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalized Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	Opening Borrowing	Interest expense @ 13.39% to be capitalised	Total	Interest paid	Closing Borrowing
	(1)	(2)	(3)	(4)	(5) = (3) – (4)
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,651	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of Rs. 48,753 will be capitalized to the cost of qualifying asset.

Question 8

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

The other relevant details are as follows:

(₹ in crore)

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



Based on the above information, discuss the treatment of borrowing cost as per cash outflow basis and accrual basis and also suggest the appropriate amount of interest that should be capitalised to the cost of the plant in the financial statements for the year ended 31st March, 20X2? (RTP May '22)

Answer 8

Paragraph 14 of Ind AS 23, inter-alia, states that to the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period. However, an entity shall exclude from this calculation borrowing costs applicable to borrowings made specifically for the purpose of obtaining a qualifying asset until substantially all the activities necessary to prepare that asset for its intended use or sale are complete. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

In this context, a question arises whether such expenditure should be based on costs accrued or actual cash outflows. To contrast these two alternatives, presented below is the computation of borrowing costs based on both the alternatives:

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

If the average capital expenditure on the basis of costs accrued is taken, the borrowing costs eligible to be capitalised would be ₹2.74 crore $\times 11\% = 0.30$ crore. Whereas, if average capital expenditure on the basis of cash flows is taken, the borrowing costs eligible to be capitalised would be ₹4.02 crore $\times 11\% = 0.44$ crore. Thus, there is a wide variance in the amount of borrowing cost to be capitalised, based on the accrual basis and on actual cash flows basis. This divergence is often experienced during the implementation of large projects, for example, an advance given to a supplier involves an upfront cash outflow while the actual expenditure accrues in later periods (with the receipt of goods and services).

As per paragraph 18 of Ind AS 23, expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with the asset (see Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance). The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalization rate is applied in that period.

Where cash has been paid but the corresponding cost has not yet accrued interest becomes payable on payment of cash. Therefore, the amount so paid should be considered for determining the amount of interest eligible for capitalisation, subject to the fulfillment of other conditions prescribed in paragraph 16 of Ind AS 23. Accordingly, in the present case, interest should be computed on the basis of the cash flows rather than on the basis of costs accrued. Therefore, the amount of interest eligible for capitalisation would be ₹0.44 crore.



Another important factor to be noted is that paragraph 14 requires, inter alia, that the amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period. Thus, the amount of borrowing costs to be capitalised should not exceed the total borrowing costs incurred during the period, that is ₹ 0.5 crore.

Question 9

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

	Phase I	Phase II	Phase III	Phase IV
	₹	₹	₹	₹
Cash expenditure	10	30	25	30
Building purchased	24	34	30	38
Total expenditure	34	64	55	68
Total expenditure of all phases				221
Loan taken @ 15% at the beginning of the year				200

After taking substantial period of construction, at the mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year. (RTP Nov'22)

Answer 9

1	Interest expense on loan ₹ 2,00,00,000 at 15%	30,00,000
2	Total cost of Phases I and II (₹ 34,00,000 + ₹ 64,00,000)	98,00,000
3	Total cost of Phases III and IV (₹ 55,00,000 + ₹ 68,00,000)	1,23,00,000
4	Total cost of all 4 phases	2,21,00,000
5	Total loan	2,00,00,000
6	Interest on loan used for Phases I & II, based on proportionate Loan amount = $\frac{30,00,000}{2,21,000} \times 98,00,000$	13,30,317 (approx)
7	Interest on loan used for Phases III & IV, based on proportionate Loan amount = $\frac{30,00,000}{2,21,000} \times 1,23,00,000$	16,69,683 (approx)

Accounting treatment:

1. For Phase I and Phase II

Since Phase I and Phase II have become operational at mid of the year, half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be expensed off during the year.

2. For Phase III and Phase IV

Interest of ₹ 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases



has not been completed yet.

Question 10

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

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

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

For each of the financial years ended 31st March 20X1, 20X2 and 20X3, calculate the borrowing cost that LT Ltd. is permitted to capitalize as a part of the building cost. (RTP May '23)

Answer 10

Applying paragraph 17 of Ind AS 23 to the fact pattern, the entity would not begin capitalising borrowing costs until it incurs borrowing costs (i.e. from 1 st July, 20X1)

In determining the expenditures on a qualifying asset to which an entity applies the capitalisation rate (paragraph 14 of Ind AS 23), the entity does not disregard expenditures on the qualifying asset incurred before the entity obtains the general borrowings. Once the entity incurs borrowing costs and therefore satisfies all three conditions in para 17 of Ind AS 23, it then applies paragraph 14 of Ind AS 23 to determine the expenditures on the qualifying asset to which it applies the capitalisation rate.

Calculation of borrowing cost for financial year 20X0-20X1

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1st January 20X1	₹ 5 crore	0/3	Nil

Borrowing Costs eligible for capitalisation = NIL. LT Ltd. cannot capitalise borrowing costs before 1st July, 20X1 (the day it starts to incur borrowing costs).

Calculation of borrowing cost for financial year 20X1-20X2

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1st January, 20X1	₹ 5 crore	9/12*	₹ 3.75 crore
30th June, 20X1	₹ 20 crore	9/12	₹ 15 crore
31st March, 20X2	₹ 20 crore	0/12	Nil
Total			₹ 18.75 crore



Borrowing Costs eligible for capitalisation = 18.75 cr. x 10% = ₹ 1.875 cr.

*LT Ltd. cannot capitalise borrowing costs before 1st July, 20X1 (the day it starts to incur borrowing costs). Accordingly, this calculation uses a capitalization period from 1st July, 20X1 to 31st March, 20X2 for this expenditure.

Calculation of borrowing cost for financial year 20X2-20X3

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1st January, 20X1	₹ 5 crore	3/12	₹ 1.25 crore
30th June, 20X1	₹ 20 crore	3/12	₹ 5 crore
31st March, 20X2	₹ 20 crore	3/12	₹ 5 crore
30th June, 20X2	₹ 5 crore	0/12	Nil
Total			₹ 11.25 crore

Borrowing costs eligible for capitalisation = ₹ 11.25 cr. x 10% = ₹ 1.125 cr.

Question 11

Zera Limited obtained a term loan of ₹ 1,080 lakh for complete renovation and modernization of its factory on 1st April, 2021. Plant and Machinery was acquired under the modernization scheme and installation was completed on 30th April, 2022. An expenditure of ₹ 910 lacs was incurred on installation of Plant and Machinery and the balance loan was used for working capital purposes. Management of Zera Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ₹ 94.40 lacs during financial year 2021-2022 on the above loan. Discuss the treatment in the books of account of Zera Limited of interest paid of ₹ 94.40 lakh during the financial year 2021-2022. Will your answer be different, if the whole process of renovation and modernization gets completed by 31st December, 2021?(PYP 7 Marks May '22)

Answer 11

Treatment procedure:

As per Ind AS 23, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense. Where, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Applicability to the given case:

Accordingly, the treatment of interest of ₹ 94.40 lakh occurred during the year 2021-2022 would be as follows:

(i) When construction of asset completed on 30th April, 2022

The treatment for total borrowing cost of ₹ 94.40 lakh will be as follows:

Purpose	Nature	Interest to be capitalised ₹ in lakh	Interest to be charged to profit and loss account ₹ in lakh
Modernisation and renovation of plant and machinery	Qualifying asset	[94.40 x (910/1,080)] = 79.54	
Working Capital	Not a qualifying asset		[94.40 x (170/1,080)] = 14.86
		79.54	14.86



(ii) When construction of assets is completed by 31st December, 2021

When the process of renovation gets completed in less than 12 months, the plant and machinery will not be considered as a qualifying asset until and unless the entity specifically considers that the asset took substantial period for completing its construction.

Accordingly, the whole of interest will be charged off to Profit and Loss account.



Chapter 6.4

Ind AS 36: Impairment of Assets

Question 1

PQR Ltd. is the company which has performed well in the past but one of its major assets, an item of equipment, suffered a significant and unexpected deterioration in performance. Management expects to use the machine for a further four years after 31 March 2020, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for PQR Ltd. has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. CFO thought that the projections were too conservative, and he intended to use the highest figures each year. These were as follows:

	Rs.
Year ended 31 March 2021	2,76,000
Year ended 31 March 2022	1,92,000
Year ended 31 March 2023	1,20,000
Year ended 31 March 2024	1,14,000

The above cash inflows should be assumed to occur on the last day of each financial year. The pre-tax discount rate is 9%. The machine could have been sold at 31 March 2020 for Rs. 6,00,000 and related selling expenses in this regard could have been Rs. 96,000. The machine was revalued previously, and at 31 March 2020 an amount of Rs. 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 31 March 2020 was Rs. 6,60,000. The Indian government has indicated that it may compensate the company for any loss in value of the assets up to its recoverable amount. (MTP 5 Marks Oct '20, RTP May '20 & Old & New SM)

Answer 1

Carrying amount of asset on 31 March 2020 = Rs. 6,60,000

Calculation of Value in Use

Year ended	Cash flow Rs.	Discount factor @ 9%	Amount Rs.
31 st March, 2021	2,76,000	0.9174	2,53,202
31 st March, 2022	1,92,000	0.8417	1,61,606
31 st March, 2023	1,20,000	0.7722	92,664
31 st March, 2024	1,14,000	0.7084	80,758
Total (Value in Use)			5,88,230

Calculation of Recoverable amount

Particulars	Amount (Rs.)
Value in use	5,88,230
Fair value less costs of disposal (6,00,000 – 96,000)	5,04,000
Recoverable amount (Higher of value in use and fair value less costs of disposal)	5,88,230

Calculation of Impairment loss

Particulars	Amount (Rs.)
Carrying amount	6,60,000
Less: Recoverable amount	(5,88,230)
Impairment loss	71,770



Calculation of Revised carrying amount

Particulars	Amount (Rs.)
Carrying amount	6,60,000
Less: Impairment loss	(71,770)
Revised carrying amount	5,88,230

Calculation of Revised Depreciation:

Revised carrying amount – Residual value

Remaining life = $(5,88,230 - 0) / 4 = \text{Rs. } 1,47,058$ per annum

Set off of Impairment loss:

The impairment loss of Rs. 71,770 must first be set off against any revaluation surplus in relation to the same asset. Therefore, the revaluation surplus of Rs. 36,000 is eliminated against impairment loss, and the remainder of the impairment loss Rs. 35,770 (Rs. 71,770 – Rs. 36,000) is charged to profit and loss.

Treatment of Government compensation:

Any compensation by government would be accounted for as such when it becomes receivable. At this time, the government has only stated that it may reimburse the company and therefore credit should not be taken for any potential government receipt.

Question 2

East Ltd. (East) owns a machine used in the manufacture of steering wheels, which are sold directly to major car manufacturers.

- The machine was purchased on 1st April, 20X1 at a cost of Rs. 5,00,000 through a vendor financing arrangement on which interest is being charged at the rate of 10 per cent per annum.
- During the year ended 31st March, 20X3, East sold 10,000 steering wheels at a selling price of Rs. 190 per wheel.
- The most recent financial budget approved by East's management, covering the period 1st April, 20X3 – 31st March, 20X8, including that the company expects to sell each steering wheel for Rs. 200 during 20X3-X4, the price rising in later years in line with a forecast inflation of 3 per cent per annum.
- During the year ended 31st March, 20X4, East expects to sell 10,000 steering wheels. The number is forecast to increase by 5 per cent each year until 31st March, 20X8.
- East estimates that each steering wheel costs Rs. 160 to manufacture, which includes Rs. 110 variable costs, Rs. 30 share of fixed overheads and Rs. 20 transport costs.
- Costs are expected to rise by 1 per cent during 20X4-X5, and then by 2 per cent per annum until 31st March, 20X8.
- During 20X5-X6, the machine will be subject to regular maintenance costing Rs. 50,000.
- In 20X3-X4, East expects to invest in new technology costing Rs. 1,00,000. This technology will reduce the variable costs of manufacturing each steering wheel from Rs. 110 to Rs. 100 and the share of fixed overheads from Rs. 30 to Rs. 15 (subject to the availability of technology, which is still under development).
- East is depreciating the machine using the straight line method over the machine's 10 year estimated useful life. The current estimate (based on similar assets that have reached the end of their useful lives) of the disposal proceeds from selling the machine is Rs. 80,000 net of disposal costs. East expects to dispose of the machine at the end of March, 20X8.
- East has determined a pre-tax discount rate of 8 per cent, which reflects the market's assessment of the time value of money and the risks associated with this asset.



Assume a tax rate of 30%. What is the value in use of the machine in accordance with Ind AS 36? (MTP 10 Marks March '21, Apr'23, RTP Nov'19, Old & New SM)

Answer 2

Calculation of the value in use of the machine owned by East Ltd. (East) includes the projected cash inflow (i.e. sales income) from the continued use of the machine and projected cash outflows that are necessarily incurred to generate those cash inflows (i.e cost of goods sold). Additionally, projected cash inflows include Rs. 80,000 from the disposal of the asset in March, 20X8. Cash outflows include routing capital expenditures of Rs. 50,000 in 20X5-X6

As per Ind AS 36, estimates of future cash flows shall not include:

- Cash inflows from receivables
- Cash outflows from payables
- Cash inflows or outflows expected to arise from future restructuring to which an entity is not yet committed
- Cash inflows or outflows expected to arise from improving or enhancing the asset's performance
- Cash inflows or outflows from financing activities
- Income tax receipts or payments.

Hence in this case, cash flows do not include financing interest (i.e. 10%), tax (i.e. 30%) and capital expenditures to which East has not yet committed (i.e. Rs. 100 000). They also do not include any savings in cash outflows from these capital expenditure, as required by Ind AS 36.

The cash flows (inflows and outflows) are presented below in nominal terms. They include an increase of 3% per annum to the forecast price per unit (B), in line with forecast inflation. The cash flows are discounted by applying a discount rate (8%) that is also adjusted for inflation.

Note: Figures are calculated on full scale and then rounded off to the nearest absolute value.

Year ended	20X3-X4	20X4-X5	20X5-20X6	20X6-X7	20X7-X8	Value in use
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Quantity (A)	10,000	10,500	11,025	11,576	12,155	
Price per unit(B)	200	206	212	219	225	
Estimated cash inflows (C=A x B)	20,00,000	21,63,000	23,37,300	25,35,144	27,34,875	
Misc. cash inflow disposal proceeds (D)					80 000	
Total	20,00,000	21,63,000	23,37,300	25,35,144	28,14,875	
estimated cash inflows (E=C+D)						
Cost per unit (F)	160	162	165	168	171	
Estimated cash outflows (G = A x F)	(16,00,000)	(17,01,000)	(18,19,125)	(19,44,768)	(20,78,505)	
Misc. cash outflow: maintenance costs (H)			(50,000)			



Total estimated cash outflows (I=G+H)	(16,00,000)	(17,01,000)	(18,69,125)	(19,44,768)	(20,78,505)	
Net cash flows (J=E-I)	4,00,000	4,62,000	4,68,175	5,90,376	7,36,370	
Discount factor 8% (K)	0.9259	0.8573	0.7938	0.7350	0.6806	
Discounted future cash flows (L=J x K)	3,70,360	3,96,073	3,71,637	4,33,926	5,01,173	20,73,169

Question 3

Himalaya Ltd. which is in a business of manufacturing and export of its product. Sometimes, back in 2016, the Government put restriction on export of goods exported by Himalaya Ltd. and due to that restriction Himalaya Ltd. impaired its assets. Himalaya Ltd. acquired identifiable assets won of Rs. 4,000 lakhs for Rs. 6,000 lakh at the end of the year 2012. The difference is treated as goodwill. The useful life of identifiable assets is 15 years and depreciated on straight line basis. When Government put the restriction at the end of 2016 the company recognized the impairment loss by determining the recoverable amount of assets for Rs. 2,720 lakh. In 2018, Government lifted the restriction imposed on the export and due to this favorable change, Himalaya Ltd. re-estimate recoverable amount, which was estimated at Rs. 3,420 lakh.

Required:

- Calculation and allocation of impairment loss in 2016.
- Reversal of impairment loss and its allocation as per AS 28 in 2018. (MTP 12 Marks April '19)

Answer 3

(i) Calculation and allocation of impairment loss in 2016 (Amount in Rs. lakhs)

	Good will	Identifiable assets	Total
Historical cost	2,000	4,000	
Accumulated depreciation/amortization (4 is.)	1600		2667
Carrying amount before impairment	400	2,933	
Impairment loss*	400	23	613
Carrying amount after impairment loss		2,720	2,720

*** Notes:**

- As per para 87 of AS 28, an impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:
 - first, to goodwill allocated to the cash-generating unit (if any); and
 - then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value.
- Since the goodwill has arisen on acquisition of assets, AS 14 comes into the picture. As per para 19 of AS 14, goodwill shall amortize over a period not exceeding five years unless a somewhat longer period can be justified. Therefore, the amortization period of goodwill is considered as 5 years.



(ii) Carrying amount of the assets at the end of 2018 (Amount in Rs. lakhs)

End of 2018	Goodwill	Identifiable assets	Total
Carrying amount in 2018	0	2,225	2,225
Add: Reversal of impairment loss(W.N.2)	-	175	175
Carrying amount after reversal of impairment loss	-	2,400	2,400

Working Note:

1. Calculation of depreciation after impairment till 2018 and reversal of impairment loss in 2018.

Amount in Rs, lakhs

	Goodwill	Identifiable assets	Total
Carrying amount after impairment loss in 2016	0	2,720	2,720
Additional depreciation (i.e. (2,720/11)x 2)	-	495	495
Carrying amount	0	225	22
Recoverable amount			420
Excess of recoverable amount over carrying amount			1,195

Note: It is assumed that the restriction by the Government has been lifted at the end of the year 2018.

2. Determination of the amount to be impaired by calculating depreciated historical cost of the identifiable assets without impairment at the end of 2018

(Amount in Rs. lakhs)

End of 2018	Identifiable assets
Historical cost	4,000
Accumulated depreciation	(266.67 X 6 Years) = (1,600)
Depreciated historical cost	2,400
Carrying amount (in W.N.1)	2,225
Amount of reversal of impairment loss	175

Notes:

- As per para 107 of AS 28, in allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset should not be increased above the lower of:
 - its recoverable amount (if determinable); and
 - the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior accounting periods.

Hence impairment loss reversal is restricted to Rs. 175 lakhs only.
- The reversal of impairment loss took place in the 6th year. However, goodwill is amortized in 5 years. Therefore, there would be no balance in the goodwill account in the 6th year even without impairment loss. Hence in W.N. 2 above there is no column for recalculation of goodwill.

Question 4

Great Ltd., acquired a machine on 1st April, 2012 for Rs. 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2016, the carrying value of the machine was reassessed at Rs. 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March 2018, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs. 79 lakhs.

Calculate the loss on impairment of the machine and show how this loss is to be treated in the



books of Great Ltd. Great Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation. (MTP 10 Marks Aug '18)

Answer 4

Statement Showing Impairment Loss

(Rs. in crores)	
Carrying amount of the machine as on 1st April, 2012	7.00
Depreciation for 4 years i.e. 2012-2013 to 2015-2016 $\left[\frac{7 \text{ Crores}}{7 \text{ years}} \times 4 \text{ years} \right]$	(4.00)
Carrying amount as on 31.03.2016	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	2.10
Carrying amount of the machine as on 1st April 2016 (revalued)	5.10
Less: Depreciation for 2 years i.e. 2016-2017 & 2017-2018 $\left[\frac{5.10 \text{ Crores}}{3 \text{ years}} \times 2 \text{ years} \right]$	(3.40)
Carrying amount as on 31.03.2018	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.2018:	
Balance in revaluation reserve as on 31.03.2016 2.10	
Less: Enhanced depreciation met from revaluation reserve	
2016-2017 & 2017-2018 = $[(1.70 - 1.00) \times 2 \text{ years}]$ (1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

Question 5

On 1st April, 20X1, Sun Ltd. has acquired 100% shares of Earth Ltd. for ₹ 30 lakh. Sun Ltd. has 3 cash-generating units A, B and C with fair value of ₹ 12 lakh, ₹ 8 lakh and ₹ 4 lakh respectively. The company recognizes goodwill of ₹ 6 lakh that relates to CGU 'C' only. During the financial year 20X2-20X3, the CFO of the company has a view that there is no requirement of any impairment testing for any CGU since their recoverable amount is comparatively higher than the carrying amount and believes there is no indicator of impairment. Analyse whether the view adopted by the CFO of Sun Ltd. is in compliance with the Ind AS. If not, advise the correct treatment in accordance with relevant Ind AS. (MTP 6 Marks April 22)

Answer 5

Para 9 of Ind AS 36 'Impairment of Assets' states that an entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

Further, paragraph 10(b) of Ind AS 36 states that irrespective of whether there is any indication of impairment, an entity shall also test goodwill acquired in a business combination for impairment annually.

Sun Ltd. has not tested any CGU on account of not having any indication of impairment is partially correct i.e. in respect of CGU A and B but not for CGU C. Hence, the treatment made by the Company is not in accordance with Ind AS 36.

Impairment testing in respect of CGU A and B are not required since there are no indications of impairment. However, Sun Ltd shall test CGU C irrespective of any indication of impairment annually as the goodwill acquired on business combination is fully allocated to CGU 'C'.

Question 6

On 1st January Year 1, Entity Q purchased a machine costing ₹ 2,40,000 with an estimated useful life of 20 years and an estimated zero residual value. Depreciation is computed on straight-line basis. The asset had been revalued on 1st January Year 3 to ₹ 2,50,000, but with no change in useful life at that date. On 1st January Year 4 an impairment review showed the machine's recoverable amount to be ₹ 1,00,000 and its estimated remaining useful life to be 10 years.

Calculate:

- (i) **The carrying amount of the machine on 31st December Year 2 and the revaluation surplus arising on 1st January Year 3.**
- (ii) **The carrying amount of the machine on 31st December Year 3 (immediately before the impairment).**
- (iii) **The impairment loss recognised in the year to 31st December Year 4 and its treatment thereon**
- (iv) **The depreciation charge in the year to 31st December Year 4.**

Note: During the course of utilization of machine, the company did not opt to transfer part of the revaluation surplus to retained earnings. (MTP 8 Marks Oct '23)

Answer 6

(i)	Calculation of Carrying amount of machine at the end of Year 2	₹
	Cost of machine	2,40,000
	Accumulated depreciation for 2 years [2 years × (2,40,000 ÷ 20)]	(24,000)
	Carrying amount of the machine at the end of Year 2	2,16,000
(ii)	Calculation of carrying amount of the machine on 31 December Year 3	₹
	Carrying amount at the beginning of Year 3	2,16,000
	Revaluation done at the beginning of Year 3	2,50,000
	Revaluation surplus	34,000

- (iii)** Calculation of Impairment loss at the end of Year 4

When machine is revalued on 1 January Year 3, depreciation is charged on the revalued amount over its remaining expected useful life.

Valuation at 1 January (re-valued amount)	2,50,000
Accumulated depreciation in Year 3 (2,50,000 / 18)	(13,889)
Carrying amount of the asset at the end of Year 3	2,36,111
On 1 January Year 4, recoverable amount of the machine	1,00,000
Impairment loss (2,36,111 – 1,00,000)	1,36,111

An impairment loss of ₹ 34,000 will be taken to other comprehensive income (reducing the revaluation surplus for the asset to zero)

The remaining impairment loss of ₹ 1,02,111 (1,36,111 – 34,000) is recognised in the Statement of Profit and Loss for the Year 4.



(iv) Calculation of depreciation charge in the Year 4

Carrying value of the machine at the beginning of Year 4	₹
1,00,000 Estimated remaining useful life	10 years
Depreciation charge is (₹ 1,00,000 / 10 years)	₹ 10,000

Question 7

Scenario A

X Ltd. has invested in a joint venture Y Ltd. by holding 50% of its equity share capital. During the year, X Ltd. sold an asset to Y Ltd. at its market value of ₹ 8,00,000. The asset's carrying value in X Ltd.'s books was ₹ 10,00,000.

Determine how should X Ltd. account for the sale transaction in its books.

Scenario B

Assume the same facts as per Scenario A except that the asset is sold by Y Ltd. to X Ltd. instead of X Ltd. selling to Y Ltd.

Determine how should X Ltd. account for the above transaction in its books. (MTP 5 Marks Oct '23)

Answer 7

Scenario A

X Ltd. should record full loss of ₹ 2,00,000 (10,00,000 – 8,00,000) in its books as that would represent the impairment loss because the market value has actually declined. This loss would have been recorded even if X Ltd. would have first impaired the asset and then sold to Y Ltd. at zero profit / loss. Following entry should be passed in the books of X Ltd.

Bank A/c	Dr.	8,00,000	
Loss on sale of asset	Dr.	2,00,000	
To Asset			10,00,000

Scenario B

X Ltd. should record loss to the extent of its share in Y Ltd. Hence, X Ltd.'s share in loss i.e. ₹ 1,00,000 [(10,00,000 – 8,00,000) x 50%] should be recorded by X Ltd. in its books. The loss should be recorded since the market value of the asset has actually declined and this would represent impairment. This loss would have been recorded even if Y Ltd. would have first recorded an impairment loss of ₹ 2,00,000 and then sold to X Ltd. at zero profit / loss. Following entry should be passed in the books of X Ltd.

Asset	Dr.	8,00,000	
Share in loss of Y Ltd.	Dr.	1,00,000	
To Bank			8,00,000
To Investment in Y Ltd.			1,00,000

Question 8

M Ltd. has three cash-generating units: A, B and C. Due to adverse changes in the technological environment, M Ltd. conducted impairment tests of each of its cash-generating units. On 31st March, 2018, the carrying amounts of A, B and C are Rs. 100 lakhs, Rs. 150 lakhs and Rs. 200 lakhs respectively.

The operations are conducted from a headquarter. The carrying amount of the headquarter assets is Rs. 200 lakhs: a headquarter building of Rs. 150 lakhs and a research centre of Rs. 50 lakhs. The relative carrying amounts of the cash-generating units are a reasonable indication of the proportion of the head-quarter building devoted to each cash-generating unit. The carrying amount of the research Centre cannot be allocated on a reasonable basis to the individual cash-generating units.



Following is the remaining estimated useful life of:

	A	B	C	Head quarter assets
Remaining estimated useful life	10	20	20	20

The headquarter assets are depreciated on a straight-line basis.

The recoverable amount of each cash generating unit is based on its value in use since net selling price for each CGU cannot be calculated. Therefore, Value in use is equal to

	A	B	C	M Ltd. as a whole
Recoverable amount	199	164	271	720*

*The research centre generates additional future cash flows for the enterprise as a whole. Therefore, the sum of the value in use of each individual CGU is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarter building.

Calculate and show allocation of impairment loss as per Ind AS 36. Ignore tax effects (RTP Nov '18)

Answer 8

1. Identification of Corporate Assets of M Ltd.

Here, the corporate assets are the headquarter building and the research centre.

For corporate building

Since, the carrying amount of the headquarter building can be allocated on a reasonable and consistent basis to the cash-generating units under review. Therefore, only a 'bottom-up' test is necessary.

For research centre

Since the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual CGU under review. Therefore, a 'top-down' test will be applied in addition to the 'bottom-up' test.

2. Allocation of Corporate Assets

Since the estimated remaining useful life of A's CGU is 10 years, whereas the estimated remaining useful lives of B and C's CGU are 20 years, the carrying amount of the headquarter building is allocated to the carrying amount of each individual cash-generating unit on weight basis.

3. Calculation of a weighted allocation of the carrying amount of the headquarter building

(Amount in Rs. lakhs)

On 31 st March, 2018	A	B	C	Total
Carrying amount (A)	100	150	200	450
Useful life	10 years	20 years	20 years	
Weighting based on useful life	1	2	2	
Carrying amount after weighting	100	300	400	800
Pro-rata allocation of the building	12.5%	37.5%	50%	100%
	(100/800)	(300/800)	(400/800)	
Allocation of the carrying amount of the building (based on pro-rata above) (B)	18.75	56.25	75	150
Carrying amount (after allocation of the building)	118.75	206.25	275	600

4. Calculation of Impairment Losses

a. Application of 'bottom-up' test

(Amount in Rs. lakhs)

31 st March, 2018	A	B	C
Carrying amount (after allocation of the building) (Refer Point 3 above)	118.75	206.25	275



Recoverable amount (given in the question)	199	164	271
Impairment loss	0	(42)	(4)

(i) **Allocation of the impairment losses for cash-generating units B and C**

(Amount in Rs. lakhs)

Cash-generating unit	B	C
To headquarter building	(12) $(42 \times 56/206)$	(1) $(4 \times 75/275)$
To assets in cash-generating unit	(30) $(42 \times 150/206)$	(3) $(4 \times 200/275)$
	(42)	(4)

Since the research centre could not be allocated on a reasonable and consistent basis to A, B and C's CGU, M Ltd. compares the carrying amount of the smallest CGU to which the carrying amount of the research centre can be allocated (i.e., M as a whole) to its recoverable amount, in accordance with the 'top-down' test.

(ii) **Application of the 'top-down' test (Amount in Rs. lakhs)**

31 st March, 2018	A	B	C	Building	Research centre	M Ltd.
Carrying amount	100	150	200	150	50	650
Impairment loss arising from the 'bottom-up' test	–	(30)	(3)	(13)	–	(46)
Carrying amount after the 'bottom-up' test	100	120	197	137	50	604
Recoverable amount						720

Since recoverable amount is more than the carrying amount of M Ltd., no additional impairment loss has been resulted from the application of the 'top-down' test. Only an impairment loss of Rs. 46 lakhs will be recognized as a result of the application of the 'bottom-up' test.

Question 9

The UK entity with a sterling functional currency has a property located in US, which was acquired at a cost of US\$ 1.8 million when the exchange rate was £1 = US\$ 1.60. The property is carried at cost. At the balance sheet date, the recoverable amount of the property (as a result of an impairment review) amounted to US\$ 1.62 million, when the exchange rate £1 = US\$ 1.80. Compute the amount which is to be reported in Profit & Loss of UK entity as a result of impairment, if any. Ignore depreciation. Also analyse the total impairment loss on account of change in value due to impairment component and exchange component. (RTP Nov '20)

Answer 9

Ignoring depreciation, the loss that would be reported in the Profit and Loss as a result of the impairment is as follows

£	
*Carrying value at balance sheet date-US\$ 16,20,000 @ £ 1.8 =	9,00,000
Historical cost- US\$ 18,00,000 @ £ 1.6 =	11,25,000
Impairment loss recognised in profit and loss	(2,25,000)
The components of the impairment loss can be analysed as follows:	
Change in value due to impairment = US\$ 1,80,000 @ £ 1.8 =	(1,00,000)
Exchange component of change =	(1,25,000)
US\$ 18,00,000 @ 1.8 – US\$ 18,00,000 @ £ 1.6	



*Recoverable amount being less than cost becomes the carrying value.

Question 10

On 31 March 20X1, Vision Ltd acquired 80% of the equity shares of Mission Ltd for Rs. 190 million. The fair values of the net assets of Mission Ltd that were included in the consolidated statement of financial position of Vision Ltd at 31 March 20X1 were Rs. 200 million. It is the Group's policy to value the non-controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

On 31 March 20X4, Vision Ltd carried out its annual review of the goodwill on consolidation of Mission Ltd and found evidence of impairment. No impairment had been evident when the reviews were carried out at 31 March 20X2 and 31 March 20X3. The review involved allocating the assets of Mission Ltd into three cash-generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A Rs. in million	Unit B Rs. in million	Unit C Rs. in million
Intangible assets	30	10	-
Property, Plant and Equipment	80	50	60
Current Assets	60	30	40
Total	170	90	100
Value in use of unit	180	66	104

It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Mission Ltd are allocated in the table shown above. The intangible assets of Mission Ltd have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Mission Ltd as a single cash-generating unit on 31 March 20X4 is Rs. 350 million. Discuss and compute the accounting treatment of impairment of goodwill as per Ind AS 36? (RTP May '21)

Answer 10

The goodwill on consolidation of Mission Ltd that is recognized in the consolidated balance sheet of Vision Ltd is Rs. 30 million (Rs. 190 million – 80% x Rs. 200 million). This can only be reviewed for impairment as part of the cash generating units to which it relates. Since here the goodwill cannot be meaningfully allocated to the units, the impairment review is in two parts. Units A and C have values in use that are more than their carrying values. However, the value in use of Unit B is less than its carrying amount. This means that the assets of unit B are impaired by Rs. 24 million (Rs. 90 million – Rs. 66 million). This impairment loss will be charged to the statement of profit and loss.

Assets of Unit B will be written down on a pro-rata basis as shown in the table below:

(Rs. in million)

Asset	Impact on carrying value		
	Existing	Impairment	Revised
Intangible assets	10	(4)	6
Property, plant and equipment	50	(20)	30
Current assets	30	Nil*	30
Total	90	(24)	66

* The current assets are not impaired because they are expected to realize at least their carrying value when disposed of. Following this review, the three units plus the goodwill are reviewed together i.e. treating Mission Limited as single cash generating Unit. The impact of this is shown in the following table, given that the recoverable amount of the business as a whole is Rs. 350 million:

(Rs. in million)



Component	Impact of impairment review on carrying value		
	Existing	Impairment	Revised
Goodwill (see note below)	37.50	(23.50)	14.00
Unit A	170.00	Nil	170.00
Unit B (revised)	66.00	Nil	66.00
Unit C	100.00	Nil	100.00
Total	373.50	(23.50)	350.00

Note: As per Appendix C of Ind AS 36, given that the subsidiary is 80% owned the goodwill must first be grossed up to reflect a notional 100% investment. Therefore, the goodwill will be grossed up to Rs. 37.50 million (Rs. 30 million x 100/80). The impairment loss of Rs. 23.50 million is all allocated to goodwill, leaving the carrying values of the individual units of the business as shown in the table immediately above.

The table shows that the notional goodwill that relates to a 100% interest is written down by Rs. 23.50 million to Rs. 14.00 million. However, in the consolidated financial statements the goodwill that is recognized is based on an 80% interest so the loss that is actually recognized is Rs. 18.80 million (Rs. 23.50 million x 80%) and the closing consolidated goodwill figure is Rs. 11.20 million (Rs. 14.00 million x 80%) or (Rs. 30 million – Rs. 18.80 million).

Question 11

On 31st March, 20X1, Jackson Ltd. purchased 80% of the equity of Kaplan Ltd. for ₹ 190 million. The fair values of the net assets of Kaplan Ltd. that were included in the consolidated balance sheet of Jackson Ltd. at 31st March, 20X1 were measured at ₹ 200 million (their fair values at that date). It is the group policy to value the non- controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

On 31st March, 20X4, Jackson Ltd. carried out its annual review of the goodwill on consolidation of Kaplan Ltd. for evidence of impairment. No impairment had been evident when the reviews were carried out on 31 st March, 20X2 and 31st March, 20X3. The review involved allocating the assets of Kaplan Ltd. into three cash-generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A ₹ in million	Unit B ₹ in million	Unit C ₹ in million
Intangible assets	30	10	-
Property, Plant and Equipment	80	50	60
Current Assets	60	30	40
Total	170	90	100
Value in use of unit	180	66	104

It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Kaplan Ltd. are allocated in the table shown above.

The intangible assets of Kaplan Ltd. have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Kaplan Ltd. as a single cash-generating unit on 31st March, 20X4 is ₹ 350 million.

Recommend the treatment for impairment of goodwill. (RTP Nov '23)

Answer 11

The goodwill on consolidation of Kaplan Ltd. that is recognized in the consolidated balance sheet of Jackson Ltd. is ₹ 30 million (₹ 190 million – 80% x ₹ 200 million). This can only be reviewed for impairment as part of the cash generating units to which it relates. Since here the goodwill cannot be meaningfully allocated to the units, the impairment review is in two parts.



Units A and C have values in use that are more than their carrying values. However, the value in use of Unit B is less than its carrying amount. This means that the assets of unit B are impaired by ₹ 24 million (₹ 90 million – ₹ 66 million). This impairment loss will be charged to the Statement of Profit and Loss.

Assets will be written down on a pro-rata basis as shown in the table below:

₹ in million

Asset	Impact on carrying value		
	Existing	Impairment	Revised
Intangible assets	10	(4)	6
Property, plant and equipment	50	(20)	30
Current assets	30	Nil*	30
Total	90	(24)	66

*The current assets are not impaired because they are expected to realize at least their carrying value when disposed of.

Following this review, the three units plus the goodwill are reviewed together. The impact of this is shown in the following table, given that the recoverable amount of the business as a whole is ₹ 350 million.

₹ in million

Component	Impact of impairment review on carrying value		
	Existing	Impairment	Revised
Goodwill (see below)	37.50	(23.50)	14.00
Unit A	170.00	Nil	170.00
Unit B (revised)	66.00	Nil	66.00
Unit C	100.00	Nil	100.00
Total	373.50	(23.50)	350.00

As per Appendix C of Ind AS 36, given that the subsidiary is 80% owned the goodwill must first be grossed up to reflect a notional 100% investment. Therefore, the goodwill will be grossed up to ₹ 37.50 million (₹ 30 million x 100/80). The impairment loss of ₹ 23.50 million is all allocated to goodwill, leaving the carrying values of the individual units of the business as shown in the table immediately above.

The table shows that the notional goodwill that relates to a 100% interest is written down by ₹ 23.50 million to ₹ 14.00 million. However, in the consolidated financial statements the goodwill that is recognized is based on an 80% interest so the loss that is actually recognized is ₹ 18.80 million (₹ 23.50 million x 80%) and the closing consolidated goodwill figure is ₹ 11.20 million (₹ 14.00 million x 80%) or (₹ 30 million – ₹ 18.80 million).

Question 12

XYZ Limited has three cash-generating units - X, Y and Z, the carrying amounts of which as on 31st March, 2018 are as follows:

Cash Generating Units	Carrying Amount (Rs. in lakh)	Remaining useful life in years
X	800	20
Y	1000	10
Z	1200	20



XYZ Limited also has corporate assets having a remaining useful life of 20 years as given below:

Corporate Assets	Carrying amount (Rs. in lakh)	Remarks
AU	800	The carrying amount of AU can be allocated on a reasonable basis to the individual cash generating units.
BU	400	The carrying amount of BU cannot be allocated on a reasonable basis to the individual cash-generating units.

Recoverable amounts as on 31st March, 2018 are as follows:

Cash-generating units	Recoverable amount (Rs. in lakh)
X	1000
Y	1200
Z	1400
XYZ Limited	3900

Calculate the impairment loss if any of XYZ Ltd. Ignore decimals. (PYP 10 Marks, Nov'18)(Same concept but different figures- MTP 10 Marks Mar'22, , PYP 8 Marks Nov'20, Old & New SM)

Answer 12

(i) Allocation of corporate assets to CGU

The carrying amount of AU is allocated to the carrying amount of each individual cash-generating unit. A weighted allocation basis is used because the estimated remaining useful life of Y's cash-generating unit is 10 years, whereas the estimated remaining useful lives of X and Z's cash-generating units are 20 years.

(Rs. in lakh)					
	Particulars	X	Y	Z	Total
(a)	Carrying amount	800	1000	1,200	3,000
(b)	Useful life	20 years	10 years	20 years	
(c)	Weight based on useful life	2	1	2	
(d)	Carrying amount (after assigning weight) (a x c)	1,600	1,000	2,400	5,000
(e)	Pro-rata allocation of AU	32% (1,600/5,000)	20% (1,000/5,000)	48% (2,400/5,000)	100%
(f)	Allocation of carrying amount of AU (32: 20: 48)	256	160	384	800
(g)	Carrying amount (after allocation of AU) (a+f)	1,056	1,160	1,584	3,800

(ii) Calculation of impairment loss

Step 1: Impairment losses for individual cash-generating units and its allocation

(a) Impairment loss of each cash-generating units

(Rs. in lakh)			
Particulars	X	Y	Z
Carrying amount (after allocation of AU)	1,056	1,160	1,584
Recoverable amount	1,000	1,200	1,400
Impairment loss	56	Nil	184

(b) Allocation of the impairment loss (after rounding off)



(Rs. in lakh)				
Allocation to	X		Z	
AU	14	(56x256/1,056)	45	(184x384/1,584)
Other assets in cash-generating units	42	(56x800/1056)	139	(184x1,200/1,584)
Impairment loss	56		184	

Step 2: Impairment loss for the larger cash-generating unit, i.e., XYZ Ltd. as a whole

(Rs. in lakh)						
Particular s	X	Y	Z	AU	BU	XYZ Ltd.
Carrying amount	800	1,000	1,200	800	400	4,200
Impairment loss (Step I)	(42)	-	(139)	(59)*	-	(240)
Carrying amount (after Step I)	758	1,000	1,061	741	400	3,960
Recoverable amount						3,900
Impairment loss for the 'larger' cash-generating unit						60

*Rs. 14 lakh + Rs. 45 lakh = Rs. 59 lakh.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A few examinees made mistake in the calculation of larger cash-generating unit. Some examinees though applied correct provisions but made calculation errors while arriving at the impairment loss.

Question 13

A Limited purchased an asset of ₹ 200 lakh on 1st April 2017. It has useful life of 4 years with no residual value. Recoverable amount of the asset is as follows:

As on	Recoverable amount
31 st March 2018	₹ 120 lakh
31 st March 2019	₹ 80 lakh
31 st March 2020	₹ 56 lakh

Calculate the amount of impairment loss or its reversal, if any,

- On 31st March 2018;
- On 31st March 2019;
- On 31st March 2020.

Depreciation is provided on SLM basis under the cost method. (PYP 6 Marks July 21)

Answer 13

As on 31st March, 2018

Carrying amount of the asset (opening balance)	₹ 200 lakh
Depreciation (₹ 200 lakh / 4 years)	(₹ 50 lakh)
Carrying amount of the asset (closing balance)	₹ 150 lakh
Recoverable amount (given)	₹ 120 lakh
Difference	₹ 30 lakh

Therefore, an impairment loss of ₹ 30 lakh should be recognised as on 31st March, 2018.



Depreciation for subsequent years should be charged on the carrying amount of the asset (after providing for impairment loss), i.e., ₹ 120 lakh.

As on 31st March, 2019

Carrying amount of the asset (opening balance)	₹ 120 lakh
Depreciation (₹ 120 lakh / 3 years)	(₹ 40 lakh)
Carrying amount of the asset (closing balance)	₹ 80 lakh
Recoverable amount (Given)	₹ 80 lakh
Difference	NIL

Therefore, no impairment loss should be recognised as on 31st March, 2019.

As on 31st March, 2020

Carrying amount of the asset (opening balance)	₹ 80 lakh
Depreciation (₹ 80 lakh / 2 years)	(₹ 40 lakh)
Carrying amount of the asset (closing balance)	₹ 40 lakh
Recoverable amount (given)	₹ 56 lakh
Difference	(₹ 16 lakh)

Since, the recoverable amount of the asset exceeds the carrying amount of the asset by ₹ 16 lakh, impairment loss recognised earlier should be reversed. However, reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognised for the asset in prior years.

Carrying amount as on 31st March, 2020 had no impairment loss being recognised would have been ₹ 50 lakh [ie. ₹ 200 lakh – (200 lakh / 4 x 3)]. Therefore, the reversal of an impairment loss of ₹ 10 lakh (₹ 50 lakh - ₹ 40 lakh) should be done as on 31st March, 2020.

Question 14

Violet Limited is a beverages manufacturing company having various plants across India. There is Machinery A in the Surat plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also be sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machinery A it cannot produce output as well. The company considers this group of assets as a Cash Generating Unit and an Inventory amounting to ₹ 1.65 lakhs and Goodwill amounting to ₹ 1.50 lakhs is included in such CGU.

Machinery A was purchased on 1st April 2016 for ₹ 12 lakhs and residual value is ₹ 60 thousand. Machinery B was purchased on 1st April, 2018 for ₹ 5 lakhs with no residual value. The useful life of both Machinery A and B is 10 years. The company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of company is 10% p.a.

Year	Cash Flows from Machinery A
1	2,00,000
2	1,50,000
3	1,00,000
4	1,50,000
5	1,00,000 (Excluding Residual Value)
Total	7,00,000

On 31st March, 2021, the professional valuers have estimated that the current market value of machinery A is ₹ 8.5 lakhs. There is a need to dismantle the machinery before delivering it to the



buyer. Dismantling cost is ₹ 1.60 lakhs. Specialized packaging cost would be ₹ 30,000 and legal fees would be ₹ 68,000.

The inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is ₹ 10 lakhs as on 31st March, 2021. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is

₹ 11 lakhs i.e. on 31st March, 2022. The recoverable value of Machinery A is ₹ 5,50,000 and combined for Machinery A and Machinery B is ₹ 8,00,000 as on 31st March, 2022.

You are required to:

- Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2021 by providing all the relevant working notes to arrive at such calculation.
- Compute the carrying value after considering prospective depreciation for the year 2021-2022 on the above assets.
- Compute the carrying value of CGU as at 31st March, 2022.

(Note: Present value factor of ₹ 1 should be taken upto 4 decimals for the purpose of calculation) (PYP 8 Marks Nov 22) (Same concept different figures: RTP May'19, Old & New SM)

Answer 14

- Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss

(a) Calculation of carrying value of Machinery A and B before impairment

Machinery A		
Cost	(A)	₹ 12,00,000
Residual value		₹ 60,000
Useful life		10 years
Useful life already elapsed		5 years
Yearly depreciation	(B)	₹ 1,14,000
WDV as at 31st March 2021 [A- (B x 5)]		₹ 6,30,000
Machinery B		
Cost	(C)	₹ 5,00,000
Residual value		-
Useful life		10 years
Useful life already elapsed		3 years
Yearly depreciation	(D)	₹ 50,000
WDV as at 31st March 2021 [C- (D x 3)]		₹ 3,50,000

(b) Calculation of Value-in-use of Machinery A

Period	Cash Flows (₹)	PVF@10%	PV
1	2,00,000	0.9091	1,81,820
2	1,50,000	0.8264	1,23,960
3	1,00,000	0.7513	75,130
4	1,50,000	0.6830	1,02,450
5	1,00,000	0.6209	62,090
5	60,000	0.6209	37,254
Value in use			5,82,704



(c) Calculation of Fair Value less cost of disposal of Machinery A

	₹
Fair Value	8,50,000
Less: Dismantling cost	(1,60,000)
Packaging cost	(30,000)
Legal Fees	(68,000)
Fair value less cost of disposal	5,92,000

(d) Calculation of Impairment loss on Machinery A

	₹
Carrying Value	6,30,000
Less: Recoverable Value ie higher of Value-in-use (₹ 5,82,704) and Fair value less cost of disposal (₹ 5,92,000)	(5,92,000)
Impairment Loss	38,000

(e) Calculation of Impairment loss of CGU

1. First goodwill will be impaired fully and then the remaining impairment loss of CGU will be allocated to Machinery A and Machinery B.
2. After deduction of value of goodwill ₹ 1,50,000 from total impairment loss of CGU of ₹ 2,95,000, remaining impairment loss would be ₹ 1,45,000. If we allocate remaining impairment loss to Machinery A and B on pro- rata basis, it will come to ₹ 93,214 on Machinery A. However, the impairment loss of Machinery A cannot exceed ₹ 38,000 since its recoverable value is ₹ 5,92,000. Hence, impairment loss to CGU will be as follows:

	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	₹	₹	₹
Machinery A	6,30,000	38,000	5,92,000
Machinery B	3,50,000	1,07,000*	2,43,000
Inventory	1,65,000	-	1,65,000
Goodwill	1,50,000	1,50,000	-
Total	12,95,000	2,95,000	10,00,000

* Balancing figure.

(ii) Carrying value after adjustment of depreciation of 2021-2022

	₹
Machinery A $[5,92,000 - \{(5,92,000 - 60,000)/5\}]$	4,85,600
Machinery B $[2,43,000 - (2,43,000/7)]$	2,08,286
Inventory	1,65,000
Goodwill	-
Total	8,58,886

(iii) Calculation of carrying value of CGU as on 31st March 2022

The revised value of CGU is ₹ 11 lakh. However, impaired goodwill cannot be reversed. Further, the individual assets cannot be increased above the lower of recoverable value or carrying value as if the assets were never impaired.

Accordingly, the carrying value as on 31st March 2022 assuming that the impairment loss had never



incurred, will be:

	Carrying Value	Recoverable Value	Final CV as at 31st March 2022
Machinery A	[12,00,000 - (1,14,000 x 6)] 5,16,000	5,50,000	5,16,000
Machinery B	[5,00,000 – (50,000x4)] 3,00,000	(8,00,000 – 5,50,000) 2,50,000	2,50,000
Inventory	1,65,000*	1,65,000*	1,65,000*
Goodwill	-	-	-
Total	9,81,000	9,65,000	9,31,000

Hence, the impairment loss to be reversed will be limited to ₹ 72,114 only (₹ 9,31,000 – ₹ 8,58,886).

*Note: The question required valuation of CGU at the year-end 31st March 2022, for which value of inventory was required. In the absence of the value of inventory for the year ended 31st March 2022, it is assumed that the value of inventory for the year ended 31st March 2022 is same as it was for the year ended 31 st March, 2021.



Chapter 6.5

Ind AS 38: Intangible Assets

Question 1

A Ltd. intends to open a new retail store in a new location in the next few weeks. It has spent a substantial sum on a series of television advertisements to promote this new store. It has paid for advertisements costing Rs. 8,00,000 before 31st March, 20X2. Rs. 7,00,000 of this sum relates to advertisements shown before 31st March, 20X2 and Rs. 1,00,000 to advertisements shown in April, 20X2. Since 31st March, 20X2, A Ltd. has paid for further advertisements costing Rs. 4,00,000. The accountant charged all these costs as expenses in the year to 31 March 20X2. However, CFO of A Ltd. does not want to charge Rs.12,00,000 against my 20X1-20X2 profits. He believes that these costs can be carried forward as intangible assets because the company's market research indicates that this new store is likely to be highly successful. (MTP 6 Marks Oct '19, RTP Nov'18, Old & New SM)

Answer 1

Ind AS 38 specifically prohibits recognising advertising expenditure as an intangible asset. Irrespective of success probability in future, such expenses have to be recognized in profit or loss. Therefore, the treatment given by the accountant is correct since such costs should be recognised as expenses. However, the costs should be recognised on an accruals basis. Therefore, of the advertisements paid for before 31st March, 20X2, Rs. 7,00,000 would be recognized as an expense and Rs. 1,00,000 as a pre-payment in the year ended 31st March 20X2. Rs. 4,00,000 cost of advertisements paid for since 31st March, 20X2 would be charged as expenses in the year ended 31st March, 20X3.

Question 2

CARP Ltd. is engaged in developing computer software.

The expenditures incurred by CARP Ltd. in pursuance of its development of software is given below:

- (i) Paid Rs. 1,50,000 towards salaries of the program designers.
- (ii) Incurred Rs. 3,00,000 towards other cost of completion of program design.
- (iii) Incurred Rs. 80,000 towards cost of coding and establishing technical feasibility.
- (iv) Paid Rs. 3,00,000 for other direct cost after establishment of technical feasibility.
- (v) Incurred Rs. 90,000 towards other testing costs.
- (vi) A focus group of other software developers was invited to a conference for the introduction of this new software. Cost of the conference aggregated to Rs. 60,000.
- (vii) On 15 March 2020, the development phase was completed and a cash flow budget was prepared.

Net profit for the year 2019-2020 was estimated to be equal to Rs. 30,00,000. How CARP Ltd. should account for the above-mentioned cost as per relevant Ind AS? (MTP 4 Marks Oct '20, PYP 5 Marks May'19, Old & New SM)

Answer 2

Costs incurred in creating computer software, should be charged to research & development expenses when incurred until technical feasibility/asset recognition criteria have been established for the product. Here, technical feasibility is established after completion of detailed program design. In this case, Rs. 5,30,000 (salary cost of Rs. 1,50,000, program design cost of Rs. 3,00,000 and coding and technical feasibility cost of Rs. 80,000) would be recorded as expense in Profit and Loss since it belongs to research phase. Cost incurred from the point of technical feasibility are capitalized as software costs. But the conference cost of Rs.60,000 would be expensed off. In this situation, direct cost after establishment of technical feasibility of Rs. 3,00,000 and testing cost of Rs. 90,000 will be capitalized. The cost of software capitalized is = Rs. (3,00,000 + 90,000) = Rs. 3,90,000.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees wrongly capitalized cost of coding ` 80,000. Hence they were not able to arrive at the correct capitalized value of the software.

**Question 3**

(Includes concepts of Chp 6.8-Ind AS 116 Leases)

The Company has taken a particular application software of a supplier namely, Crystal Systems Limited, which is available on a cloud infrastructure managed and controlled by the Crystal Systems Limited. The Company contracts to pay a fee of ₹ 5,00,000 per month in exchange for a right to receive access to the Crystal Systems Limited's application software for 2 years. The Company accesses the software on need basis over the internet. The contract does not convey any rights to New Age Technology Limited over the tangible assets of the Crystal Systems Limited.

The Chief Accountant of New Age Technology Limited has sought your advice, whether the IT should account for this transaction for use of software with Crystal Systems Limited in terms of Ind AS 116 leases or an intangible asset in terms of Ind AS 38 'Intangible Assets'. Help him to understand your assessment. (MTP 6 Marks March '22)

Answer 3

Assessment of applicability of Ind AS 38 in the given scenario

As per Ind AS 38, to be an intangible asset the asset should meet following criteria:

- Identifiability;
- Control over a Resource (Asset); and
- Existence of Future Economic Benefits.

Crystal Systems Limited manages and controls the application software available on a cloud infrastructure and New Age Technology Limited has limited rights to use the same. Merely right to access the application of Crystal Systems Limited, does not give New Age Technology Limited power to obtain future economic benefits flowing from the software itself. Hence, the application software should not be recognised as an asset under Ind AS 38.

Assessment of applicability of Ind AS 116 in the given scenario

At the inception of a contract, an entity shall assess whether the contract is or contains a lease. For the purpose, a lease is defined as a contract, or part of a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. This right to control the asset throughout the period of use is emphasized ONLY if the customer has both (i) right to obtain substantially all the economic benefits from the use of the identified asset, and (ii) the right to direct the use of the identified asset.

In the given case, the contract gives the New Age Technology Limited only the right to access the Crystal Systems Limited's application software over the contract term, and hence the contract is not a lease contract within the meaning of Ind AS 116.

Conclusion

The right to access the Crystal Systems Limited's application software for a price over a specified period is a service contract. If the Crystal Systems Limited pays amounts for which the services are yet to be received, then the advance payment is a prepayment and an asset for the Crystal Systems Limited.

Question 4

Super Sounds Limited had the following transactions during the Financial Year 20 X1-20X2.

- On 1st April 20X1, Super Sounds Limited purchased the net assets of Music Limited for ₹ 13,20,000. The fair value of Music Limited's identifiable net assets was ₹ 10,00,000. Super Sounds Limited is of the view that due to popularity of Music Limited's product, the life of goodwill is 10 years.**
- On 4th May 20X1, Super Sounds Limited purchased a Franchisee to organize musical shows from Armaan TV for ₹ 80,00,000 and at an annual fee of 2% of musical shows revenue. The Franchisee expires after 5 years. Musical shows revenue were ₹ 10,00,000 for financial year 20X1-20X2. The projected future revenues for financial year 20X2-20X3 is**



₹ 25,00,000 and ₹ 30,00,000 p.a. for remaining 3 years thereafter.

- (iii) On 4th July 20X1, Super Sounds Limited was granted a Copyright that had been applied for by Music Limited. During financial year 20X1-20X2, Super Sound Limited incurred ₹ 2,50,000 on legal cost to register the Patent and ₹ 7,00,000 additional cost to successfully prosecute a copyright infringement suit against a competitor.

The life of the Copyright is for 10 years.

Super Sound Limited follows an accounting policy to amortize all intangible on SLM (Straight Line Method) basis or any appropriate basis over a maximum period permitted by relevant Ind AS, taking a full year amortization in the year of acquisition.

- (i) You are required to prepare A Schedule showing the intangible section in Super Sound Limited Balance Sheet as on 31st March 20X2, and
- (ii) A Schedule showing the related expenses that would appear in the Statement of Profit and Loss of Super Sound Limited for the year ended 20X1-20X2.(MTP 10 Marks Sep'22, PYP 10 Marks, Jan'21)

Answer 4

Super Sounds Limited Balance Sheet (Extract relating to intangible asset) as at 31 st March 20X2

	Note No.	₹
Assets		
(1) Non- current asset		
Intangible assets	1	69,45,000

Super Sounds Limited
Statement of Profit and Loss (Extract)
for the year ended 31st March 20X2

	Note No.	₹
Revenue from Operations		10,00,000
Total Revenue		
Expenses:		
Amortization expenses	2	16,25,000
Other expenses	3	7,20,000
Total Expenses		

Notes to Accounts (Extract)

1. Intangible Assets

		Gross Block (Cost)			Accumulated amortisation			Net block	
		Opening balance	Additions	Closing Balance	Opening balance	Additions	Closing Balance	Opening balance	Closing Balance
		₹	₹	₹	₹	₹	₹	₹	₹
1.	Goodwill* (W.N.1)	-	3,20,000	3,20,000	-	-	-	-	3,20,000
2.	Franchise** (W.N.2)	-	80,00,000	80,00,000	-	16,00,000	16,00,000	-	64,00,000
3.	Copyright (W.N.3)	-	2,50,000	2,50,000	-	25,000	25,000	-	2,25,000
		-	85,70,000	85,70,000	-	16,25,000	16,25,000	-	69,45,000

*As per Ind AS 36, irrespective of whether there is any indication of impairment, an entity shall test goodwill acquired in a business combination for impairment annually. This implies that goodwill is not amortised annually but is subject to annual impairment, if any.



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

2.	Amortization expenses		
	Franchise (W.N.2)	16,00,000	
	Copyright (W.N.3)	25,000	16,25,000
3.	Other expenses		
	Legal cost on copyright	7,00,000	
	Fee for Franchise (10,00,000 x 2%)	20,000	7,20,000

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business	13,20,000
	Less: Fair value of net assets acquired	(10,00,000)
	Goodwill	3,20,000
(2)	Franchise	80,00,000
	Less: Amortisation (over 5 years)	(16,00,000)
	Balance to be shown in the balance sheet	64,00,000
(3)	Copyright	2,50,000
	Less: Amortisation (over 10 years as per SLM)	(25,000)
	Balance to be shown in the balance sheet	2,25,000

Question 5

X Ltd. purchased a franchise from a restaurant chain at a cost of ₹ 1,00,00,000 under a contract for a period of 10 years. Can the franchise right be recognised as an intangible asset in the books of X Ltd. under Ind AS 38? (MTP 4 Marks Oct'22) (RTP Nov 21)

Answer 5

An intangible asset is an identifiable non-monetary asset without physical substance.

For considering an asset as an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control over a resource and existence of future economic benefits.

In the given case, the franchise right meets the identifiability criterion as it is arising from contract to purchase the franchise right for 10 years. In addition, X Ltd. will have future economic benefits and control over them from the franchise right. Accordingly, the franchise right meets the definition of intangible asset. The same can be recognised if the following recognition criteria laid down in para 21 of Ind AS 38 is met:

An intangible asset shall be recognised if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
- (b) the cost of the asset can be measured reliably.

In the instant case, identifiability criterion is fulfilled, future economic benefits from franchise right are expected to flow to the entity and cost can also be measured reliably. Therefore, X Ltd. should recognise the franchise right as an intangible asset.

Question 6

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial

statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director for approval. Mr. Y, who is not an accountant, had raised following queries from Mr. X after going through the draft financial statements:

In the year to March, 2018, ABC Ltd. spent considerable amount on designing a new product. ABC Ltd. spent the six months from April, 2017 to September, 2017 researching into the feasibility of the product. Mr. X charged these research costs to profit or loss. From October, 2017, A Ltd. was confident that the product would be commercially successful and A Ltd. is fully committed to finance its future development. A Ltd. spent remaining part of the year in developing the product, which is expected to start from selling in the next few months. These development costs have been recognised as intangible assets in the Balance Sheet. State whether the treatment done by Mr. X is correct when all these research and development costs are design costs. Justify your answer with reference to relevant Ind AS. Provide answers to the queries raised by the managing director Mr. Y as per Ind AS. (RTP Nov '18)

Answer 6

As per Ind AS 38 'Intangible Assets', the treatment of expenditure on intangible items depends on how it arose. Internal expenditure on intangible items incurred during research phase cannot be recognised as an asset. Once it can be demonstrated that a development project is likely to be technically feasible, commercially viable, overall profitable and can be adequately resourced, then future expenditure on the project can be recognised as an intangible asset. The difference in the treatment of expenditure upto 30th September, 2017 and expenditure after that date is due to the recognition phase ie. research or development phase.

Question 7

One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors. The senior engineer believes that the cost reductions will exceed the project costs within twenty four months of their implementation. Regulatory testing and health and safety approval was obtained on 1 June 20X5. This removed uncertainties concerning the project, which was finally completed on 20 April 20X6. Costs of Rs. 18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset. An offer of Rs. 7,80,000 for the new developed technology has been received by potential buyer but it has been rejected by XYZ. Utkarsh believes that the project will be a major success and has the potential to save the company Rs. 12,00,000 in perpetuity. Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long term prospects of the new process and she is of the opinion that competitors would have developed new technology at some time which would require to replace the new process within four years. She estimates that the present value of future cost savings will be Rs. 9,60,000 over this period. After that, she thinks that there is no certainty about its future. What would be the appropriate accounting treatment of aforesaid issue? (RTP May '20, Old & New SM)

Answer 7

'Intangible Assets' requires an intangible asset to be recognised if, and only if, certain criteria are met. Regulatory approval on 1 June 20X5 was the last criterion to be met, the other criteria have been met as follows:

- Intention to complete the asset is apparent as it is a major project with full support from board
- Finance is available as resources are focused on project
- Costs can be reliably measured
- Benefits are expected to exceed costs – (in 2 years)

Amount of Rs. 15,00,000 (Rs. 18,00,000 x 10/12) should be capitalized in the Balance sheet of year ending 20X5-20X6 representing expenditure since 1 June 20X5.

The expenditure incurred prior to 1 June 20X5 which is Rs. 3,00,000 (2/12 x Rs. 18,00,000) should be recognized as an expense, retrospective recognition of expense as an asset is not allowed.

Ind AS 36 'Impairment of assets' requires an intangible asset not yet available for use to



be tested for impairment annually.

Cash flow of Rs. 12,00,000 in perpetuity would clearly have a present value in excess of Rs. 12,00,000 and hence there would be no impairment. However, the research director is technically qualified, so impairment tests should be based on her estimate of a four-year remaining life and so present value of the future cost savings of Rs. 9,60,000 should be considered in that case.

9,60,000 is greater than the offer received (fair value less costs to sell) of Rs. 7,80,000 and so Rs. 9,60,000 should be used as the recoverable amount.

So, the carrying amount should be consequently reduced to Rs. 9,60,000.

Calculation of Impairment loss:

Particulars	Amount Rs.
Carrying amount (Restated)	15,00,000
Less: Recoverable amount	<u>9,60,000</u>
Impairment loss	<u>5,40,000</u>

Impairment loss of Rs. 5,40,000 is to be recognised in the profit and loss for the year 20X5-20X6.

Necessary adjusting entry to correct books of account will be:

	Rs.	Rs.
Operating expenses- Development expenditure Dr.	3,00,000	
Operating expenses–Impairment loss of intangible assets Dr.	5,40,000	
Intangible To assets – Development expenditure		8,40,000

Question 8

ABC Pvt. Ltd., recruited a player. As per the terms of the contract, the player is prohibited from playing for any other entity for coming 5 years and have to in the employment with the company and cannot leave the entity without mutual agreement. The price the entity paid to acquire this right is derived from the skills and fame of the said player. The entity uses and develops the player through participation in matches. State whether the cost incurred to obtain the right regarding the player can be recognised as an intangible asset as per Ind AS 38? (RTP Nov '20)

Answer 8

As per Ind AS 38, for an item to be recognised as an intangible asset, it must meet the definition of an intangible asset, i.e., identifiability, control over a resource and existence of future economic benefits and also recognition criteria.

With regard to establishment of control, paragraph 13 of Ind AS 38 states that an entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.

Further, paragraph 15 of Ind AS 38 provides that an entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.



Since the right in the instant case is contractual, identifiability criterion is satisfied. Based on the facts provided in the given case, the player is prohibited from playing in other teams by the terms of the contract which legally binds the player to stay with ABC Ltd for 5 years.

Accordingly, in the given case, the company would be able to demonstrate control. Future economic benefits are expected to arise from use of the player in matches. Further, cost of obtaining rights is also reliably measurable. Hence, it can recognise the costs incurred to obtain the right regarding the player as an intangible asset. However, careful assessment of relevant facts and circumstances of each case is required to be made.

Question 9

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

Discuss the accounting treatment of the above in the financial statements of PQR Ltd. (RTP May '21)

Answer 9

In order to determine the accounting treatment of 'cloud9 videogame series' and 'Headspace', definition of asset and intangible asset given in Ind AS 38 may be noted: "An asset is a resource:

- (a) controlled by an entity as a result of past events; and
- (b) from which future economic benefits are expected to flow to the entity."

"An intangible asset is an identifiable non-monetary asset without physical substance."

In accordance with the above, for recognizing an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control and existence of future economic benefits.

In order to determine whether 'cloud9 videogame series' meet the aforesaid conditions, following provisions of Ind AS 38 regarding Internally Generated Intangible Assets may be noted:

As per paragraph 63 and 64 of Ind AS 38, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognized as intangible assets. Expenditure on such items cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Accordingly, though the cash flow projections suggest that the cloud9 brand will lead to future economic benefits, yet the asset has been internally generated; therefore, the Cloud9 brand cannot be recognised as intangible asset in the financial statements.

In order to determine whether 'Headspace' meet the aforesaid conditions, following provisions of Ind AS 38 regarding 'Separately acquired Intangible Assets' should be analysed.

As per paragraphs 25 and 26 of Ind AS 38, normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The Headspace game has been purchased for INR 10,00,000 and it is expected to generate future economic benefits to the entity. Since Headspace game is a separately acquired asset and the future



benefits are expected to flow to the entity, therefore, an intangible asset should be recognised in respect of the 'Headspace' asset at its cost of INR 10,00,000. After initial recognition, either cost model or revaluation model can be used to measure headspace intangible asset as per guidance given in paragraphs 74-87 of Ind AS 38. In accordance with this, Headspace intangible asset should be carried at its cost/revalued amount (as the case may be) less any accumulated amortisation and any accumulated impairment losses.

Question 10

D Ltd. a leading publishing house, purchased copyright of a book from its author for publishing the same. As per the terms of the contract, if D Ltd. chooses to make the payment upfront then, copyright consideration of ₹ 80,00,000 is to be paid (which is in line with general practice in such arrangements). However, the contract also provided that, in case D Ltd. chooses to pay the consideration after 2 years, then it will be required to pay ₹ 1,00,00,000. At what value should the intangible asset be recognised as per Ind AS 38? (RTP May '22)

Answer 10

As per paragraph 32 of Ind AS 38, "If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognized as interest expense over the period of credit unless it is capitalized in accordance with Ind AS 23, Borrowing Costs."

In the given case, if the payment for an intangible asset i.e. copyright is deferred beyond normal credit terms, the cash price equivalent ₹ 80,00,000 should be considered as its cost and the intangible asset will be recorded initially at this value.

The difference of ₹ 20,00,000 between cash price equivalent (i.e. ₹ 80,00,000) and the total payment (i.e. ₹ 1,00,00,000) should be recognised as interest expense over the period of credit (i.e. 2 years in this case), unless it is eligible for capitalisation in accordance with Ind AS 23, Borrowing Costs.

Question 11

An entity has an intangible asset in the form of a product protected by patented technology which is expected to be a source of net cash inflows for at least 15 years. It has been recognised in the books on initial date at ₹12,00,000. The entity has a commitment from a third party to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in five years. Company is amortising the asset in 15 years considering its residual value to be Zero. Annual amortization charged to Profit and Loss is ₹80,000. State, whether the accounting treatment done by the Company is in accordance with Ind AS 38? If not, then calculate the annual amortization of the intangible asset and also the amount at which it will be reflected in the balance sheet. (RTP Nov'22)

Answer 11

For determination of amortisation of the intangible asset, which has finite useful life, two elements need to be determined: useful life and residual value.

Useful life is defined as:

- i. the period over which an asset is expected to be available for use by an entity; or
- ii. the number of production or similar units expected to be obtained from the asset by an entity.

In the instant case, since the entity expects that the asset will be available for use by it for the period of 5 years and thereafter it will be transferred, the useful life of the asset is 5 years.

For residual value, paragraphs 100-102 of Ind AS 38 states that the residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:

- (a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
- (b) there is an active market (as defined in Ind AS 113) for the asset and:
 - (i) residual value can be determined by reference to that market; and



(ii) it is probable that such a market will exist at the end of the asset's useful life.

The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.

An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used.

On application of above paragraphs, the depreciable amount of the patent will be determined after deducting the residual value, which is 60 % of its fair value at the date of its acquisition. Accordingly, the patent will be amortised over its useful life of 5 years, with a residual value equal to 60% of its fair value at the date of its acquisition. The patent will also be reviewed for impairment in accordance with Ind AS 36. Therefore, the accounting policy of amortising the asset over a period of 15 years considering its residual value of Zero is not in accordance with Ind AS 38.

Computation of correct amount of residual value and annual amortization:

		₹
Cost of Intangible asset		12,00,000
Residual value	(60% of ₹ 12,00,000)	7,20,000
Depreciable value of intangible asset	(12,00,000 – 7,20,000)	4,80,000
Useful life		5 years
Annual amortisation	(4,80,000 / 5)	₹ 96,000 p.a.

Question 12

(include also Chapter 13 Ind AS 103:Business Combination and Corporate Restructuring)

An entity acquired two trade secrets (secret recipes) in a business combination. Recipe A is patented. Recipe B is not legally protected. How the acquisition of Recipe A and Recipe B would be accounted for by the entity as per relevant Ind AS. (RTP May '23)

Answer 12

Para 11 and 12 of Ind AS 38 states that the definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognized in a business combination is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements.

Further, an asset is identifiable if it either:

- is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

In the given case, Recipe A meets the contractual-legal criterion for identification as an intangible asset because it is protected by a patent. This recipe is identified and recognized separately from goodwill while accounting the business combination.

Since Recipe B is not protected by a patent, it does not meet the contractual-legal criterion for identification as an intangible asset. However, Recipe B is identified as a separate intangible asset because it meets the separability criterion. Such recipes can be, and often are, exchanged, licensed or leased to others. Therefore, the unpatented Recipe B should be accounted for as a separate intangible asset acquired in the business combination.



Question 13

A company engaged in the provision of Information Technology Products and Services incurred following expenditure during the development phase of its software product that is to be offered to its customers. The entity also purchases software from third parties for incorporating into its end software product offered to its customers. The company is in the process of launching it in the market for licensing to customers. The company also takes services of external professional software developers for such software development purpose. Costs incurred in relation to the development of its software product for the year ended 31st March, 20X2 are as follows:

Particulars	Amount (₹ thousands)
Purchase price of imported software	600
Employment costs (Note 1)	1,200
Testing costs	1,800
Other costs directly related to customization (Note 2)	450
Professional fees paid for external software developers	220
Costs of training provided to staff to operate the asset	195
Costs of advertising in market	1,560
Administrative and general overheads	825

Note 1:

The software was developed in nine months ended 31st December, 20X1 and was capable of operating in the manner intended by the entity. It was brought into use on 31st March, 20X2. The employment costs are for the period of twelve months (i.e. up to 31st March, 20X2). The employees were engaged in developing the software and related activities.

Note 2:

Other costs directly related to development include an abnormal cost of 50,000 in respect of repairing the damage which resulted from a security breach.

What will be the amount of the software development costs that can be capitalized by explaining the reason for each element of cost? (RTP Nov '23)

Answer 13

In the given fact pattern, the entity should apply the recognition and measurement principles relevant for an internally generated intangible asset. The entity has to ensure compliance with additional requirements relating to internally generated intangible assets in addition to general recognition criteria and initial measurement of intangible asset. In the instant case, for the measurement of software development cost, entity must evaluate the costs incurred for recognition of an intangible asset arising from development phase with reference to paragraphs 65 to 67 of Ind AS 38.

According to the said paragraphs, the initial carrying amount of the software will be computed as follows:

Particulars	Amount (₹ in thousands)	Amount to be capitalised as Intangible Assets (₹ in thousands)	Remarks
Purchase price of imported software	600	600	The cost of materials or / and services used or consumed in generating the intangible asset and any directly attributable cost of preparing the asset for its intended use.



Employment costs (Note 1)	1,200	900	Employment costs for the period of nine months are directly attributable costs. Therefore, the cost to be
			capitalized is ₹ 900 thousand (i.e., $9/12 \times ₹ 1,200$ thousand) for nine months as the asset was ready for its intended use by that time. It is assumed that ₹ 100 thousand is equally incurred each month. Capitalisation of eligible costs should cease when the asset is capable of operating in the manner intended by management.
Testing costs	1,800	1,800	The cost of testing whether the asset is functioning properly is a directly attributable cost. (Refer paragraph 59 of Ind AS 38)
Other costs directly related to development (Note 2)	450	400	Cost of identified inefficiencies deducted, i.e., ₹ 450 thousand – ₹ 50 thousand.
Professional fees paid for bringing the software to its working condition	220	220	The cost of materials or/and services used or consumed in generating the intangible asset
Costs of training provided to staff	195	Nil	Expenditure on training staff to operate the asset cannot be capitalised. (Refer paragraph 67 of Ind AS 38)
Costs of advertising in market	1,560	Nil	Selling, administrative and other general overhead expenditure cannot be capitalised. (Refer paragraph 67 of Ind AS 38)
Administrative and general overheads	825	Nil	
Total	6,850	3,920	

Accordingly, the initial carrying value of the software is ₹ 39,20,000. The remaining costs will be charged to profit or loss.



Chapter 6.6

Ind AS 40: Investment Property

Question 1

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

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

Building A was purchased 5 years ago at the cost of Rs.10 crore and building life is estimated to be 20 years. The company follows straight line method for depreciation. During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 20X1 at the cost of Rs. 2 crore. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation. Further, during the year 20X1-20X2, the company earned / incurred following direct operating expenditure relating to Building A and Building B:

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

The company does not have any restrictions and contractual obligations against buildings - A and

B. For complying with the requirements of Ind AS, the management sought an independent report from the specialists so as to ascertain the fair value of buildings A and B. The independent valuer has valued the fair value of property as per the valuation model recommended by International valuation standards committee. Fair value has been computed by the method by streamlining present value of future cash flows namely, discounted cash flow method.

The other key inputs for valuation are as follows:

The estimated rent per month per square feet for the period is expected to be in the range of Rs. 50 - Rs. 60. It is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%. Assume that the fair value of properties based on discounted cash flow method is measured at Rs. 10.50 crore on 31st March, 20X2.

What would be the treatment of Building A and Building B in the balance sheet of Shaurya Limited? Provide detailed disclosures and computations in line with relevant Indian accounting standards. Treat it as if you are preparing a separate note or schedule, of the given assets in the balance sheet. (MTP 8 Marks Mar '21, RTP Nov '20, Old & New SM)

Answer 1

Investment property is held to earn rentals or for capital appreciation or both. Ind AS 40 shall be applied in the recognition, measurement and disclosure of investment property. An investment property shall be measured initially at its cost. After initial recognition, an entity shall measure all of its investment properties in accordance with the requirement of Ind AS 16 for cost model.



The measurement and disclosure of Investment property as per Ind AS 40 in the balance sheet would be depicted as follows:

INVESTMENT PROPERTIES:

Particulars	Period ended 31 st March, 20X2 (Rs. in crore)
Gross Amount:	
Opening balance (A)	10.00
Additions during the year (B)	2.00
Closing balance (C) = (A) + (B)	12.00
Depreciation:	
Opening balance (D)	2.50
Depreciation during the year (E) (0.5 + 0.05)	0.55
Closing balance (F) = (D) + (E)	3.05
Net balance (C) - (F)	8.95

The changes in the carrying value of investment properties for the year ended 31st March, 20X2 are as follows:

Amount recognised in Profit and Loss with respect to Investment Properties

Particulars	Period ending 31 st March, 20X2 (Rs. in crore)
Rental income from investment properties (0.75 + 0.25)	1.00
Less: Direct operating expenses generating rental income (5+1+2.5+1.5+2+1)	(0.13)
Profit from investment properties before depreciation and indirect expenses	0.87
Less: Depreciation	(0.55)
Profit from earnings from investment properties before indirect expenses	0.32

Disclosure Note on Investment Properties acquired by the entity

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

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

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



Question 2

(Includes concepts of Chp 7.2 Property Plant & Equipment)

UK Ltd. has purchased a new head office property for Rs. 10 crores. The new office building has 10 floors and the organisation structure of UK Ltd. is as follows:

Floor	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th
Use	Waiting Area	Admin	HR	Accounts	Inspection	MD Office	Canteen	Vacant		

Since UK Ltd. did not need the floors 8, 9 and 10 for its business needs, it has leased out the same to a restaurant on a long-term lease basis. The terms of the lease agreement are as follows:

- Tenure of Lease Agreement - 5 Years
- Non-Cancellable Period - 3 years
- Lease Rental-annual lease rental receivable from these floors are Rs. 10,00,000 per floor with an escalation of 5% every year.

Based on the certificate from its architect, UK Ltd. has estimated the cost of the 3 top floors as approximately Rs. 3 crores. The remaining cost of Rs. 7 crores can be allocated as 25% towards Land and 75% towards Building.

As on 31st March, 2018, UK Ltd. obtained a valuation report from an independent valuer who has estimated the fair value of the property at Rs. 15 crores. UK Ltd. wishes to use the cost model for measuring Property, Plant & Equipment and the fair value model for measuring the Investment Property. UK Ltd. depreciates the building over an estimated useful life of 50 years, with no estimated residual value. Advise UK Ltd. on the accounting and disclosures for the above as per the applicable Ind AS.(MTP 10 Marks Aug '18)

Answer 2

Ind AS 16 'Property, Plant and Equipment' states that property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. As per Ind AS 40 'Investment property', investment property is a property held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes or sale in the ordinary course of business.

Further, as per para 8 of Ind AS 40, the building owned by the entity and leased out under one or more operating leases will be classified as investment property.

Here top three floors have been leased out for 5 years with a non-cancellable period of 3 years. The useful life of the building is 50 years. The lease period is far less than the useful life of the building leased out. Further, the lease rentals of three years altogether do not recover the fair value of the floors leased i.e. $15 \text{ crore} \times 30\% = 4.50 \text{ crore}$. Hence the lease is an operating lease. Therefore, the 3 floors leased out as operating lease will be classified as investment property in the books of lessor i.e. UK Ltd.

However, for investment property, Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property. Ind AS 40 also requires that an entity shall disclose the fair value of such investment property(ies).

(in crore)				
	Total	PPE (70%)		Investment property (30%)
		Land (25%)	Building (75%)	
Cost	10	1.75	5.25	3
FV	15	2.625	7.875	4.5
Valuation model followed		Cost	Cost	Cost (as per para 30 of Ind AS 40)



Value recognized in the books		1.75	5.25	3
Less: Depreciation		Nil	$(5.25/50) = 0.105$ crore	$(3/50) = 0.06$
Carrying value as on 31 st March, 2018		1.75	5.145	2.94
Impairment loss		No impairment loss since fair value is more than the cost		

Question 3

X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1?

During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

- How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?**
- Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?**
- Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?**
- Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2? (MTP 5 Marks March '23, PYP 5 Marks May'22, RTP May'21, Old & New SM)**

Answer 3

As per paragraph 8(b) of Ind AS 40, any land held for currently undetermined future use, should be classified as an investment property. Hence, in this case, the land would be regarded as held for capital appreciation. Hence the land property should be classified by X Ltd as investment property in the financial statements as at 31 March 20X1.

As per Para 57 of the Standard, an entity can change the classification of any property to, and from, an investment property when and only when evidenced by a change in use. A change occurs when the property meets or ceases to meet the definition of investment property and there is evidence of the change in use. Mere management's intention for use of the property does not provide evidence of a change in use.

Accordingly, the property in different cases would be classified as under:

- Since X Ltd has commenced construction of office building on it for own use, the property should be reclassified from investment property to owner occupied as at 31 March 20X2.
- As per Para 59, transfers between investment property, owner occupied and inventories do not change the carrying amount of the property transferred and they do not change the cost of the property for measurement or disclosure purposes.
- No. The change in classification to, or from, investment properties is due to change in use of the property. No retrospective application is required and prior period's financial statements need not be re-stated.
- Mere management intentions for use of the property do not evidence change in use. Since X Ltd has no plans to commence construction of the office building during 20X1-20X2, the property should continue to be classified as an investment property by X Ltd. in its financial statements as at 31 March 20X2.

**Question 4**

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 2013, X Ltd. purchased a large property (consisting of land) for Rs. 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were Rs. 20,00,000. On 31st March, 2017, the fair value of the property was Rs. 2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 2017 and vacated the property on 30th September, 2017. On 30th September, 2017, the fair value of the property was Rs. 2,90,00,000. On 1st October, 2017, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of Rs. 60,00,000 on this conversion project between 30th September, 2017 to 31st March, 2018. The project was incomplete at 31st March, 2018 and the directors of X Ltd. estimate that they need to spend a further Rs. 40,00,000 to complete the project, after which each flat could be sold for Rs. 50,00,000.

Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 2018. as per Ind AS (RTP Nov '18, Old & New SM)

Answer 4

From 1st April, 2013, the property would be regarded as an investment property since it is being held for its investment potential rather than being owner occupied or developed for sale.

The property would be measured under the cost model. This means it will be measured at Rs. 2,00,00,000 at each year end.

On 30th September, 2017, the property ceases to be an investment property. X Ltd. begins to develop it for sale as flats. The increase in the fair value of the property from 31st March, 2017 to 30th September, 2017 of Rs. 30,00,000 (Rs. 29,00,000 – Rs. 26,00,000) would be recognised in P/L for the year ended 31st March, 2018.

Since the lease of the property is an operating lease, rental income of Rs. 10,00,000 (Rs. 20,00,000 x 6/12) would be recognised in P/L for the year ended 31st March, 2018.

When the property ceases to be an investment property, it is transferred into inventory at its then fair value of Rs. 2,90,00,000. This becomes the initial 'cost' of the inventory.

The additional costs of Rs. 60,00,000 for developing the flats which were incurred up to and including 31st March, 2018 would be added to the 'cost' of inventory to give a closing cost of Rs. 3,50,00,000.

The total selling price of the flats is expected to be Rs. 5,00,00,000 (10 x Rs. 50,00,000). Since the further costs to develop the flats total Rs. 40,00,000, their net realisable value is Rs. 4,60,00,000 (Rs. 5,00,00,000 – Rs. 40,00,000), so the flats will be measured at a cost of

Rs. 3,50,00,000.

The flats will be shown in inventory as a current asset.

Question 5

(Includes concepts of Chp 7.2 Ind AS 16: Property, Plant and Equipment)

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

Answer 5

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

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



b) sale in the ordinary course of business.

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

On applying the above provisions, Floor 1 of the building is classified as an item of investment property by the entity (lessor) because it is held to earn rentals. Ind AS 40 is applicable in this case. An investment property should be measured initially at its cost. After initial recognition, an entity shall measure all of its investment properties in accordance with Ind AS 16's requirements for cost model. However, entities are required to measure the fair value of investment property, for the purpose of disclosure even though they are required to follow the cost model.

Floor 2 of the building will be classified as property, plant and equipment because it is held by administrative staff i.e. it is held for use for administrative purposes. Ind AS 16 is applicable in this case. An item of property, plant and equipment that qualifies for recognition as an asset should be initially measured at its cost. After recognition, an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.

Question 6

(Includes concepts of Chp 7.2 Ind AS 16 Property, Plant & Equipment)

On 1st April 2019, an entity purchased an office block (building) for ₹ 50,00,000 and paid a non-refundable property transfer tax and direct legal cost of ₹ 2,50,000 and ₹ 50,000 respectively while acquiring the building.

During 2019, the entity redeveloped the building into two-story building. Expenditures on re-development were:

- ₹ 1,00,000 Building plan approval;
- ₹ 10,00,000 construction costs (including ₹ 60,000 refundable purchase taxes); and
- ₹ 40,000 due to abnormal wastage of material and labour.

When the re-development of the building was completed on 1st October 2019, the entity rents out Ground Floor of the building to its subsidiary under an operating lease in return for rental payment. The subsidiary uses the building as a retail outlet for its products. The entity kept first floor for its own administration and maintenance staff usage. Equal value can be attributed to each floor. How will the entity account for all the above mentioned expenses in the books of account?

Also, discuss how the above building will be shown in Consolidated financial statement of the entity as a group and in its separate financial statements as per relevant Ind AS (PYP 5 Marks, Jan'21)

Answer 6

In accordance with Ind AS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalized. Therefore, the initial purchase price of the building would be:

Particulars	Amount (₹)
Purchase amount	50,00,000
Non-refundable property tax	2,50,000
Direct legal cost	50,000
	53,00,000
Expenditures on redevelopment:	
Building plan approval	1,00,000
Construction costs (10,00,000 – 60,000)	9,40,000
Total amount to be capitalised at 1 st October 2019	63,40,000

Treatment of abnormal wastage of material and labour:

As per Ind AS 16, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. It will be charged to Profit and Loss in the year it is incurred. Hence, abnormal wastage of ₹ 40,000 will be expensed off in Profit & Loss in the financial year 2019 -2020.

Accounting of property- Building

When the property is used as an administrative centre, it is not an investment property, rather it is an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

When the property (land and/or buildings) is held to earn rentals or for capital appreciation (or both), it is an Investment property. Ind AS 40 prescribes the cost model for accounting of such investment property.

Since equal value can be attributed to each floor, Ground Floor of the building will be considered as Investment Property and accounted as per Ind AS 40 and First Floor would be considered as Property, Plant and Equipment and accounted as per Ind AS 16.

Cost of each floor = ₹ 63,40,000 / 2 = ₹ 31,70,000

As on 1st October 2019, the carrying value of building vis-à-vis its classification would be as follows:

- (i) **In Separate Financial Statements:** The Ground Floor of the building will be classified as investment property for ₹ 31,70,000, as it is property held to earn rentals. While First Floor of the building will be classified as item of property, plant and equipment for ₹31,70,000.
- (ii) **In Consolidated Financial Statements:** The consolidated financial statements present the parent and its subsidiary as a single entity. The consolidated entity uses the building for the supply of goods. Therefore, the leased-out property to a subsidiary does not qualify as investment property in the consolidated financial statements. Hence, the whole building will be classified as an item of Property, Plant and Equipment for ₹63,40,000.

Question 7

(Includes concepts of Chp 7.2 Ind AS 16 Property, Plant & Equipment)

Special Limited is a multinational entity that owns 3 properties. All 3 properties were purchased on 1st April, 2020. The following details were furnished:

Particulars	Property 1	Property 2	Property 3
Purchase Price	₹ 7,50,000	₹ 10,50,000	₹ 12,00,000
Estimated life	10 years	15 years	15 years
Fair value as on 31 st March, 2021	₹ 8,00,000	₹ 9,50,000	₹ 13,00,000

The Company uses Property 1 and Property 2 for its business purposes. The Company is exploring the opportunity to sell Property 3 if it gets reasonable consideration. Till the time it is not sold, the Company has rented the property.

It has adopted revaluation model for subsequent measurement of these properties. The depreciation is charged on straight line method. However, the Company has not charged any depreciation on Property 1 and Property 3 for the current year since the fair value of properties exceeds their carrying amount. The difference between their fair value and carrying amount has been recognized in the statement of profit and loss. The properties are shown under the head property, plant and equipment in the Balance Sheet. Analyze whether the accounting policies adopted by the Company in relation to the given properties are in accordance with Ind AS. If not, advise the correct treatment and present an extract of the Balance Sheet for the year ended 31st March 2021. (PYP 8 Marks July 21)

Answer 7

(a) Preamble:

The given issue needs to be examined in the umbrella of the provisions given in Ind AS 1 'Presentation of Financial Statements', Ind AS 16 'Property, Plant and Equipment' in relation to property '1' and '2' and Ind AS 40 'Investment Property' in relation to property '3'.

Guidance given in relevant Ind AS:

1. Property '1' and '2'

Definition and applicability:

As per Ind AS 16, Property plant and equipment are tangible items that:

- (a) are held for use in the production or supply of goods or services or for administrative purposes; and
- (b) are expected to be used during more than one period.

Hence, property 1 and 2 are held for use in the business, therefore Ind AS 16 shall apply in respect of these two properties.

Accounting Principles:

- If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

If an asset's carrying amount is decreased as a result of revaluation, the decrease shall be recognised in profit and loss statement.

2. Property '3'

Definition and applicability:

As per Ind AS 40, Investment property is property held to earn rentals or for capital appreciation or both, rather than for:

- Use in the production of goods or services or for administrative purposes; or
- Sale in the ordinary course of business.

Therefore, property 3 is an investment property and company shall follow cost model for its subsequent measurement.

Accounting Principles:

- An entity shall adopt as its accounting policy the cost model to all of its investment property; and (Refer paragraph 30 of Ind AS 40)
- requires that an entity shall disclose the fair value of investment property. (Refer paragraph 79 (e) of Ind AS 40

Further, paragraph 54 (2) of Ind AS 1 'Presentation of Financial Statements' requires that as a minimum, the balance sheet shall include line items that present the following amounts:

- a. Property, Plant and Equipment
- b. Investment Property.

Analysis:

As per the facts given in the question, Special Ltd. has

- a. Presented all three properties in balance sheet as 'property, plant and equipment';
- b. Not charged depreciation to Property '1' and '3';
- c. Upward revaluation is recognised in the statement of profit and loss as profit; and
- d. Applied revaluation model to Property '3' being classified as Investment Property.



The above accounting treatment is neither correct nor in accordance with provision of Ind AS 1, Ind AS 16 and Ind AS 40.

Accordingly, Special Ltd. shall depreciate Property 1 irrespective of the fact that, their fair value exceeds the carrying amount. The revaluation gain shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. There is no alternative of revaluation model in respect to property '3' being classified as Investment Property and only cost model is permitted for subsequent measurement. However, Special Ltd. is required to disclose the fair value of the property in the Notes to Accounts. Further, Property '3' shall be presented as separate line item as Investment Property and depreciation should be charged on it as well.

Therefore, as per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet will be as follows:

Balance Sheet (extracts) as at 31st March, 2021

Assets	₹
Non-Current Assets	
Property, Plant and Equipment	
Property '1' 8,00,000	
Property '2' 9,50,000	17,50,000
Investment Properties	
Property '3' (1,200,000 – 80,000)	11,20,000
Equity and Liabilities	
Other Equity	
Revaluation Reserve	
Property '1' [8,00,000 – (7,50,000 – 75,000)]	1,25,000

The revaluation reserve should be routed through Other Comprehensive Income (subsequently not reclassified to Profit and Loss) and shown in a separate column under Statement of Changes in Equity.

Working Notes:

Particulars	Property 1	Property 2	Property 3
Purchase Price	₹ 7,50,000	₹ 10,50,000	₹ 12,00,000
Estimated Life	10 years	15 years	15 years
Depreciation for the year	₹ 75,000	₹ 70,000	₹ 80,000
Carrying Value as on 31 st March, 2021	₹ 6,75,000	₹ 9,80,000	₹ 11,20,000
Fair Value as on 31 st March, 2021	₹ 8,00,000	₹ 9,50,000	₹ 13,00,000
Subsequent Measurement	Fair Value	Fair Value	Cost
Revaluation Surplus / (Deficit)	₹ 1,25,000	(₹ 30,000)	

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A few examinees wrongly presented the various non-current assets in the balance sheet though the classification made by them was correct. Some examinees erroneously calculated depreciation on fair value instead of on purchase price. A hand full of examinees are not clear with the term 'carrying value' and 'fair value' and its applicability.



Chapter 6.7

Ind AS 105: Non-Current Assets held for Sale and Discontinued Operations

Question 1

A Ltd. is to sell a non-current asset, being a piece of land. The piece of land has been contaminated and will require the entity to carry out Rs. 100,000 of work in order to rectify the contamination. If the land was not contaminated, it could be sold for Rs. 300,000. With the contamination, it is worth only Rs. 200,000. The work that is needed to rectify the contamination will extend the period of sale by one year from the date the land is first marketed for sale.

Required:

In the following situations, examine with suitable reasons whether land can be classified as held for sale in accordance with Ind AS 105: Non-current assets held for sale and discontinued operations

Situation 1 The land is marketed for Rs. 300,000 and A Ltd. was not aware of the contamination till the time a firm purchase commitment was signed with a purchaser. The purchaser found the contamination through a survey. The purchaser signed the firm purchase commitment on condition that the contamination damage will be rectified.

Situation 2 A Ltd. marketed the land for Rs. 300,000, knowing about the contamination when the proposal to sale the land went in the market. However, A Ltd. marketed it with an agreement that it would carry out the rectification work within few months from signing the firm purchase commitment.

Situation 3 A Ltd. knew about the contamination prior to float the proposal to sell the land and markets it for Rs. 200,000 with no obligation on itself to rectify or fix the contamination. (MTP 8 Marks April '18)

Answer 1

Situation 1

As far as the entity was aware, the land was marketed and available for immediate sale in its present condition at a reasonable price. The event extending the one-year period was imposed by the buyer after the firm purchase commitment was received and the entity is taking steps to address it. The land qualifies as held for sale and continues to do so after it is required to carry out the rectification work.

Situation 2

The land is not available for immediate sale in its present condition when it is first marketed. It is being marketed at a price that involves further work to the land. It cannot be classified as held for sale when it is first marketed. It also cannot be classified as held for sale when a purchase commitment is received, because even then it is not for sale in its present condition and no conditions have been unexpectedly imposed. The land will not be classified as held for sale until the rectification work is actually carried out.

Situation 3

The land in this case is available for immediate sale in its present condition and it would qualify to be classified as held for sales since it is being marketed at reasonable price.

Question 2

On June 1, 20X2, entity D Limited plans to sell a group of assets and liabilities, which is classified as a disposal group. On July 31, 20X2, the Board of Directors approved and committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity G Limited. However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by November 30, 20X2 and the sale is expected to be completed by 31st March, 20X3. Entity D Limited follows December year end. The assets and liabilities attributable to this manufacturing unit are as under:



(₹ in lakh)

Particulars	Carrying value as on 31 st December, 20X1	Carrying value as on 31 st July, 20X2
Goodwill	1,000	1,000
Plant and Machinery	2,000	1,800
Building	4,000	3,700
Debtors	1,700	2,100
Inventory	1,400	800
Creditors	(600)	(500)
Loans	(4,000)	(3,700)
Net	5,500	5,200

The fair value of the manufacturing unit as on December 31, 20X1 is ₹ 4,000 lakh and as on July 31, 20X2 is ₹ 3,700 lakh. The cost to sell is ₹ 200 lakh on both these dates. The disposal group is not sold at the period end i.e., December 31, 20X2. The fair value as on 31st December, 20X2 is lower than the carrying value of the disposal group as on that date.

Required:

- Assess whether the manufacturing unit can be classified as held for sale and reasons thereof. If yes, then at which date?
- The measurement of the manufacturing unit as on the date of classification as held for sale.
- The measurement of the manufacturing unit as at the end of the year.

(MTP 10 Marks Nov 21, PYP 10 Marks Nov'19)(Same concept but different figures Old & New SM)

Answer 2

- Assessment of manufacturing unit whether to be classified as held for sale

The manufacturing unit can be classified as held for sale due to the following reasons:

- The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group is classified as held for sale will be 31st July, 20X2, i.e. the date at which management becomes committed to the plan.
- The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.
- A firm purchase agreement has been entered with the buyer.
- The sale is expected to be complete by 31st March, 20X3, i.e., within one year from the date of classification.

- Measurement of the manufacturing unit as on the date of classification as held for sale

Following steps need to be followed:

Step 1: Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS. This has been done and the carrying value of the disposal group as on 31st July, 20X2 is determined at ₹ 5,200 lakh. The difference between the carrying value as on 31st December, 20X1 and 31st July, 20X2 is accounted for as per Ind AS 36.

Step 2: An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell., The fair value less cost



to sell of the disposal group as on 31st July, 20X2 is ₹ 3,500 lakh (i.e. ₹ 3,700 lakh - ₹ 200 lakh). This is lower than the carrying value of ₹ 5,200 lakh. Thus, an impairment loss needs to be recognised and allocated first towards goodwill and thereafter pro-rata between assets of the disposal group which are within the scope of Ind AS 105 based on their carrying value.

Thus, the assets will be measured as under:

(₹ in lakh)

Particulars	Carrying value as on 31 st July, 20X1	Impairment	Carrying value as on 31 st July, 20X2
Goodwill	1,000	1,000 (Refer WN)	-
Plant and Machinery	1,800	(229) (Refer WN)	1,571
Building	3,700	(471)	3,229
Debtors	2,100	-	2100
Inventory	800	-	800
Creditors	(500)	-	500
Loans	(3,700)	-	3,700
Net	5,200	1,700	3,500

Working Note:

(i) Allocation of impairment loss to Plant and Machinery and Building

After adjustment of impairment loss of ₹ 1,000 lakh from the full value of goodwill, the balance ₹ 700 lakh (₹ 1,700 lakh – ₹ 1,000 lakh) is allocated to plant and machinery and Building on proportionate basis. Plant and machinery – ₹ 700 lakh x ₹ 1,800 lakh / ₹ 5,500 lakh = ₹ 229 lakh (rounded off) Building – ₹ 700 lakh x ₹ 3,700 lakh / ₹ 5,500 lakh = ₹ 471 lakh (rounded off)

(ii) Measurement of the manufacturing unit as on the date of classification as at the year end

The measurement as at the year-end shall be on similar lines as done above.

The assets and liabilities in the disposal group not within the scope of this Standard are measured as per the respective standards. The fair value less cost to sell of the disposal group as a whole is calculated. This fair value less cost to sell as at the year-end shall be compared with the carrying value as at the date of classification as held for sale. It is provided that the fair value as on the year end is less than the carrying amount as on that date – thus the impairment loss shall be allocated in the same way between the assets of the disposal group falling within the scope of this standard as shown above. Measurement of the manufacturing unit as on the date of classification as at the year-end shall be on similar lines as done above.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A handful examinees have committed mistake in 'computation of measurement of the manufacturing unit as on the date of classification as held for sale'. Some of the examinees either did not allocate impairment loss or wrongly allocated impairment loss to various assets.

Question 3

Identify which of the following is a disposal group at 31st March, 20X1:

- (1) On 21st March, 20X1, XYZ Ltd. announced the Board's intention to sell its shares in a subsidiary company, Alpha Ltd., contingent upon the approval of Alpha Ltd.'s shareholders. It seems unlikely that approval will be granted in the near future and no specific potential buyer has been identified.
- (2) PQR Ltd. has entered into a contract to sell the entire delivery fleet of vehicles operated from its warehouse to a competitor, ABC Ltd., on 14th March, 20X1. The assets will be transferred on



28th April, 20X1 from which date the Group will outsource its delivery activities to another company, LMN Ltd.

- (3) On 16th January, 20X1, DEF's management and shareholders approved a plan to sell its retail business in Mumbai and a consultant is hired to manage the sale. As at 31st March, 20X1 heads of agreement had been signed although due diligence and the negotiation of final terms are still in process. The transaction is expected to be completed in April, 20X1. (MTP 6 Marks April 22, Old & New SM)

Answer 3

Presented as disposal group held for sale

- (1) PQR Ltd.'s fleet of vehicles is classified as held for sale because it constitutes a group of assets to be sold in their present condition and the sale is highly probable at the reporting date (as a contract has been entered into).
- (2) DEF Ltd.'s sale of its retail business will not be completed until the final terms (e.g. of purchase price) are agreed. However, the business is ready for immediate sale and the sale is highly probable to be completed by April, 20X1. This implies that the retail business is a disposal group held for sale, unless other evidence after the reporting date but before the financial statements are approved for issue, comes to light to indicate the contrary.

Not presented as disposal group held for sale

- (1) XYZ Ltd.'s shares in Alpha Ltd. are not available for an immediate sale as shareholders' approval is required. Also, no specific potential buyer has been identified. Taking these facts into consideration, it is clear that the sale is not highly probable.

Question 4

G Ltd. is a wholly owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January, 20X2, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April, 20X2. They made a public announcement of their decision on 15th February, 20X2.

G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May, 20X2. U Ltd. would collect any amounts still owed by G Ltd.'s customers after 31st May, 20X2. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.:

- On the date of public announcement, it is estimated by G Ltd. that it would have to pay ₹ 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be ₹ 60 lakhs. The actual termination payments totalling to ₹ 520 lakhs were made in full on 15th May, 20X2. As per latest estimates made on 15th May, 20X2, the total relocation cost is ₹ 63 lakhs.
- G Ltd. had taken a property on lease, which was expiring on 31st March, 20X6. The present value of the future lease rentals (using an appropriate discount rate) is ₹ 430 lakhs. On 15th May, 20X2, G Ltd. made a payment to the lessor of ₹ 410 lakhs in return for early termination of the lease.

The loss after tax of G Ltd. for the year ended 31st March, 20X2 was ₹ 400 lakhs. G Ltd. made further operating losses totalling ₹ 60 lakhs till 30th April, 20X2.

What are the provisions that the Company is required to make as per Ind AS 37 as on 31st March, 20X2? (MTP 8 Marks Sep '23)

Answer 4

A discontinued operation is one that is discontinued in the period or classified as held for sale at the year end. The operations of G Ltd were discontinued on 30th April, 20X2 and therefore, would be treated as discontinued operation for the year ending 31st March, 20X3. It does not meet the criteria for held for sale since the company is terminating its business and does not hold these for sale.

As per para 72 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', restructuring includes sale or termination of a line of business. A constructive obligation to restructure arises when an entity:



- (a) has a detailed formal plan for the restructuring
- (b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

The Board of directors of U Ltd have decided to terminate the operations of G Ltd. from 30th April, 20X2. They have made a formal announcement on 15th February, 20X2, thus creating a valid expectation that the termination will be implemented. This creates a constructive obligation on the company and requires provisions for restructuring.

A restructuring provision includes only the direct expenditures arising from the restructuring that are necessarily entailed by the restructuring and are not associated with the ongoing activities of the entity.

The termination payments fulfil the above condition. As per Ind AS 10 'Events after Reporting Date', events that provide additional evidence of conditions existing at the reporting date should be reflected in the financial statements. Therefore, the company should make a provision for ₹ 520 lakhs in this respect.

The relocation costs relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Hence, these would be recognised on the same basis as if they arose independently of a restructuring.

The lease would be regarded as an onerous contract. A provision would be made at the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. Hence, a provision shall be made for ₹ 410 lakhs.

Further operating losses relate to future events and do not form a part of the closure provision.

Therefore, the total provision required = ₹ 520 lakhs + ₹ 410 lakhs = ₹ 930 lakhs.

Question 5

S Ltd purchased a property for ₹ 6,00,000 on 1st April, 20X1. The useful life of the property is 15 years. On 31st March, 20X3, S Ltd classified the property as held for sale. The impairment testing provides the estimated recoverable amount of ₹ 4,70,000.

The fair value less cost to sell on 31st March, 20X3 was ₹ 4,60,000. On 31st March, 20X4 management changed the plan, as property no longer met the criteria of held for sale. The recoverable amount as at 31st March, 20X4 is ₹ 5,00,000.

Provide the accounting treatment of events for the year ending 31 st March, 20X3 and 31st March, 20X4 and value the property thereupon. (MTP 8 Marks Oct '23)

Answer 5

- I. Value of property immediately before the classification as held for sale as per Ind AS

16 as on 31st March, 20X3	₹	
Purchase price	6,00,000	
Less: Accumulated depreciation	(80,000)	(for two years)
Less: Impairment loss	(50,000)	(5,20,000-4,70,000)
Carrying Amount	4,70,000	

On initial classification as held for sale on 31st March, 20X3, the value will be

lower of: Carrying amount after impairment ₹ 4,70,000

Fair value less cost to sell ₹ 4,60,000

On 31st March, 20X3, Non-current asset classified as held for sale

will be recorded at ₹ 4,60,000.

Depreciation of ₹ 40,000 and Impairment Loss of ₹ 60,000 (50,000 +10,000) is



charged in profit or loss for the year ended 31st March, 20X3.

- II. On 31st March, 20X4, held for sale property is reclassified as criteria doesn't met. The value will be lower of:

Carrying amount immediately before classification on 31st March, 20X3 ₹ 4,70,000

Less: Depreciation based on 13 years balance life (₹ 36,154)

Carrying amount had the asset not classified as held for sale ₹ 4,33,846

Recoverable Amount ₹ 5,00,000

Property will be valued at ₹ 4,33,846 on 31st March, 20X4

Adjustment to the carrying amount of ₹ 26,154 (₹ 4,60,000 - 4,33,846) is charged to the profit or loss.

Question 6

Following is the extract of the consolidated financial statements of A Ltd. for the year ended on:

Asset/ (liability)	Carry amount as on 31 st March, 20X1 (In Rs. '000)
Attributed goodwill	200
Intangible assets	950
Financial asset measured at fair value through other comprehensive income	300
Property, plant & equipment	1100
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	600
Current liabilities	(850)
Non-current liabilities – provisions	(300)
Total	2,250

On 15th September 20X1, Entity A decided to sell the business. It noted that the business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with that standard.

The disposal group is stated at the following amounts immediately prior to reclassification as held for sale.

Asset/ (liability)	Carry amount as on 15 th September 20X1 (In Rs. '000)
Attributed goodwill	200
Intangible assets	930
Financial asset measured at fair value through other comprehensive income	360
Property, plant & equipment	1,020
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	520
Current liabilities	(870)
Non-current liabilities – provisions	(250)
Total	2,160



Entity A proposed to sell the disposal group at Rs. 19,00,000. It estimates that the costs to sell will be Rs. 70,000. This cost consists of professional fee to be paid to external lawyers and accountants.

As at 31st March 20X2, there has been no change to the plan to sell the disposal group and entity A still expects to sell it within one year of initial classification. Mr. X, an accountant of Entity A premeasured the following assets/ liabilities in accordance with respective standards as on 31st March 20X2:

Available for sale:	(In Rs. '000)
Financial assets	410
Deferred tax assets	230
Current assets- Inventory, receivables and cash balances	400
Current liabilities	900
Non- current liabilities- provisions	250

The disposal group has not been trading well and its fair value less costs to sell has fallen to Rs. 16,50,000.

Required:

What would be the value of all assets/ liabilities within the disposal group as on the following dates in accordance with Ind AS 105?

- 15 September, 20X1 and
- 31st March, 20X2 (RTP May 18, Old & New SM)

Answer 6

- As at 15 September, 20X1 The disposal group should be measured at Rs. 18,30,000 (19,00,000-70,000). The impairment write down of Rs. 3,30,000 (Rs. 21,60,000 – Rs. 18,30,000) should be recorded within profit from continuing operations. The impairment of Rs. 3,30,000 should be allocated to the carrying values of the appropriate non-current assets.

Asset/ (liability)	Carrying value as at 15 June 2004	Impairment	Revised carrying value as per IND AS 105
Attributed goodwill	200	(200)	-
Intangible assets	930	(62)	868
Financial asset measured at fair value through other comprehensive income	360	-	360
Property, plant & equipment	1,020	(68)	952
Deferred tax asset	250	-	250
Current assets – inventory, receivables and cash balances	520	-	520
Current liabilities	(870)	-	(870)
Non-current liabilities – provisions	(250)	-	(250)
Total	2,160	(330)	1,830

impairment loss is allocated first to goodwill and then pro rata to the other assets of the disposal group within Ind AS 105 measurement scope. Following assets are not in the measurement scope of the standard- financial asset measured at other comprehensive income, the deferred tax asset or the current assets. In addition, the impairment allocation can only be made against assets and is not allocated to liabilities.



(b) As on 31 March, 20X2:

All of the assets and liabilities, outside the scope of measurement under IFRS 5, are remeasured in accordance with the relevant standards. The assets that are remeasured in this case under the relevant standards are the Financial asset measured at fair value through other comprehensive income (Ind AS 109), the deferred tax asset (Ind AS 12), the current assets and liabilities (various standards) and the non-current liabilities (Ind AS 37).

Asset/ (liability)	Carrying amount as on 15 September, 20X1	Change in value to 31st March 20X2	Impairment	Revised carrying value as per Ind AS 105
Attributed goodwill	-	-	-	-
Intangible assets	868	-	(29)	839
Financial asset measured at fair value through other comprehensive income	360	50	-	410
Property, plant & equipment	952	-	(31)	921
Deferred tax asset	250	(20)	-	230
Current assets – inventory, receivables and cash balances	520	(120)	-	400
Current liabilities	(870)	(30)	-	(900)
Non-current liabilities – provisions	(250)	-	-	(250)
Total	1,830	(120)	(60)	1,650

Question 7

On February 28, 20X1, Entity X is committed to the following plans:

- To sell a property after completion of certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months.
- To sell a commercial building to a buyer after the occupant vacates the building. The time required for vacating the building is usual and customary for sale of such commercial property. The entity considers the sale to be highly probable.

Can the above-mentioned property and commercial building be classified as non- current assets held for sale at the reporting date i.e. 31st March, 20X1? (RTP Nov 21)

Answer 7

Ind AS 105 provides guidance on classification of a non-current asset held for sale in paragraph 7 which states that, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.

- In respect of Entity X's plan to sell property which is being renovated and such renovation is incomplete as at the reporting date. Although, the renovations are expected to be completed within 2 months from the reporting date i.e., March 31, 20X1, the property cannot be classified as held for sale at the reporting date as it is not available for sale immediately in its present condition.
- In case of Entity X's plan to sell commercial building, it intends to transfer the commercial building to a buyer after the occupant vacates the building and the time required for vacating such building



is usual and customary for sale of such non-current asset. Accordingly, the criterion of the asset being available for immediate sale would be met and hence, the commercial building can be classified as held for sale at the reporting date

Question 8

X Ltd. acquires B Ltd. exclusively with a view to sale and it meets the criteria to be classified as discontinued operation as per Ind AS 105. Further, following information is available about B Ltd.:

Fair value of total assets excluding liabilities on acquisition – ₹ 360

Costs to sell as on acquisition and on reporting date – ₹ 10

Fair value of liabilities on acquisition and reporting date – ₹ 80

Fair value of total assets excluding liabilities on the reporting date – ₹ 340

How discontinued operation pertaining to B Ltd. should be measured in consolidated financial statements of X Ltd. on acquisition date and reporting date? (RTP May '22)

Answer 8

Ind AS 105 defines a disposal group as a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a cash-generating unit to which goodwill has been allocated in accordance with the requirements of paragraphs 80–87 of Ind AS 36, Impairment of Assets, or if it is an operation within such a cash-generating unit.

In the given case, B Ltd. is acquired exclusively with a view to sell and meets the criteria to be classified as discontinued operation.

The discontinued operation would be measured in accordance with paragraphs 15 and 16 of Ind AS 105

As per para 15, an entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

As per para 16, if a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale (see paragraph 11), applying paragraph 15 will result in the asset (or disposal group) being measured on initial recognition at the lower of its carrying amount had it not been so classified (for example, cost) and fair value less costs to sell. Hence, if the asset (or disposal group) is acquired as part of a business combination, it shall be measured at fair value less costs to sell.

Therefore, on acquisition date, in line with paragraph 16, X Ltd. will measure B Ltd. as a disposal group at fair value less costs to sell which will be calculated as Fair value of total assets excluding liabilities on acquisition – Costs to sell = ₹360 – ₹10 = ₹350.

Fair value of liabilities on acquisition = ₹80.

At the reporting date, in line with paragraph 15, X Ltd. will remeasure the disposal group at the lower of its cost and fair value less costs to sell which will be calculated as:

Fair value of total assets excluding liabilities on subsequent reporting date – Costs to sell
= ₹340 – ₹10 = ₹330

Fair value of liabilities on reporting date = ₹80.

At the reporting date, X Ltd. shall present these assets and liabilities separately from other assets and liabilities in its consolidated financial statements.

In the statement of profit and loss, X Ltd. shall recognise loss on subsequent measurement (of net assets at fair value) of B Ltd. which equals to ₹20 (₹270 – ₹250).

**Question 9**

Company A has financial year ending 31st March, 20X0. On 1st June, 20X0, the Company has classified its Division B as held for sale in accordance with Ind AS 105. How property, plant and equipment (PPE) for which the company has adopted cost model shall be measured immediately before the classification as held for sale on 1st June, 20X0? (RTP Nov'22)

Answer 9

Paragraph 18 of Ind AS 105 provides that immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS.

In the instant case, Company A should measure the property, plant and equipment (for which it has adopted cost model), in accordance with Ind AS 16, Property, Plant and Equipment. Hence, depreciation should be provided upto 31st May, 20X0.

Question 10

On 1st January, 20X1, the carrying amounts of the relevant assets of the division of an entity, Star Ltd. were as follows:

- **Purchased goodwill ₹ 1.2 lakhs;**
- **Property, plant and equipment (average remaining estimated useful life two years) ₹ 4 lakhs;**
- **Inventories ₹ 2 lakhs.**

From 1st January, 20X1, Star Ltd. began to actively market the division and has received a number of serious enquiries.

On 1st January, 20X1, the directors estimated that they would receive ₹ 6.4 lakhs from the sale of the division. Since 1st January, 20X1, market conditions have improved and on 30th April, 20X1, Star Ltd. received and accepted a firm offer to purchase the division for ₹ 6.6 lakhs. The sale is expected to be completed on 30th June, 20X1.

₹ 6.6 lakhs can be assumed to be a reasonable estimate of the value of the division on 31st March, 20X1.

During the period from 1st January 20X1 to 31st March, 20X1, inventories of the division costing ₹ 1.6 lakhs were sold for ₹ 2.4 lakhs. At 31st March, 20X1, the total cost of the inventories of the division was ₹ 1.8 lakhs. All of these inventories have an estimated net realizable value that is in excess of their cost.

Explain the disclosure requirement related to sale of division and provide the accounting treatment of property held for sale and discontinued operations. (RTP May '23)(Same concepts different figures- RTP May'19, Old & New SM)

Answer 10

The decision to offer the division for sale on 1st January, 20X1 means that from that date the division is classified as held for sale. The division available for immediate sale, is being actively marketed at a reasonable price, and the sale is expected to be completed within one year.

The consequence of this classification is that the assets of the division will be measured at the lower of their existing carrying amounts (₹ 7.20 lakhs i.e. Goodwill ₹ 1.2 lakh + PPE ₹ 4 lakhs + Inventory ₹ 2 lakhs) and their fair value less costs to sell (₹ 6.40 lakhs).

This implies that the assets of the division will be measured at ₹ 6.40 lakhs on 1st January, 20X1.

The reduction in carrying value of the assets of ₹ 0.80 lakhs (₹ 7.20 lakhs – ₹ 6.40 lakhs) will be treated as an impairment loss and allocated to goodwill, leaving a carrying amount for goodwill of ₹ 0.40 lakhs (₹ 1.20 lakhs – ₹ 0.80 lakhs).

The increased expectation of the selling price of ₹ 0.20 lakhs (₹ 6.60 lakhs – ₹ 6.40 lakhs) will be treated as a reversal of an impairment loss. However, since this reversal relates to goodwill, it cannot be recognised.



The assets of the division need to be presented separately from other assets in the balance sheet. Their major classes of assets classified as held for sale should be separately disclosed, either in the balance sheet or in the notes.

The property, plant and equipment should not be depreciated after 1 st January, 20X1, so it's carrying value at 31st March, 20X1 will be ₹ 4 lakhs. The inventories of the division will be shown at their year-end cost of ₹ 1.80 lakhs.

The division will be regarded as a discontinued operation for the year ended 31st March, 20X1. It will represent a separate line of business and will be held for sale at the year end.

The statement of profit and loss should disclose, as a single amount, the post-tax profit or loss of the division and the impairment loss arising on the re-measurement of the division on classification as held for sale. Further analysis of this single amount may be presented in the notes or in the statement of profit and loss. If it is presented in the statement of profit and loss it shall be presented in a section identified as relating to discontinued operations, i.e. separately from continuing operations.

Question 11

Company X has identified one of its division (disposal group) to be sold to a prospective buyer and the Board has approved the plan to sell the division on 30th September, 20X1. The sale is expected to complete after one year but it still qualifies to be held for sale under Appendix B of Ind AS 105. Costs to sell the division is estimated to be ₹ 10 crores (to be incurred in March, 20X3). The fair value of the division is ₹ 400 crores (on 30th September, 20X1 and 31st March, 20X2) and carrying value is ₹ 500 crores.

How shall such a division (disposal group) be measured under Ind AS 105 on following reporting dates:

A. 30th September, 20X1

B. 31st March, 20X2

Consider the discounting factor @ 10% for 1 year to 0.909 and for 1.5 years to be 0.867. (RTP Nov '23)

Answer 11

Paragraph 15 of Ind AS 105 states that an entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

Further, paragraph 17 of Ind AS 105 states that when the sale is expected to occur beyond one year, the entity shall measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in profit or loss as a financing cost.

Company X has identified a disposal group and is committed to sell the same. The sale is expected to be completed after a period of one year hence, it will measure the costs to sell such disposal group at present value as per paragraph 17 of Ind AS 105.

A. On 30th September, 20X1

The disposal group will be measured at fair value less costs to sell which will be as follows:

Fair value:	₹ 400.00 crores	
PV of costs to sell:	(₹ 8.67 crores)	(₹ 10 crores x 0.867)
Total:	₹ 391.33 crores	

B. On 31st March, 20X1

The disposal group will be measured at fair value less costs to sell which will be as follows:

Fair value:	₹ 400.00 crores	
PV of costs to sell:	(₹ 9.09 crores)	(10 x 0.909)



Total:	₹ 390.91 crores	

The increase in costs to sell the division by ₹ 0.42 crore (₹ 9.09 crores – ₹ 8.67 crores) will be recognised in profit and loss as financing cost in accordance with paragraph 17 of Ind AS 105.

Question 12

Black Ltd. is a manufacturing company. The following balances as at 31st March, 2021 are from the audited Financial Statements and as at 30th September, 2021 & 31st March, 2022 are provided by the accountant of Black Ltd:

Asset / (Liability)	Carrying Amount as at (₹ in lakh)		
	31.3.2021	30.9.2021	31.3.2022
Attributed goodwill	2,560	2,560	
Intangible assets	12,680	11,080	
Financial assets measured at Fair Value through Other Comprehensive Income (FVTOCI)	4,310	5,260	7,310
Property, plant & equipment	16,820	18,670	
Deferred tax assets	3,120	3,120	2,970
Current assets: inventory, receivables, cash & cash equivalents	8,640	7,040	4,860
Current liabilities	(11,110)	(13,230)	(16,190)
Non-current liabilities: Provisions	(3,670)	(4,610)	(4,610)
Total	33,350	29,890	(5,660)

Black Ltd. decided to sell the business on 30th September, 2021. The business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with Ind AS 105. Black Ltd. proposed to sell the disposal group at ₹ 26,000 lakh. The costs to sell is estimated at ₹ 200 lakh. As at 31st March, 2022, there has been no change to the plan to sell the disposal group and Black Ltd. still expects to sell it within one year of initial classification. The disposal group has not been trading well and its fair value less costs to sell has fallen to ₹ 19,738 lakh. You are asked to calculate the value of all assets / liabilities within the disposal group as at 30th September, 2021 and 31st March, 2022 in accordance with Ind AS 105. (PYP 8 Marks May '22)

Answer 12

(a) As at 30th September, 2021

The disposal group should be measured at ₹ 25,800 lakh (₹ 26,000 lakh - ₹ 200 lakh). The impairment write down of ₹ 4,090 lakh (₹ 29,890 lakh – ₹ 25,800 lakh) should be recorded within profit from continuing operations.

The impairment of ₹ 4,090 should be allocated to the carrying values of the appropriate non-current assets.

Asset / (liability)	Carrying value as at 30 th September, 2021	Impairment	Revised carrying value as per Ind AS 105
Attributed goodwill	2,560	(2,560)	-
Intangible assets	11,080	(570)*	10,510
Financial asset measured at fair value through other comprehensive income	5,260	-	5,260



Property, plant & equipment	18,670	(960)**	17,710
Deferred tax asset	3,120	-	3,120
Current assets – inventory, receivables and cash balances	7,040	-	7,040
Current liabilities	(13,230)	-	(13,230)
Non-current liabilities – provisions	(4,610)	-	(4,610)
Total	29,890	(4,090)	25,800

$$*[(4,090 - 2,560) \times \{11,080 / (11,080 + 18,670)\}]$$

$$**[(4,090 - 2,560) \times \{18,670 / (11,080 + 18,670)\}]$$

The impairment loss is allocated first to goodwill and then pro-rata to the other assets of the disposal group within Ind AS 105 measurement scope. Following assets are not in the measurement scope of this standard- financial asset measured at other comprehensive income, the deferred tax asset or the current assets. In addition, the impairment allocation can only be made against assets and is not allocated to liabilities.

(b) As on 31st March, 2022

All the assets and liabilities, outside the scope of measurement under Ind AS 105, are remeasured in accordance with the relevant standards. The assets that are remeasured in this case under the relevant standards are the financial asset measured at fair value through other comprehensive income (Ind AS 109), the deferred tax asset (Ind AS 12), the current assets and liabilities (various standards) and the non-current liabilities (Ind AS 37).

Asset / (liability)	Carrying amount as on 30th September, 2021	Change in value to 31st March, 2022	Impairment	Revised carrying value as per Ind AS 105
Attributed goodwill	-	-	-	-
Intangible assets	10,510	-	(1,051)*	9,459
Financial asset measured at fair value through other comprehensive income	5,260	2,050	-	7,310
Property, plant & equipment	17,710	-	(1,771)**	15,939
Deferred tax asset	3,120	(150)	-	2,970
Current assets – inventory, receivables and cash balances	7,040	(2,180)	-	4,860
Current liabilities	(13,230)	(2,960)	-	(16,190)
Non-current liabilities – provisions	(4,610)	-	-	(4,610)
Total	25,800	(3,240)	(2822)	19,738

$$*[2,822 \times \{10,510 / (10,510 + 17,710)\}]$$

$$**[2,822 \times \{17,710 / (10,510 + 17,710)\}]$$



Question 13

Venus Limited had purchased on 1st April, 2020, a PPE kits manufacturing plant for ₹ 12.00 lakhs. The useful life of the plant is 8 years. The depreciation is provided on straight line method. On 30th September, 2022, Venus Limited temporarily discontinues production at the said plant due to decline in the demand for PPE kits. However, the plant is maintained in a workable condition, and it can be used in future whenever the demand picks up.

The accountant of Venus Limited decided to treat the plant as held for sale under Ind AS 105 until the demand picks up. She, thus measures the plant at lower of carrying amount and fair value less cost to sell.

She also stopped charging the depreciation for the rest of period as the plant was held for sale. The fair value less cost to sell the said plant on 30th September, 2022 and 31st March, 2023 was ₹ 6.75 lakhs and ₹ 6.00 lakhs respectively.

She performed the following working to determine the carrying amount of the plant on initial classification as held for sale:

Particulars	₹ in lakhs
Purchase price of the plant	12.00
Less: Accumulated depreciation for 2.5 years (₹ 12.00 lakhs / 8 years x 2.5 years)	(3.75)
	8.25
Fair value less cost to sales as on 30th September, 2022	6.75
The carrying amount is lower of ₹ 8.25 lakhs and ₹ 6.75 lakhs	6.75

Balance Sheet extracts as at 31st March, 2023

Particulars	₹ in lakhs
Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	6.00

Discuss whether the above accounting treatment made by the accountant is as per applicable Ind AS. If not, what should be the correct treatment. Provide balance sheet extract as at 31st March, 2023 together with the computation of the carrying value of PPE as at 31st March, 2023. (PYP 8 Marks May '23)

Answer 13

The treatment of PPE kits manufacturing plant needs to be examined in the light of the provisions given in Ind AS 16 'Property, Plant and Equipment' and Ind AS 105 'Noncurrent Assets Held for Sale and Discontinued Operations'.

Paragraph 6 of Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' states that an entity shall classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

Paragraph 7 of Ind AS 105 states that for this to be the case, the asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sale of such assets (or disposal groups) and its sale must be highly probable. Thus, an asset cannot be classified as a non-current asset held for sale, if the entity intends to sell it in the distant future.

Further, paragraph 8 of Ind AS 105 states that for the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from



the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

*** PS: Read financial year '2022-2023' as '2021-2022'.**

Paragraph 13 of Ind AS 105 states that an entity shall not classify as held for sale a noncurrent asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use.

Paragraph 14 of Ind AS 105 states that an entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.

Paragraph 55 of Ind AS 16 states that depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

Going by the guidance given above, the Accountant of Venus Ltd. has treated the plant as held for sale and measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.

Accordingly, the manufacturing plant should neither be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use. Venus Ltd. shall not stop charging depreciation or treat the plant as held for sale because its carrying amount will be recovered principally through continuing use to the end of their economic life.

The working of the same for presenting in the balance sheet is given as below:

Calculation of carrying amount as on 31st March, 2023	₹
Purchase Price of Plant	12,00,000
Less: Accumulated depreciation (12,00,000/ 8 years) x 3 years	(4,50,000)
	7,50,000
Less: Impairment loss	(1,50,000)
	6,00,000

Balance Sheet extracts as on 31st March, 2023

Assets	₹
Non-Current Assets	
Property, Plant and Equipment	6,00,000

Working Note:

Fair value less cost to sell of the Plant = ₹ 6,00,000

Value in use (not given) or Nil (since plant has temporarily not been used for manufacturing due to decline in demand)

Recoverable amount = higher of above i.e. ₹ 6,00,000

Impairment loss = Carrying amount – Recoverable amount
Impairment loss = ₹ 7,50,000 - ₹ 6,00,000 = ₹ 1,50,000.



Chapter 6.8

Ind AS 116: Leases

Question 1

A retailer (lessee) entered into 3-year lease of retail space beginning at 1st April 20X1 with three annual lease payments of ₹ 2,00,000 due on 31st March 20X2, 20X3 and 20X4, respectively. The lease is classified as an operating lease under the erstwhile, accounting standard. The retailer initially applies Ind AS 116 for the first time in the annual period beginning at 1st April 20X3. The incremental borrowing rate at the date of the initial application (i.e., 1st April 20X3) is 10% p.a. and at the commencement of the lease (i.e., 1st April 20X1) was 12% p.a. The ROU asset is subject to straight-line depreciation over the lease term. Assume that no practical expedients are elected, the lessee did not incur initial direct costs, there were no lease incentives and there were no requirements for the lessee to dismantle and remove the underlying asset, restore the site on which it is located or restore the underlying asset to the condition under the terms and conditions of the lease.

What would be the impact for the lessee as per Ind AS 116 using the following transition approaches:

- (i) Full Retrospective Approach
- (ii) Modified Retrospective Approach (when ROU asset is not equal to lease liability)

Show the impact of adjustments through journal entries, consequent to transition for the year 20X2-20X3 and 20X3-20X4. (MTP 16 Marks Oct 21, Old & New SM)

Answer 1

Full Retrospective Approach:

Under the full retrospective approach, the lease liability and the ROU asset are measured on the commencement date (i.e., 1st April, 20X1 in this case) using the incremental borrowing rate at **lease commencement date** (i.e., 12% p.a. in this case). The lease liability is accounted for by the interest method subsequently and the ROU asset is subject to depreciation on the straight-line basis over the lease term of three years. The Lease Liability and ROU Asset are as follows:

Year	Payments (Cash flows)	Present Value Factor @ 12%	Discounted Cash flows / Present Value
31 Mar 20X2	2,00,000	0.8929	1,78,580
31 Mar 20X3	2,00,000	0.7972	1,59,440
31 Mar 20X4	2,00,000	0.7118	1,42,360
	6,00,000		4,80,380

Lease Liability Schedule:

Year	Opening	Interest Expense @ 12%	Payments	Closing
31 Mar 20X2	4,80,380	57,646	(2,00,000)	3,38,026
31 Mar 20X3	3,38,026	40,563	(2,00,000)	1,78,589
31 Mar 20X4	1,78,589	21,411*	(2,00,000)	-

*Difference is due to approximation

ROU Asset Schedule:

Year	Opening	Depreciation	Closing
31 Mar 20X2	4,80,380	(1,60,126)	3,20,254
31 Mar 20X3	3,20,254	(1,60,127)	1,60,127
31 Mar 20X4	1,60,127	(1,60,127)	-



The following table shows account balances under this method beginning at lease commencement:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
1 Apr 20X1	4,80,380	4,80,380	-	-	-
31 Mar 20X2	3,20,254	3,38,026	-	-	-
1 Apr 20X2	3,20,254	3,38,026			(17,772)
31 Mar 20X3	1,60,127	1,78,589	40,563	1,60,127	-
1 Apr 20X3	1,60,127	1,78,589	-	-	-
31 Mar 20X4	-	-	21,411	1,60,127	-

Ind AS 116 is applicable for the financial year beginning from 1st April, 20X3. Hence, 20X3-20X4 is the first year of adoption and using Full retrospective method the comparative for 20 X2-20X3 needs to be restated and 1st April, 20X2 (i.e the opening of the comparative) is taken as transition date for adoption of this standard. At adoption, the lessee would record the ROU asset and lease liability at the 1st April, 20X2 by taking values from the above table, with the difference between the ROU asset and lease liability going to retained earnings as of 1st April, 20X2 (assuming that only the 20X2-20X3 financial information is included as comparatives).

ROU Asset	Dr.	3,20,254	
Retained Earnings	Dr.	17,772	
To Lease Liability			3,38,026
<i>To initially recognise the lease-related asset and liability as of 1 April 20X2.</i>			

The following journal entries would be recorded during 20X2-20X3:

Interest expense	Dr.	40,563	
To Lease Liability			40,563
<i>To record interest expense and accrete the lease liability using the interest method.</i>			
Depreciation expense	Dr.	1,60,127	
To ROU Asset			1,60,127
<i>To record depreciation expense on the ROU asset.</i>			
Lease Liability	Dr.	2,00,000	
To Cash			2,00,000
<i>To record lease payment.</i>			

The following journal entries would be recorded during 20X3-20X4:

Interest expense	Dr.	21,411	
To Lease Liability			21,411
<i>To record interest expense and accrete the lease liability using the interest method.</i>			
Depreciation expense	Dr.	1,60,127	
To ROU Asset			1,60,127
<i>To record depreciation expense on the ROU asset.</i>			
Lease Liability	Dr.	2,00,000	
To Cash			2,00,000
<i>To record lease payment.</i>			

Modified Retrospective Approach (When ROU asset is not equal to lease liability):

Under the modified retrospective approach (Alternative 1), the lease liability is measured based



on the remaining lease payments (i.e., from the date of transition to the lease end date, viz., 1st April, 20X3 to 31st March, 20X4 in this case) discounted using the incremental borrowing rate as of the date of initial **application being 1st April, 20X3** (i.e. 10% p.a. in this case). The ROU asset is at its carrying amount as if Ind AS 116 had been applied since the commencement date (i.e., 1st April 20X1 in this case) by using incremental borrowing rate as at transition date. The Lease Liability and ROU Asset are as follows:

Year	Payments (Cash flows)	Discounting Factor @10%	Discounted Cash flows / Present Value
31 Mar 20X4	2,00,000	0.9091	1,81,820
	2,00,000		1,81,820

Lease Liability Schedule:

Year	Opening Balance	Interest Expense @ 10%	Payments	Closing Balance
31 Mar 20X4	1,81,820	18,180*	(2,00,000)	-

*Difference is due to approximation

ROU Asset Schedule:

Year	Opening Balance	Depreciation	Closing Balance
31 Mar 20X4	1,65,787***	(1,65,787)	-

*** (Refer W.N.3)

The following table shows account balances under this method beginning at lease commencement:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
1 Apr 20X1	4,97,360*	4,97,360*	-	-	-
31 Mar 20X2	3,31,574	3,47,096	49,736	1,65,786	-
31 Mar 20X3	1,65,787	1,81,806	34,710	1,65,787	(16,019)
1 Apr 20X3	1,65,787	1,81,806	-	-	-
31 Mar 20X4	-	-	18,194	1,65,787	-

*(Refer W.N.1)

**(Refer W.N.2)

At adoption, the lessee would record the ROU asset and lease liability at 1st April 20X3 by taking values from the above table, with the difference between the ROU asset and lease liability going to retained earnings as 1st April 20X3.

ROU Asset	Dr.	1,65,787	
Retained Earnings	Dr.	16,019	
To Lease Liability			1,81,806
<i>To initially recognise the lease-related asset and liability as of 1st April 20X3.</i>			

The following journal entries would be recorded during 20X3-20X4:

Interest expense	Dr.	18,194	
To Lease Liability			18,194



To record interest expense and accrete the lease liability using the interest method.

Depreciation expense	Dr.	1,65,787	
To ROU Asset			1,65,787
<i>To record depreciation expense on the ROU asset.</i>			
Lease Liability	Dr.	2,00,000	
To Cash			2,00,000
<i>To record lease payment.</i>			

Working Notes

1. Calculation of Present value of lease payments as at commencement date i.e., 1st April, 20X1

Year	Payments (Cash flows)	Discounting Factor @10%	Discounted Cash flows / Present Value
31 Mar 20X2	2,00,000	0.9091	1,81,820
31 Mar 20X3	2,00,000	0.8264	1,65,280
31 Mar 20X4	2,00,000	0.7513	1,50,260
	6,00,000		4,97,360

2. Lease Liability Schedule:

Year	Opening	Interest Expense @ 10%	Payments	Closing
31 Mar 20X2	4,97,360	49,736	(2,00,000)	3,47,096
31 Mar 20X3	3,47,096	34,710	(2,00,000)	1,81,806
31 Mar 20X4	1,81,806	18,194*	(2,00,000)	-

*Difference is due to approximation

3. Calculation of ROU asset as at transition date i.e., 1st April, 20X3

Year	Opening	Depreciation	Closing
31 Mar 20X2	4,97,360	(1,65,786)	3,31,574
31 Mar 20X3	3,31,574	(1,65,787)	1,65,787
31 Mar 20X4	1,65,787	(1,65,787)	-

Question 2

UK Ltd. has installed Wind Turbine Equipment at Rajasthan to generate electricity for which it has entered into a Power Purchase Agreement (PPA) with the State Government. The terms of the PPA are as follows:

- The PPA is for an initial period of 3 years, renewable at mutual terms and conditions. The Management estimates the useful life of such project around 20 years.
- The price per unit is fixed for a period of one year and is renewed every year as per the State Government policy.
- The Company's Management is of the view that the power generated by the project will be completely sold to the State Government and not to any third party. However, there is no such restriction prescribed in the PPA.
- Currently the Company has classified the Wind Turbine Equipment as part of the Property,



Plant & Equipment and is charging depreciation on the same.

For the above PPA, which condition, as per the applicable Ind AS, is not relevant in determining whether an arrangement is or contains a lease?

- (A) Use of Specific Assets;**
- (B) Right to Operate the assets;**
- (C) Right to control the Physical access;**
- (D) Price is contractually fixed by the purchaser;**

UK Ltd. also wants you to give your suggestion on the accounting of the above arrangement under applicable Ind AS. (MTP 10 Marks Oct '18)

Answer 2

As per paragraph 6 of Appendix C to Ind AS 17 (**Ind AS 116**), "Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

- (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and
- (b) the arrangement conveys a right to use the asset."

In the present case, the PPA with the State Government can be fulfilled by the use of the Wind Turbine Equipment which is a specific asset. Accordingly, condition (a) above is satisfied. With respect to condition (b), paragraph 9 of Appendix C to Ind AS 17 (**Ind AS 116**) provides as below:

"An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

- (a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
- (b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
- (c) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output."

Accounting of the PPA with the State Government under applicable Ind AS:

Continuing the rationale to the above, in the present case, criteria (c) above is fulfilled since:

- The entire output of Wind Turbine Equipment is estimated to be consumed by the purchaser i.e. the State Government
- The price paid by the State Government includes an element of revision in price every year which makes the price for the output variable.

Accordingly, the PPA with the State Government contains an embedded lease arrangement.

Further to determine whether the lease arrangement is an operating lease or a finance lease, paragraph 10 of Ind AS 17 (**Ind AS 116**) provides certain examples (that individually or in combination would normally lead to a lease being classified as a finance lease) which can be analyzed as below:



- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term - Not fulfilled, as the ownership is not transferred to the State Government.
- (b) the lessee has the option to purchase the asset after completion of the agreement - Not fulfilled, as the State Government doesn't have an option to purchase the Wind Turbine Equipment after the completion of PPA.
- (c) the lease term is for the major part of the economic life of the asset even if title is not transferred - Not fulfilled, as the PPA is for 3 years whereas the useful life of the Wind Turbine Equipment project is 20 years.
- (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset – Cannot be determined since the price per unit is not fixed for the entire tenure of the PPA. Definition of the 'inception of the lease' (given in para 4 of Ind AS 17) inter alia states that in the case of a finance lease, the amounts to be recognized at the commencement of the lease term are determined. This implies that the given PPA is not a finance lease.
- (e) the leased assets are of such a specialized nature that only the lessee can use them without major modifications - Not fulfilled, as the asset is not specialized in nature.

Conclusion:

Based on the evaluation above, PPA with the State Government shall be accounted by UL Ltd. as "Property, plant and equipment under an operating lease arrangement".

Question 3

The Company has entered into a lease agreement for its retail store as on 1 st April, 20X1 for a period of 10 years. A lease rental of ₹ 56,000 per annum is payable in arrears. The Company recognized a lease liability of ₹ 3,51,613 at inception using an incremental borrowing rate of 9.5% p.a. as at 1st April 20X1. As per the terms of lease agreement, the lease rental shall be adjusted every 2 years to give effect of inflation. Inflation cost index as notified by the Income tax department shall be used to derive the lease payments. Inflation cost index was 280 for financial year 20X1-20X2 and 301 for financial year 20X3-20X4. The current incremental borrowing rate is 8% p.a. Show the Journal entry at the beginning of year 3, to account for change in lease (MTP 5 Marks Sep'22, RTP Nov'21)

Answer 3

As per para 27 (b) of Ind AS 116, variable lease payments that depend on an index or a rate, are initially measured using the index or rate as at the commencement date.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of ₹ 60,200 discounted at an original discount rate of 9.5% per annum as per para 43 of Ind AS 116.

Year	Revised lease rental	Discount factor @ 9.5%	Present value
3	$[(56,000 / 280) \times 301] = 60,200$	0.913	54,963
4	60,200	0.834	50,207
5	60,200	0.762	45,872
6	60,200	0.696	41,899
7	60,200	0.635	38,277
8	60,200	0.580	34,916
9	60,200	0.530	31,906
10	60,200	0.484	29,137
			3,27,127



Table showing amortised cost of lease liability

Year	Opening balance	Interest @ 9.5%	Rental paid	Closing balance
1	3,51,613	33,403	56,000	3,29,016
2	3,29,016	31,257	56,000	3,04,273

Difference of ₹ 22,854 (3,27,127 – 3,04,273) will increase the lease liability with corresponding increase in ROU Asset as per para 39 of Ind AS 116.

Journal entry at the beginning of year 3 would be:

Right-of-use asset Dr.	₹ 22,854	
To Lease liability		₹ 22,854

Question 4

Feel Fresh Limited (the Company) is into manufacturing and retailing of FMCG products listed on stock exchanges in India. One of its products is bathing soap which the Company sells under the brand name 'Feel Fresh'. The Company does not have its own manufacturing facilities for soap and therefore it enters into arrangements with a third party to procure the soaps. The Company entered into a long term purchase contract of 10 years with M/s. Radhey. Following are the relevant terms of the contract with M/s. Radhey.

- M/s. Radhey has to purchase a machine costing ₹ 10,00,000 from the supplier as specified by the Company. The machine will be customized to produce the soaps as designed by the Company. This machine cannot be used by M/s. Radhey to produce the soaps for buyers other than the Company due to the design specifications. The machine has a useful life of 10 years and the straight line method of depreciation is best suited considering the use of the machine.
- The Company will pay ₹ 4.75 per soap for the first year of contract. This is calculated based on the budgeted annual purchase of 7,00,000 soaps as follows:

Particulars	Per soap price
Variable cost of manufacturing	4.00
Cost of machine (₹ 1,74,015 / 7,00,000 soaps)	0.25
M/s. Radhey's margin	0.50
Per soap cost to the Company	4.75

In case the Company purchases more than 7,00,000 (i.e. budgeted number of soaps) soaps in the first year then the cost of the machine (i.e. 0.25 per soap) will not be paid for soaps procured in excess of 7,00,000 units. However, in case Company procures less than budgeted number of soaps, then the Company will pay the differential unabsorbed cost of the machine, at the end of the year. For example, if the Company purchases only 6,00,000 soaps in first year then the differential amount of ₹ 24,015 (1,74,015 - (6,00,000 x 0.25)) will be paid by the Company to M/s. Radhey at the end of the year. Variable cost will be actualized at the end of the year.

- The cost per soap will be calculated for each year in advance based on the budgeted number of soaps to be produced each year. An amount of ₹ 1,74,015 shall be considered each year for the cost of machine for year 1 to year 8 while calculating the cost per soap. Any differential under absorbed amount shall be paid by the Company to M/s. Radhey at the end of that year. A charge of ₹ 1,74,015 per annum for the machine is derived using borrowing cost of 8% p.a. For year 9 and year 10, only variable cost and margins will be paid.
- M/s. Radhey does not have any right to terminate the contract but the Company has the right to terminate the contract at the end of each year. However, if the Company terminates the contract, it has to compensate M/s. Radhey for any unabsorbed cost of Machine. For example, if the Company terminates the contract at the end of second year then it has to pay ₹ 10,44,090 (i.e. 1,74,015 per year x 6 remaining years). If it terminates the contract after the 8th year then the



Company does not have to pay the compensation since the cost of the machine would have been absorbed.

- (v) In the first year, the Company purchases 5,50,000 soaps at ₹ 4.75 per soap.

Evaluate the contract of the Company with M/s. Radhey and provide necessary accounting entries for first year in accordance with Ind AS with working notes. Assume all cash flows occur at the end of the year. (MTP 15 Marks) (Oct'22)

Answer 4

Identification of the contract (by applying para 9 of Ind AS 116)

(a) Identified asset

Feel Fresh Ltd. (a customer company) enters into a long-term purchase contract with M/s Radhey (a manufacturer) to purchase a particular type and quality of soaps for 10 year period.

Since for the purpose of the contract M/s Radhey has to buy a customized machine as per the directions of Feel Fresh Ltd. and also the machine cannot be used for any other type of soap, the machine is an identified asset.

(b) Right to obtain substantially all of the economic benefits from use of the asset throughout the period of use

Since the machine cannot be used for manufacture of soap for any other buyer, Feel Fresh Ltd. will obtain substantially all the economic benefits from the use of the asset throughout the period of use.

(c) Right to direct the use

Feel Fresh Ltd. controls the use of machine and directs the terms and conditions of the contract with respect to recovery of fixed expenses related to machine.

Hence the contract contains a lease.

Lease term

The lease term shall be 10 years assuming reasonable certainty. Though the lessee is not contractually bound till 10th year, i.e., the lessee can refuse to make payment anytime without lessor's permission but, it is assumed that the lessee is reasonably certain that it will not exercise this option to terminate.

Identification of lease payment

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

- (a) fixed payments (including in-substance fixed payments), less any lease incentives
- (b) variable lease payments that depend on an index or a rate
- (c) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option
- (d) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

Here in-substance fixed payments in the given lease contract are ₹ 1,74,015 p.a. The present value of lease payment which would be recovered in 8 years @ 8% would be ₹ 10,00,000 (approx.)

Variable lease payments that do not depend on an index or rate and are not, in substance, fixed are not included as lease payments. Instead, they are recognised in profit or loss in the period in which the event that triggers the payment occurs (unless they are included in the carrying amount of another asset in accordance with other Ind AS).

Hence, lease liability will be recognized by ₹ 10,00,000 in the books of Feel Fresh Ltd. Since there are no payments made to lessor before commencement date less lease incentives received from lessor or initial direct costs incurred by lessee or estimate of costs for restoration / dismantling of underlying asset, the right of use asset is equal to lease liability.



Journal Entries On initial recognition

ROU Asset	Dr.	10,00,000	10,00,000
To Lease Liability			
To initially recognise the Lease Liability and the corresponding ROU Asset			

At the end of the first year

Interest Expense	Dr.	80,000	80,000
To Lease Liability			
To record interest expense and accrete the lease liability using the effective interest method (₹ 10,00,000 x 8%)			
Depreciation Expense (10,00,000 / 10 years)	Dr.	1,00,000	1,00,000
To ROU Asset			
To record depreciation on ROU using the straight-line method (₹ 10,00,000 / 10 years)			
Lease Liability	Dr.	1,74,015	1,74,015
To Bank / M/s. Radhey			
To record lease payment			
Cost of soap	Dr.	24,75,000	24,75,000
To Bank / M/s. Radhey {5,50,000 x (4 + 0.5)}			
To record variable expenses paid as cost of the goods purchased			

Question 5

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are ₹ 1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., ₹ 1,00,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7% p.a. How should the said modification be accounted for? Pass the journal entry for the said modification. (MTP 10 Marks April 22, Old & New SM)

Answer 5

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on:

- (a) Remaining lease term = 8 years
- (b) Annual payments = ₹ 1,00,000 and
- (c) Lessee's incremental borrowing rate = 7% p.a.

The modified lease liability equals ₹ 5,97,100 (W.N.1). The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is ₹ 3,46,355 (W.N.3).

Lessee recognises the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (i.e., ₹ 2,50,745) (W.N.4) as an adjustment to the ROU Asset.

Journal Entry

	₹	₹
ROU Asset A/c	Dr.	2,50,745
To Lease Liability A/c		2,50,745
(Being difference in lease liability on account of modification of lease adjusted through ROU Asset A/c)		

Working Notes:

1. Calculation of present value of modified lease liability at the beginning of 7th year



Year	Lease Payment (A)	Present value factor @ 7% (B)	Present value of lease payments (A x B = C)
7	1,00,000	0.935	93,500
8	1,00,000	0.873	87,300
9	1,00,000	0.816	81,600
10	1,00,000	0.763	76,300
11	1,00,000	0.713	71,300
12	1,00,000	0.666	66,600
13	1,00,000	0.623	62,300
14	1,00,000	0.582	58,200
PV of the modified lease liability at the beginning of the 7th year			5,97,100

2. Calculation of present value of lease liability at the commencement date

Year	Lease Payment (A)	Present value factor @ 6% (B)	PV of lease payments (A x B = C)
1	1,00,000	0.943	94,300
2	1,00,000	0.890	89,000
3	1,00,000	0.840	84,000
4	1,00,000	0.792	79,200
5	1,00,000	0.747	74,700
6	1,00,000	0.705	70,500
7	1,00,000	0.665	66,500
8	1,00,000	0.627	62,700
9	1,00,000	0.592	59,200
10	1,00,000	0.558	55,800
Present value of the lease liability at the commencement date			7,35,900

3. Calculation of lease liability immediately before the modification date

Year	Opening lease liability (A)	Interest @ 6% (B) = [A x 6%]	Lease payments (C)	Closing liability (D) = [A+B-C]
1	7,35,900	44,154	1,00,000	6,80,054
2	6,80,054	40,803	1,00,000	6,20,857
3	6,20,857	37,251	1,00,000	5,58,108
4	5,58,108	33,486	1,00,000	4,91,594
5	4,91,594	29,496	1,00,000	4,21,090
6	4,21,090	25,265	1,00,000	3,46,355
Lease liability as at modification date				3,46,355

4. Adjustment to ROU asset

Modified Lease liability	5,97,100
Original Lease liability as at modification date	(3,46,355)
Adjustment to ROU asset	2,50,745

The ROU asset will be increased by ₹ 2,50,745 on the date of modification.



Question 6

On 1st April, 2017, J Ltd. began to lease a property on a 20-year lease. J Ltd. paid a lease premium of Rs. 30,00,000 on 1st April, 2017. The terms of the lease required J Ltd. to make annual payments of Rs. 500,000 in arrears, the first of which was made on 31st March, 2018.

On 1 April, 2017 the fair values of the leasehold interests in the leased property were as follows:

- Land Rs. 30,00,000.
- Buildings Rs. 45,00,000.

There is no opportunity to extend the lease term beyond 31st March, 2037. On 1st April, 2017, the estimated useful economic life of the buildings was 20 years.

The annual rate of interest implicit in finance leases can be taken to be 9.2%. The present value of 20 payments of Re. 1 in arrears at a discount rate of 9.2% is Rs. 9.

Required:

Explain the accounting treatment for the above property lease and produce appropriate extract from the financial statements of J Ltd. for the year ended 31 March, 2018. (MTP 12 Marks April '19)

Answer 6

Statement of Profit and Loss

	Rs.'000
Operating Lease rental	(260)
Amortization of asset leased on finance lease	(225)
Finance cost relating to finance leases	(248.4)

Balance Sheet

	Rs.'000
Property, plant and equipment	4,275
Prepaid Operating lease rentals:	
In non-current assets	1,080
In Current assets	60
Lease liability:	
In non-current liabilities	(2,592.1)
In Current liabilities	(56.3)

Explanation and supporting calculations:

Separate decisions are made for the land and buildings elements of the lease.

- (1) The **land lease is an operating lease** because land has an indefinite useful economic life and the lease term is 20 years.

The lease premium and annual rentals are apportioned 40% (3/7 5) to the land element.

Therefore, the premium for the land element is Rs. 12,00,000 (Rs. 30,00,000 x 40%) and the annual rentals for the land element Rs. 200,000 (Rs. 500,000 x 40%). This makes the total lease payment Rs. 52,00,000 (Rs. 12,00,000 + 20 x Rs. 200,000).

The rental expense for the current period is Rs. 2,60,000 (Rs. 52,00,000 x 1/20).

The amount paid in the current period regarding the land element is Rs. 14,00,000 (Rs. 12,00,000 + Rs. 200,000). Therefore, there is a prepayment of Rs. 1,140,000 (Rs. 14,00,000 — Rs. 2,60,000) at the year end.

In the next 19 periods, the rental expense will be Rs. 2,60,000 and the rental payment will be Rs. 200,000. Therefore, Rs. 60,000 of the rental prepayment will reverse in each period. This means that Rs. 60,000 of the prepayment will be a current asset, and the balance a non-current asset.

- (2) The buildings element of the lease will be a finance lease because the lease term is for substantially all of the useful life of the buildings.



The premium apportioned to the buildings element is Rs. 18,00,000 (Rs. 30,00,000 x 60%) and the annual rental apportioned to the buildings is Rs. 300,000 (Rs. 500,000 x 60%).

The initial carrying value of the leased asset in PPE is Rs. 45,00,000 (Rs. 18,00,000 + Rs. 300,000 x 9).

Therefore, the annual depreciation charge is Rs. 2,25,000 (Rs. 45,00,000 x 1/20) and the closing PPE = Rs. 42,75,000 (Rs. 45,00,000 — Rs. 2,25,000).

The finance cost in respect of the finance lease and the closing non-current liability is shown in the working below.

The closing current liability is Rs. 56,300 (Rs. 26,48,400 — Rs. 25,92,100).

Lease liability profile — working

Year ended 31st March	Bal b/f Rs. '000	Finance Cost @ 9.2 % Rs. '000	Lease rental Payment Rs. '000	Bal c/f Rs. '000
2018	* 2700	248.4	(300)	2,648.4
2019	2,648.4	243.7	(300)	2,592.1

* Balance brought forward is equal to net of lease premium of Rs. 8,00,000 i.e.

Rs. 45,00,000 - Rs. 18,00,000 = Rs. 27,00,000

Question 7

Determine the lease term in the following scenarios:

Scenario A: Entity ABC enters into a lease for equipment that includes a non-cancellable term of six years and a two-year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception. There are no termination penalties or other factors indicating that Entity ABC is reasonably certain to exercise the renewal option. What is the lease term?

Scenario B: Entity XYZ enters into a lease for a building that includes a non-cancellable term of eight years and a two-year, market-priced renewal option. Before it takes possession of the building, Entity XYZ pays for leasehold improvements. The leasehold improvements are expected to have significant value at the end of eight years, and that value can only be realised through continued occupancy of the leased property. What is the lease term?

Scenario C: Entity PQR enters into a lease for an identified retail space in a shopping centre. The retail space will be available to Entity PQR for only the months of October, November and December during a non-cancellable term of seven years. The lessor agrees to provide the same retail space for each of the seven years. What is the lease term? (MTP 6 Marks Sep '23)

Answer 7

Scenario A: At the lease commencement date, the lease term is six years (being the non-cancellable period). The renewal period of two years is not taken into consideration since Entity ABC is not reasonably certain to exercise the option because there are no penalties or other factors which indicate that the entity will opt for renewal of lease.

Scenario B: At the lease commencement, Entity XYZ determines that it is reasonably certain to exercise the renewal option because it would suffer a significant economic penalty if it abandoned the leasehold improvements at the end of the initial non-cancellable period of eight years. Thus, at the lease commencement, Entity XYZ concludes that the lease term is ten years (being eight years of non-cancellable period plus the renewal period of two years where the lessee is reasonably certain to exercise the option).



Scenario C: At the lease commencement date, the lease term is 21 months (three months per year over the seven annual periods as specified in the contract), i.e., the period over which Entity PQR controls the right to use the underlying asset.

Question 8

Entity X (lessee) entered into a lease agreement ('lease agreement') with Entity Y (lessor) to lease an entire floor of a shopping mall for a period of 9 years. The annual lease rent of Rs. 70,000 is payable at year end. To carry out its operations smoothly, Entity X simultaneously entered into another agreement ('facilities agreement') with Entity Y for using certain other facilities owned by Entity Y such as passenger lifts, DG sets, power supply infrastructure, parking space etc., which are specifically mentioned in the agreement, for annual service charges amounting to Rs. 1,00,000. As per the agreement, the ownership of the facilities shall remain with Entity Y. Lessee's incremental borrowing rate is 10%.

The facilities agreement clearly specifies that it shall be co-existent and coterminous with 'lease agreement'. The facility agreement shall stand terminated automatically on termination or expiry of 'lease agreement'.

Entity X has assessed that the stand-alone price of 'lease agreement' is Rs. 1,20,000 per year and stand-alone price of the 'facilities agreement' is Rs. 80,000 per year. Entity X has not elected to apply the practical expedient in paragraph 15 of Ind AS 116 of not to separate non-lease component (s) from lease component(s) and accordingly it separates non-lease components from lease components.

How will Entity X account for lease liability as at the commencement date? (RTP Nov '20, Old & New SM)

Answer 8

Entity X identifies that the contract contains lease of premises and non-lease component of facilities availed. As Entity X has not elected to apply the practical expedient as provided in paragraph 15, it will separate the lease and non-lease components and allocate the total consideration of Rs. 1,70,000 to the lease and non-lease components in the ratio of their relative stand-alone selling prices as follows:

Particulars	Stand-alone Prices	% of total Stand-alone Price	Allocation of consideration
	Rs.		Rs.
Building rent	1,20,000	60%	1,02,000
Service charge	80,000	40%	68,000
Total	2,00,000	100%	1,70,000

As Entity X's incremental borrowing rate is 10%, it discounts lease payments using this rate and the lease liability at the commencement date is calculated as follows:

Year	Lease Payment (A)	Present value factor @ 10% (B)	Present value of lease payments (A X B = C)
Year 1	1,02,000	.909	92,718
Year 2	1,02,000	.826	84,252
Year 3	1,02,000	.751	76,602
Year 4	1,02,000	.683	69,666
Year 5	1,02,000	.621	63,342
Year 6	1,02,000	.564	57,528
Year 7	1,02,000	.513	52,326
Year 8	1,02,000	.467	47,634



Year 9	1,02,000	.424	43,248
Lease Liability at commencement date			5,87,316

Further, Rs. 68,000 allocated to the non-lease component of facility used will be recognised in profit or loss as and when incurred.

Question 9

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

How will entity X measure the right of use (ROU) asset and lease liability initially and at the end of Year 1? (MTP Apr'23, RTP May' 21, Old & New SM)

Answer 9

On initial measurement, Entity X will measure the lease liability and ROU asset as under:

Year	Lease Payments (USD)	Present Value factor @ 5%	Present Value of Lease Payment	Conversion rate (spot rate)	INR value
1	10,000	0.952	9,520	68	6,47,360
2	10,000	0.907	9,070	68	6,16,760
3	10,000	0.864	8,640	68	5,87,520
4	10,000	0.823	8,230	68	5,59,640
5	10,000	0.784	7,840	68	5,33,120
Total			43,300		29,44,400

As per Ind AS 21, The Effects of Changes in Foreign Exchange Rates, monetary assets and liabilities are restated at each reporting date at the closing rate and the difference due to foreign exchange movement is recognised in profit and loss whereas non-monetary assets and liabilities carried measured in terms of historical cost in foreign currency are not restated.

Accordingly, the ROU asset in the given case being a non-monetary asset measured in terms of historical cost in foreign currency will not be restated but the lease liability being a monetary liability will be restated at each reporting date with the resultant difference being taken to profit and loss.

At the end of Year 1, the lease liability will be measured in terms of USD as under: Lease Liability:

Year	Initial Value (USD) (a)	Lease Payment (b)	Interest @ 5% (c) = (a x 5%)	Closing Value (USD) (d = a + c - b)
1	43,300	10,000	2,165	35,465

Interest at the rate of 5% will be accounted for in profit and loss at average rate of Rs. 69 (i.e., USD 2,165 x 69) = Rs. 1,49,385.

Particulars	Dr. (Rs.)	Cr. (Rs.)
Interest Expense	Dr. 1,49,385	
To Lease liability		1,49,385

Lease payment would be accounted for at the reporting date exchange rate, i.e. Rs. 70 at the end of year 1

Particulars	Dr. (Rs.)	Cr. (Rs.)
Lease liability	Dr. 7,00,000	



To Cash		7,00,000

As per the guidance above under Ind AS 21, the lease liability will be restated using the reporting date exchange rate i.e., Rs. 70 at the end of Year 1. Accordingly, the lease liability will be measured at Rs. 24,82,550 (35,465 x Rs. 70) with the corresponding impact due to exchange rate movement of Rs. 88,765 (24,82,550 – (29,44,400 + 1,49,385 – 700,000) taken to profit and loss.

At the end of year 1, the ROU asset will be measured as under:

Year	Opening Balance (Rs.)	Depreciation (Rs.)	Closing Balance (Rs.)
1	29,44,400	5,88,880	23,55,520

Question 10

Jeevan India Limited is in the business of development of smart city. For development of smart city, Jeevan India Limited allots its land to customer on 99 years of lease. The customer is required to pay lease premium at the time of execution of lease deed and lease rent on annual basis over a period of 99 years.

The lease premium amount is the market value of land and lease rent is nominal amount say Rs. 1 per square metre per year. The lease premium is non-refundable. As per the lease terms, on completion of 99 years, the lease is renewable at mutual consent of lessor and lessee.

How would income in respect of lease premium collected by Jeevan India Limited (which is the market value of land and is not refundable) at the time of execution of lease deed be recognised as per Ind AS, if for subsequent years, only nominal lease rent is collected. (RTP Nov '19)

Answer 10

Paragraph 5 of Ind AS 115 scopes out revenue arising from lease agreements. Principles enunciated under Ind AS 17, Leases would be applicable for revenue arising from leasing agreements.

Recognition of income in respect of lease would depend on its classification as per Ind AS 17, Leases.

If the lease of land is an operating lease, then it will be accounted for as given below:

- Lessors shall present assets subject to operating leases in their balance sheet according to the nature of the asset.
- Lease income from operating leases shall be recognised in income on a straight-line basis over the lease term, unless either:
 - (a) another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished, even if the payments to the lessors are not on that basis; or
 - (b) the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary according to factors other than inflation, then this condition is not met.

The long lease term may be an indication that the lease is classified as a finance lease. **If it is a finance lease** then lessor Jeevan India Ltd. shall recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease. The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Nominal lease rent collected every year will also be accounted every year on accrual basis.

**Question 11****Case I**

Scenario 1: The 'last mile' is a dedicated cable that connects Entity Y's network with the end customer's device. The use of this cable is at the discretion of the customer. Entity Y decides the location of end points and has right to replace the lines (dedicated cable), however it is not practical to replace the lines, since replacement would require additional costs to be incurred without any corresponding benefit. Whether the arrangement would be within the scope of Ind AS 116?

Scenario 2: If it is practical for the Entity Y to replace the lines and Entity Y would benefit from this replacement, would the answer be different?

Case II

Customer X enters into a 10-year contract with a utility company, Entity Y, for the right to use three specified, physically distinct fibers within a larger cable connecting Mumbai to Delhi. Customer makes the decisions about the use of the fibers by connecting each

end of the fibers to its electronic equipment. Entity Y owns extra fibers but can substitute those for Customer's fibers only for reasons of repairs, maintenance or malfunction. The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116?

Case III

Customer X enters into a 10-year contract with Entity Y for the right to use a specified amount of capacity within a cable connecting Mumbai to Delhi. The specified amount is equivalent to Customer X having the use of the full capacity of three fiber strands within the cable (the cable contains multiple fibers with similar capacities). Entity Y makes decisions about the transmission of data (i.e., Entity Y lights the fibers, makes decisions about which fibers are used to transmit Customer's traffic). The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116? (RTP May '22)

Answer 11

Paragraph 9, B9, B13 and B14 of Ind AS 116 state the following:

"9 At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration."

"B9 To assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

- (a) the right to obtain substantially all of the economic benefits from use of the identified asset; and
- (b) the right to direct the use of the identified asset."

"B13 An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer."

"B14 Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

- (a) the supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
- (b) the supplier would benefit economically from the exercise of its right to substitute the asset (i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset)."

Paragraph B20 of Ind AS 116 which provides guidance regarding identified asset in case of portion of



assets states that a capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

Paragraph B21 of Ind AS 116, inter alia, states that to control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or subleasing the asset.

Further, paragraph B24 of Ind AS 116 provides that a customer has the right to direct the use of an identified asset throughout the period of use if the customer has the right to direct how and for what purpose the asset is used throughout the period of use.

Paragraph B25 of Ind AS 116 states that a customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

Case I

Scenario 1:

- (i) As per paragraph B13 of Ind AS 116, 'Last mile' which is a dedicated cable is an identified asset since it is physically distinct.
- (ii) There are no substantive substitution rights with Entity Y, as it does not have the practical ability to substitute alternative assets throughout the period of use.

Thus, this arrangement is within the scope of Ind AS 116.

Scenario 2:

If Entity Y has the practical ability to replace the lines and it would benefit from such replacement, Entity Y has substantive substitution rights. In such case, this arrangement for the 'last mile cable' will not be within the scope of Ind AS 116.

Case II

The fibers are specified in the contract and are physically distinct. Hence, in accordance with paragraph B13 and B20, the said three fibers are identified asset.

Paragraph B18, inter alia, states that the supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.

Further, paragraph B27 provides that although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and can actually be dependent on the decisions about how and for what purpose the asset is used.

In accordance with the above, as Entity Y can substitute these three distinct fibers only for reasons of repairs, maintenance or malfunction, it does not preclude them from being an identified asset.

Further, the Customer X has right to control the use of the identified fibers for 10 year since it has –

- (a) the right to obtain substantially all of the economic benefits from use of the identified fibers throughout the period of use, i.e., 10 years; and



- (b) the right to direct the use of the fibers as it makes the decisions about the use of the fibers, i.e., it has right to direct how and for what purpose the fibers are used throughout the period of use.

Hence, this arrangement is within the scope of Ind AS 116.

Case III

Paragraph B20 specifically provides that a capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset. In the given case, the capacity portion that will be provided to Customer X is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable, thus, it is not an identified asset. Further, Entity Y makes all decisions about the transmission of data, (i.e., supplier lights the fibers, makes decisions about which fibers are used to transmit customer's traffic).

Thus, the contract does not contain a lease and is therefore not within the scope of Ind AS 116.

Question 12

A company manufactures specialized machinery. The company offers customers the choice of either buying or leasing the machinery. A customer chooses to lease the machinery. Details of the arrangement are as follows:

- (i) The lease commences on 1st April, 20X1 and lasts for three years.
- (ii) The lessee is required to make three annual rentals payable in arrears of ₹ 57,500.
- (iii) The leased machinery is returned to the lessor at the end of the lease.
- (iv) The fair value of the machinery is ₹ 1,50,000, which is equivalent to the selling price of the machinery
- (v) The machinery cost ₹ 1,00,000 to manufacture. The lessor incurred costs of ₹ 2,500 to negotiate and arrange the lease.
- (vi) The expected useful life of the machinery is 3 years. The machinery has an expected residual value of ₹ 10,000 at the end of year three. The estimated residual value does not change over the term of the lease.
- (vii) The interest rate implicit in the lease is 10.19%. The lessor classifies the lease as a finance lease. How should the Lessor account for the same in its books of accounts? Pass necessary journal entries. (RTP Nov'22)

Answer 12

The cost to the lessor for providing the machinery on lease consists of the book value of the machinery (₹ 1,00,000), plus the initial direct costs associated with entering into the lease (₹ 2,500), less the future income expected from disposing of the machinery at the end of the lease (the present value of the unguaranteed residual value of ₹ 10,000 discounted @ 10.19%, being ₹ 7,470). This gives a cost of sale of ₹ 95,030. The lessor records the following entries at the commencement of the lease:

		₹	₹
Lease receivable	Dr.	1,50,000	
Cost of sales	Dr.	95,030	
To Inventory			1,00,000
To Revenue			1,42,530
To Creditors/Cash			2,500

The sales profit recognised by the lessor at the commencement of the lease is therefore ₹ 47,500 (₹ 1,42,530 - ₹ 95,030). This is equal to the fair value of the machinery of ₹ 1,50,000, less the book value of the machinery (₹ 1,00,000) and the initial direct costs of entering into the lease (₹ 2,500). Revenue is equal to the lease receivable (₹ 1,50,000), less the present value of the unguaranteed residual value (₹ 7,470).



Year	Lease receivable at the beginning of year (₹)(a)	Lease payments (₹)(b)	Interest (10.19% annum) (₹)(c)	Income per	Decrease in lease receivable (₹)(d)=(b)-(c)	Lease receivable at the end of year (₹) (e)=(a)-(d)
1	1,50,000	57,500	15,285		42,215	1,07,785
2	1,07,785	57,500	10,983		46,517	61,268
3	61,268	57,500	6,232*		51,268	10,000

*Difference is due to approximation

The lessor will record the following entries:

Year 1	Cash/Bank Dr.	57,500	
	To Lease receivable		42,215
	To Interest income		15,285
Year 2	Cash/Bank Dr.	57,500	
	To Lease receivable		46,517
	To Interest income		10,983
Year 3	Cash/Bank Dr.	57,500	
	To Lease receivable		51,268
	To Interest income		6,232

At the end of the three-year lease term, the leased machinery will be returned to the lessor, who will record the following entries:

Inventory Dr.	10,000	
To Lease receivable		10,000

Question 13

How will Entity Y account for the incentive in the following scenarios:

Scenario A:

Entity Y (lessor) enters into an operating lease of property with Entity X (lessee) for a five-year term at a monthly rental of ₹ 1,10,000. In order to induce Entity X to enter into the lease, Entity Y provides ₹ 6,00,000 to Entity X at lease commencement for lessee improvements (i.e., lessee's assets).

Scenario B:

Entity Y (lessor) enters into an operating lease of property with Entity X (lessee) for a five-year term at a monthly rental of ₹ 1,10,000. At lease commencement, Entity Y provides ₹ 6,00,000 to Entity X for leasehold improvements which will be owned by Entity Y (i.e., lessor's assets). The estimated useful life of leasehold improvements is 5 years. (RTP May '23)

Answer 13

Para 70 of Ind AS 116 state that at the commencement date, the lease payments included in the measurement of the net investment in the lease comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:

- fixed payments (including in-substance fixed payments as described in para B42), less any lease incentives payable;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;



- (d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in para B37); and
- (e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Further para 71 of the standard states that a lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.”

Scenario A

In accordance with above, in the given case, at lease commencement, Entity Y accounts for the incentive as follows:

To account for the lease incentive

Deferred lease incentive	Dr. ₹ 6,00,000
To Cash	₹ 6,00,000

Recurring monthly journal entries in Years 1 – 5

To record cash received on account of lease rental and amortisation of lease incentive over the lease term

Cash	Dr. ₹ 1,10,000	
To Lease income		₹ 1,00,000
To Deferred lease incentive		₹ 10,000*

* This is calculated as ₹ 6,00,000 ÷ 60 months.

Scenario B

Entity Y has provided lease incentive amounting to ₹ 6,00,000 to Entity X for leasehold improvements in the premises. As Entity Y has the ownership of the leasehold improvements carried out by the lessee, it shall account for the same as property, plant and equipment and shall depreciate the same over its useful life.

In accordance with above, in the given case, at lease commencement, Entity Y accounts for the incentive as follows:

To record the lease incentive

Property, plant & Equipment	Dr. ₹ 6,00,000
To Cash	₹ 6,00,000

Recurring monthly journal entries in Years 1 – 5

To record cash received on account of lease rental over the lease term

Cash	Dr. ₹ 1,10,000	
To Lease income		₹ 1,10,000

To record depreciation on PPE over the lease term using straight line method

Depreciation	Dr. ₹ 10,000
To Accumulated Depreciation	₹ 10,000

**Question 14**

Entity X, a utility company enters into a contract for twenty years with Entity Y, a power company, to purchase all of the

electricity produced by a new solar power station. The solar power station is explicitly specified in the contract and Entity Y has no substitution rights. Entity Y owns the solar power station and will receive tax credits relating to the construction and ownership of the solar power station, and Entity X will receive renewable energy credits that accrue from use of the solar power station.

Whether Entity X has the right to obtain substantially all of the economic benefits from the solar power station during the period of arrangement? (RTP Nov '23)

Answer 14

Paragraphs B21 of Ind AS 116 states that to control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or subleasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realised from a commercial transaction with third party.

In the given case, Entity X has the right to obtain substantially all of the economic benefits from the use of the solar power station over the 20-year period because it obtains:

- electricity produced by the power station i.e. the primary product from use of the asset over the lease term and
- renewable energy credits – i.e. the by-product from use of the asset.

Although Entity Y will receive economic benefits from the solar power station in the form of tax credits, those economic benefits relate to the ownership of the solar power station rather than the use of the power station. Thus, these credits are not considered in this assessment.

Question 15

The following facts are given for the Sky Ltd:

- A Lease which is non-cancellable was initiated on 1st April 2014 for equipment with an expected useful life of five years.
- Three payments are due to the 'Lessor' of an amount of Rs. 1,02,000 per year beginning 31st March 2015. Included in the lease payments is a sum of Rs. 2,000 to be paid annually by the 'Lessee' for insurance.
- The 'Lessee' guarantees Rs. 20,000 residual value on 31st March 2017 to the Lessor.
- Irrespective of the Rs. 20,000 residual value guarantee, the leased asset is expected to have only Rs. 2,000 residual value to the lessee at the end of the lease term.
- The Lessee company depreciates similar equipment that it owns on a straight line basis.
- The fair value of the equipment at 1st April 2014 is Rs. 2,64,000.
- The Lessor's implicit rate is 10%. This fact is known to the Lessee company. As per the provisions of Ind AS 17 'Leases' -
 - (i) How should Lessee Company classify and record the lease transaction at its inception on 1st April 2014? Indicate journal entry also.
 - (ii) What are the journal entries the Lessee is required to make to record the lease payments



and the interest, insurance and depreciation expenses on 31st March 2015 through 31st March 2017?

(iii) What entry should the Lessee make on 31st March 2017 to record the guaranteed residual value payment (assuming estimated residual value of Rs. 2,000) and to clear the lease related accounts from the lessee's books?

(iv) What would be the Current and Non-current classification in the books of Lessee in the first year?

(Discount factor: 2015: 0.909; 2016: 0.826; 2017: 0.751) (PYP 12 Marks, May'18)

Answer 15

- (i) The Lessee company should record the asset as a finance lease since the risk and reward is transferred. Lessee has guaranteed to the lessor, the residual value of Rs. 20,000, in spite of the fact that the estimated residual value of the asset will be Rs. 2,000.

Further the lease payments substantially cover the fair value of leased asset as per calculation given below.

Calculation of Present value of Minimum Lease Payments (MLP) at implicit rate of 10%

Year	Discount Factor	Minimum Lease payments (see note below)	Present Value of MLP
Annual Lease Rentals			
31 st March, 2015	0.909	1,00,000	90,900
31 st March, 2016	0.826	1,00,000	82,600
31 st March, 2017	0.751	1,00,000	75,100
Guaranteed Residual Value			
31 st March, 2017	0.751	20,000	15,020
		Total	2,63,620

Note: The contingent rent, taxes, insurance, maintenance expenses etc. if paid by the lessee to the lessor, then it does not form part of the minimum lease payments and will be expensed when incurred. Insurance expense is a kind of reimbursement from lessee to lessor. Hence in the above case, for calculation of present value of minimum lease payments only lease rental of Rs. 1,00,000 has been considered.

At the time of initial recognition, the lessee will recognise the leasehold asset at lower of below:

Present value of MLP 2,63,620

Fair value of leased asset 2,64,000

Hence, leasehold asset will be recognised at 2,63,620

Accounting entry for initial recognition would be :

Leasehold equipment	Dr.	2,63,620
To Leasehold obligation		2,63,620

- (ii) Lease rentals should split between principal portion of leasehold obligation and finance costs as follows:

Year	Opening balance	Payments	Finance costs @ 10%	Reduction in liability	Closing obligation
	(a)	(b)	(a) x 10% = (c)	(b)-(c)=(d)	(a)-(d) = (e)



1st April, 2014	-				2,63,620
31st March, 2015	2,63,620	1,00,000	26,362	73,638	1,89,982
31 st March, 2016	1,89,982	1,00,000	18,998	81,002	1,08,980
31 st March, 2017	1,08,980	1,00,000	11,020*	88,980	20,000

* Difference is due to approximation.

In the books of Lessee

Journal Entries (at the time of subsequent measurement)

Date	Particulars		Dr.	Cr.
			Rs.	Rs.
31st March 2015	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	73,638	
	Interest Expenses	Dr.	26,362	
	Depreciation	Dr.	87,207	
	To Cash			1,02,000
	To Accumulated Depreciation			87,207
31st March 2016	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	81,002	
	Interest Expenses	Dr.	18,998	
	Depreciation	Dr.	87,207	
	To Cash			1,02,000
	To Accumulated Depreciation			87,207
31st March 2017	Insurance Expenses	Dr.	2,000	
	Leasehold obligation	Dr.	88,980	
	Interest Expenses	Dr.	11,020	
	Depreciation	Dr.	87,206	
	To Cash			1,02,000
	To Accumulated Depreciation			87,206

(iii) Entries at the end of lease period

Leasehold Obligation Account	Dr.	20,000	
Accumulated Depreciation Account	Dr.	2,61,620	
To Cash Account			18,000
To Leasehold Equipment Account			2,63,620

(iv) The Current and Non-current Classification at the end of year 1 in the books of Lessee
Balance Sheet (An extract)

	Rs.
ASSETS	
Non-current Asset	

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Most of the examinees included insurance charges in minimum lease payments and calculated finance charges accordingly. They were unable to pass correct journal entries and classify current and non-current assets and liabilities in the balance sheet.



Leasehold Asset	
Gross Block	2,63,620
Accumulated Depreciation	(87,207)
LIABILITIES	
Non-current Liability	
Leasehold Obligation (payable after 12 months from the reporting date)	1,08,980
Current Liability	
Leasehold Obligation (payable within 12 months from the reporting date)	81,002

Question 16

Venus Ltd. (Seller-lessee) sells a building to Mars Ltd. (Buyer-lessor) for cash of Rs. 28,00,000. Immediately before the transaction, the building is carried at a cost of Rs. 13,00,000. At the same time, Seller- lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with an annual payment of Rs. 2,00,000 payable at the end of each year.

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in accordance with Ind AS 115 "Revenue from Contracts with Customers".

The fair value of the building at the date of sale is Rs. 25,00,000. Initial direct costs, if any, are to be ignored. The interest rate implicit in the lease is 12% p.a., which is readily determinable by Seller-lessee. Present Value (PV) of annual payments (20 payments of Rs. 2,00,000 each discounted @ 12%) is Rs. 14,94,000.

Buyer-lessor classifies the lease of the building as an operating lease. How should the said transaction be accounted by Venus Ltd.? (PP 8 Marks Nov'20)(Same concept different figures- Old & New SM)

Answer 16

Considering facts of the case, Venus Ltd. (seller-lessee) and Mars Ltd. (buyer-lessor) account for the transaction as a sale and leaseback.

Firstly, since the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer -lessor make adjustments to measure the sale proceeds at fair value. Thus, the amount of the excess sale price of Rs. 3,00,000 (as calculated below) is recognized as additional financing provided by Buyer-lessor to Seller-lessee.

Sale Price:	28,00,000
Less: Fair Value (at the date of sale):	(25,00,000)
Additional financing provided by Buyer-lessor to Seller-lessee	3,00,000

The present value of the annual payments is Rs. 14,94,000 (as given in the question).

Out of this Rs. 14,94,000, Rs. 3,00,000 relates to the additional financing (as calculated above) and balance Rs. 11,94,000 relates to the lease.

Accounting by Venus Ltd. (seller-lessee):

At the commencement date, Seller-lessee measures the ROU asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right-of-use retained by Seller-lessee, calculated as follows:

Carrying Amount	(A)	13,00,000
Fair Value (at the date of sale)	(B)	25,00,000
Discounted lease payments for the 20 year ROU asset	(C)	11,94,000



ROU Asset $[(A / B) \times C]$	6,20,880

Seller-lessee recognizes only the amount of the gain that relates to the rights transferred to Buyer-lessor, calculated as follows:

Fair Value (at the date of sale)	(A)	25,00,000
Carrying Amount	(B)	13,00,000
Discounted lease payments for the 20-year ROU asset (C)		11,94,000
Gain on sale of building	(D) = (A - B)	12,00,000
Relating to the right to use the building retained by Seller-lessee (E)=[(D/A)x C]		5,73,120
Relating to the rights transferred to Buyer-lessor (D - E)		6,26,880

At the commencement date, Seller-lessee accounts for the transaction, as follows:

Bank / Cash A/c	Dr.	28,00,000	
ROU Asset A/c	Dr.	6,20,880	
To Building			13,00,000
To Financial Liability			14,94,000
To Gain on rights transferred			6,26,880

Question 17

Coups Limited availed a machine on lease from Ferrari Limited. The terms and conditions of the Lease are as under:

Lease period is 3 years, machine costing ₹ 8,00,000.

- Machine has expected useful life of 5 years.
- Machine reverts back to Ferrari Limited on termination of lease.
- The unguaranteed residual value is estimated at ₹ 50,000 at the end of 3rd year.
- 3 equal annual installments are made at the end of each year.
- Implicit Interest Rate (IRR) = 10%.
- Present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is 0.7513.
- Present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is 2.4868.

You are required to ascertain whether it is a Finance Lease or Operating Lease and also calculate Unearned Finance Income with the relevant context to relevant Ind AS. (PYP 6 Marks, Jan 21)

Answer 17

It is assumed that the fair value of the machine on lease is equivalent to the cost of the machine.

- (i) A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

- (ii) Computation of annual lease payment to the lessor

	₹
Cost of equipment / fair value	8,00,000
Unguaranteed residual value	50,000
Present value of residual value after third year @ 10% (50,000 x 0.7513)	37,565
Fair value to be recovered from lease payments (8,00,000 - 37,565)	7,62,435



37,565)	
Present value of annuity for three years is 2.4868	
Annual lease payment = 7,62,435 / 2.4868	3,06,593

The present value of lease payment i.e., ₹ 7,62,435 is more than 95% of the fair market value i.e., ₹ 8,00,000. The present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years). Therefore, it constitutes a finance lease.

(iii) Computation of Unearned Finance Income

	₹
Total lease payments (₹ 3,06,593 x 3)	9,19,779
Add: Unguaranteed residual value	50,000
Gross investment in the lease	9,69,779
Less: Present value of investment (lease payments and residual value) (37,565 + 7,62,435)	(8,00,000)
Unearned finance income	1,69,779

Question 18

Ted entered into a lease contract with lessor to lease 2,000 sqm of retail space for 5 years. The rentals are payable monthly in advance. The lease commenced on 1st April 2019. In the year 2020, as a direct consequence of Covid 19 pandemic, Ted has negotiated with the lessor which may results in the following situations:

- Lessor agrees a rent concession under which the monthly rent will be reduced by 30% per month for the 12 months commencing 1st October 2020.
- Ted is granted a rent concession by the lessor whereby the lease payments for the period October 2020 to December 2020 are deferred. Three months are added to the end of the lease term at same monthly rent.
- Lessor offers to reduce monthly rent by 50% for the months October 2020 to March 2021 on the condition that its space is reduced from 2,000 sq m to 1,500 sq m.

Analyze the given situations in the light of Ind AS 116 and comment on whether rent concession/deferral is eligible for practical expedient? (PYP 4 Marks July 21)

Answer 18

Applicability of practical expedient:

The practical expedient applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic.

As a practical expedient, a lessee may elect not to assess a rent concession as a lease modification only if all of the following conditions are met:

- the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
- any reduction in lease payments affects only payments originally due on or before the 30th June, 2021; and
- there is no substantive change to other terms and conditions of the contract

Analysis:

Based on above guidance, answer to the given situations with the lessor would be as follows:

- Lessor agrees a rent concession under which the monthly rent will be reduced by 30% per month for the 12 months commencing 1st October 2020:



The rent deferral does not satisfy the criteria to apply the practical expedient because out of the listed eligibility criteria given in Ind AS 116, rent concession reduces lease payments starting from October, 2020 and reduction will continue till September, 2021 which is beyond 30th June 2021. Therefore, Ted is not permitted to apply the practical expedient.

- Ted is granted a rent concession by the lessor whereby the lease payments for the period October 2020 to December 2020 are deferred. Three months are added to the end of the lease term at same monthly rent:
 - (a) condition is met since revised consideration in the lease is substantially the same as the original
 - (b) condition is met since the rent concession only reduces lease payments originally due in 2020 – i.e. before 30th June 2021.
 - (c) condition is met since the lessee assesses that three-month extension at the end of the lease term is with substantially the same lease payments. Hence, it would not constitute a substantive change.

Since, the rent concession is a direct consequence of COVID-19 and all three conditions are met, rent concession is eligible for application of practical expedient in this case.

- Lessor offers to reduce monthly rent by 50% for the months October 2020 to March 2021 on the condition that its space is reduced from 2,000 sqm to 1,500 sqm:

The rent concession does not satisfy the criteria to apply the practical expedient because out of the listed eligibility criteria given in Ind AS 116, there is a substantive change to the terms and conditions of the lease as there is a change in the scope of lease by reducing the space from 2,000 sqm to 1,500 sqm. Therefore, Ted is not permitted to apply the practical expedient.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

There were different scenarios where examinees had to state whether practical expedient would be followed as per Ind AS 116 in Covid 19 cases. However, some of the examinees clubbed all the given situations as one and analysed the same in vain.

Question 19

Jakob Ltd. entered into a contract for lease of machinery with Jason Ltd. on 1.1.2018. The initial term of the lease is 6 years with a renewal option of further 2 years.

- **The annual payments for initial term and renewal term are ` 2,80,000 and ` 3,50,000 respectively.**
- **The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year. For example, the payment due on 1.1.2019 will be based on the CPI available at 31.12.2018.**
- **Jakob Ltd.'s incremental borrowing rate at the lease inception date and as at 1.1.2021 is 8% and 10% respectively and the CPI at lease commencement date and as at 1.1.2021 is 250 and 260 respectively.**
- **At the lease commencement date, Jakob Ltd. did not think that it will be a viable option to renew the lease but in the first quarter of 2021, Jakob Ltd. made some major changes in the retail store which increases its economic life by five years.**
- **Jakob Ltd. determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.**

Jakob Ltd. asked your opinion whether remeasurement of lease is required in the first quarter of 2021. (PYP 10 Marks Dec '21)

Answer 19

Since in the first quarter of 2021, Jakob Ltd. is reasonably certain that it will exercise its renewal option, it is required to re-measure the lease in the first quarter of 2021.



The following table summarizes information pertinent to the lease re-measurement:

Re-measured lease term	5 years (3 years remaining in the initial term plus 2 years in the renewal period)
Jakob Ltd.'s incremental borrowing rate on the re-measurement date	10%
CPI available on the re-measurement date	260
Right-of-use asset immediately before the re-measurement	` 6,99,019 (Refer note 2)
Lease liability immediately before the re-measurement	` 7,79,417 (Refer note 2)

Procedure to re-measure the lease liability:

To re-measure the lease liability, Jakob Ltd. would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 10%).

Since the initial lease payments were based on a CPI of 250, the CPI has increased by 4% $\left[\frac{(260-250)}{250} \times 100\right]$. As a result, Jakob Ltd. would increase the future lease payments by 4%.

Computation of present value of the future lease payments based on an updated CPI of 260:

	Year					Total
	4	5	6	7	8	
Lease payment	2,91,200	2,91,200	2,91,200	3,64,000	3,64,000	16,01,600
Discount @ 10%	1	0.909	0.826	0.751	0.683	
Present value	2,91,200	2,64,701	2,40,531	2,73,364	2,48,612	13,18,408

Calculation of the adjustment to the lease liability on re-measurement by comparing the recalculated and original lease liability balances on the re-measurement date:

Revised lease liability	13,18,408
Original lease liability	(7,79,417)
Adjustment to the lease liability on re-measurement	5,38,991

Based on above calculations, it is clear that re-measurement of lease is required and accordingly adjustment to lease liability and ROU asset is required in the first quarter of 2021.

Journal entry to adjust the lease liability

ROU Asset	Dr.	5,38,991	
To Lease liability			5,38,991
(Being lease liability and ROU asset adjusted on account of re-measurement)			

Working Notes:

1. Calculation of ROU asset before the date of re-measurement

Year beginning	Lease Payment (A)	Present value factor @ 8% (B)	Present value of lease payments (A x B = C)
1	2,80,000	1.000	2,80,000
2	2,80,000	0.926	2,59,280
3	2,80,000	0.857	2,39,960
4	2,80,000	0.794	2,22,320
5	2,80,000	0.735	2,05,800
6	2,80,000	0.681	1,90,680
Lease liability as at the commencement date			13,98,040



Or

$(2,80,000 \times \text{Sum of PV (4.993) @ 8\% for 5 years} = 13,98,040)$

2. Calculation of Lease Liability and ROU asset at each year end

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 8%	Closing balance	Initial Value	Depreciation for 6 years	Closing balance
	a	b	c = (a-b) x 8%	d = a-b+c			
1	13,98,040	2,80,000	89,443	12,07,483	13,98,040	2,33,007	11,65,033
2	12,07,483	2,80,000	74,199	10,01,682	11,65,033	2,33,007	9,32,026
3	10,01,682	2,80,000	57,735	7,79,417	9,32,026	2,33,007	6,99,019
4	7,79,417				6,99,019		

As per the information given in the third bullet point at page 10, it is inferred that annual lease payments are due at the beginning of the year. Hence, it can be inferred that the annual lease payment of 2021 had been paid on 1.1.2021. Accordingly lease liability considered for the purpose of remeasurement would be of 5 th, 6th, 7th and 8th year only i.e. for 4 years. However, since remeasurement has been decided in the first quarter of 2021, ROU asset balance before remeasurement will be after depreciation of 3 years i.e. till 2020.

Based on the above contention, following alternative solution is also possible:

Since in the first quarter of 2021, Jakob Ltd. is reasonably certain that it will exercise its renewal option, it is required to re-measure the lease in the first quarter of 2021.

The following table summarizes information pertinent to the lease re-measurement:

Re-measured lease term	4 years (2 years remaining in the initial term plus 2 years in the renewal period)
Jakob Ltd.'s incremental borrowing rate on the re-measurement date	10%
CPI available on the re-measurement date	260
Right-of-use asset immediately before the re-measurement	` 6,99,019 (Refer note 2)
Lease liability immediately before the re-measurement	` 5,39,370 (Refer note 2)

Procedure to re-measure the lease liability:

To re-measure the lease liability, Jakob Ltd. would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 10%).

Since the initial lease payments were based on a CPI of 250, the CPI has increased by 4% $\left[\frac{(260-250)}{250} \times 100\right]$. As a result, Jakob Ltd. would increase the future lease payments by 4%.

Computation of present value of the future lease payments based on an updated CPI of 260:

	Year				Total
	5	6	7	8	
Lease payment	2,91,200	2,91,200	3,64,000	3,64,000	13,10,400
Discount @ 10%	1	0.909	0.826	0.751	
Present value	2,91,200	2,64,701	3,00,664	2,73,764	11,30,329

Calculation of the adjustment to the lease liability on re-measurement by comparing the recalculated and original lease liability balances on the re-measurement date:

Revised lease liability	11,30,329



Original lease liability	(5,39,370)
Adjustment to the lease liability on re-measurement	5,90,959

Based on above calculations, it is clear that re-measurement of lease is required and accordingly adjustment to lease liability and ROU asset is required in the first quarter of 2022.

Journal entry to adjust the lease liability

ROU Asset	Dr.	5,90,959	
To Lease liability			5,90,959
(Being lease liability and ROU asset adjusted on account of re-measurement)			

Working Notes:

1. Calculation of ROU asset before the date of re-measurement

Year beginning	Lease Payment (A)	Present value factor @ 8% (B)	Present value of lease payments (A x B = C)
1	2,80,000	1.000	2,80,000
2	2,80,000	0.926	2,59,280
3	2,80,000	0.857	2,39,960
4	2,80,000	0.794	2,22,320
5	2,80,000	0.735	2,05,800
6	2,80,000	0.681	1,90,680
Lease liability as at commencement			13,98,040

Or

(2,80,000 x sum of PV (4.993) @ 8% for 5 years = 13,98,040)

2. Calculation of Lease Liability and ROU asset at each year end

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 8%	Closing balance	Initial Value	Depreciation for 6 years	Closing balance
	a	b	c = (a-b) x 8%	d = a-b+c			
1	13,98,040	2,80,000	89,443	12,07,483	13,98,040	2,33,007	11,65,033
2	12,07,483	2,80,000	74,199	10,01,682	11,65,033	2,33,007	9,32,026
3	10,01,682	2,80,000	57,735	7,79,417	9,32,026	2,33,007	6,99,019
4	7,79,417	2,80,000	39,953	5,39,370	6,99,019		
5	5,39,370						

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question is on accounting for modification of lease term as per Ind AS 116. Some examinees committed mistake in computation of present value of lease liability and ROU asset for initial recognition. Most of the examinees factored the lease payment right from the first year instead of from 4th or 5th year thereby ended up with the wrong solution.

Question 20

Lessee enters into a 10 years lease for 6000 square metres of office space. The annual lease payments are ₹ 1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 8% p.a. At the beginning



of the 6th year, lessee and lessor agree to amend the original lease to reduce the space to only 3,000 square metres of the original space starting from the first quarter of year 6. The annual fixed lease payments (from year 6 to year 10) are ₹ 60,000. Lessee's incremental borrowing rate at the beginning of year 6 is 6% p.a.

You are required to analyse the effect of the said modification and give journal entries for the same in the books of Lessee.

Note: Give your calculation by adopting the present value factor as:

Year	1	2	3	4	5	6	7	8	9	10
8%	0.9259	0.8573	0.7938	0.7350	0.6806	0.6302	0.5835	0.5403	0.5002	0.4632
6%	0.9434	0.8900	0.8396	0.7921	0.7473	0.7050	0.6651	0.6274	0.5919	0.5584

(PYP 8 Marks Nov 22)(Same concept but different figures- MTP 10 Marks Apr'21, Old & New SM)

Answer 20

In the books of Lessee

Calculation of ROU asset and lease liability before modification: (in ₹)

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 8%	Closing balance	Initial Value	Depreciation	Closing balance
	a	b	c = a x 8%	d = a-b + c	e	F	g
1	6,71,000 (Refer W.N.)	1,00,000	53,680	6,24,680	6,71,000	67,100	6,03,900
2	6,24,680	1,00,000	49,974	5,74,654	6,03,900	67,100	5,36,800
3	5,74,654	1,00,000	45,972	5,20,626	5,36,800	67,100	4,69,700
4	5,20,626	1,00,000	41,650	4,62,276	4,69,700	67,100	4,02,600
5	4,62,276	1,00,000	36,982	3,99,258	4,02,600	67,100	3,35,500
6	3,99,258				3,35,500		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on:

- (a) A five-year remaining lease term,
- (b) Annual payments of ₹ 60,000 and
- (c) Lessee's incremental borrowing rate of 6% p.a.

Year	Lease Payment(A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
6	60,000	0.9434	56,604
7	60,000	0.8900	53,400
8	60,000	0.8396	50,376
9	60,000	0.7921	47,526
10	60,000	0.7473	44,838
Total			2,52,744

Alternative manner of above calculation:

Annual lease payments x Sum of PVF from year 6th year to 10th year @ 6% discount rate = ₹ 60,000 x 4.2124 = ₹ 2,52,744



Lessee determines the proportionate decrease in the carrying amount of the ROU Asset on the basis of the remaining ROU Asset (i.e., 3,000 square metres corresponding to 50% of the original ROU Asset). 50% of the pre-modification ROU Asset (₹ 3,35,500) is ₹ 1,67,750. 50% of the pre modification lease liability (₹ 3,99,258) is ₹ 1,99,629.

Consequently, lessee reduces the carrying amount of the ROU Asset by ₹ 1,67,750 and the carrying amount of the lease liability by ₹ 1,99,629 and recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (₹ 1,99,629 – ₹ 1,67,750 = ₹ 31,879) as a gain in profit or loss account at the effective date of the modification (at the beginning of Year 6).

Journal Entry

Particulars	Debit (₹)	Credit (₹)
Lease Liability Dr.	1,99,629	
To ROU Asset		1,67,750
To Profit & Loss		31,879

Lessee recognises the difference between the reduced 50% lease liability of ₹ 1,99,629 and the modified lease liability of ₹ 2,52,744 (which equals ₹ 53,115) as an adjustment to the ROU Asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Journal Entry

Particulars	Debit (₹)	Credit (₹)
ROU Asset Dr.	53,115	
To Lease Liability		53,115

Working Note:

Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment(A)	Present value factor @ 8% (B)	Present value of lease payments (A x B = C)
1	1,00,000	0.9259	92,590
2	1,00,000	0.8573	85,730
3	1,00,000	0.7938	79,380
4	1,00,000	0.7350	73,500
5	1,00,000	0.6806	68,060
6	1,00,000	0.6302	63,020
7	1,00,000	0.5835	58,350
8	1,00,000	0.5403	54,030
9	1,00,000	0.5002	50,020
10	1,00,000	0.4632	46,320
			6,71,000

Alternative manner of above calculation:

Annual lease payments x Sum of PVF from year 1 to 10 @ 8% discount rate

$$= ₹ 1,00,000 \times 6.71 = ₹ 6,71,000$$

Note: It is assumed that even after modification, annual lease payment will continue to be made at the end of the year as mentioned under the original terms of the lease.



Chapter 7.1 Ind AS 41: Agriculture

Question 1

A farmer owned a dairy herd of three years old cattle as at 1 st April, 20X1 with a fair value of Rs. 13,750 and the number of cattle in the herd was 250.

The fair value of three year cattle as at 31st March, 20X2 was Rs. 60 per cattle. The fair value of four year cattle as at 31st March, 20X2 is Rs. 75 per cattle.

Calculate the measurement of group of cattle as at 31st March, 20X2 stating price and physical change separately. (MTP 4 Marks April '21, Old & New SM)

Answer 1

Particulars	Amount (Rs.)
Fair value as at 1st April, 20X1	13,750
Increase due to Price change $[250 \times \{60 - (13,750/250)\}]$	1,250
Increase due to Physical change $[250 \times \{75-60\}]$	3,750
Fair value as at 31st March, 20X2	18,750

Question 2

Entity A purchased cattle at an auction on 30th June 20X1

Purchase price at 30th June 20X1	` 1,00,000
Costs of transporting the cattle back to the entity's farm	` 1,000
Sales price of the cattle at 31st March, 20X2	` 1,10,000

The company would have to incur similar transportation costs if it were to sell the cattle at auction, in addition to an auctioneer's fee of 2% of sales price. The auctioneer charges 2% of the selling price, from both, the buyer as well as the seller.

Calculate the amount at which cattle is to be recognised in books on initial recognition and at year end 31st March, 20X2. (MTP 4 Marks Nov 21, RTP Nov '20, Old & New SM)

Answer 2

Initial recognition of cattle

	`
Fair value less costs to sell ($`1,00,000 - `1,000 - `2,000$)	97,000
Cash outflow ($`1,00,000 + `1,000 + `2,000$)	1,03,000
Loss on initial recognition	6,000
Cattle Measurement at year end	
Fair value less costs to sell ($`1,10,000 - 1,000 - (2\% \times 1,10,000)$)	1,06,800

At 31st March, 20X2, the cattle is measured at fair value of ` 1,09,000 less the estimated auctioneer's fee of ` 2,200). The estimated transportation costs of getting the cattle to the auction of ` 1,000 are deducted from the sales price in determining fair value.

Question 3

Analyze whether the following activities fall within the scope of Ind AS 41 with proper reasoning:

- Managing animal-related recreational activities like Zoo



- Fishing in the ocean
- Fish farming
- Development of living organisms such as cells, bacteria and viruses
- Growing of plants to be used in the production of drugs
- Purchase of 25 dogs for security purpose of the company's premises (MTP 6 Marks Sep'22 & Oct '23, RTP May '21, Old & New SM)

Answer 3

Activity	Whether in the scope of Ind AS 41?	Remarks
Managing animal-related recreational activities like Zoo	No	Since the primary purpose is to show the animals to public for recreational purposes, there is no management of biological transformation but simply control of the number of animals. Hence it will not fall in the purview of considered in the definition of agricultural activity.
Fishing in the ocean	No	Fishing in ocean is harvesting biological assets from unmanaged sources. There is no management of biological transformation since fish grow naturally in the ocean. Hence, it will not fall in the scope of the definition of agricultural activity.
Fish farming	Yes	Managing the growth of fish and then harvest for sale is agricultural activity within the scope of Ind AS 41 since there is Management of biological transformation of biological assets for sale or additional biological assets
Development of living organisms such as cells, bacteria viruses	Analysis required	The development of living organisms for research purposes does not qualify as agricultural activity, as those organisms are not being developed for sale, or for conversion into agricultural produce or into additional biological assets. Hence, development of such organisms for the said purposes does not fall under the scope of Ind AS 41. However, if the organisms are being developed for sale or use in dairy products the activity will be considered as agricultural activity under the scope of Ind AS 41.
Growing of plants to be used in the production of drugs	Yes	If an entity grows plants for using it in production of drugs, the activity will be agricultural activity. Hence it will come under the scope of Ind AS 41.
Purchase of 25 dogs for security purposes of the company's premises.	No	Ind AS 41 is applied to account for the biological assets when they relate to agricultural activity. Guard dogs for security purposes do not qualify as agricultural activity, since they are not being kept for sale, or for conversion into agricultural produce or into additional biological assets. Hence, they are outside the scope of Ind AS 41

Question 4

As at 31st March, 20X1, a plantation consists of 100 Pinus Radiata trees that were planted 10 years earlier. The tree takes 30 years to mature, and will ultimately be processed into building material



for houses or furniture. The enterprise's weighted average cost of capital is 6% p.a.

Only mature trees have established fair values by reference to a quoted price in an active market. The fair value (inclusive of current transport costs to get 100 logs to market) for a mature tree of the same grade as in the plantation is:

As at 31st March, 20X1: 171 As at 31st March, 20X2: 165

Assume that there would be immaterial cash flow between now and point of harvest. The present value factor of Rs. 1 @ 6% for

19th year = 0.331 20th year = 0.312

State the value of such plantation as on 31st March, 20X1 and 20X2 and the gain or loss to be recognized as per Ind AS. (MTP 6 Marks Oct '19, RTP Nov'18)

Answer 4

As at 31st March, 20X1, the mature plantation would have been valued at 17,100 (171 x 100).

As at 31st March, 20X2, the mature plantation would have been valued at 16,500 (165 x 100).

Assuming immaterial cash flow between now and the point of harvest, the fair value (and therefore the amount reported as an asset on the statement of financial position) of the plantation is estimated as follows:

As at 31st March, 20X1: $17,100 \times 0.312 = 5,335.20$. As at 31st March, 20X2: $16,500 \times 0.331 = 5,461.50$.

Gain or loss

The difference in fair value of the plantation between the two-year end dates is 126.30 (5,461.50 – 5,335.20), which will be reported as a gain in the statement of profit or loss (regardless of the fact that it has not yet been realised).

Question 5

ABC Ltd. is in the business of manufacturing an apple beverage and requires large quantity of apples to manufacture such beverage. In order to satisfy its requirement of apples, it enters into 3 years lease contracts with owners of apple orchards. The lease contracts are mainly of two types:

- (1) **Contract 1:** The owner of the apple orchard (i.e. the lessor) raises the apple trees to produce apples. ABC Ltd. (i.e. lessee) makes a fixed annual payment to the owner of the apple orchard who is required to cultivate the produce as per the specifications of ABC Ltd. ABC Ltd. harvests the apples itself for fulfilling its requirement of apples.
- (2) **Contract 2:** ABC Ltd. obtains the apple orchard from owner (i.e. the lessor) to raise the apple trees for subsequent harvest of the apples to ensure that the apples are as per the requirements of ABC Ltd. ABC Ltd. makes a fixed annual payment to the owner of the apple orchards (i.e. the lessor).

Explain whether ABC Ltd. is engaged in agricultural activity as per Ind AS 41 in both of the cases? (RTP Nov'22)

Answer 5

Paragraph 5 of Ind AS 41, Agriculture defines agricultural activity and biological transformation as follows:

"Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets."

"Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset."

Contract 1:

As per contract 1, during the 3 years of the contract, ABC Ltd. only harvests apples from the apple orchards whereas biological transformation is managed by the owners of the apple orchards (i.e. the



lessor). Since ABC Ltd. is not involved in the biological transformation of the apple orchards and is only harvesting biological assets, it cannot be said to be an agricultural activity as per Ind AS 41. Hence, ABC Ltd. is not engaged in agricultural activity as per Ind AS 41.

Contract 2:

As per contract 2, ABC Ltd. obtains the apple orchards and is actively involved in the raising of apple trees in order to ensure that the apples are as per its requirements. Since, it is actively managing the biological transformation and harvest of biological asset, Hence, ABC Ltd. is engaged in agricultural activity as per Ind AS 41.

Question 6

Fisheries Ltd. practices pisciculture in sweet waters (ponds, tanks and dams). The fishing activity of Fisheries Ltd. in such sweet waters consists only of catching the fishes. Comment whether such fishing activity will be covered within the scope of Ind AS 41? (RTP May '23)

Answer 6

Paragraph 5 of Ind AS 41, defines agricultural activity as follows:

“Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.” For fishing to qualify as agricultural activity, it must satisfy both of the below mentioned conditions:

- a) management of biological transformation of a biological asset; and
- b) harvesting of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

Therefore, when fishing involves managed activity to grow and procreate fishes in designated areas, such fishing is an agricultural activity as per the above definition. Managing the growth of fish for subsequent sale is an agricultural activity as per Ind AS 41.

In the aforementioned scenario, only fish harvesting is managed by Fisheries Ltd. Therefore, mere fish harvesting without management of biological transformation cannot be termed as an agricultural activity as per Ind AS 41.

Hence, fishing in sweet waters (pond, tanks and dams) where only fishing (harvesting) is carried out without any management of biological transformation is outside the scope of Ind AS 41.

Question 7

M. Chinnaswamy & Brothers Ltd. is a company that is engaged in growing and maintaining coconut palms and selling their output in various forms. The company has a farmland having 2,00,000 coconut palms in the coastal area of Karnataka near Mangalore.

The fair value of each coconut palm is derived based on the average realisable price of ₹ 30 per nut (fruit). Each coconut palm grows 80 nuts per annum on an average basis. Each coconut palm can generate revenue for as long as 80 years and the current palms are only 20-year-old. The management thinks that considering the risk factors in business, the valuation of each palm can be considered at 5 times its annual revenue.

During August, 20X5, the Ooty Hotels Association (OHA) chairman and his team visited the corporate office of the company at Mangalore. The deal was to supply tender coconuts to Ooty Hotels at an agreed price throughout the year. The agreement came into effect from 1st September, 20X5 whereby the company shall reserve 15,000 coconut palms (out of 2,00,000 coconut palms) for OHA and will charge a concessional rate of ₹ 15 only per nut supplied to OHA. OHA will in turn supply the tender coconuts to each Ooty Hotel at the same price. This contract price is applicable irrespective of the ownership of palm trees (it is not an entity-specific restriction). All tender coconuts of these 15,000 coconut palms were used by OHA irrespective of the agreement being effective from 1st September,



20X5.

What will be the valuation of 2,00,000 coconut palms in the company's farm for the quarter ended 30th September, 20X5? (RTP Nov '23)

Answer 7

Para 16 of Ind AS 41 says that entities often enter into contracts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in measuring fair value, because fair value reflects the current market conditions in which buyers and sellers would enter into a transaction. As a result, the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract.

Moreover, the OHA contract represents just 7.5% $[(15,000 / 2,00,000) \times 100]$ of the total number of palms in the farm. Hence, the contract price can't be considered for fair valuation of the entire inventory of bearer plants.

The valuation in this case would be as follows:

Adding the fair value for 15,000 coconut palm (15,000 palm x 80 nuts x ₹ 15 x 5 times) and 1,85,000 coconut palm (1,85,000 palm x 80 nuts x ₹ 30 x 5 times), we get total valuation of 2,00,000 coconut palm as ₹ 231 crore.

Question 8

On 1st November 2019, Crattle Agro Limited purchased 100 goats of special breed from a market for ₹ 10,00,000 with a transaction cost of 2%. Goats fair value decreased from ₹ 10,00,000 to ₹ 9,00,000 as on 31st March 2020. Determine the fair value on the date of purchase and as on financial year ended 31st March 2020. Also pass relevant journal entries on 1st November 2019 and 31st March 2020. (PYP 4 Marks, Jan'21)

Answer 8

The fair value less cost to sell of goats on the date of purchase i.e. on 1st November, 2019, would be ₹ 9,80,000 (10,00,000-20,000). Expense of ₹ 20,000 would be recognized in profit and loss.

On date of Purchase

Biological Asset	Dr. 9,80,000	
Expense on initial recognition	Dr. 20,000	
To Bank		10,00,000
(Being biological asset purchased)		

On 31st March, 2020 goats would be measured at ₹ 8,82,000 as Biological Asset (9,00,000-18,000) and loss of ₹ 98,000 (9,80,000 - 8,82,000) would be recognized in profit or loss.

At the end of reporting period

Loss – Change in fair value	Dr. 98,000	
To Biological Asset		98,000
(Being change in fair value recognized at the end of reporting period)		

Note: It is assumed that the transaction cost is borne by the seller.

Question 9

A herd of 15, 4-year-old cows valued at 500 thousand per cow were held in 'M Dairy Farm' as at 1st April 2021. The following transactions took place on 1st October, 2021:

- (A) One cow aged 4.5 years was purchased for 520 thousands.
- (B) One calf was born.



No cow was sold or disposed off during the year.

The per cow/calf fair value less cost to sell was as follows:

₹ in thousands

4 year old cow on 1st April 2021	500
New born calf on 1st October 2021	400
4.5 year old cow on 1st October 2021	520
New born calf on 31st March, 2022	410
0.5 year old calf on 31st March, 2022	440
4 year old cow on 31st March, 2022	516
4.5 year old cow on 31st March, 2022	540
5 year old cow on 31st March, 2022	560

You are required to:

- Calculate change in fair value less costs to sell showing:
 - The portion attributable to physical changes
 - The portion attributable to price changes.
- Calculate the carrying cost of the herd as on 31st March, 2022.
- Prepare an extract of the livestock account for the year ended 31st March, 2022. (PYP Marks Nov 22)

Answer 9

- Change in fair value less costs to sell, due to physical change and price change:

₹ in thousand

Fair value less costs to sell of herd at 1st April 2021 (15 × 500)		7,500
Purchase on 1st October 2021 (1 × 520)		520
(a)	Increase in fair value less costs to sell due to price change:	
	15 cows x (516 – 500)	240
	1 cows x (540 – 520)	20
	1 calf x (410 – 400)	10
		270
(b)	Increase in fair value less costs to sell due to physical change:	
	15 cows x (560 – 516)	660
	1 cows x (560 – 540)	20
	1 calf x (440 – 410)	30
	1 calf x 400 (Gain on initial recognition)	400
		1,110
		9,400

- Calculation of carrying cost of herd as on 31st March 2022
i.e. Fair value less costs to sell of herd at 31st March 2022

16 × 560	8,960	
1 × 440	440	9,400

- Extract of Livestock Account for the year 31st March 2022

Particulars	Amount (₹ in 000)	Particulars	Amount (₹ in 000)
To Opening Stock	7500	By Closing Balance	9,400
To Purchases (1x520)	520		



To Increase in fair value (Price Changes)	270		
To Increase in fair value (Physical Changes)	1,110		
Total	9,400	Total	9,400

Question 10

ABC Ltd. is into dairy farm. Cows are milked on a daily basis. After milking, milk is immediately kept in cold storage. The milk is sold to retail distributors on a weekly basis.

On 1st April, 2022, ABC Ltd. had 500 cows which were all 3 years old.

During the financial year 2022-2023, some of the cows became sick and on 30th September, 2022, 20 cows died. On 1st October, 2022, ABC Ltd. purchased 20 replacement cows from the market for ₹ 63,000 each. These 20 cows were all 1-year-old when they were purchased.

On 31st March, 2023, ABC Ltd. had 1,000 litres of milk in cold storage which had not been sold to retail distributors. The market price of milk as at 31st March, 2023 was ₹ 60 per litre. While selling the milk to distributors, ABC Ltd. incurs selling costs of ₹ 3 per litre. These amounts did not change during March, 2023 and are not expected to change during April, 2023.

Information relating to fair value and costs to sell is given below:

Date	Fair value of a dairy cow aged				Cost to sell a cow
	1 year	1.5 year	3 years	4 years	
1.4.2022	60,000	66,000	81,000	75,000	3,000
1.10.2022	63,000	69,000	84,000	78,000	3,000
31.3.2023	64,500	70,500	87,000	79,500	3,300

You can assume that fair value of 3.5 year old cow as on 30th September, 2022 is ₹ 81,000.

Provide necessary journal entries in the books of account with respect to cows for above events & transactions in the financial statements of ABC Ltd. as at-

- 30th September, 2022;
- 1st October, 2022 and
- 31st March, 2023.

Also determine the value of milk inventory as at 31st March, 2023. (PYP 8 Marks May '23)

Answer 10

Journal Entries

(All figures in ₹)

S. No.	Date	Particulars		Dr.	Cr.
(i)	30th September, 2022	Loss (on death of 20 cows) (Refer W.N.)	Dr.	15,60,000	
		To Biological asset (Loss booked on death of 20 cows)			15,60,000
(ii)	1st October, 2022	Biological Asset (purchase of 20 new cows) (Refer W.N.)	Dr.	12,00,000	
		Loss on initial recognition (of 20 new cows)	Dr.	60,000	



		To Bank			12,60,000
(iii)	31st March, 2023	(Initial recognition of 20 new purchased cows at fair value less costs to sell)	Dr.	8,64,000	
		Loss on remeasurement of old cows			
		To Biological asset [(3,90,00,000 – 15,60,000) – 3,65,76,000]			8,64,000
		(Subsequent measurement of cows at fair value less costs to sell)	Dr.	1,44,000	
		Biological Asset (13,44,000 – 12,00,000)			
		To Gain on remeasurement of new cows (Subsequent measurement of cows at fair value less costs to sell)			1,44,000

Inventory (Milk) as at 31st March, 2023 = ₹ 57,000 [1,000 x (60 – 3)]

Working Note:

Calculation of Biological asset at various dates

Date	Number	Age	Fair Value (₹)	Cost to Sell (₹)	Net (₹)	Biological asset (₹)
1st April, 2022	500	3 years	81,000	3,000	78,000	3,90,00,000
30th September, 2022	(20)	3.5 years	81,000	3,000	78,000	(15,60,000)
1st October, 2022	20	1 year	63,000	3,000	60,000	12,00,000 3,86,40,000
31st March, 2023	480	4 years	79,500	3,300	76,200	3,65,76,000
	20	1.5 years	70,500	3,300	67,200	13,44,000 3,79,20,000

Question 11 (Illustration)

Moon Ltd prepares financial statements to 31st March, each year. On 1st April 20X1 the company carried out the following transactions:

-- Purchased a land for ₹ 50 Lakhs.

-- Purchased 200 dairy cows (average age at 1st April, 20X1 is 2 years) for ₹ 10 Lakhs.



- Received a grant of ₹ 1 million towards the acquisition of the cows. This grant was non-refundable.

For the year ending 31st March, 20X2, the company has incurred following costs:

- ₹ 6 Lakh to maintain the condition of the animals (food and protection).
- ₹ 4 Lakh as breeding fee to a local farmer.

On 1st October, 20X1, 100 calves were born. There were no other changes in the number of animals during the year ended 31st March, 20X2. As of 31st March, 20X2, Moon Ltd had 3,000 litres of unsold milk in inventory. The milk was sold shortly after the year end at market prices.

Information regarding fair values is as follows:

Item	Fair Value less cost to sell		
	1st April, 20X1	1st October, 20X1	31st March, 20X2
	₹	₹	₹
Land	50 Lakhs	60 Lakhs	70 Lakhs
New born calves (per calf)	1,000	1,100	1,200
Six month old calves (per calf)	1,100	1,200	1,300
Two year old cows (per cow)	5,000	5,100	5,200
Three year old cows (per cow)	5,200	5,300	5,500
Milk (per litre)	20	22	24

Prepare extracts from the Balance Sheet and Statement of Profit & Loss that would be reflected in the financial statements of the entity for the year ended 31st March, 20X2. (Old & New SM)(Same concept different figures- PYP 9 Marks Jul'21)

Answer 11

Extract from the Statement of Profit & Loss

	WN	Amount
Income		
Change in fair value of purchased dairy cow	WN 2	1,00,000
Government Grant	WN 3	10,00,000
Change in the fair value of newly born calves	WN 4	1,30,000
Fair Value of Milk	WN 5	72,000
Total Income		13,02,000
Expenses		
Maintenance Costs	WN 2	6,00,000
Breeding Fees	WN 2	4,00,000
Total Expense		(10,00,000)
Net Income		3,02,000

Extracts from Balance Sheet

Property, Plant and Equipment:		
Land	WN 1	50,00,000
Biological assets other than bearer plants:		
Dairy Cow	WN 2	11,00,000
Calves	WN 4	1,30,000



Inventory:		62,30,000
Milk	WN 5	72,000
		72,000

Working Notes:

1. **Land:** The purchase of the land is not covered by Ind AS 41. The relevant standard which would apply to this transaction is Ind AS 16. Under this standard the land would initially be recorded at cost and depreciated over its useful economic life. This would usually be considered to be infinite in the case of land and so no depreciation would be appropriate. Under Cost Model no recognition would be made for post-acquisition changes in the value of land. The allowed alternative treatment under Revaluation Model would permit the land to be revalued to market value with the revaluation surplus taken to the other comprehensive income. We have followed the Cost Model.
2. **Dairy Cows:** Under the 'fair value model' laid down in Ind AS 41 the mature cows would be recognised in the Balance Sheet at 31st March, 20X2 at the fair value of $200 \times ₹ 5,500 = ₹ 11,00,000$.

Increase in price change $200 \times (₹ 5,200 - ₹ 5,000) = ₹ 40,000$
Increase in physical change $200 \times (₹ 5,500 - ₹ 5,200) = ₹ 60,000$

The total difference between the fair value of matured herd and its initial cost ($₹ 11,00,000 - ₹ 10,00,000 =$ a gain of $₹ 1,00,000$) would be recognised in the profit and loss along with the maintenance costs and breeding fee of $₹ 6,00,000$ and $₹ 4,00,000$ respectively.
3. **Grant:** Grant relating to agricultural activity is not subject to the normal requirement of Ind AS 20. Under Ind AS 41 such grants are credited to income as soon as they are unconditionally receivable rather than being recognised over the useful economic life of the herd. Therefore, $₹ 10,00,000$ would be credited to income of the company.
4. **Calves:** They are a biological asset and the fair value model is applied. The breeding fees are charged to income and an asset of $100 \times ₹ 1,300 = ₹ 1,30,000$ recognised in the Balance sheet and credited to Profit and loss.
5. **Milk:** This is agricultural produce and initially recognised on the same basis as biological assets. Thus the milk would be valued at $3,000 \times ₹ 24 = ₹ 72,000$. This is regarded as 'cost' for the future application of Ind AS 2 to the unsold milk.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees did not mention fair value model for dairy cows and calves while some of the examinees considered biological assets (cows and calves) in inventory along with milk.



Chapter 7.2

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

Question 1

How will you recognize and present the grants received from the Government in the following cases as per Ind AS 20? A Ltd. received one acre of land to setup a plant in backward area (fair value of land Rs. 12 lakhs and acquired value by Government is Rs. 8 lakhs).

- (i) B Ltd. received an amount of loan for setting up a plant at concessional rate of interest from the Government.
- (ii) D Ltd. received an amount of Rs. 25 lakhs for immediate start-up of a business without any condition.
- (iii) S Ltd. received Rs. 10 lakhs for purchase of machinery costing Rs. 80 lakhs. Useful life of machinery is 10 years. Depreciation on this machinery is to be charged on straight line basis.
- (iv) Government gives a grant of Rs. 25 lakh to U Limited for research and development of medicine for breast cancer, even though similar medicines are available in the market but are expensive. The company is to ensure by developing a manufacturing process over a period of two years so that the cost comes down at least to 50%. (MTP 5 Marks Oct '20) (Certain adjustments similar to PYP Nov'18 & May'19 5 Marks)

Answer 1

- (i) The land and government grant should be recognized by A Ltd. at fair value of Rs. 12,00,000 and this government grant should be presented in the books as deferred income. Alternatively, if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. Land will be shown in the financial statements at Rs. 1)
- (ii) As per para 10A of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', loan at concessional rates of interest is to be measured at fair value and recognized as per Ind AS 109. Value of concession is the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for as Government grant.
- (iii) Rs. 25 lakh has been received by D Ltd. for immediate start-up of business. Since this grant is given to provide immediate financial support to an entity, it should be recognised in the Statement of Profit and Loss immediately with disclosure to ensure that its effect is clearly understood, as per para 21 of Ind AS 20.
- (iv) Rs. 10 lakh should be recognized by S Ltd. as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 1,00,000 [Rs. 10 lakh/10 years] should be credited to profit and loss each year over period of 10 years. Alternatively, if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. The machinery will be recognised at Rs. 70 lakh (Rs. 80 lakh - Rs. 10 lakh). Reduced depreciation will be charged to the Statement of Profit or Loss.
- (v) As per para 12 of Ind AS 20, the entire grant of Rs. 25 lakh should be recognized immediately as deferred income and charged to profit and loss over a period of two years based on the related costs for which the grants are intended to compensate provided that there is reasonable assurance that U Ltd. will comply with the conditions attached to the grant.

Question 2

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



- (i) The first grant relates to the “Clean river project” which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow limited to commence this research as at 31st March, 20X2.
- (ii) The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident about the technical feasibility and financial viability of this new technology which will be available for sale in the market by April 20X3.

In September 20X1, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months’ sales figure prior to the floods, for which the company is required to submit an application form on or before 30th June, 20X2 with necessary figures. The financial statements of Rainbow Limited are to be adopted on 31st May, 20X2, by which date the claim form would not have been filed with the State Government. Suggest the accounting treatment of, if any, for the two grants received and the flood-related compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2. (MTP 6 Marks March ’21, RTP May’20, Old & New SM)

Answer 2

Accounting treatment for:

1. First Grant

The first grant for ‘Clear River Project’ involving research into effects of various chemicals waste from the industrial area in Madhya Pradesh, seems to be unconditional as no details regarding its refund has been mentioned. Even though the research has not been started nor any major steps have been completed by Rainbow Limited to commence the research, yet the grant will be recognised immediately in profit or loss for the year ended 31st March, 20X2. Alternatively, in case, the grant is conditional as to expenditure on research, the grant will be recognised in the books of Rainbow Limited over the years the expenditure is being incurred.

2. Second Grant

The second grant related to commercial development of a new equipment is a grant related to depreciable asset. As per the information given in the question, the equipment will be available for sale in the market from April, 20X3. Hence, by that time, grant relates to the construction of an asset and should be initially recognised as deferred income.

The deferred income should be recognised as income on a systematic and rational basis over the asset’s useful life. The entity should recognise a liability on the balance sheet for the years ending 31st March, 20X2 and 31st March, 20X3. Once the equipment starts being used in the manufacturing process, the deferred grant income of Rs. 100,000 should be recognised over the asset’s useful life to compensate for depreciation costs.

Alternatively, as per Ind AS 20, Rainbow Limited would also be permitted to offset the deferred income of Rs. 100,000 against the cost of the equipment in April, 20X3.

3. For flood related compensation

Rainbow Limited will be able to submit an application form only after 31st May, 20X2 i.e. in the year 20X2-20X3. Although flood happened in September, 20X1 and loss was incurred due to flood related to the year 20X1-20X2, the entity should recognise the income from the government grant in the year when the application form related to it is submitted and approved by the government for compensation.

Since, in the year 20X1-20X2, the application form could not be submitted due to adoption of financials with respect to sales figure before flood occurred, Rainbow Limited should not recognise the grant income as it has not become receivable as on 31st March, 20X2.



Question 3

Entity A is awarded a government grant of Rs. 60,000 receivable over three years (Rs.40,000 in year 1 and Rs.10,000 in each of years 2 and 3), contingent on creating 10 new jobs and maintaining them for three years. The employees are recruited at a total cost of Rs.30,000, and the wage bill for the first year is Rs. 1,00,000, rising by Rs.10,000 in each of the subsequent years. Calculate the grant income and deferred income to be accounted for in the books for year 1, 2 and 3. (MTP 4 Marks Nov 21, RTP Nov 20, Old & New SM)

Answer 3

The income of Rs. 60,000 should be recognised over the three year period to compensate for the related costs.

Calculation of Grant Income and Deferred Income:

Year	Labour Cost	Grant Income		Deferred Income	
	Rs.	Rs.		Rs.	
1	1,30,000	21,667	$60,000 \times (130/360)$	18,333	$(40,000 - 21,667)$
2	1,10,000	18,333	$60,000 \times (110/360)$	10,000	$(50,000 - 21,667 - 18,333)$
3	1,20,000	20,000	$60,000 \times (120/360)$	-	$(60,000 - 21,667 - 18,333 - 20,000)$
	3,60,000	60,000			

Therefore, Grant income to be recognised in Profit & Loss for years 1, 2 and 3 are Rs. 21,667, Rs. 18,333 and Rs. 20,000 respectively.

Amount of grant that has not yet been credited to profit & loss i.e; deferred income is to be reflected in the balance sheet. Hence, deferred income balance as at year end 1, 2 and 3 are Rs. 18,333, Rs. 10,000 and Nil respectively.

Question 4

M Limited had constructed another factory few years ago with the assistance of yet another government grant, 'Innovative Product'. The grant is non-repayable and, following the construction of the factory, cannot be clawed back by the government. There are no further conditions attached to the grant that the Company is required to satisfy. The grant received has been treated as deferred income and is being credited to the income statement over the same period as the factory is being depreciated. Following an adverse change in the demand of the product the factory manufactures, during the year at the reporting date, the directors have concluded that the factory's carrying value is no longer recoverable in full and that a write down for impairment is required. The write down is more than covered by the amortized deferred income balance related to the grant.

Discuss, in the context of Ind AS framework and Ind AS 20, the impairment of the factory for which 'Innovative Product' government grant, has been received. Would your answer be different, if there are further conditions attached to grant beyond construction of factory? (MTP 6 Marks March '22)

Answer 4

Accounting treatment for Government Grant:

Government grants, related to assets, including non-monetary grants at fair value should be presented in the Balance Sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the asset's carrying amount. (Para 24 of Ind AS 20)

Government grants should be recognised as income over the periods in which the entity recognises as expenses the related costs that they are intended to compensate, on a systematic basis. The outcome should be same in the Profit and Loss account statement regardless of whether grants are netted or deferred.



In case the grant had been offset against the acquisition cost of the factory and net carrying value is less than the recoverable amount, there would be no need for an impairment write-down. The Profit and Loss account would be charged with annual depreciation on the net acquisition cost.

Government grant relating to 'Innovative Product':

To match the same result for the grant 'Innovative Product' which has been shown as deferred income and the factory is initially recorded at its cost, it is reasonable to release an amount of deferred income to the Profit and Loss account to compensate for the impairment write-down.

Treatment in case of further conditions attached:

If there are further conditions attached to the grant beyond construction of the factory, it may not be appropriate to release an amount of the deferred income to compensate for the impairment write down. An entity would need to assess those further conditions to determine the amount, if any, of deferred income to release.

Question 5

A Limited is engaged in the manufacturing of certain specialized chemicals. During the manufacturing process, certain wastewater is produced which is released by A Limited in the nearby river. To reduce pollution of the rivers, the state government has introduced a scheme with the following salient features:

- **If a manufacturer installs certain pre-approved wastewater treatment plant, the government will provide an interest free loan equal to 50% of the cost of the plant;**
- **Such loan will be repayable to the government in 5 years from the date of disbursal;**
- **The manufacturer availing the benefit of this scheme must treat the wastewater of its factory using the specified plant before releasing it to the river. If this condition is violated, the entire loan shall become immediately repayable to the government along with a penalty of ₹ 10 lakh.**

Cost of the wastewater treatment plant to be installed to avail the benefit of the scheme is ₹ 50 lakh. A Limited decided to utilise this scheme because, if it were to obtain the similar loan from a bank, it would be available at a market interest rate of 12% per annum. Accordingly, A Limited applied for and obtained the government loan of ₹ 25 lakh on 1st April, 20X1. A Limited purchased and installed the plant such that it became ready for use on the same date.

A Limited has an accounting policy of recognising government grant in relation to depreciable assets in the proportion of depreciation expense. It has determined that the plant will be depreciated over a period of 5 years using straight-line method. In the month of March, 20X3, government officials conducted a surprise audit, and it was found that A Limited was not using the wastewater treatment plant as prescribed. Accordingly, on 31st March, 20X3, the government ordered A Limited to repay the entire loan along with penalty. A Limited repaid the loan with interest and penalty as per the order on 31st March, 20X3.

Measure the amount of government grant as on 1st April, 20X1. Determine the nature of the government grant and its accounting treatment (principally) for the year ended 31 st March, 20X2. Also determine the impact on profit or loss if any, on account of revocation of government grant as on 31st March, 20X3. (MTP 12 Marks Sep'22, RTP May'22)

Answer 5

As per the principles of Ind AS 20 "Accounting for Government Grants and Disclosure of Government Assistance", the benefits of a government loan at a below market rate of interest is treated as a government grant. The loan shall be recognized and measured in accordance with Ind AS 109 "Financial Instruments". The benefit of the below market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with Ind AS 109 and the proceeds received. The benefit is accounted for in accordance with Ind AS 20. As per Ind AS 109, the loan should be initially measured at its fair value.

Initial recognition of grant as on 1st April, 20X1

Fair value of loan = ₹ 25,00,000 x 0.567 (PVF @ 12%, 5th year) = ₹ 14,17,500



A Limited will recognize ₹ 10,82,500 (25,00,000 – 14,17,500) as the government grant and will make the following entry on receipt of loan:

Date	Particulars	Dr. (₹)	Cr. (₹)
1.4.20X1	Bank account Dr.	25,00,000	
	To Deferred Grant Income		10,82,500
	To Loan account		14,17,500
	(Being grant initially recorded at fair value)		

As per para 3 of Ind AS 20, grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets.

As per para 24-27 of Ind AS 20, Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

One method recognises the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.

The other method deducts the grant in calculating the carrying amount of the asset. The grant is recognised in profit or loss over the life of a depreciable asset as a reduced depreciation expense.

A Ltd. has adopted first method of recognising the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset. Here, deferred income is recognised in profit or loss in the proportion in which depreciation expense on the asset is recognised.

Depreciation for the year (20X1-20X2) = ₹ 50,00,000 / 5 years = ₹ 10,00,000

As the loan is to finance a depreciable asset, ₹ 10,82,500 will be recognized in Profit or Loss on the same basis as depreciation.

Since the depreciation is provided on straight line basis by A Limited, it will credit ₹ 2,16,500 (10,82,500 / 5) equally to its statement of profit and loss over the 5 years.

Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
31.3.20X2	Depreciation (Profit or Loss A/c) Dr.	10,00,000	
	To Property, Plant & Equipment		10,00,000
	(Being depreciation provided for the year)		
	Deferred grant income Dr.	2,16,500	
	To Profit or Loss		2,16,500
	(Being deferred income adjusted)		

Impact on profit or loss due to revocation of government grant as on 31st March 20X3

As per para 32 of Ind AS 20, a government grant that becomes repayable shall be accounted for as a change in accounting estimate. Repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment shall be recognised immediately in profit or loss.

Amount payable to Government on account of principal= ₹ 25,00,000
loan

Amount payable to Government on account of penalty = ₹ 10,00,000

Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
31.3.20X3	Deferred grant income Dr.	2,16,500	
	To Profit or Loss		2,16,500
	(Being deferred income adjusted)		



Loan account (W.N.1)	Dr.	17,78,112	
Deferred grant income (W.N.2)	Dr.	6,49,500	
Profit or Loss	Dr.	72,388	
To Government grant payable			25,00,000
(Being refund of government grant)			
Profit or Loss	Dr.	10,00,000	
To Government grant payable			10,00,000
(Being penalty payable to government)			

Therefore, total impact on profit or loss on account of revocation of government grant as on 31st March, 20X3 will be ₹ 10,72,388 (10,00,000 + 72,388). Circumstances giving rise to repayment of a grant related to an asset may require consideration to be given to the possible impairment of the new carrying amount of the asset.

Working Notes:

1. Amortisation Schedule of Loan

Year	Opening balance of Loan	Interest @ 12%	Closing balance of Loan
31.03.20X2	14,17,500	1,70,100	15,87,600
31.03.20X3	15,87,600	1,90,512	17,78,112

2. Deferred Grant Income

Year	Opening balance	Adjustment	Closing balance
31.03.20X2	10,82,500	2,16,500	8,66,000
31.03.20X3	8,66,000	2,16,500	6,49,500

Question 6

A Limited received from the government a loan of Rs.1,00,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be realized. Also state how the grant will be recognized in the statement of profit or loss assuming that the loan is to finance a depreciable asset. (MTP 6 Marks Aug '18) (Similar concept but different figures- Old & New SM)

Answer 6

The fair value of the loan is calculated at Rs. 74,76,656.

Year	Opening Balance	Interest Calculated @ 12%	Interest paid @ 5% on Rs. 1,00,00,000 + principal paid	Closing Balance
(a)	(b)	(c) = (b) x 12%	(d)	(e) = (b) + (c) – (d)
1	74,76,656	8,97,200	5,00,000	78,73,856
2	78,73,856	9,44,862	5,00,000	83,18,718
3	83,18,718	9,98,246	5,00,000	88,16,964
4	88,16,964	10,58,036	5,00,000	93,75,000
5	93,75,000	11,25,000	1,05,00,000	Nil

A Limited will recognise Rs. 25,23,344 (Rs. 1,00,00,000 – Rs. 74,76,656) as the government grant and will make the following entry on receipt of loan:

Bank Account	Dr.	Rs. 1,00,00,000
To Deferred Income		Rs. 25,23,344
To Loan Account		Rs. 74,76,656



Rs. 25,23,344 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognise the related costs (which the grant intends to compensate) as expenses.

If the loan is to finance a depreciable asset, Rs. 25,23,344 will be recognised in profit or loss on the same basis as depreciation.

Question 7

An entity opens a new factory and receives a government grant of ₹ 15,000 in respect of capital equipment costing ₹ 1,00,000. It depreciates all plant and machinery at 20% per annum on straight-line basis. Show the statement of profit and loss and balance sheet extracts in respect of the grant for first year under both the methods as per Ind AS 20. (MTP 6 Marks March '23, Old & New SM)

Answer 7

When grant is treated as deferred income

Statement of profit and loss – An extract

	₹
Depreciation (₹ 1,00,000 x 20%)	(20,000)
Government grant credit (W.N.1)	3,000

Balance Sheet - An extract

		₹
Non-current assets		
Property, plant and equipment	1,00,000	
Less: Accumulated depreciation	(1,00,000 x 20%) (20,000)	80,000
Non-current liabilities		XX
Government grant	[12,000 – 3,000 (current liability)]	9,000
Current liabilities		
Government grant	(15,000 x 20%)	3,000
		XX

Working Note:

Government grant deferred income account

	₹		₹
To Profit or loss	3,000	By Grant cash received	15,000
(15,000 x 20%)			
To Balance c/f	12,000		
	15,000		15,000

When grant is deducted from cost of the asset

Statement of profit and loss – An extract

	₹
Depreciation [(₹ 1,00,000 – 15,000) x 20%]	(17,000)

Balance Sheet – An extract

		₹
Non-current assets		
Property, plant and equipment	(1,00,000-15,000) 85,000	
Less: Accumulated depreciation	(17,000)	68,000

**Question 8**

ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters' contribution have been recognized in capital reserve and treated as part of shareholders' funds in accordance with the provisions of AS 12, Accounting for Government Grants. State whether the accounting treatment of the grants in the nature of promoters' contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance. If not, then what will be the accounting treatment of such grants recognized in capital reserve as per previous GAAP on the date of transition to Ind AS (RTP May 18, Old & New SM)

Answer 8

Paragraph 2 of Ind AS 20, "Accounting for Government Grants and Disclosure of Government Assistance" inter alia states that the Standard does not deal with government participation in the ownership of the entity. Since ABC Ltd. is a Government company, it implies that government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will be shown in the Statement of Profit and Loss. Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101 'First Time Adoption of Ind AS'. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter's contribution directly to shareholders' funds. Where it is concluded that the contributions are in the nature of shareholder contributions and are recognised in capital reserve under previous GAAP, the provisions of paragraph 10 of Ind AS 101 would be applied which states that, which states that except in certain cases, an entity shall in its opening Ind AS Balance Sheet:

- (a) Recognise all assets and liabilities whose recognition is required by Ind AS;
- (b) Not recognise items as assets or liabilities if Ind AS do not permit such recognition;
- (c) Reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and
- (d) Apply Ind AS in measuring all recognised assets and liabilities."

Accordingly, as per the above requirements of paragraph 10(c) in the given case, contributions recognised in the Capital Reserve should be transferred to appropriate category under 'Other Equity' at the date of transition to Ind AS.

Question 9

A Ltd. has been conducting its business activities in backward areas of the country and due to higher operating costs in such regions, it has collectively incurred huge losses in previous years. As per a scheme of government announced in March 20X1, the company will be partially compensated for the losses incurred by it to the extent of ` 10,00,00,000, which will be received in October 20X1. The compensation being paid

by the government meets the definition of government grant as per Ind AS 20. Assume that no other conditions are to be fulfilled by the company to receive the compensation.

When should the grant be recognised in statement of profit and loss? Discuss in light of relevant Ind AS. (RTP Nov '21)

Answer 9

Paragraph 7 of Ind AS 20 states that, Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

- (a) the entity will comply with the conditions attaching to them; and
- (b) the grants will be received.



Further, paragraphs 20 and 22 of Ind AS 20 state as follows:

“A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable”.

“A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised in profit or loss of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood.”

In accordance with the above, in the given case, as at March 20 X1, A Ltd. is entitled to receive government grant in the form of compensation for losses already incurred by it in the previous years. Therefore, even though the compensation will be received in the month of October 20X1, A Ltd. should recognise the compensation receivable by it as a government grant in the profit or loss for the period in which it became receivable, i.e., for the financial year 20X0-20X1 with disclosure to ensure that its effect is clearly understood.

Question 10

A Ltd. received a government grant of 10,00,000 to defray expenses for environmental protection. Expected environmental costs to be incurred is 3,00,000 per annum for the next 5 years. How should A Ltd. present such grant related to income in its financial statements? (RTP May '23, Old & New SM)

Answer 10

As per paragraph 29 of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'. Alternatively, they are deducted in reporting the related expense.

In accordance with the above, presentation of grants related to income under both the methods would be as follows:

Method 1: Credit in the Statement of Profit and Loss

The entity can recognise the grant as income on a straight-line basis i.e., ₹ 2,00,000 per year in the statement of profit and loss either separately or under the head "Other Income".

This method considered on the contention that it would be inappropriate to present income and expense items on a net basis and that separation of the grant from the expense would facilitate comparison with other expenses not affected by a grant.

Method 2: As a deduction in reporting the related expense

Since the grant relates to environmental expenses incurred/to be incurred by the entity, it can present the grant by reducing the grant amount every year from the related expense i.e., environmental expense of 1,00,000 (i.e., net expense ₹ 3,00,000 – ₹ 2,00,000).

This method is considered based on the contention that the expenses might well not have been incurred by the entity if the grant had not been available and presentation of the expense without offsetting the grant might therefore be misleading.

The Standard regards both the methods as acceptable for the presentation of grants related to income. However, method 2 may be more appropriate when the company can relate the grant to a specific expenditure.

The Standard also provides that disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate.



Question 11

An entity opens a new factory and receives at the beginning of the year a government grant of ₹ 15,000 in respect of capital equipment costing ₹ 1,00,000. It depreciates all plant and machinery at 20% p.a. using straight-line method. Assume that there is reasonable assurance that the conditions attached to the grant will be fulfilled.

For year 1, pass the necessary Journal Entries and show the presentation of the effect of this grant in both Balance Sheet and Statement of Profit and Loss under both methods permitted under paragraph 24 of Ind AS 20? (RTP Nov '23)

Answer 11

Paragraph 24 of Ind AS 20 provides that government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

In accordance with the above, journal entries and presentation of grants related to assets under both the methods are as follows:

Method 1: When the deferred income account is set-up with the amount of government grant

(i) Journal Entries

S. No.	Particulars	Nature of Account	Dr./ Cr.	Amount (in ₹)	Amount (in ₹)
(i)	Bank A/c	Balance Sheet (Asset)	Dr.	15,000	15,000
	To Government Grant Deferred Income A/c	Balance Sheet (Liability)	Cr.		
	(Being grant received and deferred income set up)				
(ii)	Government Grant Deferred Income A/c	Balance Sheet (Liability)	Dr.	3,000	3,000
	To Government Grant Income A/c	Income (P/L)	Cr.		
	(Being amortisation of the grant in Profit and loss A/c for the current year)				
(iii)	Depreciation A/c	Expense (P/L)	Dr.	20,000	20,000
	To Accumulated Depreciation A/c	Balance Sheet (Asset)	Cr.		
	(Being depreciation charge of the asset for the current year)				
(iv)	Government Grant Income A/c	Income (P/L)	Dr.	3,000	3,000
	To Profit and Loss A/c	P/L	Cr.		
	(Being transfer of government grant income to profit and loss A/c)				
(v)	Profit and Loss A/c	P/L	Dr.	20,000	20,000
	To Depreciation A/c	Expense (P/L)	Cr.		
	(Being the charge of depreciation transferred to profit and loss A/c)				



(ii) **Presentation in Balance Sheet and Statement of Profit and Loss Extract of Statement of Profit and Loss**

Particulars	Amount (in ₹)
Income	
Government grant (Refer W.N.1)	3,000
Expenses	
Depreciation (1,00,000 x 20%)	(20,000)
Net effect on profit and loss	(17,000)

Presentation in Balance Sheet (Year 1)

Particulars	Amount (in ₹)
Non-current Assets	
Property, Plant and Equipment	
Plant & machinery	1,00,000
Accumulated depreciation (1,00,000 x 20%)	(20,000)
	80,000
Non-current liabilities	
Government grant (Refer W.N.1)	9,000
Current liabilities	
Government grant (Refer W.N.1)	3,000

Working Note 1: Presentation in Balance Sheet as current and non-current liability

Particulars	Amount (in ₹)
Portion to be amortised in next 12 months (15,000 x 20%)	3,000
Portion to be amortised after 12 months	9,000
Total Balance	12,000

Method 2: When the government grant is deducted from the cost of the asset

(I) **Journal Entries**

S. No.	Particulars	Nature of Account		Dr./ Cr.	Amount (in ₹)	Amount (in ₹)
(i)	Bank A/c	Balance (Asset)	Sheet	Dr.	15,000	
	To Government Grant A/c	Balance (Liability)	Sheet	Cr.		15,000
	(Being received) grant					
(ii)	Government A/c	Balance (Liability)	Sheet	Dr.	15,000	
	To Plant & Machinery A/c	Balance (Asset)	Sheet	Cr.		15,000
	(Being cost of asset reduced with grant received)					
(iii)	Depreciation A/c (85,000 x 20%)	Expense (P/L)		Dr.	17,000	



	To Accumulated Depreciation A/c	Balance Sheet (Asset)	Cr.		17,000
	(Being depreciation charge of the asset for the current year)				
(iv)	Profit and Loss A/c	P/L	Dr.	17,000	
	To Depreciation	Expense (P/L)	Cr.		17,000
	(Being the charge of depreciation transferred to the profit and loss A/c)				

(II) Presentation in Balance Sheet and Statement of Profit and Loss Extract of Statement of Profit and Loss (Year 1)

Particulars	Amount (in ₹)
Depreciation (₹ 85,000 x 20%)	(17,000)

Extract of Balance Sheet (Year 1)

Particulars	Amount (in ₹)
Non-current Assets	
Property, Plant and Equipment	
Plant & machinery	
Original cost	1,00,000
Less: Government Grant	(15,000)
Adjusted cost	85,000
Accumulated depreciation	(17,000)
Carrying amount	68,000

Question 12

How will you recognize and present the grants received from the Government in the following cases as per Ind AS 20?

- A Ltd. received one acre of land to setup a plant in backward area (fair value of land Rs. 12 lakh and acquired value by Government is Rs. 8 lakhs).
- B Ltd. received an amount of loan for setting up a plant at concessional rate of interest from the Government.
- D Ltd. received an amount of Rs. 25 lakh for immediate start-up of a business without any condition.
- S Ltd. received Rs. 10 lakh for purchase of machinery costing Rs. 80 lakh. Useful life of machinery is 10 years. Depreciation on this machinery is to be charged on straight line basis.

Government gives a grant of Rs. 25 lakh to U Limited for research and development of medicine for breast cancer, even though similar medicines are available in the market but are expensive. The company is to ensure by developing a manufacturing process over a period of two years so that the cost comes down at least to 50%. (PYP 5 Marks, Nov'18)(Certain adjustments similar to MTP Oct 20 5 Marks, PYP May'19 5 Marks)

Answer 12

- The land and government grant should be recognized by A Ltd. at fair value of Rs. 12,00,000 and this government grant should be presented in the books as deferred income. (As per the Amendment



in IND AS 20, If the company is following the policy of recognizing non-monetary grants at nominal value, the company will not recognize any government grant. Land will be shown in the Financial statements at Re.1

- (ii) As per para 10A of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', loan at concessional rates of interest is to be measured at fair value and recognised as per Ind AS 109. Value of concession is the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for as Government grant.
- (iii) Rs. 25 lakh has been received by D Ltd. for immediate start-up of business. Since this grant is given to provide immediate financial support to an entity, it should be recognised in the Statement of Profit and Loss immediately with disclosure to ensure that its effect is clearly understood, as per para 21 of Ind AS 20.
- (iv) Rs. 10 lakh should be recognized by S Ltd. as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 1,00,000 [Rs. 10 lakh / 10 years] should be credited to profit and loss each year over period of 10 years. (As per the Amendment in IND AS 20, If the company is following the policy of recognizing non-monetary grants at nominal value, the company will not recognize any government grant. The machinery will be recognized at Rs 70 Lakhs (80 lakhs – 10 lakhs). Reduced Depreciation will be charged to the statement of Profit or Loss)
- (v) As per para 12 of Ind AS 20, the entire grant of Rs. 25 lakh should be recognized immediately as deferred income and charged to profit and loss over a period of two years based on the related costs for which the grants are intended to compensate provided that there is reasonable assurance that U Ltd. will comply with the conditions attached to the grant.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A handful of the examinees were no able to explain the presentation of government grants received under various situations.

Question 13

Med quick Ltd. has received the following grants from the Central Government for its newly started pharmaceutical business:

- **Rs. 50 lakh received for immediate start-up of business without any condition.**
- **Rs. 70 lakh received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:**
 - (i) **That drugs should be available to the public at 20% cheaper from current market price and**
 - (ii) **The drugs should be in accordance with quality prescribed by the Govt. Drug Control department.**
- **Three acres of land (fair value: Rs. 20 lakh) received for set up of plant.**
- **Rs. 4 lakh received for purchase of machinery of Rs. 10 lakh. Useful life of machinery is 4 years. Depreciation on this machinery is to be charged on straight-line basis.**

How should Med quick Ltd. recognize the government grants in its books of accounts as per relevant Ind AS? (PYP 4 Marks, May'19) (Similar concept but different figures Old & New SM)

Answer 13

Mediquick Ltd. should recognise the grants in the following manner:

- a. Rs. 50 lakhs have been received for immediate start-up of business. This should be recognised in the Statement of Profit and Loss immediately as there are no conditions attached to the grant.
- b. Rs. 70 lakhs should be recognised in profit or loss on a systematic basis over the periods in which



the entity recognises as expense the related costs for which the grants are intended to compensate. However, for this compliance, there should be reasonable assurance that Mediquick Ltd. complies with the conditions attached to the grant.

- c. Land should be recognised at fair value of Rs. 20 lakhs and government grants should be presented in the balance sheet by setting up the grant as deferred income.

Alternatively, since the land is granted at no cost, it may be presented in the books at nominal value.

- d. Rs. 4 lakhs should be recognised as deferred income and will be transferred to profit and loss account over the useful life of the asset. In this cases, Rs. 1,00,000 [Rs. 4 lakhs/ 4 years] should be credited to profit and loss account each year over the period of 4 years.

Alternatively, Rs. 4,00,000 will be deducted from the cost of the asset and depreciation will be charged at reduced amount of Rs. 6,00,000 (Rs. 10,00,000 – Rs. 4,00,000) i.e. Rs. 1,50,000 each year.

Question 14

Shagun Ltd. received two different grants from State Government as per details below:

- (i) A cash grant of ` 24 lakh was received on 31<sup>st</sup> March, 2020 towards the skill development of employees over a period of 18 months, starting from 1<sup>st</sup> April, 2020. Actual costs of the skill development program in financial year 2020 -2021 was ` 30 lakh and in financial year 2021-2022 was ` 20 lakh.

State, how this grant should be accounted for in the books of account in financial year 2019-2020, 2020-2021 & 2021-2022?

- (ii) A grant of ` 10 lakh receivable over three years (` 5 lakh in financial year 2019-2020, ` 2 lakh in financial year 2020-2021 and ` 3 lakh in financial year 2021-2022), contingent on developing 5 gardens and maintaining them for three years. The gardens are developed in financial year 2019-2020 at a total cost of ` 6 lakh, and the maintenance cost for financial year 2019-2020 is ` 12 lakh, for financial year 2020-2021 is ` 15 lakh and for financial year 2021-2022 is ` 17 lakh.

Calculate the grant income and deferred income to be accounted for in the books for financial years 2019-2020, 2020-2021 & 2021-2022. (PYP 8 Marks May '22)

Answer 14

- (i) At 31st March, 2020 the grant would be recognized as a liability and presented in the balance sheet as a split between current and non-current amounts. ` 16 lakh [(12 months / 18 month) x 24 lakhs] is current and would be recognized in profit and loss for the year ended 31<sup>st</sup> March, 2021. The balance amount of ` 8 lakh will be shown as non-current.

At the end of the year 2020-2021, there would be a current balance of ` 8 lakh (being the non-current balance at the end of year 2019-2020 reclassified as current) in the balance sheet. This would be recognised as profit in the statement of profit and loss for the year ended on 2021-2022.

2022 Balance Sheet (extracts) as at

	31 st March,2020	31 st March,2021	31 st March,2022
Current liabilities			
Deferred income	16 lakh	8 lakh	-
Non-current liabilities			
Deferred income	8 lakh	-	-



Statement of Profit and Loss (extracts) for the year ended

	31 st March, 2021	31 st March, 2022
Method 1 (As per para 29 of Ind AS 20)		
Other Income - Government grant received	16 lakh	8 lakh
Training costs	(30 lakh)	(20 lakh)
Method 2 (Alternative) (As per para 29 of Ind AS 20)		
Training costs (30 lakh – 16 lakh)	14 lakh	
Training costs (20 lakh – 8 lakh)		12 lakh

- (ii) The income of ` 10 lakh should be recognized over the three-year period to compensate for the related costs. Since the receipt of grant is depending on fulfilling the contract, it is assumed that on initial date certainty to fulfil the conditions by the entity could not be established. Hence, the grant is recognized in the books on receipt basis.

Calculation of Grant Income and Deferred Income: (` in lakh)

Year	Maintenance Cost	Grant Income	Grant received during the year	Deferred Income
	a	$b = [(10/50) \times a]$	c	d
2019-2020	18	3.6	5	$(5 - 3.6) 1.4$
2020-2021	15	3.0	2	$[(5 + 2) - (3.6 + 3.0)] 0.4$
2021-2022	17	3.4	3	$[(5 + 2 + 3) - (3.6 + 3.0 + 3.4)] -$
	50	10.0		

Therefore, Grant income to be recognised in Profit & Loss for years 2019 -2020, 2020-2021 and 2021-2022 will be ` 3.6 lakh, ` 3.0 lakh and ` 3.4 lakh respectively.

Amount of grant that has not yet been credited to profit & loss i.e. deferred income will be reflected in the balance sheet. Hence, deferred income balance as at year end 2019-2020, 2020-2021 and 2021-2022 will be ` 1.4 lakh, ` 0.4 lakh and Nil respectively.



Chapter 7.3

Ind AS 102: Share Based Payment

Question 1

Rely Industries issued share-based option to one of its key management personal which can be exercised either in cash or equity and it has following features:

Option I		Period	INR
No of cash settled shares			74,000
Service condition		3 years	
Option II			
No of equity settled shares			90,000
Conditions:			
Service		3 years	
Restriction to sell		2 years	
Fair values			
Equity price with a restriction of sale for 2 years			115
Fair value grant date			135
Fair value as on 31st March	2016		138
	2017		140
	2018		147

Pass the Journal entries? (MTP 15 marks April '18, PYP 6 Marks Nov'22, New & Old SM)

Answer 1.

Fair value of Equity option components:	
Fair value of a share with restrictive clause	Rs. 115
No. of shares	90,000 shares
Fair value (90,000 X 115) A	Rs. 1,03,50,000
Fair value of a share at the date of grant	Rs. 135
No. of cash settled shares	74,000
Fair value (74,000 X 135) B	Rs. 99,90,000
Fair value of equity component in compound instrument (A-B)	Rs. 3,60,000

Journal Entries

31/3/2016		Rs.
Employee benefit expenses Dr.	35,24,000	
To Share based payment reserve (equity) (3,60,000/3)		1,20,000
To Share based payment liability (138 x 74,000) / 3		34,04,000
(Recognition of equity option and cash settlement option)		
31/3/2017		
Employee benefits expenses Dr.	36,22,667	
To Share based payment reserve (equity) (3,60,000/3)		1,20,000
To Share based payment liability (140 x 74,000) 2/3 -34,04,000		35,02,667
(Recognition of equity option and cash settlement option)		



31/3/2018			
Employee benefits expenses	Dr.	40,91,333	
To Share based payment reserve (equity)			1,20,000
(3,60,000/3)			
To Share based payment liability			39,71,333
(147 x 74,000) 3/3 - (34,04,000 + 35,02,667)			
(Recognition of equity option and cash settlement option)			
Upon cash alternative chosen			
Share based payment liability (147 x 74,000) Dr.		1,08,78,000	
To Bank/ Cash			1,08,78,000
(Being settlement made in cash)			
Upon equity alternative chosen			
Share based payment liability (147 x 74,000) Dr.		1,08,78,000	
To Share capital			1,08,78,000
(Being settlement made in equity)			

Question 2

New Age Technology Limited has entered into following Share Based payment transactions:

- On 1st April, 20X1, New Age Technology Limited decided to grant share options to its employees. The scheme was approved by the employees on 30th June, 20X1. New Age Technology Limited determined the fair value of the share options to be the value of the equity shares on 1st April, 20X1.
- On 1st April, 20X1, New Age Technology Limited entered into a contract to purchase IT equipment from Bombay Software Limited and agreed that the contract will be settled by issuing equity instruments of New Age Technology Limited. New Age Technology Limited received the IT equipment on 30th July, 20X1. The share-based payment transaction was measured based on the fair value of 'the equity instruments as on 1 st April, 20X1.
- On 1st April, 20X1, New Age Technology Limited decided to grant the share options to its employees. The scheme was approved by the employees on 30th June, 20X1. The issue of the share options was however subject to the same being approved by the shareholders in a general meeting. The scheme was approved in the general meeting held on 30th September, 20X1. The fair value of the equity instruments for measuring the share- based payment transaction was taken on 30th September, 20X1.

Identify the grant date and measurement date in all the 3 cases of Share based payment transactions entered into by New Age Technology Limited, supported by appropriate rationale for the determination? (MTP 8 Marks April '21 & Mar '23, RTP May 22)

Answer 2.

Ind AS 102 defines grant date and measurement dates as follows:

- Grant date:** The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.
- Measurement date:** The date at which the fair value of the equity instruments granted is measured for the purposes of this Ind AS. For transactions with employees and others providing similar services, the measurement date is grant date. For transactions with parties



other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

Applying the above definitions in the given scenarios following would be the conclusion based on the assumption that the approvals have been received prospectively:

Scenario	Grant date	Measurement date	Base for grant date	Base for measurement date
(i)	30th June, 20X1	30th June, 20X1	The date on which the scheme was approved by the employees	For employees, the measurement date is grant date
(ii)	1st April, 20X1	30th July, 20X1	The date when the entity and the counterparty entered a contract and agreed for settlement by equity instruments	The date when the entity obtains the goods from the counterparty
(iii)	30th September, 20X1	30th September, 20X1	The date when the approval by shareholder was obtained	For employees, the measurement date is grant date

Question 3

A Ltd. grants 100 shares to each of its 500 employees on 1st January 20X1. The employees should remain in service during the vesting period. The shares will vest at the end of the

First year if the company's earnings increase by 12%;

Second year if the company's earnings increase by more than 20% over the two-year period;

Third year if the entity's earnings increase by more than 22% over the three-year period.

The fair value per share at the grant date is INR 122. In 20X1, earnings increased by 10%, and 29 employees left the organization. The company expects that earnings will continue at a similar rate in 20X2 and expects that the shares will vest at the end of the year 20X2. The company also expects that additional 31 employees will leave the organization in the year 20X2 and that 440 employees will receive their shares at the end of the year 20X2. At the end of 20X2, company's earnings increased by 18%. Only 29 employees left the organization during 20X2. Company believes that additional 23 employees will leave in 20X3 and earnings will further increase so that the performance target will be achieved in 20X3. At the end of the year 20X3, only 21 employees have left the organization. The company's earnings increased to desired level and the performance target has been met.

Determine the expense for each year and pass appropriate journal entries as per the relevant Ind AS? (MTP 12 Marks March '18 & April '19, Old & New SM)(Similar concepts but different figures-PYP 8 Marks May'19, Nov'18)

Answer 3

Since the earnings of the entity is non-market related, hence it will not be considered in fair value calculation of the shares given. However, the same will be considered while calculating number of shares to be vested.

Workings:

	20X1	20X2	20X3
Total employees	500	500	500
Employees left (Actual)	(29)	(58)	(79)
Employees expected to leave in the next year	(31)	(23)	-
Year end – No of employees	440	419	421



Shares per employee	100	100	100
Fair value of share at grant date	122	122	122
Vesting period	1/2	2/3	3/3
Expenses-20X1 (Note 1)	26,84,000		
Expenses-20X2 (Note 2)		7,23,867	
Expenses-20X3 (Note 3)			17,28,333

Note 1:

Expenses for 20X1 = No. of employee's x Shares per employee x Fair value of share x Proportionate vesting period

$$= 440 \times 100 \times 122 \times \frac{1}{2}$$

$$= 26,84,000$$

Note 2:

Expenses for 20X2 = (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expenses recognized in year 20X1

$$= (419 \times 100 \times 122 \times \frac{2}{3}) - 26,84,000 = 7,23,867$$

Note 3:

Expenses for 20X3 = (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expenses recognized in year 20X1 and 20X2

$$= (421 \times 100 \times 122 \times \frac{3}{3}) - (26,84,000 + 7,23,867) = 17,28,333.$$

Journal Entries

31-Dec-20X1			
Employee benefits expenses	Dr.	26,84,000	
To Share based payment reserve (equity)			26,84,000
(Equity settled shared based payment expected vesting amount)			
31-Dec-20X2			
Employee benefits expenses	Dr.	7,23,867	
To Share based payment reserve (equity)			7,23,867
(Equity settled shared based payment expected vesting amount)			
31-Dec-20X3			
Employee benefits expenses	Dr.	17,28,333	
To Share based payment reserve (equity)			17,28,333
(Equity settled shared based payment expected vesting amount)			
Share based payment reserve (equity)	Dr	51,36,200	
To Share Capital			51,36,200
(Share capital Issued)			

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees were able to calculate correctly the ESOP expenses as per the vesting years. However, they stumped in the calculation of proportionate expenses to be recognized in the financial years. Hence, the amount in the journal entries also went wrong.



Question 4

Ryder, a public limited company is reviewing certain events which have occurred since its year - end 31st March, 20X4. The financial statements were authorized for issue on 12th May, 20X4. The following events are relevant to the financial statements for the year ended 31st March, 20X4. The company granted share appreciation rights (SARs) to its employees on 1st April, 20X2 based on 10 million shares. At the date the rights are exercised, the SARs provide employees with the right to receive cash equal to the appreciation in the company's share price since the grant date. The rights vested on 31st March, 20X4 and payment was made on schedule on 1st May, 20X4. The FV of the SARs per share at 31st March, 20X3 was ₹ 6, at 31st March, 20X4 was ₹ 8 and at 1st May, 20X4 was ₹ 9. The company has recognized a liability for the SARs as at 31st March, 20X2 based upon Ind AS 102 'Share-based Payments' but the liability was stated at the same amount at 31st March, 20X4.

Discuss the accounting treatment of the above events in the financial statements of the Ryder Group for the year ending 31st March, 20X4 taking into account the implications of events occurring after the reporting period. (MTP 6 Marks Oct 21)

Answer 4

Ind AS 102 'Share-based Payments' requires a company to remeasure the fair value of a liability to pay cash-settled share-based payments at each reporting date and the settlement date until the liability is settled. Share Appreciation rights fall under this category. Hence, the company should recognize a liability of ₹ 80 million (₹ 8 x 10 million) at 31st March, 20X4, the vesting date. The liability recognised at 31st March, 20X4 was in fact based on the share price at the previous year-end and would have been shown at ₹ 6 x ½ x 10 million shares – half the cost as the SARs vest over 2 years. This liability at 31st March, 20X4 has not been changed since the previous year-end by the company. The SARs vest over a two-year period and hence on 31st March, 20X4 there would be a weighting of the eventual cost by 1 year / 2 year. Therefore, an additional liability of ₹ 50 million (30 million + 20 million) should be accounted for in the financial statements at 31st March, 20X4. The SARs would be settled on 1st May, 20X4 at ₹ 90 million (₹ 9 x 10 million). The increase of ₹ 10 million (over and above ₹ 80 million) in the value of the SARs is a non-adjusting event. Hence, the change in the fair value of ₹ 10 million during the year 20X4-20X5 would be charged to profit and loss for the year ended 31st March, 20X5 and not 31st March, 20X4.

Question 5

On 1st April, 20X1, ABC limited gives options to its key management personnel (employees) to take either cash equivalent to 1,000 shares or 1,500 shares. The minimum service requirement is 2 years and shares being taken must be kept for 3 years. (8 Marks Oct 21)

Fair values of the shares are as follows:	₹
Share alternative fair value (with restrictions)	102
Grant date fair value on 1st April, 20X1	113
Fair value on 31st March, 20X2	120
Fair Value on 31st March, 20X3	132
The employees exercise their cash option at the end of 20X2-20X3. Pass the journal entries.	

(MTP 8 Marks Oct 21, Old & New SM)

Answer 5

	1st April, 20X1	31st March, 20X2	31st March, 20X3
	₹	₹	₹
Equity alternative (1,500 x 102)	1,53,000		
Cash alternative (1,000 x 113)	1,13,000		



Equity option (1,53,000-1,13,000)	40,000		
Cash Option (cumulative) (using period end fair value)		(1,000 x 120 x ½) 60,000	1,32,000
Equity Option (cumulative)		(40,000 x ½) 20,000	40,000
Expense for the period			
Equity option		20,000	20,000
Cash Option		60,000	72,000
Total		80,000	92,000

Journal Entries

31 st March, 20X2			₹
Employee benefits expenses	Dr.	80,000	
To Share based payment reserve (equity)*			20,000
To Share based payment liability			60,000
(Recognition of Equity option and cash settlement option)			
31 st March, 20X3			
Employee benefits expenses	Dr.	92,000	
To Share based payment reserve (equity)*			20,000
To Share based payment liability			72,000
(Recognition of Equity option and cash settlement option)			
Share based payment liability	Dr.	1,32,000	
To Bank/ Cash			1,32,000
(Settlement in cash)			

*The equity component recognized (₹ 40,000) shall remain within equity. By electing to receive cash on settlement, the employees forfeited the right to receive equity instruments. However, ABC Limited may transfer the share-based payment reserve within equity, i.e. a transfer from one component of equity to another.

Question 6

A Ltd. had on 1st April, 2015 granted 1,000 share options each to 2,000 employees. The options are due to vest on 31st March, 2018 provided the employee remains in employment till 31st March, 2018. On 1st April, 2015, the Directors of Company estimated that 1,800 employees would qualify for the option on 31st March, 2018. This estimate was amended to 1,850 employees on 31st March, 2016 and further amended to 1,840 employees on 31st March, 2017. On 1st April, 2015, the fair value of an option was Rs. 1.20. The fair value increased to Rs. 1.30 as on 31st March, 2016 but due to challenging business conditions, the fair value declined thereafter. In September 2016, when the fair value of an option was Rs. 0.90, the Directors repriced the option and this caused the fair value to increase to Rs. 1.05. Trading conditions improved in the second half of the year and by 31st March, 2017 the fair value of an option was Rs.1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30th September, 2016 should be spread over the remaining vesting period from 30th September, 2016 to 31st March, 2018. The Company has requested you to suggest the suitable accounting treatment for these transaction as on 31st March, 2017. (MTP 6 Marks Mar'19, Oct'22 RTP Nov'19, Old & New SM)



Answer 6

Paragraph 27 of Ind AS 102 requires the entity to recognise the effects of repricing that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee. If the repricing increases the fair value of the equity instruments granted paragraph B43(a) of Appendix B requires the entity to include the incremental fair value granted (ie the difference between the fair value of the repriced equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted.

If the repricing occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the repricing date until the date when the repriced equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.

Accordingly, the amounts recognized in years 1 and 2 are as follows:

Year	Calculation	Compensation expense for period	Cumulative compensation expense
		Rs.	Rs.
1	$[1,850 \text{ employees} \times 1,000 \text{ options} \times \text{Rs. } 1.20] \times \frac{1}{3}$	7,40,000	7,40,000
2	$(1,840 \text{ employees} \times 1,000 \text{ options} \times [(\text{Rs. } 1.20 \times \frac{2}{3}) + \{(\text{Rs. } 1.05 - 0.90) \times 0.5/1.5\}] - 7,40,000$	8,24,000	15,64,000

Question 7

Georgy Ltd. gave its key management an option to take either 810 equity shares or cash amount equivalent to 650 equity shares on 1st April, 2020. The minimum service requirement is 2 years. If shares are opted then they are to be kept for at least 4 years.

Fair value of the shares	,
Fair value for share alternative (with restrictions)	460
Grant date fair value on 1st April, 2020	480
Fair value on 31st March, 2021	530
Fair value on 31st March, 2022	560

Pass the necessary Journal Entries for the years ended 31st March, 2021 & 2022 if the key management exercises the cash option at the end of 2022. (PYP 6 Marks Dec '21) (Similar Question But Different Figure MTP Aug '18)

Answer 7

	1st April, 2020	31st March, 2021	31st March, 2022
Equity alternative (810 x 460)	3,72,600		
Cash alternative (650 x 480)	3,12,000		
Equity option (3,72,600 – 3,12,000)	60,600		
Cash Option (cumulative) (using period end fair value)		$[(650 \times 530) \times \frac{1}{2}]$ 1,72,250	$[650 \times 560]$ 3,64,000
Equity Option (cumulative)		30,300	60,600
Expense for the period			
Equity option		30,300	30,300
Cash Option		1,72,250	1,91,750
Total		2,02,250	2,22,050



Journal Entries

31st March, 2021			
Employee benefits expenses	Dr.	2,02,250	
To Share based payment reserve (equity)			30,300
To Share based payment liability			1,72,250
(Recognition of Equity option and cash settlement option)			
31st March, 2022			
Employee benefits expenses	Dr.	2,22,050	
To Share based payment reserve (equity)			30,300
To Share based payment liability			1,91,750
(Recognition of Equity option and cash settlement option)			
Share based payment liability	Dr.	3,64,000	
To Bank/ Cash			3,64,000
(Settlement in cash)			

Question 8

ABC Limited granted 500 stock appreciation rights (SAR) each to 80 employees on 1st April, 20X1 with a fair value ₹ 100 each. The terms of the award require the employee to provide service for four years to earn the award. The SARs are expected to be settled in cash and it is expected that 100% of the employees will exercise the option. The fair value of each SAR at each reporting date is as follows:

31st March, 20X2 ₹ 110

31st March, 20X3 ₹ 120

31st March, 20X4 ₹ 115

31st March, 20X5 ₹ 130

Please present the journal entries in the books of ABC Limited over the entire life of the grants. What would be the difference if at the end of the second year of service (i.e. at 31st March, 20X3), ABC Limited modifies the terms of the award to require only three years of total service? Please present with the revised journal entries. Answer on the basis of relevant Ind AS. (MTP 10 Marks March '22) (PYP 8 Marks Nov '19) (Similar concept but different figures RTP Nov'18, Old & New SM)

Answer 8

Number of SARs = 80 Employees x 500 SARs = 40,000 SARs

1. When the term of the awards is 4 years of service

Period	Fair value	To be vested	Cumulative	Expense in proportion to the award earned	Cumulative expenses recognized
	a	b	c = 40,000 x a x b	d = [(c / no. of total years) x years completed] – e of pvs year]	e
1st April, 20X1	100	100%	40,00,000	-	-
31st March, 20X2	110	100%	44,00,000	11,00,000	11,00,000
31st March, 20X3	120	100%	48,00,000	13,00,000	24,00,000



31st March, 20X4	115	100%	46,00,000	10,50,000	34,50,000
31st March, 20X5	130	100%	52,00,000	17,50,000	52,00,000

Journal Entries

31st March, 20X2			
Employee benefits expenses/Profit and Loss A/c	Dr.	11,00,000	11,00,000
To Share based payment liability (Fair value of SARs has been recognised)			
31st March, 20X3			
Employee benefits expenses/Profit and Loss A/c	Dr.	13,00,000	13,00,000
To Share based payment liability (Fair value of SARs has been re-measured)			

31st March, 20X4			
Employee benefits expenses/Profit and Loss A/c	Dr.	10,50,000	10,50,000
To Share based payment liability (Fair value of SARs has been recognized)			
31st March, 20X5			
Employee benefits expenses A/c	Dr.	17,50,000	17,50,000
To Share based payment liability (Fair value of SARs has been recognized)			

2. When the term of the awards is modified to 3 years of service instead of 4 years of service

Period	Fair value	%age of vesting	Cumulative	Expense in proportion to the award earned	Cumulative expenses recognized
	a	b	c = 40,000 x a x b	d = [(c / no. of total years) x years completed] – e of pvs year]	e
1st April, 20X1	100	100%	40,00,000	-	-
31st March, 20X2	110	100%	44,00,000	11,00,000	11,00,000
31st March, 20X3	120	100%	48,00,000	21,00,000	32,00,000
31st March, 20X4	115	100%	46,00,000	14,00,000	46,00,000

Journal Entries

31st March, 20X2			
Employee benefits expenses	Dr.	11,00,000	11,00,000
To Share based payment liability			



(Fair value of SARs has been recognised)		
31st March, 20X3		
Employee benefits expenses	Dr.	21,00,000
To Share based payment liability		21,00,000
(Fair value of SARs has been re-measured)		
31st March, 20X4		
Employee benefits expenses	Dr.	14,00,000
To Share based payment liability		14,00,000
(Fair value of SARs has been recognized)		

Question 9

An entity which follows its financial year as per the calendar year grants 1,000 share appreciation rights (SARs) to each of its 40 management employees as on 1st January 20X5. The SARs provide the employees with the right to receive (at the date when the rights are exercised) cash equal to intrinsic value of the entity's share price. All of the rights vest on 31st December 20X6; and they can be exercised during 20X7 and 20X8. Management estimates that, at grant date, the fair value of each SAR is Rs. 11; and it estimates that 10% of the employees will leave evenly during the two-year period. The fair values of the SARs at each year end are shown below:

Year	Fair value at year end
31 December 20X5	12
31 December 20X6	8
31 December 20X7	13
31 December 20X8	12

10% of employees left before the end of 20X6. On 31st December 20X7 (when the intrinsic value of each SAR was Rs. 10), six employees exercised their options and remaining employees exercised their options at the end of 20X8 (when the intrinsic value of each SAR was equal to the fair value of Rs. 12). How much expense and liability is to be recognized at the end of each year? Also pass Journal entries.(10 Marks MTP May '20, RTP May 20, Old & New SM)

Answer 9

The amount recognized as an expense in each year and as a liability at each year end is as follows:

Year	Expense Rs.	Liability Rs.	Calculation of Liability
31 December 20X5	2,16,000	2,16,000	= 36 x 1,000 x 12 x ½
31 December 20X6	72,000	2,88,000	= 36 x 1,000 x 8
31 December 20X7	1,62,000	3,90,000	= 30 x 1,000 x 13 Expense comprises an increase in the liability of Rs. 102,000 and cash paid to those exercising their SARs of Rs. 60,000 (6 x 1,000 x 10).
31 December 20X8	(30,000)	0	Liability extinguished. Excess liability reversed, because cash paid to those exercising their SARs Rs. 3,60,000 (30 x 1,000 x 12) was less than the opening liability Rs. 3,90,000.

Journal Entries

31 December 20X5			
Employee benefits expenses	Dr.	2,16,000	



To Share based payment liability			2,16,000
(Fair value of the SAR recognized)			
31 December 20X6			
Employee benefits expenses	Dr.	72,000	
To Share based payment liability			72,000
(Fair value of the SAR re-measured)			
31 December 20X7			
Employee benefits expenses	Dr.	1,62,000	
To Share based payment liability			1,62,000
(Fair value of the SAR recognized)			
Share based payment liability	Dr.	60,000	
To Cash			60,000
(Settlement of SAR)			
31 December 20X8			
Share based payment liability	Dr.	30,000	
To Employee benefits expenses			30,000
(Fair value of the SAR recognized)			
Share based payment liability	Dr.	3,60,000	
To Cash			3,60,000
(Settlement of SAR)			

Question 10

A parent grants 200 share options to each of 100 employees of its subsidiary, conditional upon the completion of two years' service with the subsidiary. The fair value of the share options on grant date is Rs. 30 each. At grant date, the subsidiary estimates that 80 percent of the employees will complete the two-year service period. This estimate does not change during the vesting period. At the end of the vesting period, 81 employees complete the required two years of service. The parent does not require the subsidiary to pay for the shares needed to settle the grant of share options.

Pass the necessary journal entries for giving effect to the above arrangement. (RTP May '19, Old & New SM)

Answer 10

As required by paragraph B53 of the Ind AS 102, over the two-year vesting period, the subsidiary measures the services received from the employees in accordance, the requirements applicable to equity-settled share-based payment transactions as given in paragraph 43B. Thus, the subsidiary measures the services received from the employees on the basis of the fair value of the share options at grant date. An increase in equity is recognized as a contribution from the parent in the separate or individual financial statements of the subsidiary.

The journal entries recorded by the subsidiary for each of the two years are as follows:

Year 1		Rs.	Rs.
Remuneration expense	Dr.	2,40,000	
(200 x 100 employees x Rs. 30 x 80% x ½)			
To Equity (Contribution from the parent)			2,40,000
Year 2			
Remuneration expense	Dr.	2,46,000	
[(200 x 81 employees x Rs. 30) – 2,40,000]			



To Equity (Contribution from the parent)		2,46,000

Question 11

Company P is a holding company for company B. A group share-based payment is being organized in which Parent issues its own equity shares to the employees of company B. The details are as below

Number of Employees of Company B	100
Grant date fair value of share	Rs. 87
Number of shares granted to each employee	25
Vesting conditions	Immediately
Face value per share	Rs. 10

Pass the journal entries in the books of company P & company B. (RTP May '21)

Answer 11

Journal Entries in Books of Company P

Particulars	Debit (Rs.)	Credit (Rs.)
Investment in Company B Dr.	2,17,500	
To Equity Share Capital A/c (2,500 shares x Rs. 10)		25,000
To Securities Premium A/c (2,500 shares x Rs. 77)		1,92,500
(Being allotment of 25 shares each to 100 employees of B at fair value of Rs. 87 per share)		

Journal Entries in Books of Company B

Particulars	Debit (Rs.)	Credit (Rs.)
Employee Benefit Expense A/c Dr.	2,17,500	
To Capital Contribution from Parent P		2,17,500
(Being issue of shares by Parent to Employees pursuant to Group Share-based Payment Plan)		

Question 12

The following particulars in respect of stock options granted by a company are available:

No. of Employees covered	400	Nominal Value per share	` 100
No. of options per Employee	60	Exercise price per share	` 125

Shares offered were put in three groups. Group 1 was for 20% of shares offered with vesting period one-year. Group II was for 40% of shares offered with vesting period two- years. Group III was for 40% of shares offered with vesting period three-years. Fair value of option per share on grant date was ` 10 for Group I, ` 12.50 for Group II and ` 14 for Group III.

Position on 1st Year	Position on 2nd Year	Position on 3rd Year
- No. of employees left = 40	- Employees left = 35	- Employees left = 28
- Estimate of employees to leave in Year 2 = 36	- Estimate of employees to leave in Year 3 = 30	- Employees exercising Options in Group III = 295
- Estimate of employees to leave in Year 3 = 34	- Employees exercising Options in Group II = 319	
- Employees exercising Options in Group I = 350		

Options not exercised immediately on vesting, were forfeited. Compute expenses to recognize in



each year and show important accounts in the books of the company. (RTP Nov'22)

Answer 12

Total number of Options per employee = 60

Group I - 20% vesting in Year 1	Group II - 40% vesting in Year 2	Group III - 40% vesting in Yr. 3
= 12 options, Vesting period = 1 Yr.	= 24 options, Vesting period = 2 Yrs.	= 24 options, Vesting period = 3 Yrs.

Computation of Expenses for all the years

Group = No. of Options	Group I = 12 Options	Group II = 24 Options		Group III = 24 Options		
	Year 1	Year 1	Year 2	Year 1	Year 2	Year 3
(a) Employees at year end = [Opening	400 - 40 =	400 - 40 =	360 - 35 =	400 - 40 =	360 - 35 =	325 - 28 =
No. of Employees - Forfeiture]	360	360	325	360	325	297
(b) Expected to leave in future	NA	36	NA	36 + 34 = 70	30	NA
(c) No. of employees eligible (a - b)	360	324	325	290	295	297
(d) Options expected to Vest =	(360 x 12 sh.)	(324 x 24 sh.)	(325 x 24 sh.)	(290 x 24 sh.)	(295 x 24 sh.)	(297 x 24 sh.)
[(c) x No. of Shares]	4,320	7,776	7,800	6,960	7,080	7,128
(e) FV per option=	` 10	` 12.50	` 12.50	` 14	` 14	` 14
(f) Value of Total Options = [d x e]	` 43,200	` 97,200	` 97,500	` 97,440	` 99,120	` 99,792
(g) Total Cumulative Cost of Options	` 43,200	[(f) x 1/2]	[(f) x 2/2]	[(f) x 1/3]	[(f) x 2/3]	[(f) x 3/3]
= [(f) x Completed Yrs/ Total Yrs)		` 48,600	` 97,500	` 32,480	` 66,080	` 99,792
(h) Less: Recognized in last years	0	0	` 48,600	0	` 32,480	` 66,080
(i) Expenses to be recognized	` 43,200	` 48,600	` 48,900	` 32,480	` 33,600	` 33,712
(j) Employees not exercising ESOP	10Employees	325 - 319 = 6 Employees		297 - 295 = 2 Employees		
(k) Total Expenses for- Year 1	` 43,200 (Gr. 1) + ` 48,600 (Gr. 2) + ` 32,480 (Gr. 3) = ` 1,24,280					
Year 2	` 48,900 (Gr. 2) + ` 33,600 (Gr. 3) = ` 82,500					
Year 3	` 33,712 (Gr. 3 only)					

Employees Benefit Expenses A/c			
Year 1			
	`		`
To Share-based Payment Reserve A/c	1,24,280	By Profit and Loss A/c	1,24,280
	1,24,280		1,24,280
Year 2			
To Share-based Payment Reserve A/c	82,500	By Profit and Loss A/c	82,500



	82,500	82,500

Year 3			
To Share-based Payment Reserve A/c	33,712	By Profit and Loss A/c	33,712
	33,712		33,712

Share-based Payment Reserve A/c			
Year 1			
To Retained Earnings [(360 - 350) Emp x 12 Options x ` 10]	1,200	By Employees Benefit Expenses A/c	1,2s4,280
To Share Capital (350 Emp x 12 Options x ` 100)	4,20,000	By Bank A/c (350 Emp x 12 Options x ` 125)	5,25,000
To Securities Premium (350 Emp x 12 Options x ` 35)	1,47,000		
To Balance c/d	81,080		
	6,49,280		6,49,280
Year 2			
To Retained Earnings	1,800	By Balance b/d	81,080
[(325 - 319) Emp x 24 Options x ` 12.50]		By Employees Benefit Expenses A/c	82,500
To Share Capital (319 Emp x 24 Options x ` 100)	7,65,600	By Bank A/c (319 Emp x 24 Options x ` 125)	9,57,000
To Securities Premium	2,87,100		
(319 Emp x 24 Options x ` 37.50)			
To Balance c/d	66,080		
	11,20,580		11,20,580
Year 3			
To Retained Earnings	672	By Balance b/d	66,080
[(297 - 295) Emp x 24 Options x ` 14]		By Employees Benefit Expenses A/c	33,712
To Share Capital (295 Emp x 24 Options x ` 100)	7,08,000	By Bank A/c (295 Emp x 24 Options x ` 125)	8,85,000
To Securities Premium (295 Emp x 24 Options x ` 39)	2,76,120		
	9,84,792		9,84,792

Working Note:

Calculation of Securities Premium			
	Group I	Group II	Group III
	Year 1	Year 2	Year 3
Exercise Price received per share	125.00	125.00	125.00
Value of service received per share, being the FV of the Options	10.00	12.50	14.00
Total Consideration received per share	135.00	137.50	139.00
Less: Nominal Value per share	(100.00)	(100.00)	(100.00)
Securities Premium per share	35.00	37.50	39.00



Question 13

(Includes concepts of Chp 6 Ind AS 101: First-time Adoption of Ind AS & Chp 4.1 Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors)

On 1st April 20X1, Nuogen Ltd. had granted 1,20,000 share options to its employees with the vesting condition being a service condition as follows:

- Vesting date : 31st March 20X2 - 80,000 share options (1-year vesting period since grant date)
- Vesting date : 31st March 20X5 - 40,000 share options (4-year vesting period since grant date)

Each option can be converted into one equity share of Nuogen Ltd. The fair value of the options on grant date, i.e., on 1st April 20X1 was ₹ 20.

Nuogen Ltd. is required to prepare financial statements in Ind AS for the financial year ending 31st March 20X4. The transition date for Ind AS being 1st April 20X2.

The entity has disclosed publicly the fair value of both these equity instruments as determined at the measurement date, as defined in Ind AS 102.

The previous applicable GAAP for the entity was IGAAP (AS) and therein, the entity had not adopted intrinsic method of valuation.

The share options have not been yet exercised by the employees of Nuogen Ltd.

How the share based payment should be reflected in, the books of Nuogen Ltd. as on 31st March 20X4, assuming that the entity has erred by not passing any entry for the aforementioned transactions in the books of Nuogen Ltd. on grant date, i.e. 1st April 20X1? (RTP Nov'22)

Answer 13

For 80,000 share-based options vested before transition date:

Ind AS 101 provides that a first-time adopter is encouraged, but not required, to apply Ind AS 102 on 'Share-based Payment' to equity instruments **that vested before the date of transition to Ind AS**. Hence, Nuogen Ltd. may opt for the exemption given in Ind AS 101 for 80,000 share options vested before the transition date. However, since no earlier accounting was done for these share-based options under previous GAAP too, therefore this led to an error on the transition date, as detected on the reporting date i.e. 31st March, 20X4. Hence, being an error, no exemption could be availed by Nuogen Ltd. on transition date with respect to Ind AS 102.

While preparing the financial statements for the financial year 20X3 -20X4, an error has been discovered which occurred in the year 20X1 -20X2, i.e., for the period which was earlier than earliest prior period presented. The error should be corrected by restating the opening balances of relevant assets and/or liabilities and relevant component of equity for the year 20X2-20X3. This will result in consequential restatement of balances as at 1st April, 20X2 (i.e, opening balance sheet as at 1st April, 20X2).

Accordingly, on retrospective calculation of Share based options with respect to 80,000 options, Nuogen Ltd. will create 'Share based payment reserve (equity)' by ₹ 16,00,000 and correspondingly adjust the same through Retained earnings.

For 40,000 share based options to be vested on 31st March, 20X5:

Since share-based options have not been vested before transition date, no option as per Ind AS 101 is available to Nuogen Ltd. The entity will apply Ind AS 102 retrospectively. However, Nuogen Ltd. did not account for the same at the grant date. This will result in consequential restatement of balances as at 1st April, 20X2 (i.e, opening balance sheet as at 1st April, 20X2). Adjustment is to be made by recognising the 'Share based payment reserve (equity)' and adjusting the retained earnings by ₹ 2,00,000.

Further, expenses for the year ended 31st March, 20X3 and share based payment reserve (equity) as at 31st March, 20X3 were understated because of non-recognition of 'employee benefits expense' and related reserve. To correct the above errors in the annual financial statements for the year ended 31st March, 20X4, the entity should restate the comparative amounts (i.e., those for the year ended



31 st March, 20X3) in the statement of profit and loss. In the given case, 'Share based payment reserve (equity)' would be credited by ` 2,00,000 and 'employee benefits expense' would be debited by ` 2,00,000

For the year ending 31st March, 20X4, 'Share based payment reserve (equity)' would be credited by ` 2,00,000 and 'employee benefits expense' would be debited by ` 2,00,000.

Working Note:

Period	Lot	Proportion	Fair value	Cumulative expenses	Expenses
		a	b	d = b x a	e = d - previous period d
20X1-20X2	1 (1-year vesting period)	1/1	16,00,000	16,00,000	16,00,000
20X1-20X2	2 (4-year vesting period)	1/4	8,00,000	2,00,000	2,00,000
20X2-20X3	2 (4-year vesting period)	2/4	8,00,000	4,00,000	2,00,000
20X3-20X4	2 (4-year vesting period)	3/4	8,00,000	6,00,000	2,00,000

Question 14

Entity A runs a copper-mining business. Entity A has a year-end of 31st March. Dividends declared on the shares accrue to the employees during the three-year period. If the condition is met, the employees will receive the shares together with the dividends that have been declared on those shares during the three years upto 31st March, 20X3.

The entity estimates that on 1st April, 20X0 its shares are valued at ₹ 10 each. The grant date fair amount of each share is ₹ 10.

Entity A prepares annual financial statements for the year ended 31 st March and:

- ♦ on 1st April, 20X0 it estimates that 800 shares will vest;
- ♦ at the end of the first year (31st March, 20X1) it has revised this estimate to 780;
- ♦ at 31st March, 20X2 it has further revised this estimate to 750; and
- ♦ 750 shares vest on 31st March, 20X3 based on the number of employees still employed on that date.

On 1st April, 20X0 as part of a long-term incentive scheme, Entity A provisionally awards its sales employees 1,000 Entity A's shares receivable on 31st March, 20X3. Explain the accounting treatment for the above share-based awards based on satisfaction of the condition that the sales employees must remain in employment until 31st March, 20X3. The requirement to remain in employment is a service condition and would not be reflected in the fair value of the share awards. (RTP May '23)

Answer 14

The grant date fair value amount would be recognized as an expense over the three-year service period adjusted by the number of shares expected to vest. Consequently, for each period, Entity A estimates how many eligible employees are expected to be employed on 31st March, 20X3 and this forms the basis for that adjustment. The journal entries would be:

Year 1 (Year ended 31st March, 20X1)

Employee benefit expenses A/c	Dr. ₹ 2,600
To Share-based payment reserve	₹ 2,600 (To recognize the



receipt of employee services in exchange for shares)

Year 2 (Year ended 31st March, 20X2)

Employee benefit expenses A/c Dr. ₹ 2,400

To Share-based payment reserve ₹ 2,400 (To recognize the receipt of employee services in exchange for shares)

Year 3 (Year ended 31st March, 20X3)

Employee benefit expenses A/c Dr. ₹ 2,500

To Share-based payment reserve ₹ 2,500 (To recognize the receipt of employee services in exchange for shares)

Working Notes:

1. Year 1

780 shares expected to vest x ₹ 10 grant date fair value of each share x 1/3 of vesting period elapsed = ₹ 2,600 recognised in Year 1.

2. Year 2

(750 shares expected to vest x ₹ 10 grant date fair value of each share x 2/3 of vesting period elapsed) less ₹ 2,600 recognised in Year 1 = ₹ 2,400 recognised in Year 2.

3. Year 3

(750 shares x ₹ 10 grant date fair value of each share) less ₹ 5,000 recognised in Years 1 and 2 = ₹ 2,500 recognised in Year 3.

Question 15

ABC Limited issued 20,000 Share Appreciation Rights (SARs) that vest immediately to its employees on 1st April 2015. The SARs will be settled in cash. At that date it is estimated using an option pricing model, that the fair value of a SAR is Rs. 95. SAR can be exercised any time up to 31st March 2018. At the end of 31st March 2016 it is expected that 95% of total employees will exercise the option, 92 % of total employees will exercise the option at the end of next year and finally 89 % will be vested only at the end of the 3rd year. Fair values at the end of each period have been given below:

Fair value of SAR	Rs.
31 st March, 2016	110
31 st March, 2017	107
31 st March, 2018	112

Discuss the applicability of Cash Settled Share based payments under the relevant Ind AS and pass the journal entries. (PYP 10 Marks, May'18)(Similar concept but different figures MTP 6 Marks Oct'18, PYP 5 Marks Nov'20, Old & New SM)

Answer 15

Applicability of cash settled share-based payment transactions

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability.

1. When vesting conditions are attached to the share based payment plans

The recognition of such share based payment plans should be done by recognizing fair value of the liability at the time of goods/ services received and not at the date of grant.

2. When no vesting period / condition is attached or to be fulfilled

Cash settled share based payment can be recognized in full at initial recognition itself.

Until the liability is settled, the entity shall remeasure the fair value of the liability at the end



of each reporting period date and difference in fair value will be charged to profit or loss for the period as employee benefit expenses.

At the date of settlement, the liability is paid in cash based on the fair value on the date of settlement.

Calculation of expenses recognized during the year on account of change in the fair value of SARs

Period	Fair value	To be vested	Cumulative expenses	Expense / (benefit) for the current year
	a	b	c = a x b x 20,000	d = c-of current period – c of previous period
1st April, 2015	95	100%	19,00,000	19,00,000
31st March, 2016	110	95%	20,90,000	1,90,000
31st March, 2017	107	92%	19,68,800	(1,21,200)
31st March, 2018	112	89%	19,93,600	24,800
				19,93,600

Journal Entries

Date				
1st April, 2015	Employee benefits expenses	Dr.	19,00,000	
	To Share based payment liability			19,00,000
	(Fair value of the SAR recognized initially)			
31st March, 2016	Employee benefits expenses	Dr.	1,90,000	
	To Share based payment liability			1,90,000
	(Fair value of the SAR re-measured)			
31st March, 2017	Share based payment liability	Dr.	1,21,200	
	To Employee benefits expenses			1,21,200
	(Fair value of the SAR re-measured & reversed)			
31st March, 2018	Employee benefits expenses	Dr.	24,800	
	To Share based payment liability			24,800
	(Fair value of the SAR premeasured & recognized)			
	Share based payment liability	Dr.	19,93,600	
	To Cash			19,93,600
	(Settlement of SARs in cash)			

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A few of the examinees calculated the annual liability on the basis of 3 years vesting period instead of immediate vesting.

Question 16

On 1st April 2017, Kara Ltd. granted an award of 150 share options to each of its 1,000 employees, on condition of continuous employment with Kara Ltd. for three years and the benefits will then be settled in cash of an equivalent amount of share price. Fair value of each option on the grant date was ₹ 129. Towards the end of 31st March 2018, Kara Ltd.'s share price dropped; so on 1st April 2018 management chose to reduce the exercise price of the options.



At the date of the re-pricing, the fair value of each of the original share options granted was ` 50 and the fair value of each re-priced option was ` 80. Thus, the incremental fair value of each modified option was ` 30. At the date of the award, management estimated that 10% of employees would leave the entity before the end of three years (i.e., 900 awards would vest). During financial year 2018-2019, it became apparent that fewer employees than expected were leaving, so management revised its estimate of the number of leavers to only 5 % (i.e. 950 awards would vest). At the end of 31st March 2020, awards to 930 employees actually vested. Determine the expense for each year and pass appropriate journal entries as per the relevant Ind AS. (PYP 12 Marks, Jan 21)

Answer 16

Note: The first para of the question states that “benefits will then be settled in cash of an equivalent amount of share price.” This implies that the award is cash settled share-based payment. However, the second and third para talks about repricing of the option which arises in case of equity settled share-based payment.

Hence, two alternative solutions have been provided based on the information taking certain assumptions.

1st Alternative based on the assumption that the award is cash settled share-based payment.

In such a situation, the services received against share-based payment plan to be settled in cash are measured at fair value of the liability and the liability continues to be re-measured at every reporting date until it is actually paid off.

There is a vesting condition attached to the share-based payment plans i.e. to remain in service for next 3 years. The recognition of such share-based payment plans should be done by recognizing fair value of the liability at the time of services received and not at the date of grant. The liability so recognized will be fair valued at each reporting date and difference in fair value will be charged to profit or loss for the period.

Calculation of expenses:

For the year ended 31st March 2018

$$= `50 \times 150 \text{ awards} \times 900 \text{ employees} \times (1 \text{ year} / 3 \text{ years of service})$$

$$= `22,50,000$$

For the year ended 31st March 2019

Note: It is assumed that the fair value of `80 each of repriced option continues at the end of the remaining reporting period i.e. 31st March, 2019 and 31st March, 2020

$$= [`80 \times 150 \text{ awards} \times 950 \text{ employees} \times (2 \text{ year} / 3 \text{ years of service}) ] - `22,50,000$$

$$= `7,60,000 - `22,50,000 = `53,50,000$$

For the year ended 31st March 2020

$$= [`80 \times 150 \text{ awards} \times 930 \text{ employees} ] - `22,50,000 - `53,50,000$$

$$= `1,11,60,000 - `22,50,000 - `53,50,000 = `35,60,000$$

Journal Entries

31 st March, 2018			
Employee benefits expenses	Dr.	22,50,000	
To Share based payment liability (Fair value of the liability recognized)			22,50,000
31 st March, 2019			
Employee benefits expenses	Dr.	53,50,000	



To Share based payment liability (Fair value of the liability re-measured)		53,50,000	
31st March, 2020			
Employee benefits expenses Dr.	35,60,000		
To Share based payment liability (Fair value of the liability recognized)		35,60,000	
Share based payment liability Dr.	1,11,60,000		
To Bank (Being liability for awards settled in cash)			1,11,60,000

2nd Alternative based on fair value at the grant date (ignoring the fact that the award has to be settled in cash).

Calculation of expenses:

For the year ended 31st March 2018

$$= [`129 \times 150 \text{ awards} \times 900 \text{ employees} \times (1 \text{ year} / 3 \text{ years of service})]$$

$$= `58,05,000$$

For the year ended 31st March 2019

Ind AS 102 requires the entity to recognize the effects of repricing that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.

If the repricing increases the fair value of the equity instruments granted standard requires the entity to include the incremental fair value granted (ie the difference between the fair value of the repriced equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted.

If the repricing occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the repricing date until the date when the repriced equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period. Accordingly, the amounts recognised are as follows:

Year ended	Calculation	Compensation expense for period	Cumulative compensation expense
31 March, 2018	[` 129 x 150 awards x 900 employees x (1 year / 3 years of service)]	58,05,000	58,05,000
31 March, 2019	[` 129 x 150 awards x 950 employees x (2 year / 3 years of service)] + (80-50) x 150 awards x 950 employees x (1 year / 2 years of service) - 58,05,000	85,87,500	1,43,92,500
31 March, 2020	[(` 129 + 30) x 150 awards x 930 employees] - 1,43,92,500	77,88,000	2,21,80,500

Journal Entries

31st March, 2018			
Employee benefits expenses Dr.	58,05,000		
To Outstanding Share based payment option			58,05,000



(Fair value of the liability recognized)		
31st March, 2019		
Employee benefits expenses Dr.	85,87,500	85,87,500
To Outstanding Share based payment option		
(Fair value of the liability re-measured)		

Question 17

Voya Limited issued 1,000 share options to each of its 200 employees for an exercise price of ₹ 10. The employees are required to stay in employment for next 3 years. The fair value of the option is estimated at ₹ 18.

90% of the employees are expected to vest the option.

The Company faced severe crisis during the 2nd year and it was decided to cancel the scheme with immediate effect. The market price of the share at the date of cancellation was ₹ 15.

The following information is available:

- Fair value of the option at the date of cancellation is ₹ 12.
- The company paid compensation to the employees at the rate of ₹ 13.50. There were only 190 employees in the employment at that time.

You are required to show how cancellation will be recorded in the books of the Company as per relevant Ind AS. (PYP 5 Marks July 21, MTP 6 Marks Apr'23)

Answer 17

(a) (A) Calculation of employee compensation expense

	Year 1	Year 2	
Expected employees to remain in the employment during the vesting period	180	190	
Fair value of option	18	18	
Number of options	1,000	1,000	
Total	32,40,000	34,20,000	
Expense weightage	1/3	2/3	Balance 2/3 rd in full, as it is cancelled
Expense for the year	10,80,000	23,40,000	Remaining amount since cancelled

(B) Cancellation compensation to be charged in the year 2

Cancellation compensation		
Number of employees (A)	190	
Amount agreed to pay (B)	13.50	
Number of options/ employee (C)	1,000	
Compensation amount (A x B x C)		25,65,000
Less: Amount to be deducted from Equity		
Number of employees (D)	190	
Fair value of option (at the date of cancellation) (E)	12	
Number of options / employee (F)	1,000	
Amount to be deducted from Equity (D x E x F)		(22,80,000)
Balance transferred to Profit and Loss		2,85,000



EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A few examinees failed to find out the employee compensation for the second year in which the cancellation of ESOP was proposed. Some of the examinees have mistakenly considered fair value of option as ` 12 instead of ` 18 while some erred in considering number of employees as 180 instead of 190 for year 2 in computation of employee compensation expenses.



Chapter 8.1

Ind AS 19: Employee Benefits

Question 1

RKA Private Ltd is an old company established in 1995. The company started with a very small capital base and today it is one of the leading companies in India in its industry. The company has an annual turnover of Rs. 11,000 crores and planning to get listed in the next year.

The company has a large employee base. The company provided a defined benefit plan to its employees. Following is the information relating to the balances of the fund's assets and liabilities as at 1st April, 20X1 and 31st March, 20X2. Rs. in lacs

Particulars	1st April, 20X1	31st March, 20X2
Present value of benefit obligation	1,400	1,580
Fair value of plan assets	1,140	1,275

For the financial year ended 31st March, 20X2, service cost was Rs. 55 lacs. The company made a contribution of an amount of Rs. 111 lacs to the plan. No benefits were paid during the year.

Consider a discount rate of 8%.

As per Ind AS, you are required to -

- (a) Compute the balance(s) of the company to be included its balance sheet as on 31st March, 20X2 and amounts to be recognized in the statement of profit and loss and other comprehensive income for the year ended 31st March, 20X2.

Give the journal entries in respect of amount(s) to be recognized. (MTP 8 Marks Oct'19 & April '23, Old & New SM) (MTP 12 Marks Oct '23)

Answer 1

- (a) Extract of the Balance Sheet of RKA Private Ltd as at 31st March, 20X2

Rs. in lacs

Closing net defined liability (1,580 – 1,275) lacs 305

Extract of the Statement of Profit or Loss of RKA Private Ltd for the year ended 31st March, 20X2

Particulars	Rs. in lacs
Service cost	55
Net interest (<i>Refer W.N.1</i>)	21
Profit or loss	76
Other comprehensive income:	
Remeasurements (<i>Refer W.N.2</i>)	80
Total	156

- (b) Journal entries in the books of RKA Private Ltd

Particulars	Rs in lacs	Rs in lacs
Profit & Loss Dr.	76	
Other comprehensive income Dr.	80	
To Cash (Contribution)		111
To Net defined benefit liability (<i>Refer WN 3</i>)		45

Working Notes:



1. Computation of Net interest taken to the Statement of Profit or Loss

= Discount rate x Opening net defined benefit liability

= 8% x (1,400 – 1,140) lacs

= 8% x 260 lacs

= 21 lacs (Rounded off to nearest lacs)

2. Computation of Remeasurements

Actuarial gain or loss on defined benefit liability:

Particulars	Rs. in lacs
Opening balance of liability	1,400
Current service cost	55
Interest on opening liability (1,400 x 8%)	112
Actuarial loss (Bal. fig)	13
Closing balance of liability	1,580

Actual return on plan assets:

Particulars	Amount Rs. In lacs
Opening balance of asset	1,140
Cash contribution	111
Actual return (Bal. fig)	24
Closing balance of asset	1,275

Net interest on opening balance of plan asset = Rs. 91 lacs (i.e. Rs. 1,140 lacs x 8%) (Rounded off to nearest lacs)

Hence there is a decrease in plan assets due to remeasurement for which computation is as follows:

Actual Return – Net interest on opening plan asset

= Rs. 24 lacs – Rs. 91 lacs

= Rs. 67 lacs.

Net remeasurement would be computed as follows:

Actuarial loss on liability + Loss on return

= Rs. 13 lacs + Rs. 67 lacs

= Rs. 80 lacs.

Computation of increase/ decrease in net defined benefit liability:

Particulars	₹ in lacs
Opening net liability (₹ 1,400 lacs – ₹ 1,140 lacs)	260
Closing net liability (₹ 1,580 lacs – ₹ 1,275 lacs)	305
Increase in liability	45

Question 2

On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at Rs.20,40,000 and the present value of the defined obligation was Rs.21,25,000. On 31st March, 20X2 the plan received contributions from XYZ Ltd amounting to Rs. 4,25,000 and paid out benefits of Rs. 2,55,000. The current



service cost for the financial year ending 31 March 20X2 is Rs. 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was Rs.23,80,000, and the present value of the defined benefit obligation was Rs.27,20,000. Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehensive income and balance sheet? (MTP 6 Marks May '20 & Oct '20, RTP May '20, PYP 7 Marks May'22, Old & New SM)

Answer 2

Reconciliation of Plan asset and Defined benefit obligations

	Plan Asset Rs.	Defined benefit obligations Rs.
Fair value/present value as at 1 st April 20X1	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250
Current service cost		5,10,000
Contributions received	4,25,000	-
Benefits paid	(2,55,000)	(2,55,000)
Return on gain (assets) (balancing figure)	68,000	-
Actuarial Loss (balancing figure)	-	2,33,750
Closing balance as at March 31,20X2	23,80,000	27,20,000

In the Statement of Profit and loss, the following will be recognized:

Rs.

Current service cost	5,10,000
Net interest on net defined liability (Rs. 1,06,250–Rs. 1,02,000)	4,250

Defined benefit re-measurements recognised in other comprehensive income:

Rs.

Loss on defined benefit obligation	(2,33,75)
Gain on plan assets	68,000
	(1,65,75)

In the Balance sheet, the following will be recognised:

Rs.

Net defined liability (Rs. 27,20,000 – Rs. 23,80,000)	3,40,000

Question 3

Mr. Niranjana is working for InfoTech Ltd. Consider the following particulars:

	Year 20X0-20X1	Year 20X1-20X2
Annual salary	Rs. 30,00,000	Rs. 30,00,000
No. of working days during the year	300 days	300 days
Leave allowed	10 days	10 days
Leave taken	7 days	13 days
Leave unutilized carried forward to next year	3 days	NIL



Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 3 days of 20X0-20X1 in 20X1-20X2.

Infotech Ltd. contends that it will record Rs. 30,00,000 as employee benefits expense in each of the years 20X0-20X1 and 20X1-20X2, stating that the leaves will, in any case, be utilized by 20X1-20X2. Comment on the accounting treatment proposed to be followed by Infotech Ltd. Also pass journal entries for both the years. (MTP 8 Marks April '21, Old & New SM)

Answer 3

Particulars	Year 20X0-20X1	Year 20X1-20X2
Annual Salary	Rs. 30,00,000	Rs. 30,00,000
No. of working days (A)	300 days	300 days
Leaves Allowed	10 days	10 days
Leaves Taken (B)	7 days	13 days
Therefore, No. of days worked (A – B)	293 days	287 days
Expense proposed to be recognized by InfoTech Ltd.	Rs. 30,00,000	Rs. 30,00,000

Based on the evaluation above, Mr. Niranjan has worked for 6 days more (293 days – 287 days) in 20X0-20X1 as compared to 20X1-20X2.

Since he has worked more in 20X0-20X1 as compared to 20X1-20X2, the accrual concept requires that the expenditure to be recognized in 20X0-20X1 should be more as compared to 20X1-20X2.

Thus, if Infotech Ltd. recognizes the same expenditure of Rs. 30,00,000 for each year, it would be in violation of the accrual concept.

The expenditure to be recognized will be as under:

Particulars	Year 20X0-20X1	Year 20X1-20X2
Annual salary (A)	Rs. 30,00,000	Rs. 30,00,000
No. of working days (B)	300 days	300 days
Salary cost per day (A ÷ B)	Rs. 10,000 per day	Rs. 10,000 per day
No. of days worked (from above)	293 days	287 days
Expense to be recognised: In 20X0-20X1:Rs. 30,00,000 + [Rs. 10,000 per day x 3 days (leaves unutilized expected to be utilized subsequently)]	Rs. 30,30,000	
In 20X1-20X2:Rs. 30,00,000 – [Rs. 10,000 per day – 3 days (excess leave utilized in 20X1-20X2)]		Rs. 29,70,000

Journal Entry for 20X0-20X1

Employee Benefits Expense Account	Dr. 30,30,000	
To Bank Account		30,00,000
To Provision for Leave Encashment		30,000

Journal Entry for 20X1-20X2

Employee Benefits Expense Account	Dr.	29,70,000	
Provision for Leave Encashment Account	Dr.	30,000	
To Bank Account			30,00,000

Question 4

An employee Roshan has joined a company XYZ Ltd. in the year 2018. The annual emoluments of Roshan as decided is Rs. 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn annual salary of the employee for each completed year of service if the employee retires



after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.

(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)(MTP 8 Marks Oct '18)

Answer 4

Calculation of Defined Benefit Obligation

Expected last drawn salary = Rs. 14,90,210 x 110% x 110% x 110% x 110% x 110%
= Rs. 24,00,000

Defined Benefit Obligation (DBO) = Rs. 24,00,000 x 25% x 5 = Rs. 30,00,000

Amount of Rs. 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportioned amount of DBO [i.e. Rs. 30,00,000/5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	b	c = b x 8%	d	e = b + c + d
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

Question 5

RS Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid. RS Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at Rs. 18 (10% of Rs. 180).



Calculate the gain from curtailment and liability after curtailment to be recognized in the balance sheet of RS Ltd. on the basis of given information:

- (i) Immediately before the curtailment, gross obligation is estimated at Rs. 6,000 based on current actuarial assumption.
- (ii) The fair value of plan assets on the date is estimated at Rs. 5,100.
- (iii) The unamortized past service cost is Rs. 180.
- (iv) Curtailment reduces the obligation by Rs. 600, which is 10% of the gross obligation. (MTP 6 Marks April '18)

Answer 5

Gain from curtailment is estimated as under:

	Rs.
Reduction in gross obligation	600
Less: Proportion of unamortized past service cost	(18)
Gain from curtailment	582

The liability to be recognized after curtailment in the balance sheet is estimated as under:

	Rs.
Reduced gross obligation (90% of ₹ 6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300
Less: Unamortized past service cost (90% of ₹ 180)	(162)
Liability to be recognized in the balance sheet	138

Question 6

Diamond Pvt. Ltd, has a headcount of around 1,000 employees in the organisation in financial year 2X19-2X20. As per the company's policy, the employees are given 35 days of privilege leave (PL), 15 days of sick leave (SL) and 10 days of casual leave. Out of the total PL and SL, 10 PL and 5 SL can be carried forward to next year. On the basis of past trends, it has been noted that 200 employees will take 5 days of PL and 2 days of SL and 800 employees will avail 10 days of PL and 5 days of SL.

Diamond Pvt. Ltd. has a post-employment benefit plan which is in the nature of defined contribution plan where contribution to the fund amounts to ₹ 200 crores which will fall due within 12 months from the end of the accounting period.

The company has paid ₹ 40 crore to this plan in financial year 2X19-2X20.

What would be the treatment of the short-term compensating absences, profit-sharing plan and the defined contribution plan in the books of Diamond Pvt. Ltd.? (MTP 6 Marks March '22) (PYP 6Marks Nov '20)

Answer 6

- (i) **Treatment of short term compensating absences:** Diamond Pvt. Ltd. will recognize a liability in its books to the extent of 5 days of PL for 200 employees and 10 days of PL for remaining 800 employees and 2 days of SL for 200 employees and 5 days of SL for remaining 800 employees in its books as an unused entitlement that has accumulated in 2X19-2X20 as short-term compensated absences.
- (ii) **Treatment of defined contribution plan:** When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange



for that service. Under Ind AS 19, the amount of ₹ 160 crore (200-40) will be recognised as a liability (accrued expense), after deducting any contribution already paid i.e. ₹ 40 crore (with contribution of ₹ 200 crore to the plan) and an expense in the statement of profit and loss. It can also be seen that the contributions are payable within 12 months from the end of the year in which the employees render the related service; hence, they will not be discounted.

Question 7

On 1st April, 20X1, ABC limited gives options to its key management personnel (employees) to take either cash equivalent to 1,000 shares or 1,500 shares. The minimum service requirement is 2 years and shares being taken must be kept for 3 years.

Fair values of the shares are as follows:	₹
Share alternative fair value (with restrictions)	102
Grant date fair value on 1st April, 20X1	113
Fair value on 31st March, 20X2	120
Fair Value on 31st March, 20X3	132

The employees exercise their cash option at 31st March, 20X3. Pass the journal entries. (MTP 6 Marks March '23)

Answer 7

	1st April, 20X1 ₹	31st March, 20X2 ₹	31st March, 20X3 ₹
Equity alternative (1,500 x 102)	1,53,000		
Cash alternative (1,000 x 113)	1,13,000		
Equity option (1,53,000 – 1,13,000)	40,000		
Cash option (cumulative) (using period end fair value)		(1,000x120 x ½) 60,000	1,32,000
Equity option (cumulative)		(40,000 x ½) 20,000	40,000
Expense for the period			
Equity option		20,000	20,000
Cash Option		60,000	72,000
Total		80,000	92,000

Journal Entries

31st March, 20X2			₹
Employee benefits expenses	Dr.	80,000	
To Share based payment reserve (equity)*			20,000
To Share based payment liability			60,000
(Recognition of Equity option and cash settlement option)			
31st March, 20X3			
Employee benefits expenses	Dr.	92,000	
To Share based payment reserve (equity)*			20,000
To Share based payment liability			72,000
(Recognition of Equity option and cash settlement option)			
Share based payment liability	Dr.	1,32,000	



To Bank/ Cash			1,32,000
(Settlement in cash)			

*The equity component recognized (₹ 40,000) shall remain within equity. By electing to receive cash on settlement, the employees forfeited the right to receive equity instruments. However, ABC Limited may transfer the share based payment reserve within equity, i.e. a transfer from one component of equity to another.

Question 8

An entity which follows its financial year as per the calendar year grants 1,000 share appreciation rights (SARs) to each of its 40 management employees as on 1 st January, 20X5. The SARs provide the employees with the right to receive (at the date when the rights are exercised) cash equal to the appreciation in the entity's share price since the grant date. All of the rights vest on 31st December, 20X6 and they can be exercised during 20X7 and 20X8. Management estimates that, at grant date, the fair value of each SAR is ₹ 11 and it estimates that overall, 10% of the employees will leave during the two-year period. The fair values of the SARs at each year end are shown below:

Year	Fair value at year end
31st December, 20X5	12
31st December, 20X6	8
31st December, 20X7	13
31st December, 20X8	12

10% of employees left before the end of 20X6. On 31st December, 20X7 (when the intrinsic value of each SAR was ₹ 10), six employees exercised their options and the remaining 30 employees exercised their options at the end of 20X8 (when the intrinsic value of each SAR was equal to the fair value of ₹ 12).

How much expense and liability is to be recognized at the end of each year? Pass Journal entries. (10 Marks Sep '23)

Answer 8

The amount recognized as an expense in each year and as a liability at each year-end) is as follows:

Year	Expense (₹)	Liability (₹)	Calculation of Liability
31st December, 20X5	2,16,000	2,16,000	= 36 x 1,000 x 12 x ½
31st December, 20X6	72,000	2,88,000	= 36 x 1,000 x 8
31st December, 20X7	1,62,000*	3,90,000	= 30 x 1,000 x 13
31st December, 20X8	(30,000)**	0	Liability extinguished

* Expense comprises an increase in the liability of ₹ 1,02,000 and cash paid to those exercising their SARs of ₹ 60,000 (6 x 1,000 x 10).

** Difference of opening liability (₹ 3,90,000) and actual liability paid [₹ 3,60,000 (30 x 1,000 x 12)] is recognised to Profit and loss ie ₹ 30,000.

Journal Entries

31st December, 20X5			
Employee benefits expenses	Dr.	2,16,000	2,16,000
To Share-based payment liability			
(Fair value of the SAR recognized)			
31st December, 20X6			
Employee benefits expenses	Dr.	72,000	



To Share-based payment liability			
(Fair value of the SAR re-measured)			72,000
31st December, 20X7			
Employee benefits expenses	Dr.	1,62,000	
To Share-based payment liability			1,62,000
(Fair value of the SAR recognized)			
Share-based payment liability	Dr.	60,000	
To Cash			60,000
(Settlement of SAR)			
31st December, 20X8			
Share-based payment liability	Dr.	30,000	
To Employee benefits expenses			30,000
(Fair value of the SAR recognized)			
Share-based payment liability	Dr.	3,60,000	
To Cash			3,60,000
(Settlement of SAR)			

Note: Last two entries can be combined.

Question 9

ABC Limited operates a defined benefit plan which provides to the employees covered under the plan a pension benefit which is equal to 0.75% final salary for each year of completed service. An employee needs to complete minimum of five years' service for becoming eligible to the benefit. On 1st April, 2015, the entity improves the pension benefit to 1% of final salary for each year of service, including prior years. The present value of the defined benefit obligation is therefore, increased by Rs. 80 million. Given below is the composition of this amount:

Employees with more than 5 years' of service at 1 st April, 2015	Rs. 60 million
Employees with less than 5 years' of service at 1 st April, 2015	Rs. 20 million

The employees in the second category have completed average 2 and half years of service. Hence, they need to complete another two and half year of service until vesting.

Comment on the treatment of Rs. 80 million of the defined benefit obligation in the financial statements both as per AS 15 and Ind AS 19. (RTP May '19)

Answer 9

Under AS 15, a past service cost of Rs. 60 million needs to be recognized immediately, as those benefits are already vested. The remaining Rs. 20 million cost is recognized on a straight line basis over the vesting period, i.e., period to two and half years commencing from 1st April, 2015.

Under Ind AS 19, the entire past service cost of Rs. 80 million needs to be recognized and charged in profit or loss immediately. ABC Ltd. cannot defer any part of this cost.



Question 10

(All numbers in Rs. '000 unless otherwise stated) ABL Ltd. operates a defined retirement benefits plan on behalf of current and former employees. ABL Ltd. receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1st April, 20X1, the actuaries advised that the present value of the defined benefit obligation was Rs. 60,000. On the same date, the fair value of the assets of the defined benefit plan was Rs. 52,000. On 1st April, 20X1, the annual market yield on high quality corporate bonds was 5%. During the year ended 31st March 20X2, ABL Ltd. made contributions of Rs. 7,000 into the plan and the plan paid out benefits of Rs. 4200 to retired members. Assume that both these payments were made on 31st March 20X2. The actuaries advised that the current service cost for the year ended 31st March 20X2 was Rs. 6,200. On 28th February, 20X2, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by Rs. 1500 from that date. During the year ended 31st March, 20X2, ABL Ltd. was in negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by Rs. 8000. Before 31st March, 20X2, ABL Ltd. made payments of Rs. 7500 to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan. On 31st March, 20X2, the actuaries advised that the present value of the defined benefit obligation was Rs. 68,000. On the same date, the fair value of the assets of the defined benefit plan were Rs. 56,000. (RTP Nov '19, Old & New SM, RTP Nov'18)

Answer 10

(All numbers in Rs.'000 unless otherwise stated)

On 31st March 20X2, ABL Ltd. will report a net pension liability in the statement of financial position. The amount of the liability will be Rs. 12,000 (68,000 – 56,000).

For the year ended 31st March 20X2, ABL Ltd. will report the current service cost as an operating cost in the statement of profit or loss. The amount reported will be Rs. 6,200. The same treatment applies to the past service cost of Rs. 1,500.

For the year ended 31st March 20X2, ABL Ltd. will report a finance cost in profit or loss based on the net pension liability at the start of the year of Rs. 8,000 (60,000 – 52,000). The amount of the finance cost will be Rs. 400 (8,000 x 5%).

The redundancy programme represents the partial settlement of the curtailment of a defined benefit obligation. The gain on settlement of Rs. 500 (8,000 – 7,500) will be reported in the statement of profit or loss.

Other movements in the net pension liability will be reported as remeasurement gains or losses in other comprehensive income.

For the year ended 31st March 20X2, the remeasurement loss will be Rs. 3,400 (refer W.N.).

Working Note:

Calculation of remeasurement gain or loss:

Rs. '000

Liability at the start of the year (60,000 – 52,000)	8,000
Current service cost	6,200
Past service cost	1,500
Net finance cost	400
Gain on settlement	(500)
Contributions to plan	(7,000)
Remeasurement loss (balancing figure)	3,400



Liability at the end of the year (68,000 – 56,000)	12,000

Question 11

At 1 April, 20X0, the fair value of the Plan Assets was Rs. 10,00,000. The Plan paid benefits of Rs. 1,90,000 and received contributions of Rs. 4,90,000 on 30 September, 20X0. The company computes the Fair Value of Plan Assets to be Rs. 15,00,000 as on 31 March, 20X1 and the Present Value of the Defined Benefit Obligation to amount to Rs. 14,79,200 on the same date. Actuarial losses on defined benefit obligation were Rs. 6,000.

Compounding happens half-yearly. The normal interest rate for 6 months period is 10%, while the effective interest rate for 12 months period is based on the following data:

At 1 April, 20X0, the company made the following estimates based on market prices at that date:

Particulars	%
Interest and Dividend Income, after tax payable by the fund	9.25
Add: Realized and Unrealized Gains on Plan Assets (after tax)	2.00
Less: Administration Costs	(1.00)
Expected Rate of Return	10.25

Determine actual return and expected return on plan asset. Also compute amount to be recognized in 'Other Comprehensive Income' in this case. (RTP May '21)

Answer 11

Computation of Expected Return on Plan Assets

Particulars	Rs.
Return on Rs. 10,00,000 for 20X0-20X1 at 10.25% = Rs. 10,00,000 x 10.25%	1,02,500
Return on Rs. 3,00,000 for 6 months at 10% Normal Rate = [3,00,000 (Inflow Rs. 4,90,000 less Payments Rs. 1,90,000) x 10% x 6/12]	15,000
Expected Return on Plan Assets	1,17,500

Computation of Actual Return on Plan Assets

Particulars	Rs.
Fair Value of Plan Assets at the year-end – 31 March 20X1	15,00,000
Less: Fair Value of Plan Assets at the beginning – 1 April 20X0	(10,00,000)
Less: Contributions received during the year 20X0-20X1	(4,90,000)
Add: Benefits paid during the year 20X0-20X1	1,90,000
Actual Return on Plan Assets	2,00,000

Computation of Net Actuarial Gain

Particulars	Rs.
Actual Return on Plan Assets	2,00,000
Less: Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
Less: Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	76,500

Question 12

From the following particulars, compute the net defined benefit liability and expense to be recognized in Profit and Loss account.
(₹ in lakhs)

Particulars	Defined benefit obligation		Plan Assets	
	31st Dec. 20X2	31st Dec. 20X1	31st Dec. 20X2	31st Dec. 20X1
Balance at the beginning of the year	63.25	47.08	21.80	14.65
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Changes in demographic assumptions	0.62	1.86	-	-
Changes in financial assumptions	3.58	1.93	-	-
Experience variance	(2.49)	4.46	-	-
Benefits paid	-	(0.61)	-	(0.61)
Investment income	-	-	1.47	1.12
Employers' contribution	-	-	8.00	7.00
Return on plan assets	-	-	2.12	(0.35)

(RTP May '23)

Answer 12

Computation of defined benefit liability and expenses to be charged to Statement of Profit and Loss:

	Defined benefit obligation (₹ in lakhs)		Plan Assets (₹ in lakhs)	
	31st Dec 20X2	31st Dec 20X1	31st Dec 20X2	31st Dec 20X1
Balance at the beginning of year	63.25	47.08	21.80*	14.65
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Changes in demographic assumptions	0.62	1.86	-	-
Changes in financial assumptions	3.58	1.93	-	-
Experience variance	(2.49)	4.46	-	-
Benefits paid	-	(0.61)	-	(0.61)
Investment income	-	-	1.47	1.12
Employers' contribution	-	-	8.00	7.00
Return on plan assets	-	-	2.12	(0.35)
Balance at the end of year	75.07	63.25	33.39	21.81*

In the BALANCE SHEET, the following will be recognised:

Net defined liability to be recognised for the period ending 31 st December, 20X1:

= ₹ 41.44 lakhs (₹ 63.25 lakhs - ₹ 21.81 lakhs)

Net defined liability to be recognised for the period ending 31st December, 20X2:

= ₹ 41.68 lakhs (₹ 75.07 lakhs - ₹ 33.39 lakhs)



In the **STATEMENT OF PROFIT AND LOSS**, the following will be recognised:

	Defined benefit obligation (₹ in lakhs)		Plan Assets (₹ in lakhs)	
	31st Dec., 20X2	31st Dec., 20X1	31st Dec., 20X2	31st Dec., 20X1
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Investment income	-	-	(1.47)	(1.12)
Total	10.11	8.53	(1.47)	(1.12)

Expense to be recognised in the Statement of Profit and Loss for the period ending 31st December, 20X1 = ₹ 7.41 lakhs (₹ 8.53 lakhs - ₹ 1.12 lakhs)

Expense to be recognised in the Statement of Profit and Loss for the period ending 31st December, 20X2 = ₹ 8.64 lakhs (₹ 10.11 lakhs - ₹ 1.47 lakhs).

Question 13

Arunachalam Ltd. operates a **Defined Retirement Benefits Plan** for its current and former employees. Given the large size of the company, it engaged a firm of **Actuaries** for advice on the **Contribution Levels** and overall **Liabilities** of the Plan to pay benefits. Following details are given:

- On 1st April, 20X1, the actuarial valuation of the present value of the defined benefit obligation was ₹ 15 crores. On the same date, the fair value of the assets of the Defined Benefit Plan was ₹ 13 crores. On 1st April, 20X1, the annual market yield based on Government Bonds was 5%.
- During the year ended 31st March, 20X2, Arunachalam made contributions of ₹ 1.75 crore into the Plan and the Plan paid out benefits of ₹ 1.05 crore to retired members. Assume that both these payments were made on 31st March, 20X2.
- The Actuarial Firm estimated that the current service cost for the year ended 31st March, 20X2 would be ₹ 1.55 crores. On 28th February, 20X2, the rules of the Plan were amended with retrospective effect which led to an increase in the present value of the defined benefit obligation by ₹ 37.5 lakhs from that date.
- During the year ended 31st March, 20X2, Arunachalam was in negotiation with employee representatives regarding planned redundancies. These negotiations were completed shortly before the year end and the redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by ₹ 2 crores. Before 31st March, 20X2, Arunachalam made payments of ₹ 1.875 crores to the employees affected by the redundancies in compensation for a curtailment of their benefits. These payments were made out of the assets of the Retirement Benefits Plan.
- On 31st March, 20X2, the present value of the defined benefit obligation was ₹ 17 crores and the fair value of the assets of the Defined Benefit Plan was ₹ 14 crores.

Discuss how the above will be accounted in the books of Arunachalam Ltd. for the year 20X1-20X2. Also give the extracts of financial statements affected due to above transactions. (RTP Nov '23)

Answer 13

1. Extract of Balance Sheet (Net Amount in the Balance Sheet)

	(₹ in lakhs)	
	31.3.20X2	1.4.20X1
PV of Defined Benefit Obligation (given)	(1,700.00)	(1,500.00)
FV of Plan Assets (given)	1,400.00	1,300.00

Net Defined Benefit Liability (under Long-term Provision)	(300.00)	(200.00)

2. Extract of Statement of Profit and Loss

	(₹ in lakhs)
Current service cost (given)	155.00
Past service cost (given)	37.50
Gain on settlement (₹ 200 lakhs – ₹ 187.50 lakhs)	(12.50)
Net interest on net defined benefit liability [₹ 75 lakhs - ₹ 65 lakhs]	10.00
Total to Statement of Profit and Loss	190.00

3. Extract of Other Comprehensive Income (Remeasurements)

	(₹ in lakhs)
Actuarial loss on defined benefit obligation (W.N.1)	(237.50)
Return on plan assets other than expected return (W.N.2)	152.50
Total	(85.00)

Working Notes:

1. Defined Benefit Obligation Account

2. Plan Assets Account

Particulars	₹ in lakhs	Particulars	₹ in lakhs
To Balance b/f (given) [balance as on 1.4.20X1]	1,300.00	By Defined Benefit Obligation [benefits paid]	105.00
To Expected Return [5% on Opening balance]	65.00	By Payments on curtailment and settlement	187.50
To Bank (contributions paid)	175.00	By Balance c/d (given) [balance as on 31.3.20X2]	1,400.00
To Actuarial Gain (balancing figure)	152.50		
	1,692.50		1,692.50

The above Defined Benefit Obligation Account and Plan Assets Account can alternatively be presented in a statement form as follows:

Defined Benefit Obligation		Plan Assets	
Particulars	₹ in lakhs	Particulars	₹ in lakhs
PV of Obligation b/f.	1,500.00	FV of Plan Assets b/f.	1,300.00
Interest Cost [₹ 1,500 x 5%]	75.00	Interest Income [₹ 1,300 x 5%]	65.00



Current Service Cost	155.00	Contribution during 20X1-20X2	175.00
Benefits paid during 20X1-20X2	(105.00)	Benefits paid during 20X1-20X2	(105.00)
Plan Curtailment and Settlement	(200.00)	Payment towards settlement	(187.50)
Past Service Cost	37.50		
Remeasurement Loss (balancing figure)	237.50	Remeasurement Gain (balancing figure)	152.50
PV of Obligation c/f.	1,700.00	FV of Plan Assets c/f.	1,400.00

Question 14

On 1st January, 20X2, the directors of Johansen Ltd. decided to terminate production at one of the company's divisions. This decision was publicly announced on 31st January, 20X2. The activities of the division were gradually reduced from 1st April, 20X2 and closure is expected to be complete by 30th September, 20X2.

At 31st January, 20X2, the directors prepared the following estimates of the financial implications of the closure:

- Redundancy costs were initially estimated at ₹ 2 million. Further expenditure of ₹ 8,00,000 will be necessary to retrain employees who will be affected by the closure but remained with Johansen Ltd. in different divisions. This retraining will begin in early July 20X2. Latest estimates are that redundancy costs will be ₹ 1.9 million, with retraining costs of ₹ 8,50,000.
- Plant and equipment having an expected carrying value at 31 st March, 20X2 of ₹ 8 million will have a recoverable amount ₹ 1.5 million. These estimates remain valid.
- The division is under contract to supply goods to a customer for the next three years at a pre-determined price. It will be necessary to pay compensation of ₹ 6,00,000 to this customer. The compensation actually paid, on 31st May, 20X2, was ₹ 5,50,000.
- The division will make operating losses of ₹ 3,00,000 per month in the first three months of 20X2-20X3 and ₹ 2,00,000 per month in the next three months of 20X2-20X3. This estimate proved accurate for April, 20X2 and May, 20X2.
- The division operates from a leasehold premise. The lease is a non-cancellable operating lease with an unexpired term of five years from 31 st March, 20X2. The annual lease rentals (payable on 31st March in arrears) are ₹ 1.5 million. The landlord is not prepared to discuss an early termination payment.

Following the closure of the division it is estimated that Johansen Ltd. would be able to sub-let the property from 1st October, 20X2.

Johansen Ltd. could expect to receive a rental of ₹ 3,00,000 for the six-month period from 1st October, 20X2 to 31st March, 20X3 and then annual rentals of ₹ 5,00,000 for each period ending 31st March, 20X4 to 31st March, 20X7. All rentals will be received in arrears.

Any discounting calculations should be performed using a discount rate of 5% per annum. You are given the following data for discounting at 5% per annum:

Present value of ₹ 1 received at the end of year 1 = ₹ 0.95

Present value of ₹ 1 received at the end of year 1–2 inclusive = ₹ 1.86



Present value of ₹ 1 received at the end of year 1–3 inclusive = ₹ 2.72

Present value of ₹ 1 received at the end of year 1–4 inclusive = ₹ 3.54

Present value of ₹ 1 received at the end of year 1–5 inclusive = ₹ 4.32

Compute the amounts that will be included in the Statement of Profit and Loss for the year ended 31st March, 20X2 in respect of the decision to close the division of Johansen Ltd. (RTP Nov '23)

Answer 14

As per Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', closure of a division is a restructuring exercise. Ind AS 37 states that a constructive obligation to proceed with the restructuring arises when at the reporting date the entity has:

- Commenced activities connected with the restructuring; or
- Made a public announcement of the main features of the restructuring to those affected by it. In this case a public announcement has been made and so a provision will be necessary at 31st March, 20X2.

This will result in the following charges to the Statement of Profit and Loss:

(i) Estimate of redundancy costs of ₹ 1.9 million is the best estimate of the expenditure at the date the financial statements are authorized for issue. Changes in estimates after the reporting date are taken into account for this purpose as an adjusting event after the reporting date. No charge is necessary for the retraining costs as these are not incurred in 20X1-20X2 and cannot form part of a restructuring provision as they are related to the ongoing activities of the entity.

(ii) Impairment of plant and equipment of ₹ 6.5 million is although not strictly part of the restructuring provision the decision to restructure before the year-end means that related assets need to be reviewed for impairment. In this case the recoverable amount of the plant and equipment is only ₹ 1.5 million. As per Ind AS 36 'Impairment of Assets', property, plant and equipment should be written down to this amount, resulting in a charge of ₹ 6.5 million to the income statement.

(iii) For compensation for breach of contract of ₹ 0.55 million, same principle applies here as applied to the redundancy costs.

(iv) No charge is recognized in 20X1-20X2 with respect to future operating losses of 20X2-20X3. Future operating losses relate to future events and provisions are made only for the consequences of past events.

(v) Ind AS 37 states that an onerous contract is one for which the expected cost of fulfilling the contract exceeds the benefits expected from the contract. Provision is made for the lower of the expected net cost of fulfilling the contract and the cost of early termination (not available in this case).

The net cost of fulfilling the contract is ₹ 4.51 million [$₹ 1.5 \text{ million} \times 4.32 - ₹ 0.3 \text{ million} \times 0.95 - ₹ 0.5 \text{ million} \times (4.32 - 0.95)$].

Question 15

In 2017-18, Diana Ltd. has around 3,000 employees in the company. As per the company policy, the employees are given 30 days of Privilege Leave (PL), 12 days of Sick Leave (SL) and 12 days of Casual Leave. Out of the total PL and SL, 10 PL and 5 SL can be carried forward to next year. On the basis of past trends, it has been noted that 1,000 employees will take 5 days of PL and 2 days of SL and 2,000 employees will avail 10 as PL and 5 as SL. Also the company has been incurring profits since incorporation. It has been decided in 2017-18 to distribute profits to its employees @ 8% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Diana Ltd. is to be around 7%. The profits earned during 2017-18 is Rs. 12,000 lakh.

Diana Ltd. also has a post-employment benefit plan available which is in the nature of defined contribution plan where contribution to this fund amounts to Rs. 500 lakh which will fall due within



12 months from the end of accounting period. The company has paid Rs. 120 lakh to its employees in 2017-18.

What is the treatment for the short-term compensating absences, profit-sharing plan and the defined contribution plan by Diana Ltd. as per the provisions of relevant Ind AS? (PYP 5 Marks, May '19)(Same concepts but different figures- Old & New SM)

Answer 15

- (i) **For short term compensating expenses:** Diana. Ltd. will recognise a liability in its books to the extent of 5 days of PL for 1,000 employees and 10 days of PL for remaining 2,000 employees and 2 days of SL for 1,000 employees and 5 days of SL for remaining 2,000 employees in its books as an unused entitlement that has accumulated in 2017-2018.
- (ii) **For profit sharing plan:** Diana. Ltd. will recognise Rs. 840 lakh (12,000 x 7%) as a liability and expense it in books of accounts.
- (iii) **For defined contribution plan:** When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service:
 - (a) Under Ind AS 19, the amount of Rs. 380 lakh (500-120) may be recognised as a liability (accrued expense), after deducting contribution already paid. However,

if the contribution already paid would have exceeded the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense); and
 - (b) Also, Rs. 380 lakh will be recognized as an expense in this case study which will be disclosed as an expense in the statement of profit and loss.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Examinees failed to provide the correct treatment of accumulated short term compensating expenses, treatment of profit sharing plan and treatment of defined contribution plan. They have not deducted the contribution already paid by the entity

Chapter 8.2

Ind AS 37: Provisions, Contingent Liabilities and Contingent Assets

Question 1

During the year, QA Ltd. delivered manufactured products to customer K. The products were faulty and on 1st October, 2016 customer K commenced legal action against the Company claiming damages in respect of losses due to the supply of faulty product. Upon investigating the matter, QA Ltd. discovered that the products were faulty due to defective raw material procured from supplier F. Therefore, on 1st December, 2016, the Company commenced legal action against F claiming damages in respect of the supply of defective raw materials.

QA Ltd. has estimated that it's probability of success of both legal actions, the action of K against QA Ltd. and action of QA Ltd. against F, is very high.

On 1st October, 2016, QA Ltd. has estimated that the damages it would have to pay K would be Rs. 5 crores. This estimate was revised to Rs. 5.2 crores as on 31st March, 2017 and Rs. 5.25 crores as at 15th May, 2017. This case was eventually settled on 1st June, 2017, when the Company paid damages of Rs. 5.3 crores to K.

On 1st December, 2016, QA Ltd. had estimated that it would receive damages of Rs. 3.5 crores from F. This estimate was revised to Rs. 3.6 crores as at 31st March, 2017 and Rs. 3.7 crores as on 15th May, 2017. This case was eventually settled on 1st June, 2017 when F paid Rs. 3.75 crores to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31st March, 2017, provided Rs. 3.6 crores as the financial statements were approved by the Board of Directors on 26th April, 2017.

- (i) Whether the Company is required to make provision for the claim from customer K as per applicable Ind AS? If yes, please give the rationale for the same.
- (ii) If the answer to (a) above is yes, what is the entry to be passed in the books of account as on 31st March, 2017? Give brief reasoning for your choice.

(A)	Statement of Profit and Loss A/c Dr.	Rs. 5.2 crores	Rs. 5.2 crores
	To Current Liability A/c		Rs. 5.2 crores
(B)	Statement of Profit and Loss A/c Dr.	Rs. 5.3 crores	
	To Non-Current Liability A/c		Rs. 5.3 crores
(C)	Statement of Profit and Loss A/c Dr.	Rs. 5.25 crores	
	To Current Liability A/c		Rs. 5.25 crores

- (iii) What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable Ind AS? (MTP 6 Marks Mar '19)

Answer 1

- (i) Yes, QA Ltd. is required to make provision for the claim from customer K as per Ind AS 37 since the claim is a present obligation as a result of delivery of faulty goods manufactured. Also, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations. Further, a reliable estimate of Rs. 5.2 crore can be made of the amount of the obligation while preparing the financial statements as on 31st March, 2017.
- (ii) Option (A) : Statement of Profit and Loss A/c Dr. Rs. 5.2 crore
- To Current Liability A/c Rs. 5.2 crore
- (iii) As per para 31 of Ind AS 37, QA Ltd. shall not recognise a contingent asset. Here the probability of success of legal action is very high but there is no concrete evidence which makes the inflow virtually certain. Hence, it will be considered as contingent asset only and shall not be recognized.

Question 2

An entity engaged in automobile sector has assessed the impact of COVID-19 outbreak on its future viability of business model. Senior Management has identified the need for restructuring some of its business activities and retrenching its employees in many areas. Senior Management is drawing up a plan for the consideration of the Board of Directors in their meeting scheduled in May 2020, which is subsequent to the reporting date of the current financial year i.e. 31 March 2020. Can the entity recognise provisions for restructuring costs in the financial statements of the current year i.e. 2019-2020? (MTP 4 Marks Oct '20)

Answer 2

In accordance with paragraph 72 of Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', a constructive obligation to restructure arises only when an entity has detailed formal plan for restructuring identifying the business or part of business concerned; the principal locations affected; the location, function, and approximate number of employees who will be compensated for terminating their services; the expenditures that will be undertaken; and when the plan will be implemented; and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Further, paragraph 75 of Ind AS 37 provides that a management or board decision to restructure taken before the end of the reporting period does not give rise to a constructive obligation at the end of the reporting period unless the entity has, before the end of the reporting period.

- (a) started to implement the restructuring plan; or
- (b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

In the given case, since COVID-19 pandemic impact started during March 2020, it is likely that the senior management started drawing up the plan for restructuring some of its business activities after the end of the reporting period, i.e., 2019-2020. If that be so, as per Ind AS 37, the management decisions subsequent to reporting date do not give rise to constructive obligation as of reporting date and no provision is required for restructuring costs as at 31 March 2020.

In this regard, paragraph 75 of Ind AS 37 provides that if an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting period, disclosure is required under Ind AS 10, Events after the Reporting Period, if the restructuring is material and non-disclosure could influence the economic decisions that users make on the basis of the financial statements.

Question 3

G Ltd. operates oil exploration and production facilities. It is preparing its transition date opening balance sheet as per Ind AS.

There is a significant decommissioning obligation in connection with several oil wells, but it's previous GAAP did not require the obligation to be recognized.

Discuss the treatment of decommissioning obligation as per relevant Ind AS. (MTP 4 Marks March '22)

Answer 3

De-commissioning Obligation of G Ltd. and recognition of decommissioning cost:

Retrospective application of Ind AS 37 requires management to recognise the provision for decommissioning cost on the opening Ind AS Balance Sheet. The provision should reflect the net present value of the management's best estimate of the amount required to settle the obligation.

Accounting Treatment:

The obligation should be capitalised as a separate component of property, plant and equipment, together with the accumulated depreciation from the date when the obligation was incurred to the transition date. The amount to be capitalised as part of the cost of the asset is calculated by discounting



the liability back to the date when the obligation initially arose, using the best estimate of historical discount rate. The associated accumulated depreciation is calculated by applying the current estimate of the asset's useful life, using the entity's depreciation policy for the asset.

Any difference between the provision and the related component of the property, plant and equipment is adjusted against the retained earnings.

The entity could elect to apply the deemed cost exemption. Property, plant and equipment would be restated to fair value, with the corresponding adjustment to the retained earnings. Management would need to ensure that the fair value obtained was the gross fair value and not net of the decommissioning obligation. Management would recognise the provision for decommissioning costs in accordance with Ind AS 37. No cost in respect of provision should be added to property, plant and equipment but such cost should be recognised in the entity's opening retained earnings.

Question 4

Entity XYZ entered into a contract to supply 1000 television sets for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non-performance of the contract is expected to be ₹ 0.25 million. Is the contract onerous and how much provision in this regard is required? (MTP 5 Marks March '23, RTP May'20, Old & New SM)

Answer 4

Ind AS 37 "Provisions, Contingent Liabilities and Contingent Assets" defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Paragraph 68 of Ind AS 37 states that the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

In the instant case, cost of fulfilling the contract is ₹ 0.5 million (₹ 2.5 million – ₹ 2 million) and cost of exiting from the contract by paying penalty is ₹ 0.25 million.

In accordance with the above reproduced paragraph, it is an onerous contract as cost of meeting the contract exceeds the economic benefits.

Therefore, the provision should be recognised at the best estimate of the unavoidable cost, which is lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it, i.e., at ₹ 0.25 million (lower of ₹ 0.25 million and ₹ 0.5 million).

Question 5

U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 2018 as per the notified Ind AS. The financial statements are due to be authorized for issue on 15th May 2018. It is seeking your assistance for some transactions that have taken place in some of its subsidiaries during the year.

G Ltd. is a wholly owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January 2018, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April 2018. They made a public announcement of their decision on 15th February 2018.

G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 2018. U Ltd. would collect any amounts still owed by G Ltd's customers after 31st May 2018. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.:

- **On the date of public announcement, it is estimated by G Ltd. that it would have to pay 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be Rs. 60 lakhs. The actual termination payments totalling to Rs. 520 lakhs were made in full on 15th May 2018. As per latest estimates made on 15th May 2018, the**

total relocation cost is Rs. 63 lakhs.

- G Ltd. had taken a property on operating lease, which was expiring on 31st March 2022. The present value of the future lease rentals (using an appropriate discount rate) is Rs. 430 lakhs. On 15th May 2018, G Ltd. made a payment to the lessor of Rs. 410 lakhs in return for early termination of the lease.

The loss after tax of G Ltd. for the year ended 31st March 2018 was Rs. 400 lakhs. G Ltd. made further operating losses totalling Rs. 60 lakhs till 30th April 2018.

How should U Ltd. present the decision to discontinue the business of G Ltd. in its consolidated statement of comprehensive income as per Ind AS?

What are the provisions that the Company is required to make as per Ind AS 37? (RTP Nov'18, Old & New SM)

Answer 5

A discontinued operation is one that is discontinued in the period or classified as held for sale at the year end. The operations of G Ltd were discontinued on 30th April 2018 and therefore, would be treated as discontinued operation for the year ending 31st March 2019. It does not meet the criteria for held for sale since the company is terminating its business and does not hold these for sale.

Accordingly, the results of G Ltd will be included on a line-by-line basis in the consolidated statement of comprehensive income as part of the profit from continuing operations of U Ltd for the year ending 31st March 2018.

As per para 72 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', restructuring includes sale or termination of a line of business. A constructive obligation to restructure arises when:

- an entity has a detailed formal plan for the restructuring
- has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

The Board of directors of U Ltd have decided to terminate the operations of G Ltd. from 30th April 2018. They have made a formal announcement on 15th February 2018, thus creating a valid expectation that the termination will be implemented. This creates a constructive obligation on the company and requires provisions for restructuring.

A restructuring provision includes only the direct expenditures arising from the restructuring that are necessarily entailed by the restructuring and are not associated with the ongoing activities of the entity.

The termination payments fulfil the above condition. As per Ind AS 10 'Events after Reporting Date', events that provide additional evidence of conditions existing at the reporting date should be reflected in the financial statements. Therefore, the company should make a provision for Rs. 520 lakhs in this respect.

The relocation costs relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Hence, these would be recognised on the same basis as if they arose independently of a restructuring.

The operating lease would be regarded as an onerous contract. A provision would be made at the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. Hence, a provision shall be made for Rs. 410 lakhs.

Further operating losses relate to future events and do not form a part of the closure provision.

Therefore, the total provision required = Rs. 520 lakhs + Rs. 410 lakhs = Rs. 930 lakhs

Note:

Various issues related to the applicability of Ind AS / implementation under Companies (Indian Accounting Standards) Rules, 2015, are being raised by preparers, users and other stakeholders. Although many clarifications have been issued by way of ITFG Bulletins or EAC Opinion, still issues are arising on account of varying interpretations on several of its guidance. Therefore, alternate answers may be possible for the above questions based on standards, depending upon the view taken.

Question 6

- (a) A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to remedy, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. As this is the first year that the warranty has been available, there is no data from the firm to indicate whether there will be claim under the warranties. However, industry research suggests that it is likely that such claims will be forthcoming.

Should the manufacturer recognize a provision in accordance with the requirements of Ind AS 37. Why or why not?

- (b) Assume that the firm has not been operating its warranty for five years, and reliable data exists to suggest the following:
- If minor defects occur in all products sold, repair costs of Rs. 20,00,000 would result.
 - If major defects are detected in all products, costs of Rs. 50,00,000 would result.
 - The manufacturer's past experience and future expectations indicate that each year 80% of the goods sold will have no defects. 15% of the goods sold will have minor defects, and 5% of the goods sold will have major defects.

Calculate the expected value of the cost of repairs in accordance with the requirements of Ind AS 37, if any. Ignore both income tax and the effect of discounting. (RTP Nov 19)

Answer 6

- (a) For a provision to be recognized, Para 14 of Ind AS 37 requires that:
- an entity has a present obligation (legal or constructive) as a result of a past event;
 - it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
 - a reliable estimate can be made of the amount of the obligation.

Here, the manufacturer has a present legal obligation. The obligation event is the sale of the product with a warranty.

Ind AS 37 outlines that the future sacrifice of economic benefits is probable when it is more likely than less likely that the future sacrifice of economic benefits will be required. The probability that settlement will be required will be determined by considering the class of obligation (warranties) as a whole. In accordance with para 24 of Ind AS 37, it is more likely than less likely that a future sacrifice of economic benefits will be required to settle the class of obligations as a whole.

If a reliable estimate can be made the provision can be measured reliably. Past data can provide reliable measures, even if the data is not firm specific but rather industry based. Ind AS 37 notes that only in extremely rare cases, a reliable measure of a provision cannot be obtained. Difficulty in estimating the amount of a provision under conditions of significant uncertainty does not justify non-recognition of the provision.

Here, the manufacturer should recognize a provision based on the best estimate of the consideration required to settle the present obligation as at the reporting date.

- (b) The expected value of cost of repairs in accordance with Ind AS 37 is:
- $$(80\% \times \text{nil}) + (15\% \times \text{Rs. } 20,00,000) + (5\% \times \text{Rs. } 50,00,000) = 3,00,000 + 2,50,000 = 5,50,000$$

Question 7

(Includes concepts of Ind AS 12)

In order to encourage companies and organisations to generously contribute to the Government's COVID-19 relief fund, taxation laws have been amended to reckon these contributions as deductible for the financial year ending 31st March, 2020 even if the contributions are made after the year end but within three months after year end. Government of India issued the notification on 31st March, 2020 by way of an Ordinance. Such contributions to COVID-19 funds are considered for compliance with



annual spends on corporate social responsibility (CSR) for the current accounting year under the Companies Act, 2013. In this scenario, whether the contributions to COVID-19 Relief Funds made subsequent to reporting date of the current accounting period can be provided for as expenses of the current accounting period? Also show its impact on deferred tax, if any. (RTP Nov '20)

Answer 7

According to paragraph 14 of Ind AS 37, a provision shall be made if:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met as of reporting date, no provision shall be recognised for that financial year.

Government of India issued the notification on 31st March, 2020 by way of an Ordinance and hence, it is most unlikely for any entity to have a present obligation on 31st March, 2020, for such a commitment. As these conditions are not met as of reporting date of financial year 2019 - 2020, no provision should be recognised in the financial statements for that financial year.

In the fact pattern given above, the accounting implications for the financial year 2019-2020 is as follows:

- Do not recognize expense / liability for the contribution to be made subsequent to the year ended 31st March, 2020 as it does not meet the criteria of a present obligation as at the balance sheet date. However, the expected spend may be explained in the notes to the accounts as the same will also be considered in measurement of deferred tax liability.
- If the entity claims a deduction in the Income Tax return for the financial year 2019 - 2020 for that contribution made subsequent to 31st March, 2020, recognise Deferred Tax Liability as there would be a tax saving in financial year 2019 - 2020 for a spend incurred in subsequent year.

Question 8

XYZ Ltd. offers a six-month warranty on its small to medium sized equipment, which can be put to use by the customer with no installation support. The warranty comes with the equipment and the customer cannot purchase it separately. This equipment is typically sold at a gross margin of 40%. XYZ Ltd. has made a provision of ₹ 30,000 during the year ended 31st March, 20X2, which is approximately 1% of its gross margin on the sale of these equipment. Based on past experience, it is expected that 1% of equipment sold have been returned as faulty within the warranty period. Faulty equipment returned to XYZ Ltd. during the warranty period are scrapped and the sale value is fully refunded to the customer.

Assuming that sales occurred evenly during the year, how should XYZ Ltd. evaluate whether any additional warranty provision is required on equipment sold in the past as at 31st March, 20X2? Had the warranty period been 2 years instead of six months, what additional criteria would XYZ Ltd. need to consider? (RTP May '22)

Answer 8**Calculation of additional warranty provisions:**

Warranty claim covers 1% of gross margin, whereas customers are refunded the full selling price. As the goods are scrapped it is assumed XYZ Ltd has no potential for reimbursement from its supplier regarding the faulty goods.

A calculation of warranty provision is set out below:

1% of annual gross margin is ₹ 30,000 therefore 100% of annual gross margin must be ₹ 30,00,000. Since gross margin is 40%, sales should be ₹ 75,00,000. As provide in the question that the sales are evenly spread during the year and given the six month warranty, half of the sales occurred in the second half of the year is still covered within the warranty period as follows.



	% age	Annual sales	Product under warranty at 31st March, 20X2	Percentage expected to be returned	Warranty provision
Gross margin	40%	30,00,000			
Selling price	100%	75,00,000	37,50,000	1%	37,500

The warranty provision should therefore be increased by ₹ 7,500 (₹ 37,500 – ₹ 30,000). As the provision is expected to be used in the next 6 months no discounting is required.

If the warranty period is 2 years:

Since the outstanding period of warranties is 6 months (i.e. less than a year), no discounting is required. However, if a longer warranty period is to be given, the entity will have to take into account the effect of the time value of money. The amount of provision shall be the present value of the expenditures expected to be required to settle the warranty obligation. (Refer Para 45 of Ind AS 37)

The discount rate shall be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The discount rate shall not reflect risks for which future cash flow estimates have been adjusted. (Refer Para 47 of Ind AS 37)

	% age	Annual sales	Product under warranty at 31st March, 20X2	Percentage expected to be returned	Warranty provision
Gross margin	40%	30,00,000			
Selling price	100%	75,00,000	75,00,000	1%	75,000

The warranty provision should therefore be increased by ₹ 45,000 (₹ 75,000 – ₹ 30,000). Further discounting of provision would be required.

Question 9

HVCL manufactures heavy equipment for construction industry. An order for supply of 90 equipment was received from ABIL. The unit price of the equipment was agreed at ₹ 190 lakhs each. 64 equipment was supplied during the year 20X1-20X2 and balance quantity remaining to be supplied as on 31.3.20X2. HVCL has 5 equipment in its inventory as on 31.3.20X2. HVCL considered that the contract was an onerous contract and therefore, the net realisable value of inventory has been taken as value of inventory as on 31.3.20X2.

The management of HVCL contends that costs incurred towards administrative overheads, finance charges, R & D expenses, sales overhead, head quarter expenditure etc., are considered as period cost and hence not considered for creation of provision. Hence, the same have not been included in the computation of unavoidable cost.

The management of HVCL has submitted the details of costs that have been considered for creation of provision towards onerous contract:

- **Material cost** - includes cost of material procured, cost of freight & insurance incurred for material procurement and handling, loading and unloading charges incurred.
- **Labour cost/ Factory Overheads** - includes salaries and other expenses of direct production department, and also expenses allocated from indirect departments to direct department.
- **Material Overheads** - Includes salaries and other expenses (including expenses allocated from other departments) booked under departments linked with materials like purchases, stores and quality control.

Accordingly, provision has been made considering the above costs only. The value of provision created for 21 remaining equipment to be produced is as per the working shown below:



Particulars	Value (₹ in lakh)
(i) Cost of production (which includes material cost, labour cost/factory overhead and material overhead)	199.00
(ii) Selling price	(190.00)
(iii) Differential cost per equipment	9.00
(iv) Differential cost of ₹ 9 Lakh per equipment for 21 equipment	189.00

Whether the company's accounting treatment of cost for creation of provision towards onerous contracts is in line with the provisions of Ind AS 37? (RTP Nov'22)

Answer 9

As per para 68 of Ind AS 37, onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable cost under a contract reflects the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation for penalties arising from failure to fulfilling it.

Ind AS 37 provides that the amount recognised shall be the best estimate of the expenditure required to settle the present obligation, which is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. In case of onerous contracts, an amount that an entity would rationally pay to settle the obligation would be the lower of the compensation or penalties arising from failure to fulfil the contracts and excess of unavoidable cost of meeting the obligations under the contract from the economic benefits expected to be received under it.

As per para 68 of Ind AS 37, the cost of fulfilling a contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract consist of both -

- the incremental costs of fulfilling that contract—for example, direct labour and materials; and
- an allocation of other costs that relate directly to fulfilling contracts—for example, an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract among others.

The unavoidable costs of meeting the obligations under the contract are only costs that:

- "are directly variable with the contract and therefore incremental to the performance of the contract;"
- do not include allocated or shared costs that will be incurred regardless of whether the entity fulfils the contract or not; and
- cannot be avoided by the entity's future actions.

Accordingly, HVCL has correctly measured the cost for creation of provision for onerous contracts by considering material cost, labour cost (to the extent it relates directly to production) and material overheads (to the extent it relates directly to production). Further, HVCL is correct that the period cost will not be considered for measurement of cost for the purpose of creation of provision on onerous contracts as they do not relate directly to fulfilling the contracts.

Question 10

(Includes concepts of Ind AS 10)

A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and financial statements have



been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information? (RTP May'20, Old & New SM)

Answer 10

In the instant case, the condition of exceeding the specified turnover was met at the end of the reporting period and the company was entitled for the duty drawback. However, the application for the same has been filed after the stipulated time. Therefore, credit of duty drawback was discretionary in the hands of the Department. Since the claim was to be accrued only after filing of application, its accrual will be considered in the year 20X2-20X3 only.

Accordingly, the duty drawback credit is a contingent asset as at the end of the reporting period 20X1-20X2, which will be realized when the Department credits the same.

As per para 35 of Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

In accordance with the above, the duty drawback credit which was contingent asset for the

F.Y. 20X1 -20X2 should be recognised as asset and related income should be recognized in the reporting period in which the change occurs. i.e., in the period in which realization becomes virtually certain, i.e., F.Y. 20X2 - 20X3.

Question 11

Sun Limited has entered into a binding agreement with Moon Limited to buy a custom- made machine for Rs. 4,00,000. At the end of 2017-18, before delivery of the machine, Sun Limited had to change its method of production. The new method will not require the machine ordered which is to be scrapped after delivery. The expected scrap value is nil. Given that the asset is yet to be delivered, should any liability be recognized for the potential loss? If so, give reasons for the same, the amount of liability as well as the accounting entry. (PYP 4 Marks, Nov'18)

Answer 11

As per Ind AS 37, Executory contracts are contracts under which

- Neither party has performed any of its obligations; or
- Both parties have partially performed their obligations to an equal extent.

The contract entered by Sun Ltd. is an executory contract, since the delivery has not yet taken place.

Ind AS 37 is applied to executory contracts only if they are onerous.

Ind AS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

As per the facts given in the question, Sun Ltd. will not require the machine ordered. However, since it is a binding agreement, the entity cannot exit / cancel the agreement. Further, Sun Ltd. has to scrap the machine after delivery at nil scrap value.

These circumstances do indicate that the agreement/contract is an onerous contract. Therefore, a provision should be made for the onerous element of Rs. 4,00,000 ie the full cost of the machine.

		Rs.	Rs.
Onerous Contract Provision Expense A/c	Dr.	4,00,000	
To Provision for Onerous Contract Liability A/c			4,00,000
(Being asset to be received due to binding agreement recognized)			



Profit and Loss Account (Loss due to onerous contract)	Dr.	4,00,000	
To Onerous Contract Provision Expense A/c			4,00,000
(Being loss due to onerous contract recognized and asset derecognized)			

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Many examinees were not able to pass correct Journal Entries for recording of onerous contracts. The answers of the examinees showed lack of understanding of the concept of onerous and executory contracts as defined in Ind AS 37.

Question 12

An entity is a telecom operator. Laying of cables across the world is a requirement to enable the entity to run its business. Cables are also laid under the sea and contracts are entered into for the same. By virtue of laws of the countries through which the cable passes, the entity is required to restore the sea bed at the end of the contract period. What is the nature of obligation that the entity has in such a case? (Old & New SM) (PYP 4 Marks May '23)

Answer 12

Paragraph 14 of Ind AS 37 states that a provision shall be recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised.

Further, with regard to past event paragraph 17 of Ind AS 37 states that a past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

- (a) where the settlement of the obligation can be enforced by law; or
- (b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation."

On the basis of the above, provision should be recognised as soon as the obligating event takes place because the entity is under legal obligation to restore the sea bed, provided the other recognition criteria stated in paragraph 14 reproduced above are met. Moreover, the amount of the provision would depend on the extent of the obligation arising from the obligating event. In the instant case, an obligating event is the laying of cables under the sea. To the extent the cables have been laid down under the sea, a legal obligation has arisen and to that extent provision for restoration of sea bed should be recognised.



Chapter 9.1

Ind AS 12: Income Taxes

Question 1

QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS. QA Ltd. had acquired 40% shares in GK Ltd. for an aggregate amount of Rs. 45 crores. The shareholding gives QA Ltd. significant influence over GK Ltd. but not control and therefore the said interest in GK Ltd. is accounted using the equity method. Under the equity method, the carrying value of investment in GK Ltd. was Rs. 70 crores on 31st March, 2017 and Rs. 75 crores as on 31st March, 2018. As per the applicable tax laws, profits recognized under the equity method are taxed if and when they are distributed as dividend or the relevant investment is disposed of. QA Ltd. wants you to compute the deferred tax liability as on 31st March, 2018 and the charge to the Statement of Profit for the same. Consider the tax rate at 20%. (4 Marks MTP Aug '18, Old & New SM)

Answer 1

DTL created on accumulation of undistributed profits as on 31.3.2018

	Carrying value	Value as per tax records	Tax base	Taxable temporary differences	Total Deferred tax liability @ 20%	Charged to P&L during the year
a	b	c	d	E= b-d	F = e x 20%	g
31 st March, 2017	70 crore	45 crore	45 crore	25 crore	5 crore	5 crore
31 st March, 2018	75 crore	45 crore	45 crore	30 crore	6 crore	1 crore (6 crore – 5 crore)

Question 2

QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS and wants guidance on the tax treatment for the following:

- (i) QA Ltd. does not have taxable income as per the applicable tax laws, but pays 'Minimum Alternate Tax' (MAT) based on its books profits. The tax paid under MAT can be carried forward for the next 10 years and as per the Company's projections submitted to its bankers, it is in a position to get credit for the same by the end of eighth year. The Company is recognising the MAT credit as a current asset under IGAAP. The amount of MAT credit as on 31st March, 2016 is Rs. 8.5 crores and as on 31st March, 2017 is Rs. 9.75 crores;
- (ii) The Company measures its head office property using the revaluation model. The property is revalued every year as on 31st March. On 31st March, 2016, the carrying value of the property (after revaluation) was Rs. 40 crores whereas its tax base was Rs. 22 crores. During the year ended 31st March, 2017, the Company charged depreciation in its Statement of Profit and Loss of Rs. 2 crores and claimed a tax deduction for tax depreciation of Rs. 1.25 crores. On 31st March, 2017, the property was revalued to Rs.45 crores. As per the tax laws, the revaluation of Property, Plant & Equipment does not affect taxable income at the time of revaluation. The Company has no other temporary differences other than those indicated above. The Company wants you to compute the deferred tax liability as on 31st March, 2017 and the charge/credit to the Statement of Profit and Loss and/or Other Comprehensive Income for the same. Consider the tax rate at 20%. (10 Marks MTP Mar'19, Old & New SM)



Answer 2

Computation of Deferred Tax Liability

- (i) MAT credit as on 31st December of Rs. 9.75 crore will be presented in the Balance Sheet as Deferred tax asset. DTA in the current year will be Rs. 1.25 crore (Rs. 9.75 crore – Rs. 8.50 crore)

- (ii) (a) In case defer tax is created only on account of depreciation

	Carrying value without revaluation	Value as per tax records	Tax base	Taxable/ (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year
A	b	c	d	E= b-d	F = e x 20%	g
31 st March, 2016	22 crore	22 crore	22 crore	nil	nil	nil
Less: Depreciation for the year 2016-17	(2 crore)	(1.25 crore)				
Carrying value as on 31 st March, 2017	20 crore	20.75 crore	20.75 crore	(0.75 crore)	DTA (0.15 crore)	DTA (0.15 crore)

- (b) Computation of tax effect taking into account the revalued figures and adjusting impact of tax effect on account of difference in depreciation

S. No.		Carrying value after revaluation	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year	Charged to OCI during the year
	a	b	c	d	E= b-d	F = e x 20%	g	h
I	31 st March, 2016	40 crore	22 crore	22 crore	18 crore	DTL 3.6 crore	-	DTL 3.6 crore
IV	Revalued again on 31.3.2017 (It is assumed that revaluation has been done after taking into consideration the impact of depreciation for the current year)	45 crore	20.75 crore (22-1.25)	20.75 crore	24.25 crore	DTL 4.85 crore	DTA (0.15 crore) (Refer table (a) above)	DTL 5 crore (Refer Note below) [5 DTL (B/F) – 0.15 DTA = 4.85 DTL]
V	Additional DTL/DTA required during the year (IV-I)					DTL 1.25 crore	DTA (0.15 crore) (Refer table (a))	DTL (1.40 crore) (Refer Note below)

**Note:**

As per para 65 of Ind AS 12, when an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income in the periods in which they occur.

Here, it is important to understand that only the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income. However, tax effects on account of depreciation of asset and the adjustment of the tax base are recognized in profit and loss.

Accordingly, first of all the tax effect has been calculated assuming that there is no revaluation (Refer Table (a) above) [Since the information for the carrying value before revaluation has not been mentioned, it is assumed to be equal to the carrying amount as per the tax records]. Later the DTA arrived due to difference in depreciation is adjusted with the DTL created due to revaluation. DTA of Rs. 0.15 crore on account of depreciation will be charged to Profit and Loss and DTL of Rs. 1.40 crore will be charged to OCI. Net effect in the year 31.3.2017 will be DTL 1.25 crore (DTL 1.4 crore – DTA 0.15 crore) [Refer Table (b) above].

Question 3

A Limited recognizes interest income in its books on accrual basis. However, for income tax purposes the method is 'cash basis'. On December 31, 20X1, it has interest receivable of Rs. 10,000 and the tax rate was 25%. On February 28, 20X2, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on May 21, 20X2. Determine the treatment of deferred tax, as per Ind AS, in case the reporting date of A Ltd.'s financial statement is December 31, 20X1 and these are approved for issued on May 31, 20X2. (6 Marks MTP March '18, Old & New SM)

Answer 3

The difference of Rs. 10,000 between the carrying value of interest receivable of Rs. 10,000 and its tax base of NIL is a taxable temporary difference.

A Limited has to recognise a deferred tax liability of Rs. 2,500 (Rs. 10,000 x 25%) in its financial statements for the reporting period ended on December 31, 20X1.

It will not recognise the deferred tax liability @ 30% because as on December 31, 20X1, this tax rate was neither substantively enacted or enacted on the reporting date. However, if the effect of this change is material, A Limited should disclose this difference in its financial statements.

Question 4

A's Ltd. profit before tax according to Ind AS for Year 20X1 -20X2 is Rs. 100 thousand and taxable profit for year 20X1-20X2 is Rs. 104 thousand. The difference between these amounts arose as follows:

1. On 1st February, 20X2, it acquired a machine for Rs. 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 10 years according to Ind AS as well as for tax purposes.
2. In the year 20X1-20X2, expenses of Rs. 8 thousand were incurred for charitable donations. These are not deductible for tax purposes.

Prepare necessary entries as at 31st March 20X2, taking current and deferred tax into account. The tax rate is 25%. Also prepare the tax reconciliation in absolute numbers as well as the tax rate reconciliation. (8 Marks MTP Oct 21, RTP May'18, Old & New SM)



Answer 4

Current tax= Taxable profit x Tax rate = Rs. 104 thousand x 25% = Rs. 26 thousand
Computation of Taxable Profit:

	Rs. in thousand
Accounting profit	100
Add: Donation not deductible	8
Less: Excess Depreciation (6 - 2)	(4)
Total Taxable profit	104

	Rs. in thousand	Rs. in thousand
Profit & loss A/c Dr.	26	
To Current Tax		26

Deferred tax:

Machine's carrying amount according to Ind AS = Rs. 118 thousand (Rs. 120 thousand – Rs. 2 thousand)

Machine's carrying amount for taxation purpose = Rs. 114 thousand (Rs. 120 thousand – Rs. 6 thousand)

Deferred Tax Liability = Rs. 4 thousand x 25%

	Rs. in thousand
Profit & loss A/c Dr.	1
To Deferred Tax Liability	1

Tax reconciliation in absolute numbers:

	Rs. in thousand
Profit before tax according to Ind AS	100
Applicable tax rate @ 25%	
Tax	25
Expenses not deductible for tax purposes (Rs. 8 thousand x 25%)	2
Tax expense (Current and deferred)	27

Tax rate reconciliation

Applicable tax rate	25%
Expenses not deductible for tax purposes	2%
Average effective tax rate	27%

Question 5

K Ltd prepares consolidated financial statements to 31st March each year. During the year ended 31st March, 20X2, K Ltd entered into the following transactions:

- On 1st April, 20X1, K Ltd purchased an equity investment for ₹ 2,00,000. The investment was designated as fair value through other comprehensive income. On 31st March, 20X2, the fair value of the investment was ₹ 2,40,000. In the tax jurisdiction in which K Ltd operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. K Ltd has no intention of selling the investment in the foreseeable future.
- On 1st August 20X1, K Ltd sold products to A Ltd, a wholly owned subsidiary operating in the same tax jurisdiction as K Ltd, for ₹ 80,000. The goods had cost to K Ltd for ₹ 64,000. By 31st March 20X2, A Ltd had sold 40% of these goods, selling the remaining during next year.
- On 31st October, 20X1, K Ltd received ₹ 2,00,000 from a customer. This payment was in respect of services to be provided by K Ltd from 1st November, 20X1 to 31st July, 20X2. K Ltd recognised revenue of ₹ 1,20,000 in respect of this transaction in the year ended 31st March, 20X2 and will



recognise the remainder in the year ended 31st March, 20X3. Under the tax jurisdiction in which K Ltd operates, ₹ 2,00,000 received on 31st October, 20X1 was included in the taxable profits of K Ltd for the year ended 31st March, 20X2.

Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in its statement of profit or loss and other comprehensive income for the year ended 31st March, 20X2. Assume tax rate to be 25%. (6 Marks MTP Oct'22, Old & New SM)

Answer 5

- a) Because the unrealised gain on revaluation of the equity investment is not taxable until sold, there are no current tax consequences. The tax base of the investment is ₹ 2,00,000. The revaluation creates a taxable temporary difference of ₹ 40,000 (₹ 2,40,000 – ₹ 2,00,000).

This creates a deferred tax liability of ₹ 10,000 (₹ 40,000 x 25%). The liability would be non-current. The fact that there is no intention to dispose of the investment does not affect the accounting treatment. Since, the unrealised gain is reported in other comprehensive income, the related deferred tax expense is also reported in other comprehensive income.

- b) When K Ltd. sold the products to A Ltd., K Ltd. would have generated a taxable profit of ₹ 16,000 (₹ 80,000 – ₹ 64,000). This would have created a current tax liability for K Ltd and the group of ₹ 4,000 (₹ 16,000 x 25%). This liability would be shown as a current liability and charged as an expense in arriving at profit or loss for the period.

In the consolidated financial statements the carrying value of the unsold inventory would be ₹ 38,400 (₹ 64,000 x 60%). The tax base of the unsold inventory would be ₹ 48,000 (₹ 80,000 x 60%). In the consolidated financial statements there would be a deductible temporary difference of ₹ 9,600 (₹ 38,400 – ₹ 48,000) and a potential deferred tax asset of ₹ 2,400 (₹ 9,600 x 25%). This would be recognised as a deferred tax asset since A Ltd. is expected to generate sufficient taxable profits against which to utilise the deductible temporary difference. The resulting credit would reduce consolidated deferred tax expense in arriving at profit or loss.

- c) The receipt of revenue in advance on 1st October 20X1 would create a current tax liability of ₹ 50,000 (₹ 2,00,000 x 25%) as at 31st March 20X2. The carrying value of the revenue received in advance at 31st March 20X2 is ₹ 80,000 (₹ 2,00,000 – ₹ 120,000). Its tax base is nil. The deductible temporary difference of ₹ 80,000 would create a deferred tax asset of ₹ 20,000 (₹ 80,000 x 25%). The asset can be recognised because K Ltd. has sufficient taxable profits against which to utilise the deductible temporary difference.

Question 6

A Ltd. prepares financial statements to 31st March each year. The rate of income tax applicable to A Ltd. is 20%. The following information relates to transactions, assets and liabilities of A Ltd. during the year ended 31st March, 20X2:

- (i) A Ltd. has a 40% shareholding in L Ltd. A Ltd. purchased this shareholding for ₹ 45 Cr. The shareholding gives A Ltd. significant influence over L Ltd. but not control and therefore A Ltd. accounts for its interest in L Ltd. using the equity method. The equity method carrying value of A Ltd.'s investment in L Ltd. was ₹ 70 Cr on 31st March, 20X1 and ₹ 75 Cr on 31st March 20X2. In the tax jurisdiction in which A Ltd. operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend, or the relevant investment is disposed of.
- (ii) A Ltd. measures its head office building using the revaluation model. The building is revalued every year on 31st March. On 31st March, 20X1, carrying value of the building (after revaluation) was ₹ 40 Cr and its tax base was ₹ 22 Cr. During the year ended 31st March, 20X2, A Ltd. charged depreciation in its statement of profit or loss of ₹ 2 Cr and claimed a tax deduction for tax depreciation of ₹ 1.25 Cr. On 31st March, 20X2, the building was revalued to ₹ 45 Cr. In the tax jurisdiction in which A Ltd. operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.

Basis the above information, you are required to compute:

- (a) The deferred tax liability of A Ltd. at 31st March, 20X2



- (b) The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31st March, 20X2 (MTP 10 Marks Sep '23)

Answer 6

(A) Deferred Tax Liability as at 31st March, 20X2 Investment in L Ltd.:

Carrying Amount	= ₹ 75 Cr
Tax base	= ₹ 45 Cr (Purchase cost)
Temporary Difference	= ₹ 30 Cr

Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ₹ 6 Cr is recognized:

Head office building	
Carrying Amount	= ₹ 45 Cr (Revalued amount on 31st March, 20X2)
Tax base	= ₹ 20.75 Cr (22 Cr – 1.25 Cr)
Temporary Difference	= ₹ 24.25 Cr

Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ₹ 4.85 Cr is created.

Total Deferred Tax Liability ₹ 6 Cr + ₹ 4.85 Cr = ₹ 10.85 Cr

**(B) Charge to Statement of Profit and Loss for the year ended 31st March 20X2:
Investment in L Ltd.**

Particulars	Carrying amount	Tax Base	Temporary Difference
Opening Balance (1st April, 20X1)	₹ 70 Cr	₹ 45 Cr	₹ 25 Cr
Closing Balance (31st March, 20X2)	₹ 75 Cr	₹ 45 Cr	₹ 30 Cr
Net Change			₹ 5 Cr
Increase in Deferred Tax Liability (20% tax rate)			₹ 1 Cr

Considering the increase in the value of investment arising through Statement of Profit and Loss, the accounting for the increase in deferred tax liability is made as under:

Tax expense (Profit or Loss Statement)	Dr.	₹ 1 Cr
To Deferred Tax Liability		₹ 1 Cr

(Being increase in deferred tax liability recognized)

Head Office Building:

The deferred tax liability at 31st March, 20X1 is ₹ 3.6 Cr (20% x {₹ 40 Cr – ₹ 22 Cr}).

At 31st March, 20X2, prior to revaluation, the carrying amount of the property is ₹ 38 Cr and its tax base is ₹ 20.75 Cr (₹ 22 Cr – ₹ 1.25 Cr). The deferred tax liability at this point is ₹ 3.45 Cr (20% x {₹ 38 Cr – ₹ 20.75 Cr}).

The reduction in this liability is ₹ 0.15 Cr (₹ 3.6 Cr – ₹ 3.45 Cr). This would be credited to income tax expense in arriving at profit or loss.

Post revaluation, the carrying value of the building becomes ₹ 45 Cr and the tax base stays the same. Therefore, the new deferred tax liability is ₹ 4.85 Cr (20% x (₹ 45 Cr – ₹ 20.75 Cr)). The increase in the deferred tax liability of ₹ 1.4 Cr (₹ 4.85 Cr – ₹ 3.45 Cr) is charged to other comprehensive income.



Question 7

An entity is finalising its financial statements for the year ended 31st March, 20X2. Before 31st March, 20X2, the government announced that the tax rate was to be amended from 40 per cent to 45 per cent of taxable profit from 30 th June, 20X2.

The legislation to amend the tax rate has not yet been approved by the legislature. However, the government has a significant majority and it is usual, in the tax jurisdiction concerned, to regard an announcement of a change in the tax rate as having the substantive effect of actual enactment (i.e. it is substantively enacted).

After performing the income tax calculations at the rate of 40 per cent, the entity has the following deferred tax asset and deferred tax liability balances:

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

Of the deferred tax asset balance, Rs. 28,000 related to a temporary difference. This deferred tax asset had previously been recognised in OCI and accumulated in equity as a revaluation surplus.

The entity reviewed the carrying amount of the asset in accordance with para 56 of Ind AS 12 and determined that it was probable that sufficient taxable profit to allow utilisation of the deferred tax asset would be available in the future.

Show the revised amount of Deferred tax asset & Deferred tax liability and present the necessary journal entries. (RTP Nov'19, Old & New SM)

Answer 7

Calculation of Deductible temporary differences:

Deferred tax asset	=	Rs. 80,000
Existing tax rate	=	40%
Deductible temporary differences	=	80,000/40%
		Rs. 2,00,000

Calculation of Taxable temporary differences:

Deferred tax liability	=	Rs. 60,000
Existing tax rate	=	40%
Deductible temporary differences	=	60,000 / 40%
	=	Rs. 1,50,000

Of the total deferred tax asset balance of Rs. 80,000, Rs. 28,000 is recognized in OCI Hence, Deferred tax asset balance of Profit & Loss is Rs. 80,000 - Rs. 28,000 = Rs. 52,000 Deductible temporary difference recognized in Profit & Loss is Rs. 1,30,000 (52,000 / 40%) Deductible temporary difference recognized in OCI is Rs. 70,000 (28,000 / 40%)

The adjusted balances of the deferred tax accounts under the new tax rate are:

Deferred tax asset		Rs.
Previously credited to OCI-equity	Rs. 70,000 x 0.45	31,500
Previously recognised as Income	Rs. 1,30,000 x 0.45	58,500
		90,000
Deferred tax liability		
Previously recognized as expense	Rs. 1,50,000 x 0.45	67,500

The net adjustment to deferred tax expense is a reduction of Rs. 2,500. Of this amount, Rs. 3,500 is recognised in OCI and Rs. 1,000 is charged to P&L.

The amounts are calculated as follows:



	Carrying amount at 45%	Carrying amount at 40%	Increase (decrease) in deferred tax expense
Deferred tax assets			
Previously credited to OCI-equity	31,500	28,000	(3,500)
Previously recognised as Income	58,500	52,000	(6,500)
	90,000	80,000	(10,000)
Deferred tax liability			
Previously recognized as expense	67,500	60,000	7,500
Net adjustment			(2,500)

An alternative method of calculation is:

Rs.

DTA shown in OCI	Rs. 70,000 x (0.45 - 0.40)	3,500
DTA shown in Profit or Loss	Rs. 1,30,000 x (0.45-0.40)	6,500
DTL shown in Profit or Loss	Rs. 1,50,000 x (0.45 -0.40)	7,500

Journal Entries

	Rs.	Rs.
Deferred tax asset	3,500	
OCI –revaluation surplus		3,500
Deferred tax asset	6,500	
Deferred tax expense		6,500
Deferred tax expense	7,500	
Deferred tax liability		7,500

Alternatively, a combined journal entry may be passed as follows:

	Rs.	Rs.
Deferred tax asset Dr.	10,000	
Deferred tax expense Dr.	1,000	
To OCI –revaluation surplus		3,500
To Deferred tax liability		7,500

Question 8

On 1 January 2020, entity H acquired 100% share capital of entity S for Rs.15,00,000. The book values and the fair values of the identifiable assets and liabilities of entity S at the date of acquisition are set out below, together with their tax bases in entity S's tax jurisdictions. Any goodwill arising on the acquisition is not deductible for tax purposes. The tax rates in entity H's and entity S's jurisdictions are 30% and 40% respectively.

Acquisitions	Book values Rs.'000	Tax base Rs.'000	Fair values Rs.'000
Land and buildings	600	500	700
Property, plant and equipment	250	200	270
Inventory	100	100	80
Accounts receivable	150	150	150
Cash and cash equivalents	130	130	130
Accounts payable	(160)	(160)	(160)
Retirement benefit obligations	(100)	-	(100)

You are required to calculate the deferred tax arising on acquisition of Entity S. Also calculate the Goodwill arising on acquisition. (RTP Nov'20, Old & New SM)



Answer 8

Calculation of Net assets acquired (excluding the effect of deferred tax liability):

Net assets acquired	Tax base Rs.'000	Fair values Rs.'000
Land and buildings	500	700
Property, plant and equipment	200	270
Inventory	100	80
Accounts receivable	150	150
Cash and cash equivalents	130	130
Total assets	1,080	1,330
Accounts payable	(160)	(160)
Retirement benefit obligations	-	(100)
Net assets before deferred tax liability	920	1,070

Calculation of deferred tax arising on acquisition of entity S and goodwill

	Rs.'000	Rs.'000
Fair values of S's identifiable assets and liabilities (excluding deferred tax)		1,070
Less: Tax base		(920)
Temporary difference arising on acquisition		150
Net deferred tax liability arising on acquisition of entity S (Rs.150,000 @ 40%)		60
Purchase consideration		1,500
Less: Fair values of entity S's identifiable assets and liabilities (excluding deferred tax)	1,070	
Deferred tax liability	(60)	(1,010)
Goodwill arising on acquisition		490

Note: Since, the tax base of the goodwill is nil, taxable temporary difference of Rs.4,90,000 arises on goodwill. However, no deferred tax is recognised on the goodwill. The deferred tax on other temporary differences arising on acquisition is provided at 40% and not 30%, because taxes will be payable or recoverable in entity S's tax jurisdictions when the temporary differences will be reversed.

Question 9

The entity has an identifiable asset ASSOTA with a carrying amount of Rs. 10,00,000. Its recoverable amount is Rs. 6,50,000. The tax base of ASSOTA is Rs. 8,00,000 and the tax rate is 30%. Impairment losses are not tax deductible. Entity expects to continue to earn profits in future.

For the identifiable asset ASSOTA, what would be the impact on the deferred tax asset/ liability at the end of the period? (RTP May 21)

Answer 9

As per Ind AS 36, the revised carrying amount of asset ASSOTA would be Rs.6,50,000. The tax base of asset ASSOTA is given as Rs.8,00,000.

Carrying base of asset = Rs.6,50,000

Tax base of asset = Rs.8,00,000

Since tax base is greater than carrying base of asset, so deferred tax asset would be created on the temporary difference of Rs.1,50,000 (Rs.8,00,000 – Rs.6,50,000) at the given tax rate of 30%.

Hence, Deferred tax asset for the asset ASSOTA would be Rs.1,50,000 x 30% = Rs. 45,000.



Question 10

Following is the summarized statement of profit and loss of EARTH Limited as per Ind AS for the year ended 31st March 20X1:

Particulars	₹ in Crore
Revenue from operations	1,160.00
Other income	56.00
Total Income (A)	1,216.00
Purchase of stock-in-trade	40.00
Changes in inventories of stock-in-trade	6.00
Employee benefits expense	116.00
Finance costs	130.00
Depreciation and amortization expense	30.00
Other expenses	300.00
Total Expenses (B)	622.00
Profit Before Tax (A-B)	594.00
Current tax	165.40
Deferred tax	1.50
Tax Expenses	166.90
Profit after Tax	427.10

Additional information:

- Corporate income tax rate applicable to EARTH Limited is 30%.
- Other income includes long-term capital gains of ₹ 10 crore which are taxable at the rate of 10%.
- Other expenses include the following items which are not deductible for income tax purposes:

Item	₹ in Crore
Penalties	1.00
Impairment of goodwill	44.00
Corporate Social Responsibility expense	6.00

- Other expenses include research and development (R & D) expenditure of ₹ 8 crore in respect of which a 200% weighted deduction is available under income tax laws.
- Other income includes dividends of ₹ 4 crore, which is exempt from tax.
- Profit before tax of ₹ 594 crore includes (i) agriculture income of ₹ 55 crore which is exempt from tax; and (ii) profit of ₹ 60 crore earned in the USA on which EARTH Limited is required to pay tax at the rate of 20%.
- Depreciation as per income tax laws is ₹ 25.0 crore.

During review of the financial statements of EARTH Limited, the CFO multiplied profit before tax by the income tax rate and arrived at ₹ 178.2 crore as the tax expense (₹ 594 crore x 30% = ₹ 178.2 crore). However, actual income tax expense appearing in the summarized statement of profit and loss is ₹ 166.9 crore.

The CFO has sought your help in reconciling the difference between the two tax expense amounts. Prepare a reconciliation containing the disclosure as required under the relevant Ind AS. (RTP Nov'22)(Same concept different figures- PYP 6 Marks Nov'22)

Answer 10

Reconciliation of income tax expense and current tax as per accounting profit for the year ended 31st March, 20X1

Particulars	₹ in crore
Accounting profit	594.00



Tax at the applicable tax rate of 30%		178.20
Tax effect of expenses that are not deductible in determining taxable profits:		
Penalties (1.00 x 30%)	0.30	
Impairment of goodwill (44.00 x 30%)	13.20	
Corporate social responsibility expense (6.00 x 30%)	1.80	15.30
Tax effect of expenses that are deductible in determining taxable profits:		
Research and development expenses (8.00 x 30%)		(2.40)
Tax effect of income that are exempted in determining taxable profits:		
Dividend income (Exempt) (4.00 x 30%)	1.20	
Agriculture income (Exempt) (55.00 x 30%)	16.50	(17.70)
Tax effect of income on which different tax rates are used for determining taxable profits:		
Differential income tax on long term capital gain [10.00 x (30% - 10%)]	2.00	
Foreign income in USA [60.00 x (30%-20%)]	6.00	(8.00)
Income tax expense (Current) reported in the Statement of Profit and Loss for the current year		165.40

Reconciliation of deferred tax:

Particulars	₹ in crore
Deferred tax in relation to depreciation and amortization [(30 – 25) x 30%]	1.50
Tax expense (deferred) reported in the Statement of Profit or Loss for the current year	1.50

Question 11

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

- Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of Rs. 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow Y Ltd. to transfer the tax loss to other group companies. However, it allows Y Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of X Ltd. do not consider that Y Ltd. will make taxable profits in the foreseeable future.**
- Just before 31st March, 2018, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore X Ltd. recognised a provision for closure costs of Rs. 20,00,000 in its statement of financial position as at 31st March, 2018. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31 March 2019, X Ltd. expects to make taxable profits which are well in excess of Rs.20,00,000. On 31st March, 2018, X Ltd. had taxable temporary differences from other sources which were greater than Rs. 20,00,000.**
- During the year ended 31 March 2017, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 'Intangible Assets'. The total amount capitalised was Rs. 16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January 2018. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31 March 2018.**
- On 1 April 2017, X Ltd. borrowed Rs. 1,00,00,000. The cost to X Ltd. of arranging the borrowing was Rs. 2,00,000 and this cost qualified for a tax deduction on 1 April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31 March 2020 will be Rs. 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of Rs. 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.**



Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31 March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%. (RTP Nov 18, May'19)(Old & New SM)(Same concept but different figures- PYP 6 Marks Nov'20)

Answer 11

- (i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is Rs. 30,00,000.
- However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.
- (ii) The provision creates a potential deferred tax asset for the group since its carrying value is Rs. 20,00,000 and its tax base is nil.
- This deferred tax asset can be recognised because X Ltd. is expected to generate taxable profits in excess of Rs. 20,00,000 in the year to 31st March, 2019.
- The amount of the deferred tax asset will be Rs. 4,00,000 (Rs. 20,00,000 x 20%).
- This asset will be presented as a deduction from the deferred tax liabilities caused by the (larger) taxable temporary differences.
- (iii) The development costs have a carrying value of Rs. 15,20,000 (Rs. 16,00,000 – (Rs. 16,00,000 x 1/5 x 3/12)).
- The tax base of the development costs is nil since the relevant tax deduction has already been claimed.
- The deferred tax liability will be Rs. 3,04,000 (Rs. 15,20,000 x 20%). All deferred tax liabilities are shown as non-current.
- (iv) The carrying value of the loan at 31st March, 2018 is Rs. 1,07,80,000 (Rs. 1,00,00,000 – Rs. 2,00,000 + (Rs. 98,00,000 x 10%)).
- The tax base of the loan is Rs. 1,00,00,000.
- This creates a deductible temporary difference of Rs. 7,80,000 (Rs. 1,07,80,000 – Rs. 1,00,00,000) and a potential deferred tax asset of Rs. 1,56,000 (Rs. 7,80,000 x 20%).
- Due to the availability of taxable profits next year (see part (ii) above), this asset can be recognised as a deduction from deferred tax liabilities.

Question 12

On 1st April, 20X1, an entity paying tax at 30% acquired a non-tax-deductible office building for ₹ 1,00,000 in circumstances in which Ind AS 12 prohibits recognition of the deferred tax liability associated with the temporary difference of ₹ 1,00,000. The building is depreciated over 10 years at ₹ 10,000 per year to a residual value of zero. The entity's financial year ends on 31st March.

On 1st April, 20X2, the carrying amount of the building is ₹ 90,000, and it is revalued upwards by ₹ 45,000 to its current market value of ₹ 1,35,000. There is no change to the estimated residual value of zero, or to the useful life of the building after revaluation.

Determine the carrying amount, depreciation for the year ended 31st March, 20X3 and defer tax thereafter till the useful life of the building. Further analyse the treatment and impact of defer tax since 31st March, 20X3 till the useful life of the building. (RTP Nov '23)

Answer 12

Since there is no change to the estimated residual value of zero, or to the useful life of the building after revaluation, at the end of the 2nd year i.e. 31st March 20X3, the building will be depreciated over the next 9 years at ₹ 15,000 per year.

Following the revaluation, the temporary difference associated with the building is ₹ 1,35,000. Of this



amount, only ₹ 90,000 arose on initial recognition, since ₹ 10,000 of the original temporary difference of ₹ 1,00,000 arising on initial recognition of the asset has been eliminated through depreciation of the asset. The carrying amount (which equals the temporary difference, since the tax base is zero) and depreciation during the year ended 31st March, 20X3 and thereafter may then be analysed as follows:

Year	Carrying amount a	Tax base b	Gross temporary difference (c= a-b)	Unrecognised temporary difference d	Recognised temporary difference (e=c-d)	Deferred tax liability f = e @ 30%
0	1,00,000	-	1,00,000	1,00,000	-	-
1	90,000	-	90,000	90,000	-	-
Reval	1,35,000	-	1,35,000	90,000	45,000	13,500
2	1,20,000	-	1,20,000	80,000	40,000	12,000
3	1,05,000	-	1,05,000	70,000	35,000	10,500
4	90,000	-	90,000	60,000	30,000	9,000
5	75,000	-	75,000	50,000	25,000	7,500
6	60,000	-	60,000	40,000	20,000	6,000
7	45,000	-	45,000	30,000	15,000	4,500
8	30,000	-	30,000	20,000	10,000	3,000
9	15,000	-	15,000	10,000	5,000	1,500
10	-	-	-	-	-	-

Note:

The depreciation is allocated pro rata to the cost element and revalued element of the total carrying amount.

On 31st March, 20X3, the entity recognises a deferred tax liability based on the temporary difference of ₹ 45,000 arising on the revaluation (i.e., after initial recognition) giving a deferred tax expense of ₹ 13,500 (₹ 45,000 @ 30%) recognised in Other Comprehensive Income (OCI).

This has the result that the effective tax rate shown in the financial statements for the revaluation is 30% (₹ 45,000 gain with deferred tax expense of ₹ 13,500).

As can be seen from the table above, as at 31st March, 20X4 (year 3), ₹ 40,000 of the total temporary difference arose after initial recognition. The entity, therefore, provides for deferred tax of ₹ 12,000 (₹ 40,000 @ 30%), and a deferred tax credit of ₹ 1,500 (the reduction in the liability from ₹ 13,500 to ₹ 12,000) is recognised in profit or loss.

The deferred tax credit can be explained as the tax effect at 30% of the additional ₹ 5,000 depreciation relating to the revalued element of the building.

Question 13

C Ltd. acquired the following assets and liabilities of D Ltd. in a business combination: ₹ in '000s

	Fair Value	Carrying Amount	Temporary Difference
Plant & equipment	500	510	(10)
Inventory	130	150	(20)
Trade receivables	200	210	(10)
Loans and advances	80	85	(5)
	910	955	(45)
10% Debentures	200	200	
	710	755	



Consideration Paid	760	760	
Goodwill	50	5	45

Goodwill is deductible as permissible expenses under the existing tax law. Calculate Deferred Tax Asset / liability as per relevant Ind AS and also pass related journal entry in books of C Ltd. and assume tax rate at 25%. (PYP 4 Marks Jan 21)(Same concepts different figures- Old & New SM)

Answer 13

In this case there is a Deferred Tax Asset as the Tax base of assets acquired is higher by ₹45,000. Deferred Tax Asset would be ₹11,250 (45,000 x 25%)

Journal entry

Plant and equipment	Dr.	5,00,000	
Inventory	Dr.	1,30,000	
Trade receivables	Dr.	2,00,000	
Loans and advances	Dr.	80,000	
Goodwill (50,000 - 11,250)	Dr.	38,750	
Deferred Tax Asset	Dr.	11,250	
To 10% Debentures			2,00,000
To Bank			7,60,000

(Assets and liabilities taken over, goodwill and deferred tax asset have been recognised)

Question 14

PC Ltd. got incorporated on 1st April, 2020. As on 31.3.2021, the following temporary differences exist:

- Taxable temporary differences relating to accelerated depreciation of ₹ 1,24,000. These are expected to reverse equally over next 4 years.**
- Deductible temporary difference relating to preliminary expenses of ₹ 80,000 expected to reverse equally over next 5 years.**

It is expected that PC Ltd. will continue to make losses for next 5 years. Tax rate is 20%. Losses can be carried forward but not backwards. Discuss the treatment of deferred tax as on 31st March, 2021 as per relevant Ind AS. (PYP Dec '21)(Same concept different figures- 8 Marks MTP April '19, Old & New SM)

Answer 14

The year-wise anticipated reversal of temporary differences is as under:

Particulars	Year ending on 31st March, 2022	Year ending on 31st March, 2023	Year ending on 31st March, 2024	Year ending on 31st March, 2025	Year ending on 31st March, 2026
Reversal of taxable temporary difference relating to accelerated depreciation over next 4 years (₹ 1,24,000 / 4)	31,000	31,000	31,000	31,000	Nil
Reversal of deductible temporary difference relating to preliminary					



expenses over next 5 years (₹ 80,000 / 5)	16,000	16,000	16,000	16,000	16,000

Recognition of deferred tax liability:

PC Ltd. will recognise a deferred tax liability of ₹ 24,800 on taxable temporary difference relating to accelerated depreciation of ₹ 1,24,000 @ 20%.

Recognition of deferred tax asset:

However, it will limit and recognise a deferred tax asset on reversal of deductible temporary difference relating to preliminary expenses reversing up to year ending 31st March, 2025 amounting to ₹ 12,800 (₹ 64,000 @ 20%).

Reversal of deferred tax asset:

No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on 31st March, 2026 as there are no taxable temporary differences. Further, the future estimation is also a loss. However, if there are tax planning opportunities that could be identified for the year ending on 31st March, 2026, deferred tax asset on the remainder of ₹ 16,000 (₹ 80,000 – ₹ 64,000) of deductible temporary difference could be recognised at the 20% tax rate.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

The question involved computation of defer tax asset / liability in two different scenarios. In most of the cases, examinees correctly accounted for temporary difference on account of depreciation but were not able to do correct treatment for temporary difference on account of reversal of preliminary expenses i.e. whether to recognise defer tax asset or not and when and by what amount.



Chapter 9.2

Ind AS 21: The Effects of changes in Foreign Exchange Rates

Question 1

What is the functional currency of an entity? What are the primary and secondary factors that influence determination of functional currency? (MTP 4 Marks March '21, PYP 4 Marks Nov'19)

Answer 1

Functional currency is the currency of the primary economic environment in which the entity operates. In this regard, the primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates. The functional currency is normally the currency of the country in which the entity is located. It might, however, be a different currency.

The following are the factors that influence determination of an appropriate functional currency:

(1) Primary indicators:

(a) The currency

- (i) that mainly influences sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and
- (ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
- (iii) the currency that mainly influences labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.

(2) Secondary indicators:

Other factors that may provide supporting evidence to determine an entity's functional currency are-

- (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and
- (b) the currency in which receipts from operating activities are usually retained.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Most of the examinees failed to explain all the primary & secondary factors that influence determination of functional currency properly.

Question 2

(Also in Chapter 21- Ind AS 12 Income taxes)

ABC Ltd. works out translation gain/loss over the years on its investment in foreign subsidiary 2014-15: Rs. 2 lakhs, 2015-16: Rs. 4 lakhs, 2016-17: Rs. 3 lakhs. The foreign subsidiary is sold on 30th June 2017. The translation gain on sale of such investment as on that date is Rs. 2 lakhs. Assuming that deferred tax effect is computed @ 30%. How should the company present the translation gain/loss, deferred taxation and reclassification adjustment in the Profit and loss, other comprehensive income, equity and liabilities?(MTP 6 Marks Oct '18)

Answer 2

	Statement loss	of Profit and	Equity Liabilities	
	Profit and loss	Other- comprehensive income	Equity	Liabilities
2014-15				

Translation Gain		2.00		
Less: Deferred Tax Expenses		(0.60)		
		1.40		
Translation Reserve			1.40	
Deferred tax liabilities				0.60
2015-16				
Translation Gain		2.00		
Less: Deferred Tax Expenses		(0.60)		
		1.40		
Translation Reserve			2.80	
Deferred tax liabilities				1.20
2016-17				
Translation loss		(1.00)		
Less: Deferred Tax Expenses		0.30		
		(0.70)		
Translation Reserve			2.10	
Deferred tax liabilities				0.90
2017-18				
Translation loss		(1.00)		
Less: Deferred Tax Expenses		0.30		
		(0.70)		
Translation Reserve			1.40	
Deferred tax liabilities				0.60
Reclassification adjustment credited to P&L	1.40			
Current Tax				(0.60)
Adjustment of deferred tax liabilities	0.60			

Question 3

PQR Holdings Limited is based in London and has Pound sterling ("GBP") as its functional and presentation currency. On 1st April, 20X1, PQR Holdings Limited incorporated PQR India Limited as its wholly owned subsidiary in India. PQR India will be engaged in trading of items purchased from PQR Holdings. The shares of PQR India, having a face value of ₹ 10 each amounting to total of ₹ 500 crore, were issued to PQR Holdings in GBP on 1st April, 20X1.

PQR India has adopted Ind AS with effect from its incorporation. In accordance with Ind AS, management of PQR India has concluded that its functional currency is Indian Rupee ("INR"). Following is the summarized trial balance of PQR India as on 31st March, 20X2, being the reporting date of PQR India and PQR Holdings:

(Note: All amounts in the below mentioned trial balance are ₹ in crore)

S. No.	Particulars	Debit Balances	Credit Balances
1.	Share capital	-	500.0
2.	Securities premium reserve on issue of equity shares	-	150.0
3.	Retained earnings	-	110.0
4.	Long-term borrowings	-	30.0

5.	Deferred tax liability	-	10.0
6.	Income tax payable	-	25.0
7.	Import duty payable	-	5.0
8.	Employee benefits payable		7.5
9.	Sundry trade payables	-	2.5
10.	Property, plant and equipment (net of depreciation)	550.0	-
11.	Computer software (net of amortisation)	70.0	-
12.	Inventories purchased on 15 th March, 20X2	200.0	
	(there is no indicator of impairment)		
13.	Cash and bank balance	5.0	-
14.	Sundry trade receivables	17.0	-
15.	Allowance for doubtful trade receivables	-	2.0
	Total	842.0	842.0

Additional information relating to property, plant and equipment, and computer software:

Line item	Date of acquisition
Property, plant and equipment	30 th April, 20X1
Computer software	5 th May, 20X1

PQR India has adopted the following accounting policy in relation to shareholders' funds to translate equity:

Share capital	To be translated using historical exchange rate
Securities premium	To be translated using historical exchange rate
Retained earnings	To be translated using average exchange rate

Since the presentation currency of PQR Holdings is GBP, PQR India is required to translate its trial balance from INR to GBP. Following table provides relevant foreign exchange rates:

Closing spot rate as on 1 st April, 20X1	1 INR = 0.0123 GBP
Closing spot rate as on 30 th April, 20X1	1 INR = 0.0120 GBP
Closing spot rate as on 5 th May, 20X1	1 INR = 0.0119 GBP
Closing spot rate on 15 th March, 20X2	1 INR = 0.0108 GBP
Closing spot rate as on 31 st March, 20X2	1 INR = 0.0109 GBP
Average exchange rate for the year ended 31 st March, 20X2	1 INR = 0.0116 GBP

As the accountant of PQR India, you are required to do the following for its separate financial statements:

- Explain the principle of monetary and non-monetary items. Based on this principle, bifurcate the line items of the trial balance into monetary and non-monetary items.**
- Translate the trial balance of PQR India from INR to GBP. (MTP 14 Marks Nov 21)**

Answer 3

Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. Para 15 of Ind AS 21 states that the essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Similarly, a contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item.

Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency.

On the basis of above principles, the line items of trial balance should be bifurcated as follows:

Particulars	Monetary item / Non-monetary item
Share Capital	Non-monetary item
Securities Premium reserve on issue of equity shares	Non-monetary item
Retained earnings	Non-monetary item
Long-term borrowings	Monetary item
Deferred tax liability	Non-monetary item
Income tax payable	Monetary item
Import duty payable	Monetary item
Employee benefits payable	Monetary item
Sundry trade payables	Monetary item
Property, plant and equipment (net of depreciation)	Non-monetary item
Computer software (net of amortization)	Non-monetary item
Inventories purchased (there is no indicator of impairment)	Non-monetary item
Cash and bank balance	Monetary item
Sundry trade receivables	Monetary item
Allowance for doubtful trade receivables	Monetary item

As per para 38 of Ind AS 21, an entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

Translation of the balances for the purpose of consolidation

Particulars	INR in crore	Rate (GBP)	Amount in GBP
Property, plant and equipment (net of depreciation)	550.0	0.0109	5.995
Computer software (net of amortization)	70.0	0.0109	0.763
Inventories	200.0	0.0109	2.18
Cash and bank balance	5.0	0.0109	0.0545
Sundry trade receivables net of allowance for doubtful trade receivables (17.0-2.0)	15.0	0.0109	0.1635
Total Assets	840.0		9.156
Share Capital	500.0	0.0123	6.15
Securities Premium reserve	150.0	0.0123	1.845
Retained earnings	110.0	0.0116	1.276
Long-term borrowings	30.0	0.0109	0.327
Deferred tax liability	10.0	0.0109	0.109
Income tax payable	25.0	0.0109	0.2725



Import duty payable	5.0	0.0109	0.0545
Employee benefits payable	7.5	0.0109	0.08175
Sundry trade payables	2.5	0.0109	0.02725
Foreign Currency Translation reserve recognised in OCI (balancing figure)			(0.987)
Total Equity and liabilities	840.0		9.156

Question 4

Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1 st January, 20X1 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 20X1. USD 30 million is received on 1st April, 20X1 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 20X1 and 31st March, 20X1 are ₹ 72 per USD and ₹ 75 per USD respectively. (MTP 5 Marks March '23, RTP May'19, Old & New SM)

Answer 4

A Ltd. will recognise a non-monetary contract liability amounting ₹ 1,440 million, by translating USD 20 million at the exchange rate on 1st January, 20X1 ie ₹ 72 per USD.

A Ltd. will recognise revenue at 31st March, 20X1 (that is, the date on which it transfers the goods to the customer).

A Ltd. determines that the date of the transaction for the revenue relating to the advance consideration of USD 20 million is 1st January, 20X1. Applying paragraph 22 of Ind AS 21, A Ltd. determines that the date of the transaction for the remainder of the revenue as 31 st March, 20X1.

On 31st March, 20X1, A Ltd. will:

- derecognise the non-monetary contract liability of USD 20 million and recognise USD 20 million of revenue using the exchange rate as at 1st January, 20X1 ie ₹ 72 per USD; and
- recognise revenue and a receivable for the remaining USD 30 million, using the exchange rate on 31st March, 20X1 ie ₹ 75 per USD.
- the receivable of USD 30 million is a monetary item, so it should be translated using the closing rate until the receivable is settled.

Question 5

An entity can borrow funds in its functional currency (₹) @ 12%. It borrows \$ 1,000 @ 4% on 1st April, 20X1 when \$ 1 = ₹ 40. The equivalent amount in functional currency is ₹ 40,000. Interest is payable on 31st March, 20X2. On 31st March, 20X2, exchange rate is \$ 1 = ₹ 50. The loan is not due for repayment.

Compute exchange loss and borrowing cost to be capitalized as on 31 st March, 20X2. What will be exchange loss and borrowing cost to be capitalized as on 31 st March, 20X2 if the exchange rate on 31st March, 20X2, is \$ 1 = ₹ 41? (MTP 6 Marks Sep '23)

Answer 5

When the exchange rate on 31st March, 20X2, is \$ 1 = ₹ 50.

The exchange loss in this case is ₹ 10,000 [\$ 1,000 x (₹ 50 - ₹ 40)]. The borrowing cost is ₹ 2,000 (\$ 1,000 x 4% x ₹ 50).



Had the entity borrowed funds in functional currency the borrowing cost would have been ₹ 4,800 (₹ 40,000 x 12%).

The entity will treat exchange difference upto ₹ 2,800 (₹ 4,800 – ₹ 2,000) as a borrowing cost that may be eligible for capitalisation under this Standard.

Thus, the total eligible borrowing cost is ₹ 4,800 (₹ 2,000 + ₹ 2,800) equivalent to the cost of borrowing cost in functional currency.

When the exchange rate on 31st March, 20X2, is \$ 1 = ₹ 41.

The exchange loss would be ₹ 1,000 [\$ 1,000 – (₹ 41 – ₹ 40)]. The entity will treat the entire exchange loss as an eligible borrowing cost as total borrowing cost i.e. ₹ 2,640 [(₹ 1,000 x 4% x 41) + ₹ 1,000] since exchange loss in foreign currency does not exceed the cost of borrowings in functional currency, i.e., ₹ 4,800.

Question 6

On 30th January, 20X1, A Ltd. purchased a machinery for \$ 5,000 from USA supplier on credit basis. A Ltd.'s functional currency is Rupees. The exchange rate on the date of transaction is 1 \$ = ₹ 60. The fair value of the machinery determined on 31 st March, 20X1 is \$ 5,500. The exchange rate on 31st March, 20X1 is 1\$ = ₹ 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1\$ = ₹ 67. The fair value of the machinery remain unchanged for the year ended on 31 st March 20X2. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. Tax rate is 30%. A Ltd. follows Revaluation method in respect of Plant & Machinery. (MTP 8 Marks Oct '23)

Answer 6

Journal Entries

Purchase of Machinery on credit basis on 30th January, 20X1:

	₹	₹
Machinery A/c (\$ 5,000 x ₹ 60) Dr.	3,00,000	
To Creditors-Machinery A/c		3,00,000
(Initial transaction will be recorded at exchange rate on the date of transaction)		

Exchange difference arising on translating monetary item on 31 st March, 20X1:

	₹	₹
Profit & Loss A/c [(\$ 5,000 x ₹ 65) – (\$ 5,000 x ₹ 60)] Dr.	25,000	
To Creditors-Machinery A/c		25,000
Machinery A/c Dr.	30,000	
To Revaluation Surplus (OCI)		30,000
[Being Machinery revalued to \$ 5,500; (₹ 60 x (\$ 5,500 - \$ 5,000))]		
Machinery A/c Dr.	27,500	
To Revaluation Surplus (OCI)		27,500
(Being Machinery measured at the rate on exchange 31.3.20X1 [\$ 5,500 x (₹ 65 - ₹ 60)])		
Revaluation Surplus (OCI) Dr.	17,250	
To Deferred Tax Liability		17,250
(DTL created @ of 30% of the total OCI amount)		

Exchange difference arising on translating monetary item and settlement of creditors on 31st March, 20X2:

		₹	₹
Creditors-Machinery A/c (\$ 5,000 x ₹ 65)	Dr.	3,25,000	
Profit & loss A/c [(\$ 5,000 x (₹ 67 - ₹ 65))]	Dr.	10,000	
To Bank A/c			3,35,000
Machinery A/c [\$ 5,500 x (₹ 67 - ₹ 65)]	Dr.	11,000	
To Revaluation Surplus (OCI)			11,000
Revaluation Surplus (OCI)	Dr.	3,300	
To Deferred Tax Liability (DTL created @ of 30% of the total OCI amount)			3,300

Question 7

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

Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2018 as per Ind AS. (RTP Nov '18, Old & New SM)

Answer 7

As per Ind AS 21 'The Effects of Changes in Foreign Exchange Rates' the asset and liability would initially be recognised at the rate of exchange in force at the transaction date ie 1st January, 2018. Therefore, the amount initially recognised would be Rs. 1,36,00,000 (\$ 2,00 000 x Rs. 68).

The liability is a monetary item so it is retranslated using the rate of exchange in force at 31st March, 2018. This makes the closing liability of Rs. 1,30,00,000 (\$ 2,00,000 x Rs. 65).

The loss on re-translation of Rs. 6,00,000 (Rs. 1,36,00,000 – Rs. 1,30,00,000) is recognised in the Statement of profit or loss.

The machine is a non-monetary asset carried at historical cost. Therefore, it continues to be translated using the rate of Rs. 68 to \$ 1.

Depreciation of Rs. 8,50,000 (Rs. 1,36,00,000 x $\frac{1}{4}$ x 3/12) would be charged to profit or loss for the year ended 31st March, 2018.

The closing balance in property, plant and equipment would be Rs. 1,27,50,000 (Rs. 1,36,00,000 – Rs. 1,30,00,000). This would be shown as a non-current asset in the statement of financial position.

A Ltd. prepares its financial statements to 31st March each year. It operates a defined benefit retirement benefits plan on behalf of current and former employees. A Ltd. receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1st April, 2017, the actuaries advised that the present value of the defined benefit obligation was Rs. 6,00,00,000. On the same date, the fair value of the assets of the defined benefit plan was Rs. 5,20,00,000. On 1st April, 2017, the annual market yield on government bonds was 5%. During the year ended 31st March, 2018, A Ltd. made contributions of Rs. 70,00,000 into the plan and the plan paid out benefits of Rs. 42,00,000 to retired members. Both these payments were made on 31st March, 2018.

The actuaries advised that the current service cost for the year ended 31st March, 2018 was Rs. 62,00,000. On 28th February, 2018, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by Rs.

15,00,000 from that date.

During the year ended 31st March, 2018, A Ltd. was in negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by Rs. 80,00,000. Before 31st March, 2018, A Ltd. made payments of Rs. 75,00,000 to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.

On 31st March, 2018, the actuaries advised that the present value of the defined benefit obligation was Rs. 6,80,00,000. On the same date, the fair value of the assets of the defined benefit plan were Rs. 5,60,00,000.

Examine and present how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 2018 as per Ind AS.

Question 8

Global Limited, an Indian company acquired on 30th September, 20X1 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Global Limited is Rupees and its financial year end is 31st March, 20X2.

- (i) **The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30th September, 20X1. The exchange rates as at 30th September, 20X1 was Rs. 82 / EURO and at 31st March, 20X2 was Rs. 84 / EURO.**

What is the value at which the goodwill has to be recognised in the financial statements of Global Limited as on 31st March, 20X2?

- (ii) **Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 20X2. The exchange rate on the date of purchase by Global Limited was Rs. 83 / EURO and on 31st March, 20X2 was**

Rs. 84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements. (RTP Nov 19, May'21 Old & New SM)(Same concept different figures- PYP 6 Marks May'22)

Answer 8

- (i) Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42. In this case the amount of goodwill will be as follows:

Net identifiable asset	Dr.	23 million
Goodwill(bal. fig.)	Dr.	1.4 million
To Bank		17.5 million
To NCI (23 x 30%)		6.9 million

Thus, goodwill on reporting date would be 1.4 million EURO x Rs. 84
 = Rs. 117.6 million

- (ii)

Particulars	EURO in million
Sale price of Inventory	4.20
Unrealised Profit [a]	1.80

Exchange rate as on date of purchase of Inventory [b] Rs. 83 / Euro

Unrealized profit to be eliminated [a x b] Rs. 149.40 million

As per para 39 of Ind AS 21 “income and expenses for each statement of profit and loss presented (ie including comparatives) shall be translated at exchange rates at the dates of the transactions”. In the given case, purchase of inventory is an expense item shown in the statement profit and loss account. Hence, the exchange rate on the date of purchase of inventory is taken for calculation of unrealized profit which is to be eliminated on the event of consolidation.

Question 9

On 1st April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1st April, 20X1 - FCY 1 = Rs. 2.50.

- 31st March, 20X2 – FCY 1 = Rs. 2.75.

Average rate for the year ended 31st March, 20X2 – FCY 1 = Rs. 2.42. The functional currency of the group is Indian Rupee.

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2? Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain / loss. (RTP May 20, Old & New SM)

Answer 9

Initial carrying amount of loan in books

Loan amount received = 60,00,000 FCY Less:

Incremental issue costs = 2,00,000 FCY
 58,00,000 FCY

Ind AS 21, “The Effect of Changes in Foreign Exchange Rates” states that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized.

Loan to be converted in INR = 58,00,000 FCY x Rs. 2.50/FCY

= Rs. 1,45,00,000

Therefore, the loan would initially be recorded at Rs. 1,45,00,000.

Calculation of amortized cost of loan (in FCY) at the year end:

Period	Opening Financial Liability (FCY) A	Interest @ 12% (FCY) B	Cash Flow (FCY) C	Closing Financial Liability (FCY) A+B-C
20X1-20X2	58,00,000	6,96,000	6,00,000	58,96,000

The finance cost in FCY is 6,96,000

The finance cost would be recorded at an average rate for the period since it accrues over a period of time.

Hence, the finance cost for FY 20X1-20X2 in INR is Rs. 16,84,320 (6,96,000 FCY x Rs. 2.42 / FCY)

The actual payment of interest would be recorded at 6,00,000 x 2.75 = INR 16,50,000

The loan balance is a monetary item so it is translated at the rate of exchange at the reporting date.

So the closing loan balance in INR is 58,96,000 FCY x INR 2.75 / FCY = Rs. 1,62,14,000

The exchange differences that are created by this treatment are recognized in profit and loss.

In this case, the exchange difference is Rs. $[1,62,14,000 - (1,45,00,000 + 16,84,320 - 16,50,000)] = \text{Rs. } 16,79,680$.

This exchange difference is taken to profit and loss

Question 10

An Indian entity, whose functional currency is rupees, purchases USD dominated bond at its fair value of USD 1,000. The bond carries stated interest @ 4.7% p.a. on its face value. The said interest is received at the year end. The bond has maturity period of 5 years and is redeemable at its face value of USD 1,250. The fair value of the bond at the end of year 1 is USD 1,060. The exchange rate on the date of transaction and at the end of year 1 are USD 1 = Rs. 40 and USD 1 = Rs. 45, respectively. The weighted average exchange rate for the year is 1 USD = Rs. 42.

The entity has determined that it is holding the bond as part of an investment portfolio whose objective is met both by holding the asset to collect contractual cash flows and selling the asset. The purchased USD bond is to be classified under the FVTOCI category.

The bond results in effective interest rate (EIR) of 10% p.a.

Calculate gain or loss to be recognised in Profit & Loss and Other Comprehensive Income for year 1. Also pass journal entry to recognise gain or loss on above. (Round off the figures to nearest rupees) (RTP Nov 20, MTP 8 Marks Oct'22)

Answer 10

Computation of amounts to be recognized in the P&L and OCI:

Particulars	USD	Exchange rate	Rs.
Cost of the bond	1,000	40	40,000
Interest accrued @ 10% p.a.	100	42	4,200
Interest received (USD 1,250 x 4.7%)	(59)	45	(2,655)
Amortized cost at year-end	1,041	45	46,845
Fair value at year end	1,060	45	47,700
Interest income to be recognized in P&L			4,200
Exchange gain on the principal amount $[1,000 \times (45 - 40)]$			5,000
Exchange gain on interest accrual $[100 \times (45 - 42)]$			300
Total exchange gain/loss to be recognized in P&L			5,300
Fair value gain to be recognized in OCI $[45 \times (1,060 - 1,041)]$			855

Journal entry to recognize gain/loss

Bond (Rs. 47,700 – Rs. 40,000)	Dr.	7,700	
Bank (Interest received)	Dr.	2,655	
To Interest Income (P & L)			4,200
To Exchange gain (P & L)			5,300
To OCI (fair value gain)			855

Question 11

Infotech Global Ltd. (a stand-alone entity) has a functional currency of USD and needs to translate its financial statements into the presentation currency (INR). The following is the draft financial statements of Infotech Global Ltd. prepared in accordance with its functional currency.

Balance Sheet

Particulars	31st March, 20X3	31st March, 20X2
	USD	USD
Property, plant and equipment	50,000	55,000
Trade Receivables	68,500	56,000
Inventory	8,000	5,000
Cash	40,000	35,000
Total assets	1,66,500	1,51,000
Share Capital	50,000	50,000
Retained earnings	29,500	18,000
Total Equity	79,500	68,000
Trade payables	40,000	38,000
Loan	47,000	45,000
Total liabilities	87,000	83,000
Total equity and liabilities	1,66,500	1,51,000

Statement of Profit and Loss

Particulars	USD
Revenue	1,77,214
Cost of sales	1,13,100
Gross Profit	64,114
Distribution costs	2,400
Administrative expenses	18,000
Other expenses	11,000
Finance costs	12,000
Profit before tax	20,714
Income tax expense	6,214
Profit for the year	14,500

Extracts from Statement of Changes in Equity

Particulars	31st March, 20X3 (USD)
Retained earnings at the beginning of the year	18,000
Profit for the year	14,500
Dividends	(3,000)
Retained earnings at the end of the year	29,500

- Share capital was issued when the exchange rate was USD 1 = INR 70.
- Retained earnings on 1st April, 20X1 was INR 4,00,000.
- At 31st March, 20X2, a cumulative gain of INR 4,92,000 has been recognised in the foreign exchange reserve, which is due to translation of entity's financial statements into INR in the previous years.
- Entity paid a dividend of USD 3,000 when the rate of exchange was USD 1 = INR 73.5

- Profit for the year 20X1-20X2 of USD 8,000, translated in INR at INR 5,72,000.
- Profit for the year 20X2-20X3 of USD 14,500, translated in INR at INR 10,72,985.

For the sake of simplicity, items of income and expense are translated at weighted average monthly rate as there has been no significant exchange rate fluctuation during the entire year and the business of the entity is not cyclical in nature.

Relevant exchange rates are as follows:

- Rate at 31st March, 20X2 USD 1= INR 73
- Rate at 31st March, 20X3 USD 1= INR 75

Prepare financial statements of Infotech Global Ltd. translated from functional currency (USD) to presentation currency (INR). (RTP Nov '23)

Answer 11

As per paragraph 39 of Ind AS 21, all assets and liabilities are translated at the closing exchange rate which is USD 1 = INR 73 on 31st March, 20X2 and USD 1 = INR 75 on 31st March, 20X3.

In the given case, share capital is translated at the historical rate USD 1 = INR 70. The share capital will not be restated at each year end. It will remain unchanged.

Accordingly, the translated financial statements will be as follows:

Note 1: Retained earnings at 31st March, 20X3 and 31st March, 20X2:

Particulars	31st March, 20X3	31st March, 20X2
	INR	INR
Opening retained earnings	9,72,000	4,00,000
Profit for the year	10,72,985	5,72,000
Dividends paid (USD 3,000 x INR 73.5)	(2,20,500)	-
Closing retained earnings	18,24,485	9,72,000

Balance Sheet

Particulars	31st March, 20X3			31st March, 20X2		
	USD	Rate	INR	USD	Rate	INR
Property, plant and equipment	50,000	75	37,50,000	55,000	73	40,15,000
Trade Receivables	68,500	75	51,37,500	56,000	73	40,88,000
Inventory	8,000	75	6,00,000	5,000	73	3,65,000
Cash	40,000	75	30,00,000	35,000	73	25,55,000
Total assets	1,66,500		1,24,87,500	1,51,000		1,10,23,000
Share Capital	50,000	70	35,00,000	50,000	70	35,00,000
Retained earnings (Refer note 1)	29,500		18,24,485	18,000		9,72,000
Foreign Exchange reserve (Balancing figure)			6,38,015	-		4,92,000
Total Equity	79,500		59,62,500	68,000		49,64,000

Trade payables	40,000	75	30,00,000	38,000	73	27,74,000
Loan	47,000	75	35,25,000	45,000	73	32,85,000
Total liabilities	87,000		65,25,000	83,000		60,59,000
Total equity and liabilities	1,66,500		1,24,87,500	1,51,000		1,10,23,000

The foreign exchange reserve is the exchange difference resulting from translating income and expense at the average exchange rate and assets and liabilities at the closing rate.

Other Comprehensive Income

Exchange differences on translating from USD to INR (6,38,015 - 4,92,000)	INR 1,46,015

Statement of Changes in Equity (INR)

Particulars	Share capital	Retained Earnings	Foreign exchange reserve	Total
Balance at 1st April, 20X2	35,00,000	9,72,000	4,92,000	49,64,000
Dividends	-	(2,20,500)	-	(2,20,500)
Profit for the year	-	10,72,985	-	10,72,985
Exchange difference (transferred to OCI)	-	-	1,46,015	1,46,015
Balance at 31st March, 20X3	35,00,000	18,24,485	6,38,015	59,62,500

Question 12

XYZ Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of XYZ Info. (Euro).

The following is the statement of financial position of XYZ Global Ltd. prior to translation :

	USD	Euro
Property, plant and equipment	60,000	
Receivables	9,00,000	
Total assets	9,60,000	
Issued capital	40,000	25,000
Opening retained earnings	25,000	15,000
Profit for the year	22,000	
Accounts payable	8,15,000	
Accrued liabilities	58,000	
Total equity and liabilities	9,60,000	

Additional information:

Relevant exchange rates are:

Rate at the beginning of the year – Euro = USD 1.25 = 1

Average rate for the year - Euro 1 = USD 1.20 Rate at the end of the year - Euro 1 = USD 1.15 You are required to :

(i) Translate the statement of financial position of XYZ Global Ltd. into Euro which is ready for

consolidation by XYZ Info. (Share capital and opening retained earnings have been pre-calculated.)

- (ii) Prepare a working of the cumulative balance of the foreign currency translation reserve as per relevant Ind AS. (PYP 5 Marks, May'19) (Same concept different figures- Old & New SM)

Answer 12

Translation of the financial statements

	USD a	Rate/Euro b	Euro a/b
Property, plant and equipment	60,000	1.15	52,174
Receivables	9,00,000	1.15	7,82,609
Total assets	9,60,000		8,34,783
Issued capital	40,000		25,000
Opening retained earnings	25,000		15,000
Profit for the year	22,000	1.20	18,333
Accounts payable	8,15,000	1.15	7,08,696
Accrued liabilities	58,000	1.15	50,435
Total equity and liabilities	9,60,000		8,17,464
Foreign Currency Translation Reserve (FCTR) (Refer the below working)			17,319
Total equity and liabilities			8,34,783

Working of the cumulative balance of the FCTR

Particulars	Actual translated amount in Euro	Amount	Difference translated at closing rate of USD 1.15 / EURO
	a	b	b-a
Issued capital	25,000	34,783*	9,783
Opening retained earnings	15,000	21,739**	6,739
Profit for the year	18,333	19,130***	797
	58,333	... 75,652	17,319

$$* \frac{40,000}{1.15} = 34,783 \quad ** \frac{25,000}{1.15} = 21,739 \quad *** \frac{22,000}{1.15} = 19,130$$

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Many examinees have multiplied the USD value by EURO rates instead of dividing it. Thus, the whole solution went wrong. A few examinees failed to present the working of cumulative balance of Foreign Currency Translation Reserve (FCTR).

Question 13

SB Limited is engaged in the business of producing extracts from the natural plants for pharmaceuticals and Ayurvedic companies. It has a wholly owned subsidiary, UB Limited which is engaged in the business of pharmaceuticals. UB Limited purchases the pharmaceuticals extracts from its parent company. The demand of UB Limited is very high and hence to cater its shortfall, UB Limited also purchases the pharmaceutical extracts from other companies. Purchases are made at the competitive prices.



SB Limited sold pharmaceutical extracts to UB Limited for Euro 10 lakhs on 1st February, 2021. The cost of these extracts was ₹ 770 lakh in the books of SB Limited at the time of sale. At the year-end, i.e. 31st March 2021, all these pharmaceutical extracts were lying as closing stock and payable with UB Limited.

Euro is the functional currency of UB Limited while Indian-Rupee is the functional currency of SB Limited.

Following additional information is available:

Exchange rate on 1st February 2021 1 Euro = ₹ 85

Exchange rate on 31st March 2021 1 Euro = ₹ 88

Provide the accounting treatment of the above in the books of SB Limited and UB Limited.

Also show its impact on consolidated financial statements. Support your answer by journal entries, wherever necessary. Assume NRV to be higher than the cost. (PYP 5 Marks July 21) (Same concept different figures- MTP 8 Marks April 22, Old & New SM)

Answer 13

Accounting treatment in the books of SB Ltd (Functional Currency INR)

SB Ltd will recognize sales of ₹ 850 lakh (10 lacs Euro x ₹ 85) Profit on sale of inventory = 850 lakh – 770 lakh = ₹ 80 lakh.

On balance sheet date receivable from UB Ltd. will be translated at closing rate i.e. 1 Euro = ₹ 88. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ₹ 30 lakh [i.e. (₹ 88 - ₹ 85) x 10 lakh Euro].

Journal Entries

Date		(₹ in lakh)	(₹ in lakh)
1.2.2021	UB Ltd. A/c Dr. To Sales (Being revenue recorded on initial recognition)	850	850
31.3.2021	UB Ltd. A/c Dr. To Foreign exchange difference (unrealised) (Being foreign exchange difference recorded at year end)	30	30

Accounting treatment in the books of UB Ltd (Functional currency EURO)

Date		in Euros	in Euros
1.2.2021	Purchase account Dr. To SB limited (Being purchased recorded at the date of transaction)	10 lakh	10 lakh

UB Ltd will recognize inventory on 1st February, 2021 of Euro 10 lakh which will also be its closing stock at year end

Accounting treatment in the consolidated financial statements

Receivable and payable in respect of abovementioned sale / purchase between SB Ltd and UB Ltd will get eliminated.

The closing stock of UB Ltd will be recorded at lower of cost or NRV.

Since the question ask to assume that NRV is higher than cost, inventory will be measured at cost only.

Therefore, no write off is required.

The amount of closing stock of ₹ 850 lakh include two components–

- Cost of inventory for ₹ 770 lakh ; and
- Profit element of ₹ 80 lakh; and

At the time of consolidation, the second element amounting to ₹ 80 lakh will be eliminated from the closing stock.

Journal Entry

				(₹ in lakh)	(₹ in lakh)
Consolidated P&L A/c			Dr.	80	
To Inventory					80
(Being profit element eliminated)	of	intragroup	transaction		

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Examinees were not able to pass correct journal entries specifically for UB Ltd. and for the purpose of consolidated financial statements.

Question 14

Hari Ltd. purchased an equipment for 10,200 CAD from Canada supplier on credit basis on 31st January, 2020. Hari Ltd.'s functional currency is INR. The fair value of the equipment determined on 31st March, 2020 is 12,100 CAD. The payment to overseas supplier done on 31st March 2021 and the fair value of the equipment remains unchanged for the year ended on 31st March, 2021.

The exchange rates are as follow:

- On the date of transaction - 1 CAD = INR 57.68
- On 31st March, 2020 - 1 CAD = INR 62.12
- On 31st March 2021 -1 CAD = INR 69.24

Prepare the journal entries for the year ended on 31st March, 2020 and 31st March, 2021 according to Ind AS 21. Tax rate is 25%. Hari Ltd. follows revaluation model as per Ind AS 16 in respect of Property Plant & Equipment. (PYP 5 Marks Dec '21) (Same concept different figures- RTP May 18, Old & New SM)

Answer 14

Journal Entries

Purchase of an equipment on credit basis on 30th January 2020:

	₹	₹
Equipment A/c (10,200 CAD x ₹ 57.68) Dr.	5,88,336	
To Creditors – Equipment A/c		5,88,336
(Being initial transaction recorded at exchange rate on the date of transaction)		

Exchange difference arising on translating monetary item on 31 st March 2020:

	₹	₹
Profit & Loss A/c [(10,200 CAD x ₹ 62.12) – (10,200 CAD x ₹ 57.68)] Dr.	45,288	
To Creditors – Equipment A/c		45,288
(Being loss on exchange difference recognised)		
Equipment A/c Dr.	1,09,592	



To Revaluation Surplus (OCI) (Being equipment revalued to 12,100 CAD [$\text{₹ } 57.68 \times (12,100 \text{ CAD} - 10,200 \text{ CAD})$])		1,09,592
Equipment A/c Dr. To Revaluation Surplus (OCI) (Being equipment measured at the exchange rate on 31.3.2020 [$12,100 \text{ CAD} \times (\text{₹ } 62.12 - \text{₹ } 57.68)$])	53,724	53,724
Revaluation Surplus (OCI) [$(1,09,592 + 53,724) \times 25\%$] Dr. To Deferred Tax Liability (Being DTL created @ 25% of the total OCI amount)	40,829	40,829

Exchange difference arising on translating monetary item and settlement of creditors on 31st March 2021:

	₹	₹
Creditors - Equipment A/c ($10,200 \text{ CAD} \times \text{₹ } 62.12$) Dr.	6,33,624	
Profit & loss A/c [$(10,200 \text{ CAD} \times (\text{₹ } 69.24 - \text{₹ } 62.12))$] Dr.	72,624	
To Bank A/c (Being final settlement of creditors done)		7,06,248
Equipment A/c [$(12,100 \text{ CAD} \times (\text{₹ } 69.24 - \text{₹ } 62.12))$] Dr.	86,152	
To Revaluation Surplus (OCI) (Being equipment revalued)		86,152
Revaluation Surplus (OCI) ($86,152 \times 25\%$) Dr.	21,538	
To Deferred Tax Liability (Being DTL created @ 25% of the total OCI amount)		21,538

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question required application of Ind AS 21 on purchase of an asset in foreign currency from foreign vendor. Examinees wrongly credited change in the value of asset due to revaluation through Profit and Loss Account instead of OCI. A few examinees either did not compute the defer tax liability on revaluation of the asset or wrongly treated it as defer tax asset.



Chapter 10.1

Ind AS 24 Related Party Disclosures

Question 1

Mr. X has a 100% investment in A Ltd. He is also a member of the key management personnel (KMP) of B Ltd. B Ltd has a 100% investment in C Ltd.

Examine related party relationship of A Ltd., as per Ind AS 24, in the financial statements of C Ltd. (MTP 4 Marks Aug '18)

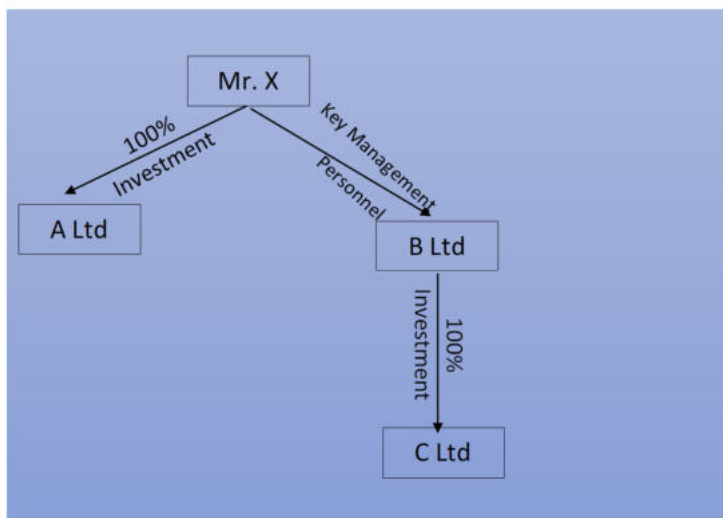
Answer 1

Para 9 of Ind AS 24 defines the term “key management personnel” as persons having authority and responsibility for planning, directing and controlling the activities of the entity directly or indirectly, including any director (whether executive or not). Further, significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Therefore, a key management personnel (KMP) has significant influence over the entity. Accordingly, Mr. X has significant influence over B Ltd. since he is a key management personnel of B Ltd.

Now, para 9(vii) of the standard states that an entity is related to a reporting entity if the person identified in para 9(a)(i) (here KMP ie. Mr. X) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)”

Therefore, if C Ltd. is a reporting entity, A Ltd. is related to C Ltd. because a key management personnel of parent B Limited has control over A Limited. Therefore, the relationship of C Ltd. and A Ltd. will be “Entities controlled by key management personnel of the Parent Entity”.



Question 2

An Indian company has a parent company out side India. Parent company negotiates software licenses with end vendor and based on number of licences, parent company get its reimbursement from Indian company. Say, license cost of Rs. 12 Lac is charged for calendar year of 2018. Parent company generates invoice in February'18. Indian company accounts full invoice in February'18 and then for Indian financial year, accounts Reimbursement expense of Rs. 3.00 Lac during FY 1718 (for licencing cost relating to period January'18 to March'18) and Prepaid expenses of Rs. 9 Lac for licensing cost reimbursement relating to April'18 to December'18. Prepaid expense is subsequently reversed and expense of Rs. 9 Lac is accounted for in FY 18-19.

What amount should be disclosed at Related party transaction?(MTP 4 Marks Mar '19)

**Answer 2**

Paragraph 9 of Ind AS 24 Related Party Disclosures defines Related Party Transactions as under:

“A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.”

Paragraph 6 of Ind AS 24 states as under:

“6 A related party relationship could have an effect on the profit or loss and financial position of an entity...”

In the given case, there is a transfer of resources to the extent of Rs.12 lac from the company to the parent towards software license. Of this transfer of resources, the company has consumed the benefits relating to Rs.3 lac of software license cost which is recognised in profit or loss. The benefits relating to Rs.9 lac of software license cost will be consumed in the next reporting period and therefore is recognised in balance sheet as prepaid expenses.

Paragraph 18 of Ind AS 24 states as under:

“18 If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments necessary for users to understand the potential effect of the relationship of the financial statements. At a minimum, disclosures shall include:

- a. The amount of the transactions;
- b. The amount of outstanding balances, including commitments, and;
 - (i) Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
 - (ii) Details of any guarantees given or received;
- c. Provisions for doubtful debts related to the amount of outstanding balances; and
- d. The expense recognised during the period in respect of bad and doubtful debts due from related parties.”

Therefore, the company has to disclose:

1. The amount of transaction with the parent of Rs.12 lac towards software license;
2. Outstanding balance of Rs.9 lac presented as prepaid expense along with the terms and conditions and state that the same will be settled in the next reporting period by receipt of software licensing services.
3. The amount of Rs.3 lac recognized as software license expense in profit or loss for the benefits consumed during the period to make it understandable to users.

Paragraph 113 of Ind AS 1 Presentation of Financial Statements states as under:

“113 An entity shall present notes in a systematic manner. An entity shall cross-reference each line items in the balance sheet and in the statement of profit and loss, and in the statement of changes in equity and of cash flows to any related information in the notes.”

Therefore, the company shall cross-reference the software license expense recognised in profit or loss and prepaid expenses recognised in balance sheet to the notes disclosing related party transactions.

Question 3

Mr. Atul is an independent director of a company X Ltd. He plays a vital role in the management of X Ltd. and contributes in major decision making process of the organisation. X Ltd. pays sitting fee of Rs.2,00,000 to him for every Board of Directors' (BOD) meeting he attends. Throughout the year, X Ltd. had 5 such meetings which was attended by Mr. Atul.

Similarly, a non-executive director, Mr. Naveen also attended 5 BOD meetings and charged Rs.



1,50,000 per meeting. The Accountant of X Ltd. believes that they being not the employees of the organisation, their fee should not be disclosed as per related party transaction.

Examine whether the sitting fee paid to independent director and non-executive director is required to be disclosed in the financial statements prepared as per Ind AS? (MTP 4 Marks May '20, RTP May'18, Old & New SM)

Answer 3

As per paragraph 9 of Ind AS 24, Related Party Disclosures, "Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity."

Accordingly, key management personnel (KMP) includes any director of the entity who are having authority and responsibility for planning, directing and controlling the activities of the entity. Hence, independent director Mr. Atul and non-executive director Mr. Naveen are covered under the definition of KMP in accordance with Ind AS.

Also as per paragraph 7 and 9 of Ind AS 19, 'Employee Benefits', an employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of the Standard, Employees include directors and other management personnel.

Therefore, contention of the Accountant is wrong that they are not employees of X Ltd.

Paragraph 17 of Ind AS requires disclosure about employee benefits for key management personnel. Therefore, an entity shall disclose key management personnel compensation in total i.e. disclosure of directors' fee of (Rs. 10,00,000 + Rs. 7,50,000) Rs. 17,50,000 is to be made as employees benefits (under various categories).

Since short-term employee benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services, the sitting fee paid to directors will fall under it (as per Ind AS 19) and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.

Question 4

ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs. P whose husband is a director in XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1 June 2019. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1 April 2019 to 31 May 2019 totalled

Rs. 8,00,000. Following the share purchase by Mrs. P, XYZ Ltd. began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months' credit (previously ABC Ltd. was only allowed one month's credit, XYZ Ltd.'s normal credit policy). Sales of products from XYZ Ltd. to ABC Ltd. in the ten-month period from 1 June 2019 to 31 March 2020 totalled Rs. 60,00,000. On 31 March 2020, the trade receivables of XYZ Ltd. included Rs. 18,00,000 in respect of amounts owing by ABC Ltd.

Analyse and show (where possible by quantifying amounts) how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31 March 2020 as per Ind AS. You are required to mention the disclosure requirements as well.(MTP 5 Marks Oct '20, RTP Nov'18, Old & New SM)

Answer 4

XYZ Ltd. would include the total revenue of Rs. 68,00,000 (Rs. 60,00,000 + Rs. 8,00,000) from ABC Ltd. received / receivable in the year ended 31st March 2020 within its revenue and show Rs. 18,00,000 within trade receivables at 31 March 2020.

Mrs. P would be regarded as a related party of XYZ Ltd. because she is a close family member of one of the key management personnel of XYZ Ltd.

From 1st June 2019, ABC Ltd. would also be regarded as a related party of XYZ Ltd. because from that date ABC Ltd. is an entity controlled by another related party.



Since ABC Ltd. is a related party with whom XYZ Ltd. has transactions, XYZ Ltd. should disclose:

- The nature of the related party relationship.
- The revenue of Rs. 60,00,000 from ABC Ltd. since 1st June 2019.
- The outstanding balance of Rs. 18,00,000 at 31st March 2020.

In the current circumstances it may well be necessary for XYZ Ltd. to also disclose the favourable terms under which the transactions are carried out.

Question 5

Mr. X has a 100% investment in A Limited. He is also a member of the key management personnel (KMP) of C Limited. B Limited has a 100% investment in C Limited.

Required

Examine related party relationships from the perspective of C Limited for A

- (a) Limited.**
- (b) Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a KMP of B Limited and not C Limited.**
- (c) Will the outcome in (a) & (b) would be different if Mr. X has joint control over A Limited.**
- (d) Will the outcome in (a) & (b) would be different if Mr. X has significant influence over A Limited. (MTP 4 Marks Nov 21)**

Answer 5

- (a) A Limited is related to C Limited because Mr. X controls A Limited and is a member of KMP of C Limited.
- (b) Still A Limited will be related to C Limited.
- (c) No, Still A Limited will be related to C Limited.
- (d) Yes, A Ltd. is not controlled by Mr. X. Therefore, despite Mr. X being KMP of C Ltd., A Ltd., having significant influence of Mr. X, will not be considered as related party of C Limited.

Question 6

State any 5 major differences between Ind AS 24 and AS 18. (MTP 5 Marks Oct'22)

Answer 6

Note: Students may answer any 5 points out of the 11 points mentioned below.

S.No.	Particulars	Ind AS 24	AS 18
1.	Definition of Relative	Ind AS 24 uses the term "a close member of the family of a person".	AS 18 uses the term "relatives of an individual"
		Definition of close members of family as per Ind AS 24 includes those family members, who may be expected to influence, or be influenced by, that person in their dealings with the entity, including: (a) that person's children, spouse or domestic partner, brother, sister, father and mother; (b) children of that person's spouse or domestic partner; and (c) dependents of that person or that person's spouse or domestic partner.	AS 18 covers the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.



		Hence, the definition as per Ind AS 24 is much wider.	
2.	State Controlled Enterprise:	Ind AS 24, there is extended coverage of Government Enterprises, as it defines a government-related entity as “an entity that is controlled, jointly controlled or significantly influenced by a government.” Further, “Government refers to government, government agencies and similar bodies whether local, national or international.”	AS 18 defines state- controlled enterprise as “an enterprise which is under the control of the Central Government and/or any State Government(s)”.
3.	Key Management Personnel	Ind AS 24 covers KMP of the parent as well. Ind AS 24 also covers the entity, or any member of a group of which it is a part, providing key management personnel services to the reporting entity or to the parent of the reporting entity	AS 18 covers key management personnel (KMP) of the entity only
4.	Related Parties in case of Joint Venture	Under Ind AS 24 there is extended coverage in case of joint ventures. Two entities are related to each other in both their financial statements, if they are either co- venturers or one is a venturer and the other is an associate.	As per AS 18, co-venturers or co-associates are not related to each other.
5.	Effect of influences which do not lead to transactions	Ind AS 24 does not specifically mention this.	AS 18 mentions that where there is an inherent difficulty for management to determine the effect of influences which do not lead to transactions, disclosure of such effects is not required
6.	Post-employment Benefits	Ind AS 24 specifically includes post-employment benefit plans for the benefit of employees of an entity or its related entity as related parties.	AS 18 does not specifically cover entities that are post-employment benefit plans, as related parties.
7.	Next Most Senior Parent	Ind AS 24 requires an additional disclosure as to the name of the next most senior parent which produces consolidated financial statements for public use.	AS 18 has no such requirement.
8.	Disclosure for Compensation	Ind AS 24 requires extended disclosures for compensation of KMP under different categories.	AS 18 does not specifically require
9.	Disclosure of ‘Amount of the Transactions’ vs ‘Volume of the Transactions	Ind AS 24 requires “the amount of the transactions” need to be disclosed.	AS 18 gives an option to disclose the “Volume of the transactions either as an amount or as an appropriate proportion”.
10.	Government Related Entities:	Ind AS 24 requires disclosures of certain information by the government related entities.	AS 18 presently exempts the disclosure of such information.
11.	Clarification of Control, Substantial Interest and Significant	Ind AS 24 neither defines these terms nor it includes such clarificatory text and allows respective standards to deal with	AS 18 includes definition and clarificatory text, primarily with regard to control, substantial



	Influence	the same.	interest (including 20% threshold), significant influence (including 20% threshold)

Question 7

Mr. X is a domestic partner of Ms. Y. Mr. X has an investment in A Limited and Ms. Y has an investment in B Limited.

- (i) **Examine when can a related party relationship is established, from the perspective of A Limited's financial statements.**
- (ii) **Examine when can related party relationship is established, from the perspective of B Limited's financial statements.**
- (iii) **Will A Limited and B Limited be related parties if Mr. X has only significant influence over A Limited and Ms. Y also has significant influence over B Limited. (MTP 5 Marks April 22)**

Answer 7

- (i) If Mr. X controls or jointly controls A Limited, then Mr. X is a related party to A limited. B Limited will be considered as related to A Limited when Ms. Y also has control, joint control or significant influence over B Limited because Ms. Y is a domestic partner of Mr. X.
- (ii) If Ms. Y controls or jointly controls B Limited, then Ms. Y is a related party to B limited. A Limited will be considered as related to B Limited when Mr. X also has control, joint control or significant influence over A Limited because Mr. X is a domestic partner of Ms. Y.
- (iii) No, Significant influence does not lead to direct / indirect control between the A Ltd. and B Ltd. Hence, they will not be considered as related party.

Question 8

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director for approval. Mr. Y, who is not an accountant, had raised following queries from Mr. X after going through the draft financial statements:

One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period. Mr. Y own 100% of the shares in PQR Ltd.. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases. (RTP Nov '18, Old & New SM)

Answer 8

Ongoing through the queries raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

- (a) Related parties are generally characterised by the presence of control or influence between the two parties.

Ind AS 24 'Related Party Disclosures' identifies related parties as, inter alia, key management personnel and companies controlled by key management personnel. On this basis, PQR Ltd. is a related party of ABC Ltd.

The transaction is required to be disclosed in the financial statements of ABC Ltd. since Mr. Y is Key Management personnel of ABC Ltd. Also at the same time, it owns 100% shares of PQR Ltd. ie. he controls PQR Ltd. This implies that PQR Ltd. is a related party of ABC Ltd.

Where transactions occur with related parties, Ind AS 24 requires that details of the transactions are disclosed in a note to the financial statements. This is required even if the transactions are carried out on an arm's length basis.



Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to ABC Ltd. does not affect the need for disclosure.

Question 9

Uttar Pradesh State Government holds 60% shares in PQR Limited and 55% shares in ABC Limited. PQR Limited has two subsidiaries namely P Limited and Q Limited. ABC Limited has two subsidiaries namely A Limited and B Limited. Mr. KM is one of the Key management personnel in PQR Limited.

- (a) Determine the entity to whom exemption from disclosure of related party transactions is to be given. Also examine the transactions and with whom such exemption applies.**
- (b) What are the disclosure requirements for the entity which has availed the exemption? (RTP Nov '19, Old & New SM)**

Answer 9

- (a)** As per para 18 of Ind AS 24, 'Related Party Disclosures', if an entity had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements.

However, as per para 25 of the standard a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with:

- (i) a government that has control or joint control of, or significant influence over, the reporting entity; and
- (ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity

According to the above paras, for Entity P's financial statements, the exemption in paragraph 25 applies to:

- (i) transactions with Government Uttar Pradesh State Government; and
- (ii) transactions with Entities PQR and ABC and Entities Q, A and B.

Similar exemptions are available to Entities PQR, ABC, Q, A and B, with the transactions with UP State Government and other entities controlled directly or indirectly by UP State Government. However, that exemption does not apply to transactions with Mr. KM. Hence, the transactions with Mr. KM needs to be disclosed under related party transactions.

- (b)** It shall disclose the following about the transactions and related outstanding balances referred to in paragraph 25:
 - (a) the name of the government and the nature of its relationship with the reporting entity (ie control, joint control or significant influence);
 - (b) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
 - (i) the nature and amount of each individually significant transaction; and
 - (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Question 10

Mr. X owns 95% of entity A and is its director. He is also beneficiary of a trust that owns 100% of entity B, of which he is a director.

Whether entities A and B are related parties? Would the situation be different if:

- (a) Mr. X resigned as a director of entity A, but retained his 95% holding?**



(b) Mr. X resigned as a director of entities A and B and transferred the 95% holding in entity A to the trust? (RTP Nov '20)

Answer 10

Entities A and B are related parties, because the director (Mr. X) controls entity A and is a member of the key management personnel of entity B.

Answers to different given situations would be as under:

Mr. X resigned as a director of entity A, but retained his 95% holding

Mr. X continues to control entity A through his 95% holding even though he is not (nominally) a director of the entity. Entities A and B are related if Mr. X controls the trust. Mr. X controls entity A and also, through the trust, controls entity B. Entities A and B are controlled by the same person, and so they are related parties.

Mr. X might still be a member of 'key management personnel' even though he is not (nominally) a director of entity A. Key management personnel includes, but is not restricted to, directors, which include those who are executive 'or otherwise' provided they had authority and responsibility for planning, directing and controlling the activities of the entity. There could be two reasons why entities A and B would continue to be related parties: Mr. X being a member of 'Key management personnel' of entity A and Mr. X controlling entity A.

Mr. X resigned as a director of entities A and B and transferred the 95% holding in entity A to the trust.

If Mr. X controls the trust, he controls entities A and B through the trust, so they will be related parties (see reason in (a) above)

Mr. X is a member of 'key management personnel' of the two entities (see (a) above) if, as seems likely, he continues to direct their operating and financial policies. The substance of the relationship and not merely the legal form should be considered. If Mr X is regarded as a member of the key management personnel of, say, entity A, entity B is a related party, because he exercises control or significant influence over entity B by virtue of his control over the trust.

Question 11

Entity A owns 30% of the share capital of entity B and has the ability to exercise significant influence over it.

Entity B holds the following investments:

- 70% of the share capital of its subsidiary, entity C; and
- 30% of the share capital of entity D, with the ability to exercise significant influence.

Entity A transacts with entities C and D. Should entity A disclose these transactions as related party transactions in its separate financial statements? Also explain the disclosure of such transactions in the financial statements of C and D as related party transaction. (RTP May '22)

Answer 11

Entity A should disclose its transactions with entity C in entity A's separate financial statements. Entity C is a related party of entity A, because entity C is the subsidiary of entity A's associate, entity B.

Entity A's management is not required to disclose entity A's transactions with entity D in its financial statements. Entity D is not a related party of entity A, because entity A has no ability to exercise control or significant influence over entity D.

Entity C is required to disclose its transactions with entity A in its financial statements, because entity A is a related party.

Entity D is not required to disclose transactions with entity A, because they are not related parties.



Question 12

Mr. M has an investment in X Limited and Y Limited

- i. Under what circumstances, Mr. M is a related party of X Limited and Y Limited?**
- ii. Will X Limited and Y Limited be related parties, if Mr. M has only significant influence over both X Limited and Y Limited? (PYP 4 Marks May '23)**

Answer 12

- (i) As per para 9(a) of Ind AS 24, Mr. M will be considered as a related party to X Limited, when
 1. Mr. M has control or joint control over X Limited
 2. Mr. M has significant influence over X LimitedSimilar will be the circumstances for Mr. M being considered as related party to Y Limited.
- (ii) Even if Mr. X has only significant influence over both the entities i.e., X Limited & Y Limited, then both the entities (X Limited & Y Limited) will not be considered as related party, if no direct or indirect control is exercised on each other in any of the manner.



Chapter 10.2

Ind AS 33 Earnings Per Share

Question 1

Mittal Motors Limited is preparing financials for the year ended March 31, 20 X2. The Company had some queries in preparation of certain data that is required to be presented in the financials. As the retainer of the Company, please advise the company for the following issues:

- (i) Mittal Motors has issued 10,00,000 numbers of 9% cumulative preference shares. The Company has arrears of Rs. 15 crores of preference dividend as on March 31, 20X2, it includes current year arrears of Rs. 1.75 crores. The Company did not declare any dividend for equity shareholders as well as for preference shareholders.

What is the amount of dividend to be reduced from profit or loss for the year for calculating basic Earnings Per Share?

- (ii) Further Mittal Motors has also issued certain convertible debentures, which are outstanding as at the year end. For the purpose of computation of weighted average number of shares (to arrive at diluted EPS) when should the dilutive potential shares should be deemed to have been converted into shares?
- (A) At the start of the period.
- (B) The date of issue of the potential shares
- (C) At the start of the period or, if later, the date of the issue of the potential shares
- (D) At the end of the period. (MTP 5 Marks Oct '19)

Answer 1

- i. As per para 14 (b) of Ind AS 33 "Earnings per share", "The after-tax amount of preference dividends that is deducted from profit or loss is the after-tax amount of the preference dividends for cumulative preference shares required for the period, whether or not the dividends have been declared. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods". In the given case, the amount of preference dividends Rs.1.75 crores declared for the year ended March 31, 20X2 (i.e., the current period) is to be deducted from profit or loss for calculating EPS.
- ii. As per para 36 of Ind AS 33 "Earnings per share", "For the purpose of calculating diluted earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares. Dilutive potential ordinary shares shall be deemed to have been converted into ordinary shares at the beginning of the period or, if later, the date of the issue of the potential ordinary shares"

Question 2

Explain why weighted average number of shares are used in the calculation of earnings per share and how it is calculated.

Following is the data for company XYZ in respect of number of equity shares during the financial year 20X1-20X2. Find out the number of shares for the purpose of calculation of basic EPS.

S. No.	Date	Particulars	Number of shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	1,00,000
2	15-Jun-20X1	Issue of equity shares	75,000
3	8-Nov-20X1	Conversion of convertible preference shares in Equity	50,000
4	22-Feb-20X2	Buy back of shares	(20,000)
5	31-Mar-20X2	Closing balance of outstanding equity shares	205,000



(MTP 4 Marks May '20, Oct'22 Old & New SM)

Answer 2

As per para 20 of Ind AS 33, Earnings per share, the weighted average number of ordinary shares outstanding during the period reflects the possibility that the amount of shareholders' capital varied during the period as a result of a larger or smaller number of shares being outstanding at any time. The weighted average number of ordinary shares outstanding during the period is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time - weighting factor. The time weighting factor is the number of days that the shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

Formula

The weighted average number of shares is calculated as follows:

Number of shares x (number of days the shares were held during the year / 365)

Following the above formula, the weighted average number of shares for calculation of EPS for the year 20X1-20X2 will be as follows:

Sr. No.	Date	Particulars	No of shares	No of days shares were outstanding	Weighted average no of shares
1	1April 20X1	Opening balance of outstanding equity shares	1,00,000	365	1,00,000
2	15June 20X1	Issue of equity shares	75,000	290	59,589
3	8November 20X1	Conversion of convertible preference shares in Equity	50,000	144	19,726
4	22February 20X2	Buy back of shares	(20,000)	(38)*	(2,082)
5	31March 20X2	Closing balance of outstanding equity shares	2,05,000		1,77,233

*These shares had already been considered in the shares issued. The same has been deducted assuming that the bought back shares have been extinguished immediately.

Question 3

ABC Ltd. has 1,000,000 Rs. 1 ordinary shares and 1,000 Rs. 100 10% convertible bonds (issued at par), each convertible into 20 ordinary shares on demand, all of which have been in issue for the whole of the reporting period. ABC Ltd.'s share price is Rs. 4.50 per share and earnings for the period are Rs. 500,000. The tax rate applicable to the entity is 21%.

Calculate basic EPS, earnings per incremental share for the convertible bonds and diluted EPS.

(MTP 4 Marks March '21, Old & New SM)

Answer 3

Basic EPS is Rs. 0.50 per share (ie 500,000/1,000,000)

The earnings per incremental share for the convertible bonds is calculated as follows:

Earnings effect = No. of bonds x nominal value x interest cost x (1 – applicable tax rate)

= 1,000 x 100 x 10% x (1- 0.21) = Rs. 7,900.

Incremental shares calculation

Assume all bonds are converted to shares, even though this converts Rs. 100 worth of bonds into 20



Consolidated earnings per share

Basic EPS Rs. 1.63 calculated:

Rs. 12.000(a) + Rs. 4.300 (b) / 10.000(c)

Diluted EPS Rs. 1.61 calculated: Rs. 12.000 + Rs. 2.928(d) + Rs. 55(e) + Rs. 1,098(f) / 10,000

- (a) Parent's profit attributable to ordinary equity holders of the parent entity.
- (b) Portion of subsidiary's Profit to be included in consolidated basic earnings per share, calculated: (800X Rs. 5.00) + (300X Re.1.00)
- (c) Parent's ordinary shares outstanding.
- (d) Parent's proportionate interest in subsidiary's earnings attributable to ordinary shares, calculated: (800 / 1,000) X (1,000 shares X Rs. 3.66 per share).
- (e) Parent's proportionate interest in subsidiary's earnings attributable to warrants, calculated: (30 + 150) X (75 incremental shares X Rs. 3.66 per share).
- (f) Parent's proportionate interest in subsidiary's earnings attributable to convertible preference shares, calculated: (300 + 400) X (400 shares from conversion X Rs. 3.66 per share).

Question 5

Sohan has been recently hired in Zio Life Limited. Since he is facing difficulty in computation of EPS as per Ind AS 33, guide him by discussing the steps for the calculation of Basic EPS and Diluted EPS along with the necessary computations for EPS of Year 1.

The following basic facts relate to Company Zio Life Limited.

- Net profit for Year 1 is ₹ 46,00,000.
- The number of ordinary shares outstanding on 1st April Year 1 is 30,00,000. The following facts are also relevant for Year 1.
- On 1st April, Zio Life Limited issues 20,00,000 three-year term convertible bonds for ₹ 1 each.
- Zio Life Limited has an option to settle the principal amount in ordinary shares (every 10 bonds are convertible into one ordinary share) or cash on settlement date.
- The principal amount of the bonds is classified as an equity instrument and the interest is classified as a financial liability.
- The interest expense relating to the liability component of the bonds is ₹ 1,800.
- The interest expense is tax-deductible. The applicable income tax rate is 40%. (MTP 7 Marks Oct 21)

Answer 5

The EPS computations for Year 1 as per Ind AS 33 are as follows.

Basic EPS	Diluted EPS
1. Determine the numerator No adjustment is necessary until the convertible bonds are converted and ordinary shares are issued. The numerator is net profit ie. ₹ 46,00,000.	1. Identify Potential Ordinary Shares (POSS) The convertible bonds are the only POSS.
2. Determine the denominator There is no change in the number of outstanding shares during the year. The denominator is therefore	2. For each POS, calculate Earnings per Incremental Share (EPIS) Since Zio Life Limited has the choice of settlement, for the purpose of determining the EPIS, it assumes the



30,00,000.	share-settlement assumption. Potential adjustment to the numerator for EPIS: The convertible bonds, when settled in ordinary shares, would increase profit or loss for the year by the post-tax amount of the interest expense: (Interest expense on the convertible bonds) x (1 - income tax rate) = (₹ 1,800) x (1 - 40%) = ₹ 1,080 Potential adjustment to the denominator for EPIS: The convertible bonds, when settled in ordinary shares, would increase the number of outstanding shares by 2,00,000 (20,00,000 / 10). EPIS is calculated as follows: EPIS = 1,080 / 2,00,000 = 0.01
3. Determine basic EPS Basic EPS = 46,00,000 / 30,00,000 = 1.53	3. Rank the POSs This step does not apply, because the convertible bonds are the only class of POSs.
	4. Identify dilutive POSs and determine diluted EPS The potential impact of convertible bonds is determined as follows. (Refer W.N. below)
	Accordingly, Zio Life Limited includes the impact of the convertible bonds in diluted EPS. Diluted EPS = ₹ 1.44

Working Note:

Calculation of Diluted EPS

	Earnings (₹)	Weighted average number of shares	Per Share (₹)	Dilutive?
Basic EPS	46,00,000	30,00,000	1.53	
Convertible bonds	1,080	2,00,000		
Total	46,01,080	32,00,000	1.44	Yes

Question 6

The following information is available relating to Space India Limited for the Financial Year 20X1-20X2.

Net profit attributable to equity shareholders	₹ 90,000
Number of equity shares outstanding	16,000
Average fair value of one equity share during the year	₹ 90

Potential Ordinary Shares:

Options	900 options with exercise price of ₹ 75
Convertible Preference Shares	7,500 shares entitled to a cumulative dividend of ₹ 9 per share. Each preference share is convertible into 2 equity shares.
10% Convertible Debentures of ₹ 100 each	₹ 10,00,000 and each debenture is convertible into 4 equity shares
Tax rate	25%

You are required to compute Basic and Diluted EPS of the company for the financial year 20X1-20X2. (MTP 8 Marks March '22, PYP 8 Marks Nov'20)



Answer 6

(i) Basic Earnings per share

		Year ended 31.3.20X2
Net profit attributable to equity shareholders	(A)	₹ 90,000
Number of equity shares outstanding	(B)	16,000
Earnings per share	(A/B)	₹ 5.625

(ii) Diluted earnings per share

Options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 10% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered (as per W.N.).

	Net profit attributable to equity shareholders ₹	No. of equity shares	Net Profit attributable le per share ₹	
Net profit attributable to equity shareholders	90,000	16,000	5.625	
Options	90,000	150		
	90,000	16,150	5.572	Dilutive
10% Convertible debentures	75,000	40,000		
	1,65,000	56,150	2.939	Dilutive
Convertible Preference Shares	67,500	15,000		
	2,32,500	71,150	3.268	Anti-Dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (₹ 2.939 to ₹ 3.268), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share for the year ended 31st March, 20X2. Therefore, diluted earnings per share for the year ended 31st March, 20X2 is ₹ 2.939.

Working Note:

Calculation of incremental earnings per share and allocation of rank

	Increase in earnings (1)	Increase in number of equity shares (2)	Earnings per incremental share (3) = (1) ÷ (2)	Rank
	₹		₹	
Options				
Increase in earnings	Nil			
No. of incremental shares issued for no consideration [900 x (90-75)/90]		150	Nil	1
Convertible Preference Shares				
Increase in net profit attributable to equity shareholders as adjusted by attributable dividend tax [(₹ 9 x 7,500) + 8% (₹ 9 x 7,500)]	67,500			



No. of incremental shares (2 x 7,500)		15,000	4.50	3
10% Convertible Debentures				
Increase in net profit [(₹ 10,00,000 x 10% x (1 - 0.25))]	75,000			
No. of incremental shares (10,000 x 4)		40,000	1.875	2

Question 7

ABC Ltd.	1st January, 20X1	Shares in issue 10,00,000
	31st March, 20X1	(a) Rights issue 1 for 5 at 90 paise
		(b) Fair value of shares ₹ 1 (cum-rights price)

Calculate the number of shares for use in the EPS calculation for the calendar year. (MTP 5 Marks Sep '22, Old & New SM)

Answer 7

Rights issue bonus fraction

	Shares	₹ per share	₹
Cum-rights	5	1	5.0
Rights	1	0.9	0.9
Ex-rights	6		5.9
Theoretical ex-rights price	(5.9 / 6)	= 0.983	
Bonus fraction = Cum-rights price / Theoretical ex-rights price = 1/0.983			
			Number of shares
1 January - 31 March (10,00,000 x 3/12 x 1/0.983)			2,54,323
1 April - 31 December (12,00,000 x 9/12)			9,00,000
Number of shares for the purpose of EPS calculation			11,54,323

Question 8

(Includes concepts of Chp 12 Ind AS 107, 109, 32, Accounting and Reporting of Financial Instruments)

An entity issues 2,000 convertible bonds at the beginning of Year 1. The bonds have a three - year term and are issued at par with a face value of Rs. 1,000 per bond, giving total proceeds of

Rs. 20,00,000. Interest is payable annually in arrears at a nominal annual interest rate of 6%. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has given an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.

When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9%. At the issue date, the market price of one ordinary share is Rs. 3. Income tax is ignored.

Calculate basic and diluted EPS when

Profit attributable to ordinary equity holders of the parent entity Year 1	Rs. 10,00,000
Ordinary shares outstanding	12,00,000
Convertible bonds outstanding	2,000

(MTP 5 Marks Oct '20, RTP May'19, Old & New SM)



Answer 8

Allocation of proceeds of the bond issue:

Liability component (W.N.1)	Rs. 18,47,720
Equity component	Rs. 1,52,280
	Rs. 2,000,000

The liability and equity components would be determined in accordance with Ind AS 32. These amounts are recognised as the initial carrying amounts of the liability and equity components. The amount assigned to the issuer conversion option equity element is an addition to equity and is not adjusted.

Basic earnings per share Year 1:

$$\frac{\text{Rs. } 10,00,000}{12,00,000} = \text{Rs. } 0.83 \text{ Per ordinary share}$$

Diluted earnings per share Year 1:

It is presumed that the issuer will settle the contract by the issue of ordinary shares. The dilutive effect is therefore calculated in accordance with the Standard.

$$\frac{\text{Rs. } 10,00,000 + \text{Rs. } 1,66,295 \text{ (W.N.2)}}{12,00,000 + 5,00,000 \text{ (W.N.3)}} = \text{Rs. } 0.69 \text{ Per ordinary share}$$

Working Notes:

- This represents the present value of the principal and interest discounted at 9% $1,20,000 \times 2.531 =$
Rs. 3,03,720
 $20,00,000 \times 0.772 =$ Rs. 15,44,000
Rs. 18,47,720
- Profit is adjusted for the accretion of Rs. 1,66,295 (Rs. 18,47,720 $\times$ 9%) of the liability because of the passage of time. However, it is assumed that interest @ 6% for the year has already been adjusted.
- 5,00,000 ordinary shares = 250 ordinary shares $\times$ 2,000 convertible bonds

Question 9

P Ltd. is a subsidiary company of ABC Ltd. It preparing both Separate financial statement (SFS) and consolidated financial statements (CFS) for the year ending on 31st March, 20XI. It has net profit after tax of Rs. 20,00,000 as per SFS & Rs. 16,00,000 as per CFS. Share capital of P Ltd. is 2,00,000 shares of Rs. 10 each. ABC Ltd. has acquired 80% shares of P Ltd. Accountant of P Ltd. had calculated following Basic EPS for its SFS:

Calculation of Basic EPS in its SFS	
Net Profit after tax	Rs. 16,00,000
Number of equity shares attributable to Parent company ABC Ltd. (2,00,000 $\times$ 80%)	1,60,000 shares
Basic EPS	Rs. 10 per share

Examine the correctness of the above presentation of Basic EPS. (RTP May '18)

Answer 9

As per paragraph 4 of Ind AS 33 "Earnings per Share", when an entity presents both consolidated financial statements and separate financial statements prepared in accordance with Ind AS 110, Consolidated Financial Statements, and Ind AS 27, Separate Financial Statements, respectively, the disclosures required by this Standard shall be presented both in the consolidated financial statements and separate financial statements. In consolidated financial statements such disclosures shall be based on consolidated information and in separate financial statements such disclosures shall be based on information given in separate financial statements. An entity shall not present in consolidated financial statements, earnings per share based on



the information given in separate financial statements and shall not present in separate financial statements, earnings per share based on the information given in consolidated financial statements.

Also paragraph 9 of the standard states that an entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.

Further, paragraph A1 of Appendix A of Ind AS 33 states that for the purpose of calculating earnings per share based on the consolidated financial statements, profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting for non- controlling interests.

Therefore, the requirements of paragraph 9 of Ind AS 33 have been provided in the context of calculating EPS in the consolidated financial statements of an entity.

The accountants of P Ltd. had followed this for calculation of Basic EPS in its SFS. As per ITFG Bulletin 11, for SFS analogy may be drawn from paragraph 9 of Ind AS 33 that in case of separate financial statements, the parent entity mentioned in paragraph 9 will imply the legal entity of which separate financial statements are being prepared and accordingly, when an entity presents EPS in its separate financial statements, then the same shall be calculated based on the profit or loss attributable to its equity shareholders.

Hence, the presentation of Basic EPS by the Accountant of P Ltd. on the basis of consolidated financial statements in its separate financial statements is not correct. The correct presentation of Basic EPS would be as follows:

Calculation of Basic EPS of P Ltd. in SFS	
Net Profit after tax	Rs. 20,00,000
No. of share issued	2,00,000 shares
Basic EPS	Rs. 10 per share

Question 10 VIVITSU 1

CAB Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31st March, 20X3 and the extract of the same is as follows:

Particulars	Attributable to CAB Limited	Non-controlling interest	Total (Rs. in '000)
Profit for the year	39,000	3,000	42,000
Other Comprehensive Income	5,000	Nil	5,000
Total Comprehensive Income	44,000	3,000	47,000

The long-term finance of the company comprises of the following:

- 20,00,00,000 equity shares at the beginning of the year and the company has issued 5,00,00,000 shares on 1st July, 20X2 at full market value.
- 8,00,00,000 irredeemable preference shares. These shares were in issue for the whole of the year ended 31st March, 20X3. The dividend on these preference shares is discretionary.
- Rs. 18 crores of 6% convertible debentures issued on 1st April, 20X1 and repayable on 31st March, 20X5 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their convertible debentures for 10 crores ordinary shares in the company. On 1st April, 20X1, the prevailing market interest rate for four-year convertible debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of Rs. 1 payable in four years is 0.74 and the cumulative present value of Rs. 1 payable at the end of years one to four is 3.31.

In the year ended 31st March, 20X3, CAB Limited declared an ordinary dividend of

0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

Compute the following:



- the finance cost of convertible debentures and its closing balance as on 31st March, 20X3 to be presented in the consolidated financial statements.
- the basic and diluted earnings per share for the year ended 31st March, 20X3. Assume that income tax is applicable to CAB Limited and its subsidiaries at 25%. (RTP May '20, MTP 12 Marks Apr'21, Old & New SM)(Same concept different figures- 8 Marks Nov'22)

Answer 10

Calculation of the liability and equity components on 6% Convertible debentures:

Present value of principal payable at the end of 4th year (Rs. 1,80,000 thousand x 0.74)

= Rs. 1,33,200 thousand

Present value of interest payable annually for 4 years (Rs. 1,80,000 thousand x 6% x 3.31)

= Rs. 35,748 thousand

Total liability component = Rs. 1,68,948 thousand

Therefore, equity component = Rs. 1,80,000 thousand – Rs. 1,68,948 thousand = Rs. 11,052 thousand

Calculation of finance cost and closing balance of 6% convertible debentures

Year	Opening balance in '000	Finance cost @ 8% in '000	Interest paid @ 6% in '000	Closing balance in '000
	a	b = a x 8%	c	d = a + b - c
31.3.20X2	1,68,948	13,515.84	10,800	1,71,663.84
31.3.20X3	1,71,663.84	13,733.11	10,800	1,74,596.95

Finance cost of convertible debentures for the year ended 31.3. 20X3 is Rs. 13,733.11 thousand and closing balance as on 31.3. 20X3 is Rs. 1,74,596.95 thousand.

Calculation of Basic EPS in '000

Profit for the year	39,000
Less: Dividend on preference shares (80,000 thousand x Rs. 0.05)	(4,000)
Profit attributable to equity shareholders	35,000

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)}

= 23,75,00,000 shares or 2,37,500 thousand shares

Basic EPS = Rs. 35,000 thousand / 2,37,500 thousand shares = Rs. 0.147

Calculation of Diluted EPSRs. in '000

Profit for the year	39,000
Less: Dividend on preference shares (80,000 x 0.05)	(4,000)
	35,000
Add: Finance cost (as given in the above table)	13,733.11
Less: Tax @ 25%	(3,433.28)
	10,299.83
	45,299.83

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)} + 10,00,00,000

= 33,75,00,000 shares or 3,37,500 thousand shares

Diluted EPS= Rs. 45,299.83 thousand / 3,37,500 thousand shares = Rs. 0.134



Question 11

Following information pertains to an entity for the year ending 31 st March 20X1:

Net profit for the year	₹ 12,00,000
Weighted average number of equity shares outstanding during the year	5,00,000 shares
Average market price per share during the year	₹ 20
Weighted average number of shares under option during the year	1,00,000 shares
Exercise price per share under option during the year	₹ 15

Calculate basic and diluted earnings per share. (RTP Nov '21, Old & New SM)

Answer 11

Calculation of earnings per share

	Earnings	Shares	Per share
Profit attributable to equity holders	₹ 12,00,000		
Weighted average shares outstanding during year 20X1		5,00,000	
Basic earnings per share			₹ 2.40
Weighted average number of shares under option		100,000	
Weighted average number of shares that would have been issued at average market price: $(1,00,000 \times ₹ 15.00) \div ₹ 20.00$	Refer Note	(75,000)	
Diluted earnings per share	₹ 1,200,000	525,000	₹ 2.29

Note: Earnings have not increased because the total number of shares has increased only by the number of shares (25,000) deemed to have been issued for no consideration.

Question 12

Company S is a subsidiary of Company P. Following facts are in respect of Company S:

- Company S has 10,000 ordinary shares and 1,000 options outstanding, of which Company P owns 9,000 shares and 500 options, respectively.
- The options have an exercise price of ₹ 40.
- The average market price of Company S's ordinary share was ₹ 50 in 20X1.
- In 20X1, Company S's profit was ₹ 30,000.

Following facts are in respect of Company P:

- Company P has 5,000 ordinary shares outstanding.
- In 20X1, Company P's profit (excluding any distributed and undistributed earnings of subsidiaries) was ₹ 7,000.
- The options outstanding are dilutive at P's level.

Determine the diluted EPS of Company P for the year 20X1. Ignore income tax. (RTP Nov'22)

Answer 12

To determine the diluted EPS of Company P, the diluted EPS of Company S has to be calculated first.

Calculation of Company S's diluted EPS:

Company S's earnings for the period	₹ 30,000
Weighted average ordinary shares	10,000



Incremental shares (refer W.N.)	200
Company S's diluted EPS	₹ 30,000/ (10,000 + 200)
	₹2.94
Calculation of Company P's diluted EPS:	
Company P's earning for the period	₹7,000
Company P's share of Company S's earning attributable to ordinary shares $[(9,000 / 10,000) \times (2.94 \times 10,000)]$	₹ 26,460
Company P's share of Company S's earning attributable to options $[(500 / 1,000) \times (2.94 \times 200)]$	₹294
Company P's weighted average ordinary shares outstanding	5,000
Company P's diluted EPS = $(7,000 + 26,460 + 294) / 5,000$	₹ 6.75

Working Note:

Computation of Incremental shares related to weighted average options outstanding:

All options are dilutive because their exercise price is below the average market price of Company S's ordinary shares for the period.

The incremental shares are calculated as follows:

Shares issued on assumed exercise of options	1,000
Less: Shares that would be issued at average market Price $[(40 \times 1,000)/50]$	(800)
Incremental shares	200

Question 13

Company P has both ordinary shares and equity-classified preference shares in issue. The reconciliation of the number of shares during Year 1 is set out below:

Number of shares

Dates in Year 1	Transaction	Ordinary shares	Treasury shares	Preference shares
1st April	Balance	30,00,000	(5,00,000)	5,00,000
15th April	Bonus issue – 5% (no corresponding changes in resources)	1,50,000	(25,000)	-
1st May	Repurchase of shares for cash	-	(2,00,000)	-
1st November	Shares issued for cash	4,00,000	-	-
31st March	Balance	35,50,000	(7,25,000)	5,00,000

The following additional information is relevant for Year 1.

- Company P's net profit for the year is ₹ 46,00,000.
- On 15th February, non-cumulative preference dividends of ₹ 1.20 per share were declared. The dividends were paid on 15th March. Preference shares do not participate in additional dividends with ordinary shares.
- Dividends on non-cumulative preference shares are deductible for tax purposes.



The applicable income tax rate is 30%.

The financial year of Company P ends on 31st March.

Determine the Basic EPS of the Company P for Year 1. Use the number of months or part of months, rather than the number of days in the calculation of EPS. (RTP May '23)

Answer 13

Determination of numerator for calculation of Basic EPS

The first step in the basic EPS calculation is to determine the profit or loss that is attributable to ordinary shareholders of Company P for the period.

Non-cumulative dividends paid on equity-classified preference shares are not deducted in arriving at net profit or loss for the period, but they are not returns to ordinary shareholders. Accordingly, these dividends are deducted from net profit or loss for the period in arriving at the numerator.

		(₹)
Net profit		46,00,000
Preference dividends (5,00,000 shares x 1.2)	(6,00,000)	
Related tax (₹ 6,00,000 x 30%)	1,80,000	(4,20,000)
Profit or loss attributable to P's ordinary shareholders		41,80,000
Accordingly, the numerator for calculation of Basic EPS is ₹ 41,80,000		

Determination of denominator for calculation of Basic EPS

The second step in the basic EPS calculation is to determine the weighted-average number of ordinary shares outstanding for the reporting period.

Number of shares	Time weighting	Weight	Weighted average number of shares
1st April – opening balance (30,00,000 – 5,00,000)	25,00,000	1	
15th April – bonus issue (1,50,000 – 25,000)	1,25,000		
1st April to 30th April	26,25,000	1/12	2,18,750
1st May – repurchase of shares	(2,00,000)		
1st May to 31st October	24,25,000	6/12	12,12,500
1st November – new shares issued	4,00,000		
1st November to 31st March	28,25,000	5/12	11,77,083
Weighted average number of shares for the year			26,08,333

The denominator for calculation of Basic EPS is 26,08,333 shares. Basic EPS = ₹ 41,80,000 / 26,08,333 shares = ₹ 1.60 per share (approx.).

Question 14

At 31st March, 2019 the issued share capital of SB Limited consisted of 20,00,000 ordinary shares of ₹ 1 each. On 1st July 2019, the Company issued ₹ 25,00,000 of 8% convertible loan stock for cash at par. Each ₹ 100 nominal of the loan stock may be converted, at any time during the years ended 2024 to 2027, into the number of ordinary shares set out below:

- 31st March, 2024: 135 Ordinary Shares
- 31st March, 2025: 130 Ordinary Shares
- 31st March, 2026: 125 Ordinary Shares



- 31st March, 2027: 120 Ordinary Shares

If the loan stock is not converted by 2027, they would be redeemed at par. It is assumed that the written equity conversion option is accounted for as a derivative liability and marked to market through profit or loss. The change in the options fair value reported on 31st March 2020 and 31st March 2021 amounted to losses of ₹ 5,000 and ₹ 5,300 respectively. Further, it is assumed that there are no tax consequences arising from these losses.

The profit before interest, fair value movements and taxation for the year ended 31st March, 2020 and 2021 amounted to ₹ 16,50,000 and ₹ 17,90,000 respectively and relate wholly to continuing operations. The rate of tax for both the periods is 33% (including cess and surcharge if any). Calculate Basic and Diluted EPS for 31st March 2020 & 31st March 2021. (PYP 8 Marks July 21, MTP 8 Marks April '23) (Same concept different figures- Old & New SM)

Answer 14

	2021	2020
	₹	₹
Trading results		
A. Profit before interest, fair value movements and tax	17,90,000	16,50,000
B. Interest on 8% convertible loan stock (2020: $9/12 \times ₹ 2,00,000$)	(2,00,000)	(1,50,000)
C. Change in fair value of embedded option	(5,300)	(5,000)
Profit before tax	15,84,700	14,95,000
Taxation @ 33% on (A-B)	(5,24,700)	(4,95,000)
Profit after tax	10,60,000	10,00,000
Calculation of basic EPS		
Number of equity shares outstanding	20,00,000	20,00,000
Earnings	10,60,000	10,00,000
Basic EPS	53 paise	50 paise

Calculation of diluted EPS

Test whether convertibles are dilutive:

The saving in after-tax earnings, resulting from the conversion of ₹ 100 nominal of loan stock, amounts to $(₹ 100 \times 8\% \times 67\%) + (₹ 5,300 / 25,000) = ₹ 5.36 + ₹ 0.21 = ₹ 5.57$.

There will then be 135 extra shares in issue.

Therefore, the incremental EPS is 4 paise (ie. ₹ 5.57 / 135). As this incremental EPS is less than the basic EPS at the continuing level, it will have the effect of reducing the basic EPS of 53 paise. Hence the convertibles are dilutive.

	2021	2020
	₹	₹
Adjusted earnings		
Profit for basic EPS	10,60,000	10,00,000
Add: Interest and other charges on earnings saved as a result of the conversion	(2,00,000 + 5,300) 2,05,300	(1,50,000 + 5,000) 1,55,000
Less: Tax relief on interest portion	(66,000)	(49,500)
Adjusted earnings for equity	11,99,300	11,05,500

Adjusted number of shares

From the conversion terms, it is clear that the maximum number of shares issuable on conversion of ₹ 25,00,000 loan stock after the end of the financial year would be at the rate of 135 shares per ₹ 100 nominal (that is, 33,75,000 shares).



	2021	2020
Number of equity shares for basic EPS	20,00,000	20,00,000
Maximum conversion at date of issue (33,75,000 × 9/12)	-	25,31,250
Maximum conversion after balance sheet date	33,75,000	-
Adjusted shares	53,75,000	45,31,250
Adjusted earnings for equity	11,99,300	11,05,500
Diluted EPS (approx.)	22 paise	24 paise

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Most of the examinees did not considered tax on interest portion. No examinee applied the test to decide whether the convertibles are dilutive. Many examinees had not taken into account changes in fair value of embedded option.

Question 15

From the following information you are asked to calculate (a) Basic and Diluted EPS of Duck Ltd. and (b) Diluted EPS of Swan Ltd.:

	Duck Ltd.	Swan Ltd.
	Amount (₹)	Amount (₹)
Income/(Loss) from Continuing Operations	2,52,000	(1,80,000)
Income/(Loss) from Discontinued Operations	(4,20,000)	3,25,920
Net Income/(Loss)	(1,68,000)	1,45,920
Weighted Average Number of Shares outstanding	80,000	96,000
Incremental common shares outstanding relating to stock options	16,000	25,600

(PYP 8 Marks Dec '21)(Same concept different figures Old & New SM)

Answer 15

For Duck Ltd.

i. Calculation of Basic EPS

Basic EPS = Profit for the year / Weighted average number of shares outstanding

Basic EPS (Continued Operations) = Profit from continued operations /

Weighted average number of shares outstanding

$$= ₹ 2,52,000 / 80,000 = ₹ 3.15$$

Basic Loss per share (Discontinued operations) = Loss from discontinued operations / Weighted average number of shares outstanding

$$= (₹ 4,20,000) / 80,000 = (₹ 5.25)$$

$$\text{Overall Basic Loss per share} = (₹ 1,68,000) / 80,000 = (₹ 2.10) \quad (i)$$

ii. Calculation of Diluted EPS

Diluted EPS = Profit for the year / Adjusted weighted average number of shares outstanding

$$\text{EPS (Continued Operations)} = \text{Profit from continued operations} / \text{Adjusted}$$



weighted average number of shares outstanding

$$= ₹ 2,52,000 / 96,000 = ₹ 2.625$$

Loss per share (Discontinued operations) = Loss from discontinued operations / Adjusted weighted average number of shares outstanding

$$= (₹ 4,20,000) / 96,000 = (₹ 4.375)$$

$$\text{Overall Diluted Loss per share} = (₹ 1,68,000) / 96,000 = (₹ 1.75) \text{ (ii)}$$

Reporting Status:

The income from continuing operations is the control number, there is a dilution in basic EPS for income from continuing operations (reduction of EPS from ₹ 3.15 to ₹ 2.625). Therefore, even though there is an anti-dilution [Loss per share reduced from ₹ 2.10 (i) to ₹ 1.75 (ii) above], diluted loss per share of ₹ 1.75 is reported.

For Swan Ltd.

Treatment of potential shares:

In case of loss from continuing operations, the potential shares are excluded since including those shares would result into anti-dilution effect on the control number (loss from continuing operations).

Therefore, the diluted EPS will be calculated as under:

Diluted EPS = Profit for the year / Adjusted weighted average number of shares outstanding

Overall Profit = Loss from continuing operations + Gain from discontinued operations

$$= (₹ 1,80,000) + ₹ 3,25,920 = ₹ 1,45,920$$

$$\begin{aligned} \text{Weighted average number of shares outstanding} &= 96,000 \\ \text{Diluted EPS} &= ₹ 1,45,920 / 96,000 = ₹ 1.52 \end{aligned}$$

Reporting Status:

The dilutive effect of the potential common shares on EPS for income from discontinued operations and net income would not be reported because of the loss from continuing operations.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question mandated computation of Basic and Diluted EPS under the situation of Income / Loss from continuing and discontinued operations. Most of the examinees were unable to compute diluted EPS when there is loss in continuing operations of the business in case of Swan Ltd. The reporting status part of the question was not presented by almost all the examinees.

Question 16

GOLD Ltd., a manufacturing company, prepares its financial statements on 31st March every year. On 1st April, 2021, it had issued (a) 10,00,000 ordinary shares and (b) 6% convertible bonds amounting to ₹ 1,00,000, the terms of conversion being 120 ordinary shares for every ₹ 100. On 30th June, 2021, ₹ 50,000 bonds converted to ordinary shares. The profit for the year ended 31st March, 2022 is ₹ 2,50,000. The applicable tax rate is 25%.

Calculate basic and diluted EPS. Ignore the need to split the convertible bonds into liability and equity element. (PYP 4 Marks May '22, Old & New SM)



Answer 16

	Number of shares	Profit (₹)
Profit		2,50,000
Outstanding ordinary shares	10,00,000	
New shares on conversion (weighted average) $[(9/12 \times ₹ 50,000 / 100 \times 120)]$	45,000	
Figures for basic EPS	10,45,000	2,50,000
Basic EPS is $(₹ 2,50,000 / 10,45,000 \text{ shares})$ $= ₹ 0.239 \text{ per share}$		
Dilution adjustments		
Unconverted shares $(₹ 50,000 / 100 \times 120)$	60,000	
Interest $(₹ 50,000 \times 6\% \times 0.75 \text{ net of tax})$		2,250
Converted shares pre conversion adjustment $(3/12 \times ₹ 50,000 / 100 \times 120)$	15,000	
Interest: $[3/12 \times ₹ 50,000 \times 6\% \times 0.75 \text{ net of tax}]$		562.50
Diluted EPS is $(₹ 2,52,812.50 / 11,20,000 \text{ shares}) = ₹ 0.226 \text{ per share}$	11,20,000	2,52,812.50

Question 17

1 January Shares in issue 1,000,000

 5% Convertible bonds ₹ 100,000

(terms of conversion 120 ordinary shares for ₹ 100)

31 March Holders of ₹ 25,000 bonds converted to ordinary shares.

Profit for the year ended 31 December ₹ 200,000

Tax rate 30%.

Calculate basic and diluted EPS. Ignore the need to split the convertible bonds into liability and equity elements. (New SM) (MTP 6 Marks Sep '23)

Answer 17

	Number of shares	Profit ₹
Profit		200,000
Outstanding shares	1,000,000	
New shares on conversion (weighted average)		
$9/12 \times ₹ 25,000 / 100 \times 120$	22,500	-
Figures for basic EPS	1,022,500	200,000
Basic EPS is $(₹ 200,000 / 1,022,500) = 0.196 \text{ per share}$		
Dilution adjustments		
Unconverted shares $₹ 75,000 / 100 \times 120$	90,000	
Interest: $₹ 75,000 \times 5\% \times 0.7$		2,625
Converted shares pre conversion adjustment		



$3/12 \times ₹ 25,000 / 100 \times 120$	7,500	
Interest: $[3/12 \times ₹ 25,000 \times 5\% \times 0.7]$		219
	1,120,000	202,844
Diluted EPS is (₹ 202,844 / 1,120,000) = 0.181		



Chapter 10.3

Ind AS 108 Operating Segments

Question 1

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

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

The characteristics of each segment are as under:

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

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

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

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

Required:

Whether it is appropriate to aggregate Segments 1 and 2 with reference to Ind AS 108 'Operating Segments'? and

Discuss, in the above context, whether disclosure of segment information is relevant to an investor's appraisal of financial statements? (MTP 6 Marks March '21, Old & New SM)

Answer 1

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 the 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.

Question 2

A Ltd. is a cash rich company. It has its business running across the country which as per AS 17 constitutes geographical segments. The company has also got substantial investments. The company has provided its segmental report for its primary segment and secondary geographical segments and the extract of its Note on Investment from its draft financial statements for the year ending 31st March 2018:

Primary segment report

	Segment 1	Segment 2	Segment 3	Total
Segment Revenue	2,655	2,121	1,264	6,040
Segment Results	504	1,111	114	1,729
Unallocable Costs				
Interest Income				403
Finance Costs				(120)
Others				(50)
Net Profit Before Tax				1,962

Segmental report for its secondary geographical segments

All figures are Rs. in crores

Geography	Segment Assets	Segment Revenue
Delhi	1,962	2522
Mumbai	1,691	1241
Chennai	2,030	1255
Others (refer Additional information 1)	1,082	1022
Total	6,765	6040

Note on Investment

Investment in:	Rs. in crores
Mutual Funds - Liquid Funds	500
Mutual Funds - ETFs	20
X Ltd. a wholly owned subsidiary	100
A Foundation – 100%	20
Time Deposit	20
Total	660



Additional information:

1. Segment Assets in 'Others' category comprises of Rs. 744 crores held for a new project yet to commence operations in Kolkata.
2. Tax expenses are not considered in above segment reporting as the management is of the opinion that taxes are not a part of operating cost.
3. Mutual funds are valued at MTM basis as of year-end. These were initially invested for Rs. 300 crore for liquid funds and Rs. 25 crore for ETFs respectively.
4. The Foundation has a clause in its deed that in the event of liquidation, the net assets of the trust shall be transferred to another trust with similar objects.

Analyze the extracts given above and Identify the errors and misstatements in the segment reports / Note on Investment and also prepare the rectified Note to Accounts on Investment in accordance with the Accounting Standards. (MTP 15 Marks April '18)

Answer 2

Geographical segment reporting: The category 'others' in the secondary geographical segment report represents 16% of the total geographical segment assets. Para 48 of AS 17 inter alia requires to disclose the total carrying amount of segment assets by geographic allocation of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segments'.

Hence to comply with AS 17 disclosures, the management has to further breakdown the 'others' category and identify reportable geographies. Kolkata segment assets is 10.997% of total geographical assets i.e. $[(744 / 6,765) \times 100]$. Therefore, Kolkata segment will be considered as the reportable geographical segment.

The revised secondary segmental reporting will be as follows:

All figures are Rs. in crores

Geography	Segment Assets	Segment Revenue
Delhi	1,962	2,522
Mumbai	1,691	1,241
Chennai	2,030	1,255
Kolkata	744	0
Others	338	1,022
TOTAL	6,765	6,040

Besides above, the same para also mandates to disclose 'the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all segments'. Hence, the management has to show the addition to segment assets in a separate table; and if there are no additions during the year, the same has to be stated as 'Nil' for the year.

1. **Primary Business Segment Report:** The management's interpretation of presenting 'Net profit before taxes' is incorrect. The standard requires allocating expenses to each segment to the possible extent, and unallocated costs to be shown separately. In this case, tax expense will be added as an unallocable cost.

2. Notes to Accounts on Investment

	Refer Note No.	Rs. in crore
Non-current Investment (at cost)		
X Ltd., a wholly owned subsidiary		100



A Foundation	1	20
Total Non-current Investment (A)		120
Current Investment	2	325
Total Current Investment (B)		325
Total (A+B)		445

In accordance with Para 35 (d) of AS 13, a note should be given that there exists a significant restriction on the realisability of investments or the remittance of income and proceeds of disposal. Accordingly, the note is prepared as follows:

Note 1: The Company has a 100% stake holding in A Foundation. There exists a significant restriction on the realisability of investments due to the clause in the constitution deed of the Foundation that in the event of liquidation, the net assets of the trust shall be transferred to another trust with similar objects.

Note 2: Para 31 of AS 13 states – ‘Investment classified as current investment should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis’. Assuming that the MTM values provided represent the fair value, accordingly investments in mutual funds are treated as follows:

Investment in Mutual Funds	Rs. in crore
Mutual Funds - Liquid Funds (MTM)	300
Mutual Funds - ETFs	25
Total	325

Note 3: Time deposit will be a part of cash and cash equivalents.

Question 3

XYZ Ltd. has eight segments namely A, B, C, D, E, F, G and H. The information regarding respective segments for the year ended 31st 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 result 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 31st March, 20X1? (MTP 5 Marks April '23, RTP May'22)

Answer 3

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

Criteria 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	
Reportable segments	A	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



Profit	5	-	15	-	8	-	5	7	40
Segments 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	
Reportable segments	-	B	C	-	-	-	-	-	

Criteria 3: 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
Reportable segments	A	B	-	D	-	-	-	-	

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
% of reportable segments external sales to entity's sales					69.14%
Required percentage					75%

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

Question 4

From the following transactions taken from a parent company having multiple businesses and multiple segments, identify which transactions will be classified as Operating, Investing and Financing:

Sr. No.	Nature of transaction
1	Issued preference shares
2	Purchased the shares of 100% subsidiary company
3	Dividend received from shares of subsidiaries
4	Dividend received from other companies
5	Bonus shares issued
6	Purchased license for manufacturing of special drugs
7	Royalty received from the goods patented by the company
8	Rent received from the let-out building (letting out is not main business)
9	Interest received from loans and advances given
10	Dividend paid
11	Interest paid on security deposits
12	Purchased goodwill
13	Acquired the assets of a company by issue of equity shares (not parting any cash)
14	Interim dividends paid
15	Dissolved the 100% subsidiary and received the amount in final settlement

(MTP 6 Marks Oct '23)

Answer 4

Sr. No.	Nature of transaction	Operating/Investing/Financing/Not to be considered
1	Issued preference shares	Financing
2	Purchased the shares of 100% subsidiary company	Investing
3	Dividend received from shares of subsidiaries	Investing
4	Dividend received from other companies	Investing
5	Bonus shares issued	No cash flow
6	Purchased license for manufacturing of special drugs	Investing
7	Royalty received from the goods patented by the company	Operating
8	Rent received from the let-out building (letting out is not main business)	Investing
9	Interest received from loans and advances given	Investing
10	Dividend paid	Financing
11	Interest paid on security deposits	Financing
12	Purchased goodwill	Investing
13	Acquired the assets of a company by issue of equity shares (not parting any cash)	Not to be considered
14	Interim dividends paid	Financing
15	Dissolved the 100% subsidiary and received the amount in final settlement	Investing

Question 5

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. Which cost formula should be used for Ind AS 108 disclosure purposes? (RTP May '19, Old & New SM)

Answer 5

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

Question 6

Seeds Ltd. is operating in oil industry. Its business segments comprise crushing and refining. Certain information for financial year 2017-18 is given below:

(Rs. in lakh)						
Segments	External Sale	Tax	Other Operating Income	Result	Assets	Liabilities
Crushing	1,00,000	2,500	20,000	5,000	25,000	15,000
Refining	35,000	1,500	7,500	2,000	15,000	5,000

Additional Information: (Rs. in lakh)

- Unallocated revenue net of expenses is Rs. 1,500.
- Interest and bank charges is Rs. 1,000



- Income-tax expense is Rs. 1,000 (current tax Rs. 975 and deferred tax Rs. 25)
- Investments Rs. 5,000 and unallocated assets Rs. 5,000
- Unallocated liabilities, Reserves & Surplus and Share capital are Rs. 10,000; Rs. 15,000 and Rs. 5,000 respectively.
- Depreciation amounts for crushing and refining are Rs. 500 and Rs. 150 respectively.
- Capital expenditure for crushing and refining are Rs. 2,500 and Rs. 1,000 respectively.
- Revenue from outside India is Rs. 15,000 and segment assets outside India Rs. 5,000.

Based on the above information, how Seeds Ltd. would disclose information about reportable segment revenue, profit or loss, assets and liabilities for financial year 2017-18? (PYP 10 Marks, May'18) (Same concept but different figures MTP 10 Marks Apr'22, Old & New SM, PYP 8 Marks Jul'21)

Answer 6

Segment revenues, results and other information (Rs. in lakh)

	Revenue	Crushing	Refining	Total
1.	External sales (gross)	1,00,000	35,000	1,35,000
	Tax	(2,500)	(1,500)	(4,000)
	External sales (net)	97,500	33,500	1,31,000
	Other operating income	20,000	7,500	27,500
	Total Revenue	1,17,500	41,000	1,58,500
2.	Results			
	Segment results	5,000	2,000	7,000
	Unallocated income (net of unallocated expenses)			1,500
	Profit from operation before interest, taxation and exceptional items			8,500
	Interest and bank charges			(1,000)
	Profit before exceptional items			7,500
	Exceptional items			Nil
	Profit before taxation			7,500
	Less: Income Taxes			
	Current taxes			(975)
	Deferred taxes			(25)
	Profit after taxation			6,500
3.	Other Information			
(a)	Assets			
	Segment Assets	25,000	15,000	40,000
	Investments			5,000
	Unallocated assets			5,000
	Total Assets			50,000
(b)	Liabilities/Shareholder's funds			
	Segment liabilities	15,000	5,000	20,000
	Unallocated liabilities			10,000
	Share capital			5,000
	Reserves and surplus			15,000
	Total liabilities / shareholder's funds			50,000
(c)	Others			
	Capital Expenditure	2,500	1,000	3,500
	Depreciation	500	150	650



Geographical Information

			(Rs. in lakh)
	India	Outside India	Total
Revenue	1,43,500	15,000	1,58,500
Segment assets	35,000	5,000	40,000
Capital expenditure	3,500	-	3,500

Note: Segment revenue, results, assets and liabilities include the respective amounts identifiable to each of the segments.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A few examinees were unable to give information about disclosure of results and geographical information in an orderly manner. They presented their answers either without headings or mixed the disclosure information rather than disclosing it categorically.

Question 7

John Limited has identified four segments for which revenue data is given as per below:

	External Sale (Rs.)	Internal Sale (Rs.)	Total (Rs.)
Segment A	4,00,000	Nil	4,00,000
Segment B	80,000	Nil	80,000
Segment C	90,000	20,000	1,10,000
Segment D	70,000	6,20,000	6,90,000
Total sales	6,40,000	6,40,000	12,80,000

The following additional information is available with respect to John Limited:

Segment C is a high growing business and management expects that this segment to make a significant contribution to external revenue in coming years. Discuss, which of the segments would be reportable under the threshold criteria identified in Ind AS 108 and why? (PYP 6 Marks, Nov'20) (Same concept different figures MTP 5 Marks Oct '19 & March '18, Old & New SM)

Answer 7

Threshold amount of 10% of total revenue is Rs. 1,28,000 (Rs. 12,80,000 × 10%).

Segment A exceeds the quantitative threshold (Rs. 4,00,000 > Rs. 1,28,000) and hence is a reportable segment.

Segment D exceeds the quantitative threshold (Rs. 6,90,000 > Rs. 1,28,000) and hence is a reportable segment.

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

However, the total external revenue generated by these two segments A & D represent only 73.44% (Rs. 4,70,000 / 6,40,000 × 100) of the entity's total external revenue. If the total external revenue reported by operating segments constitutes less than 75% of the entity's 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 John Limited, it is given that Segment C is a high growing business and management expects this segment to make a significant contribution to external revenue in coming years. In accordance with the requirement of Ind AS 108, John Limited may designate segment C as a reportable segment, making the total external revenue attributable to reportable segments be 87.5% (Rs. 5,60,000 / 6,40,000 × 100) of total entity's external revenue.



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

Alternatively, Segment B may be considered as a reportable segment instead of Segment C, based on the choice of John Ltd. 's management, if it meets the definition of operating segment.

If Segment B is considered as reportable segment, external revenue reported will be

Rs. 4,00,000 + Rs. 80,000 + Rs. 70,000 = Rs. 5,50,000

% of Total External Revenue = Rs. 5,50,000 / Rs. 6,40,000 = 85.94%

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

Question 8

Heavy Goods Ltd. has 6 operating segments namely L-Q (below). The total revenues (internal and external), profits or losses and assets are set out below: (In Rs.)

Segment	Inter Segment Sales	External Sales	Profit / loss	Total assets
L	4,200	12,300	3,000	37,500
M	3,500	7,750	1,500	23,250
N	1,000	3,500	(1,500)	15,750
O	0	5,250	(750)	10,500
P	500	5,500	900	10,500
Q	1,200	1,050	600	5,250
	10,400	35,350	3,750	1,02,750

Heavy Goods Ltd. needs to determine how many reportable segments it has. You are required to advice Heavy Goods Ltd. as per the criteria defined in Ind AS 108 (PYP 4 Marks ,Jan'21)(Same concept different figures Old & New SM)

Answer 8

As per paragraph 13 of Ind AS 108, an entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:

- (a) Its reported revenue, including both sales to external customers and inter-segment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.

Combined total sales of all the segment = Rs. 10,400 + Rs. 35,350 = Rs. 45,750. 10% thresholds = 45,750 x 10% = 4,575.

- (b) The absolute amount of its reported profit or loss is 10 per cent 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 the given situation, combined reported profit = Rs. 6,000 and combined reported loss (Rs. 2,250). Hence, for 10% thresholds Rs. 6,000 will be considered.

10% thresholds = Rs. 6,000 x 10% = Rs. 600

- (c) Its assets are 10 per cent or more of the combined assets of all operating segments. Combined total assets of all the segment = Rs.1,02,750

10% thresholds = Rs.1,02,750 x 10% = 10,275

Accordingly, quantitative thresholds are calculated below:



Segments	L	M	N	O	P	Q	Reportable segments
% segment salesto total sales	36.66%	24.59%	9.84%	11.48%	13.11%	4.92%	L,M,O,P
% segment profit to total profits	50%	25%	25%	12.5%	15%	10%	L,M,N,O,P,Q
% segment assets to total assets	36.50%	22.63%	15.33%	10.22%	10.22%	5.11%	L,M,N,O,P

Segments L, M, O and P clearly satisfy the revenue and assets tests and they are separate reportable segments.

Segments N does not satisfy the revenue test, but it does satisfy the asset test and it is a reportable segment.

Segment Q does not satisfy the revenue or the assets test but is does satisfy the profits test. Therefore, Segment Q is also a reportable segment.

Hence, all segments i.e.; L, M, N, O, P and Q are reportable segments.

Question 9

Pharmaceuticals Limited has 5 operating segments namely K, L, M, N and O. The profit/ loss of respective segments for the year ended 31st March, 2022 are as follows:

Segment	Profit / (Loss) (₹ in crore)
K	1,560
L	3,000
M	(4,600)
N	(9,000)
O	12,000
Total	2,960

Based on the quantitative thresholds, you are required to determine that which of the above segments would be considered as reportable segments for the year ending 31st March, 2022. (PYP 5 Marks Nov 22) (Same concept different figures RTP May'20, Old & New SM)

Answer 9

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

"The absolute amount of its reported profit or loss is 10 per cent 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:

- All segments in profit, i.e., K, L and O – Total profit ₹ 16,560 crores.
- All segments in loss, i.e., M and N – Total loss ₹ 13,600 crores. Greater of the above – ₹ 16,560 crores.



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

Segment	Profit/(Loss) (₹ in crore)	% age of ₹ 16,560 crore*	Reportable segment
K	1,560	9.42%	No
L	3,000	18.12%	Yes
M	(4,600)	27.78%	Yes
N	(9,000)	54.35%	Yes
O	12,000	72.46%	Yes
Total	2,960		

Hence, L, M, N, O are reportable segments.

Question 10

A Limited 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 2022-2023 is given below:

All amounts in ` lakhs						
Segments	External revenue (including GST)	GST	Other operating income	Result	Assets	Liabilities
Coating	1,20,000	3,000	24,000	6,000	30,000	18,000
Others	42,000	1,800	9,000	2,400	18,000	6,000

Additional Information:

- Unallocated income net of expenses is ` 18,00,00,000
- Interest and bank charges is ` 12,00,00,000
- Income tax expenses is ` 12,00,00,000 (current tax ` 11,70,00,000 and deferred tax ` 30,00,000)
- Unallocated Investments are ` 60,00,00,000 and other assets are ` 60,00,00,000.
- Unallocated liabilities, Reserve & Surplus and Share Capital are ` 1,20,00,00,000, ` 1,80,00,00,000 & ` 60,00,00,000 respectively.
- Depreciation amounts for coating & others are ` 6,00,00,000 and ` 1,80,00,000 respectively.
- Capital expenditure for coating and others are ` 30,00,00,000 and ` 12,00,00,000 respectively. viii. Revenue from outside India is ` 3,72,00,00,000 and segment asset outside India ` 60,00,00,000.

Based on the above information, how A Limited would disclose information about reportable segment, revenue, profit or loss, assets and liabilities for financial year 2022-2023. Ignore corresponding figures for the previous year. Give figures in ` lakhs. (PYP 16 Marks May '23)

Answer 10

Segment information

Information about operating segment

(1) the company's operating segments comprise:

Coatings: consisting of decorative, automotive, industrial paints and related activities.



Others: consisting of chemicals, polymers and related activities.

(2) Segment revenues, results and other information:

(` in lakhs)

	Revenue	Coating	Others	Total
1.	External revenue (gross)	1,20,000	42,000	1,62,000
	GST	(3,000)	(1,800)	(4,800)
	Total revenue (net)	1,17,000	40,200	1,57,200
	Other operating income	24,000	9,000	33,000
	Total Revenue	1,41,000	49,200	1,90,200
2.	Results			
	Segment results	6,000	2,400	8,400
	Unallocated income (net of unallocated expenses)			1,800
	Profit from operation before interest, taxation and exceptional items			10,200
	Interest and bank charges			(1,200)
	Profit before exceptional items			9,000
	Exceptional items			Nil
	Profit before taxation			9,000
	Income taxes			
	Current taxes			(1,170)
	Deferred taxes			(30)
	Profit after taxation			7,800
3.	Other information			
(a)	Assets			
	Segment assets	30,000	18,000	48,000
	Investments			6,000
	Unallocated assets			6,000
	Total assets			60,000
(b)	Liabilities and Shareholder's funds			
	Segment liabilities	18,000	6,000	24,000
	Unallocated liabilities			12,000
	Share capital			6,000
	Reserves and surplus			18,000
	Total liabilities and shareholder's funds			60,000
(c)	Others			
	Capital expenditure	(3,000)	(1,200)	(4,200)
	Depreciation	(600)	(180)	(780)
Geographical Information		India	Outside India	Total
	Revenue	1,53,000	37,200	1,90,200
	Segment assets	54,000	6,000	60,000
	Capital expenditure	4,200		4,200



Notes:

- (i) The operating segments have been identified in line with Ind AS 108, taking into account the nature of products, 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 noncurrent assets and other current assets. Unallocable liabilities include unallocable current liabilities and net deferred tax liability.



Chapter 11

Accounting and Reporting of Financial Instruments

Question 1

An asset is sold in 2 different active markets (a market in which transaction for the asset or liability takes place with sufficient frequency and volume to provide pricing information on an ongoing basis) at different prices. An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

In Market A:

The sale price of the asset is Rs. 26, transaction cost is Rs. 3 and the cost to transport the asset to Market A is Rs. 2 (i.e., the net amount that would be received is Rs. 21).

In Market B:

The sale price of the asset is Rs. 25, transaction cost is Re. 1 and the cost to transport the asset to Market B is Rs. 2 (i.e., the net amount that would be received is Rs. 22).

Determine the fair value of the asset by supporting your answer with proper reason. (MTP 4 Marks Aug '18)

Answer 1

If Market A is the principal market for the sale of asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport cost of Rs. 24. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs.

If neither market is the principal market for the sale of asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received by selling the asset, after taking into account transport cost (i.e., the net amount that would be received in the respective markets). Since the entity would maximise the net amount that would be received for the asset in Market B, the fair value of the asset would be measured using the price in that market i.e. sale of asset Rs. 25 less transport cost Rs. 2, resulting in a fair value measurement of Rs. 23.

Question 2

On 1 January 2018, Entity X writes a put option for 1,00,000 of its own equity shares for which it receives a premium of Rs. 5,00,000. Under the terms of the option, Entity X may be obliged to take delivery of 1,00,000 of its own shares in one year's time and to pay the option exercise price of Rs. 22,000,000. The option can only be settled through physical delivery of the shares (gross physical settlement). Examine the nature of the financial instrument and how it will be accounted assuming that the present value of option exercise price is Rs. 2,00,000? (MTP 5 Marks Aug' 18, RTP Nov'21)

Answer 2

This derivative involves Entity X taking delivery of a fixed number of equity shares for a fixed amount of cash. Even though the obligation for Entity X to purchase its own equity shares for Rs. 22,000,000 is conditional on the holder of the option exercising the option, Entity X has an obligation to deliver cash which it cannot avoid.

As per para 23 of Ind AS 32 'Financial Instruments: Presentation', the accounting for financial instrument will be as below:

- The financial liability is recognized initially at the present value of the redemption amount, and is reclassified from equity. This would imply that a financial liability for an amount of present value of Rs. 22,000,000, say Rs. 20,000,000 will be recognised through a debit to equity. The initial premium received (Rs. 5,00,000) is credited to equity.
- Subsequently, the financial liability is measured in accordance with Ind AS 109. While a

subsequent paragraph will deal with measurement of financial liabilities. The financial liability of Rs. 20,000,000 will be measured at amortised cost as per Ind AS 109 and finance cost of Rs. 2,000,000 will be recognised over the exercise period.

- If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity i.e. an amount of Rs. 22,000,000 will be reclassified from financial liability to equity.

Question 3

- (1) QA Ltd. issued 10,00,000 of 8% Long Term bond-A Series of Rs. 1 each on 1st April, 2016. The bond tenure is 3 years. Interest is payable annually on 1st April each year. The investors expect an effective interest rate on the loan at 10%. QA Ltd. wants you to suggest the suitable accounting entries for the issue of these bonds as per applicable Ind AS. Consider the discounting factor 3 years, 10% discounting factor is 0.751315 and 3 years cumulative discounting factor is 2.48685.
- (i) What is the principal value of the bond at the initial recognition at the time of issue of bond as per applicable Ind AS?
 - (ii) What is the present value of the interest payment to be recognised as part of the sale price of the bond as per applicable Ind AS?
 - (iii) What are the proceeds of the sale of the bond to be recognized at the time of initial recognition as per applicable Ind AS?
 - (iv) What is the accounting entry to be passed at the time of accounting for payment of interest for the first year?
- (2) QA Ltd. has also issued 10,00,000 of 8% Long Term Bond-B Series of Rs. 1 each on 1st April, 2016. The bond tenure is 3 years. Interest is payable annually on 1st April each year. However, the bond holders of this series are entitled to convert the bonds to shares of Rs. 1 each on the date of maturity, instead of receiving the principal repayment. Interest rate on the similar bond without conversion option is 10%. QA Ltd. has requested you to suggest the following for this type of instrument:
- (a) What is entry to be passed at the date of issuance of the bond as per applicable Ind AS?
 - (b) What is entry to be passed at the date of conversion of the bond as per applicable Ind AS? (MTP 8 Marks Mar '19)

Answer 3

- [illegible]

Workings for the above

Since the Effective interest rate on the loan is 10% while the Bond has been issued at 8%, the financial liability will be recognized at fair value determined as follows:



Calculation of initial recognition amount of 8% Long term Loan Bond A Series

Particulars	Rs.
Present value of the principal repayable after 3 years (10,00,000 x .751315)	7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]	1,98,948
Total Present Value of Long term Loan Bond	9,50,263

Interest for the first year recognized in the books as per effective interest rate method

$$= \text{Rs. } 9,50,263 \times 10\% = \text{Rs. } 95,026$$

However, interest paid is @ 8% i.e. Rs. 10,00,000 x 8% = Rs. 80,000

(2) Option (B) : Cash/Bank A/c Rs. 10,00,000

To 8% LT Bond Series B A/c Rs. 9,50,263

To Share Option A/c Rs. 49,737

Workings for the above

It is a compound instrument.

Calculation of initial recognition amount of 8% Long term Loan Bond B Series liability and equity component

Particulars	Rs.
Present value of the principal repayable after 3 years (10,00,000 x .751315)	7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]	
Total Present Value of Long Term Loan Bond B I	1,98,948
Issue proceeds from convertible bond II	
Value of equity component (II – I)	9,50,263
	10,00,000
	49,737

8% LT Bond Series B A/c Rs. 10,00,000 Share Option A/c Rs.
49,737

To Share Capital A/c Rs. 10,00,000

To Share Premium A/c Rs. 49,737

Reasoning:

As per para AG32 of Ind AS 32, on conversion of a convertible instrument at maturity, the entity derecognizes the liability component and recognizes it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity.

Question 4

On 1 April 2018, an 8% convertible loan with a nominal value of Rs. 6,00,000 was issued at par. It is redeemable on 31 March 2022 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each Rs. 200 worth of loan.

An equivalent loan without the conversion option would have carried interest at 10%. Interest of Rs. 48,000 has already been paid and included as a finance cost.

Present value rates are as follows:



Year End	@ 8%	@ 10%
1	0.93	0.91
2	0.86	0.83
3	0.79	0.75
4	0.73	0.68

How will the Company present the above loan notes in the financial statements for the year ended 31 March 2019?(MTP 8 Marks Mar '19)(Same concept different figures in MTP 8 Marks Mar'23 & PYP 6 Marks Nov'20)

Answer 4

Step 1 There is an 'option' to convert the loans into equity i.e. the loan note holders do not have to accept equity shares; they could demand repayment in the form of cash.

Ind AS 32 states that where there is an obligation to transfer economic benefits there should be a liability recognised. On the other hand, where there is not an obligation to transfer economic benefits, a financial instrument should be recognised as equity.

In the above illustration we have both – 'equity' and 'debt' features in the instrument. There is an obligation to pay cash – i.e. interest at 8% per annum and a redemption amount – this is 'financial liability' or 'debt component'. The 'equity' part of the transaction is the option to convert. So it is a compound financial instrument.

Step 2 Debt element of the financial instrument so as to recognise the liability is the present value of interest and principal

The rate at which the same is to be discounted, is the rate of equivalent loan note without the conversion option would have carried interest at 10%, therefore this is the rate to be used for discounting

Step 3 Calculation of the debt element of the loan note as follows:

8% Interest discounted at a rate of 10% Present Value (6,00,000 x 8%)

S. No	Year	Interest amount	PVF	Amount
Year 1	2019	48,000	0.91	43,680
Year 2	2020	48,000	0.83	39,840
Year 3	2021	48,000	0.75	36,063
				1,19,583
Year 4	2022	648,000	0.68	4,40,640
Amount to be recognised as a liability				5,60,223

Initial proceeds(6,00,000)

Amount to be recognised as equity 39,777

- In year 4, the loan note is redeemed therefore Rs. 6,00,000 + Rs. 48,000 = Rs. 6,48,000.

Step 4 The next step is to recognise the interest component equivalent to the loan that would carry if there was no option to cover. Therefore, the interest should be recognised at 10%. As on date Rs. 48,000 has been recognised in the statement of profit and loss i.e. 6,00,000 x 8% but we have discounted the present value of future interest payments and redemption amount using discount factors of 10%, so the finance charge in the statement of profit and loss must also be recognised at the same rate i.e. for the purpose of consistency.

The additional charge to be recognised in the income statement is calculated as: Debt component of the financial instrument Rs. 5,60,000

Interest charge (5,60,000 x 10%)	Rs. 56,000
Already charged to the income statement	(Rs. 48,000)
Additional charge required	Rs. 8,000



Journal Entries for recording additional finance cost for year ended 31 March 2019

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Finance cost A/c To Debt component A/c (Being interest recorded for difference between amount recorded earlier and that to be recorded per Ind AS 32)	8,000	8,000

Question 5

Croton Limited is engaged in the business of trading commodities. The company's main asset are investments in equity shares, preference shares, bonds, non-convertible debenture (NCD) and mutual funds.

The Company collects the periodical income (i.e. interest, dividend, etc.) from the investments and regularly sells the investment in case of favorable market conditions. Such investments have been classified as non-current investments in the financial statements.

Also, the company buys and sells equity shares of companies for earning short term profits from the stock market.

The CFO of company classified all the non-current investments as Fair Value Through Other Comprehensive Income (FVTOCI) and all the current investment as Fair value Through Profit and Loss (FVTPL).

Croton Limited raised the following queries:

- Can the Company classify the equity shares previously held under current investment as FVTOCI if the company decides to hold them for more than one-year (i.e. classify it as non-current)?
- The Company had classified NCDs with a maturity period of less than twelve months from the reporting period as current. This has been classified as FVTPL by the CFO of the company. The Company wants to know whether these NCDs can be recognized as FVTOCI? (MTP 8 Marks Oct '19)

Answer 5

- It seems that the equity shares are acquired for the purpose of selling it in the near term and therefore are held for trading. Such investments have been appropriately classified as subsequently measured at fair value through profit or loss. Such investments in equity shares cannot be classified as subsequently measured at fair value through other comprehensive income. The option to measure investment in equity shares at fair value through other comprehensive income has to be made at initial recognition. Therefore, equity shares that were held for trading previously cannot be reclassified to fair value through other comprehensive income due to change in business model to not held for trading.
- In absence of contractual terms of NCDs, it is assumed that the contractual terms give rise on specified dates to cash flows that are solely payment of principal and interest on the principal outstanding. The business model also includes sales of these instruments on a regular basis. Hence, these instruments will be classified as FVTOCI. Therefore, such NCD investments shall be classified as subsequently measured at Fair Value through Other Comprehensive Income. The classification does not change based on whether the investment is current or non-current as the end of the reporting period. It seems the company has previously classified these investments at fair value through profit or loss. The company must rectify this by reclassifying as FVTOCI.

Question 6

Blueberry Ltd entered into the following transactions during the year ended 31st March,20X2:



- (a) Entered into a speculative interest rate option costing Rs. 10,000 on 1st April, 20X0 to borrow Rs. 6,000,000 from Exon Bank commencing 30th June, 20X2 for 6 months at 4%.

The value of the option at 31st March, 20X2 was Rs. 15,250.

- (b) Purchased 6% debentures in Fox Ltd on 1st April, 20X1 (their issue date) for Rs. 150,000 as an investment. Blueberry Ltd. intends to hold the debentures, until their redemption at a premium, in 5 years' time. The effective rate of interest of the bond is 8%.
- (c) Purchased 50,000 shares in Cox Ltd on 1st October, 20X2 for Rs. 3.50 each as an investment. The share price on 31st March, 20X2 was Rs. 3.75.

Show the accounting treatment and relevant extracts from the financial statements for the year ended 31st March, 20X2 of transactions related to financial instruments. Blueberry Ltd designates financial assets at fair value through Profit or loss only when this is unavoidable. (MTP 10 Marks May '20)

Answer 6

Balance Sheet as at 31st March, 20X2 (Extracts)

	Rs.
Financial Assets:	
Interest rate option (W.N.1)	15,250
6% Debentures in Fox Ltd. (W.N.2)	1,53,000
Shares in Cox Ltd. (W.N.3)	1,87,500

Statement of Profit and Loss (Extracts)

Finance Income:	
Gain on interest rate option (W.N.1)	5,250
Effective interest on 6% Debentures (W.N.2)	12,000

Working Notes:

1. Interest rate option

This is a derivative and so it must be treated as at fair value through profit or loss

Particulars	Rs.	Rs.
Initial measurement (at cost)		
Financial Asset Dr.	10,000	
To Cash A/c		10,000

At 31st March, 20X2

Particulars	Rs.	Rs.
(Re-measured to fair value)		
Financial Asset (Rs. 15,250 - Rs. 10,000) Dr.	5,250	
To Profit and loss A/c		5,250

Financial Assets (Rs. 10,000 + Rs. 5,250) = Rs. 15,250 (Balance Sheet)

Gain on interest option = Rs. 5,250 (Statement of Profit and Loss)

2. Debentures

On the basis of information provided, this can be treated as a held-to-maturity investment

Particulars	Rs.	Rs.
Initial measurement (at cost)		
Financial Asset Dr.	1,50,000	
To Cash A/c		1,50,000



At 31st March, 20X2 (Amortized cost)

Particulars		Rs.	Rs.
Financial Asset (Rs.1,50,000 x 8%)	Dr.	12,000	
To Finance Income			12,000

Cash (Rs. 1,50,000 x 6%)	Dr.	9,000	
To Financial asset			9,000

Amortized cost at 31st March, 20X2

(Rs. 150,000 + Rs. 12,000 – Rs. 9,000) = **Rs. 153,000 (Balance Sheet)**

Effective interest on 6% debenture = **Rs. 12,000 (Statement of Profit and Loss)**

3. Shares in Cox Ltd.

These are treated as an available for sale financial asset (shares cannot normally be held to maturity and they are clearly not loans or receivables)

Particulars		Rs.	Rs.
Initial measurement (at cost)			
Financial Asset (Rs.50,000 x Rs.3.50)	Dr.	1,75,000	
To Cash A/c			1,75,000

At 31st March, 20X2 (Re-measured at fair value)

Particulars		Rs.	Rs.
Financial Asset [(Rs.50,000 x 3.75) – 1,75,000]	Dr.	12,500	
To Other Equity A/c			12,500

Shares in Cox Ltd (Rs.1,75,000 + Rs.12,500) = **Rs.1,87,500 (Balance Sheet)**

Question 7

D Ltd. issues preference shares to G Ltd. for a consideration of Rs. 10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime up to a period of 3 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 3 years. The preference shares carry a coupon of RBI base rate plus 1% p.a.

The prevailing market rate for similar preference shares, without the conversion feature or issuer's redemption option, is RBI base rate plus 4% p.a. On the date of contract, RBI base rate is 9% p.a.

Calculate the value of the liability and equity components. (MTP 4 Marks May '20, Old & New SM)

Answer 7

The values of the liability and equity components are calculated as follows:

Present value of principal payable at the end of 3 years (Rs. 10 lakhs discounted at 13% for 3 years) = Rs. 6,93,050

Present value of interest payable in arrears for 3 years (Rs. 10,00,000 discounted at 13% for each of 3 years) = Rs. 2,36,115

Paragraph AG31 of Ind AS 32 states that a common form of compound financial instruments is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivatives features.

The liability component = Present value of principal + Present value of Interest

= Rs. 6,93,050 + Rs.2,36,115 = Rs. 9,29,165

Equity Component = Rs. 10,00,000 – Rs. 9,29,165 = Rs. 70,835



Question 8

On 1 April 2019, Shelter Ltd. issued 5,000, 8% debentures maturing on 31 March 2024. The debentures are convertible at the option of the holder into equity shares of Shelter Ltd. at a conversion price of Rs. 105 per share or redeemable at face value of Rs. 100 each. Interest is payable annually in cash. At the date of issue, Shelter Ltd. could have issued non-convertible debt with a 5 year term bearing a coupon interest rate of 12%. On 1 April 2022, the convertible debentures have a fair value of Rs. 5,25,000. Shelter Ltd. makes a tender offer to debenture holders to repurchase the debentures for Rs. 5,25,000, which the holders accepted. At the date of repurchase, Shelter Ltd. could have issued non-convertible debt with a 2 year term bearing a coupon interest rate of 9%.

Show accounting entries in the books of Shelter Ltd. for recording of equity and liability component:

- At the time of initial recognition and
- At the time of repurchase of the convertible debentures.

The following present values of Rs. 1 at 8%, 9% & 12% are supplied to you:

Interest Rate	Year 1	Year 2	Year 3	Year 4	Year 5
8%	0.926	0.857	0.794	0.735	0.681
9%	0.917	0.842	0.772	0.708	0.650
12%	0.893	0.797	0.712	0.636	0.567

(MTP 10 Marks Oct '20, MTP 12 Marks Apr'19, MTP 10 Marks Aug'18)(Same concept different figures- RTP Nov'21)

Answer 8

- At the time of initial recognition

(ii)	Rs.
Liability component	
Present value of 5 yearly interest payments of Rs. 40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of Rs. 5,00,000 due at the end of 5 years, discounted at 12%, compounded yearly (5,00,000 x 0.567)	2,83,500
	4,27,700
Equity component	
(Rs. 5,00,000 – Rs. 4,27,700)	72,300
Total proceeds	5,00,000

Note: Since Rs. 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs. 100 each only.

Journal Entry

	Rs.	Rs.
Bank Dr.	5,00,000	
To 8% Debentures (Liability component)		4,27,700
To 8% Debentures (Equity component)		72,300
(Being Debentures are initially recorded a fair value)		

- At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	Fair Value @ 9%	Difference
	Rs.	Rs.	Rs.



Liability component			
Present value of 2 remaining yearly interest payments of Rs. 40,000, discounted at 12% and 9%, respectively	67,600	70,360	
Present value of Rs. 5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively	3,98,500	4,21,000	
Liability component	4,66,100	4,91,360	(25,260)
Equity component	72,300	33,640*	38,660
Total	5,38,400	5,25,000	13,400

$$*(5,25,000 - 4,91,360) = 33,640$$

Journal Entries

		Rs.	Rs.
8% Debentures (Liability component)	Dr.	4,66,100	
Profit and loss A/c (Debt settlement expense)	Dr.	25,260	
To Bank A/c			4,91,360
(Being the repurchase of the liability component recognised)			
8% Debentures (Equity component)	Dr.	72,300	
To Bank A/c			33,640
To Reserves and Surplus A/c			38,660
(Being the cash paid for the equity component recognised)			

Question 9

KK Ltd. has granted an interest free loan of Rs. 10,00,000 to its wholly owned Indian Subsidiary YK Ltd. There is no transaction cost attached to the said loan. The Company has not finalised any terms and conditions including the applicable interest rates on such loans. The Board of Directors of the Company are evaluating various options and has requested your firm to provide your views under Ind AS in following situations:

- The Loan given by KK Ltd. to its wholly owned subsidiary YK Ltd. is interest free and such loan is repayable on demand.
- The said Loan is interest free and will be repayable after 3 years from the date of granting such loan. The current market rate of interest for similar loan is 10%. Considering the same, the fair value of the loan at initial recognition is Rs.8,10,150.
- The said loan is interest free and will be repaid as and when YK Ltd. has funds to repay the Loan amount.

Based on the same, KK Ltd. has requested you to suggest the accounting treatment of the above loan in the stand-alone financial statements of KK Ltd. and YK Ltd. and also in the consolidated financial statements of the group. Consider interest for only one year on the above loan for the purpose of providing journal entries. (MTP 8 Marks Oct '20, RTP May'19, Old & New SM) (Same concept different figures- PYP 12 Marks Dec'21)

Answer 9

Scenario (i)

Since the loan is repayable on demand, it has fair value equal to cash consideration given. KK Ltd. and YK Ltd. should recognize financial asset and liability, respectively, at the amount of loan given (assuming that loan is repayable within a year). Upon, repayment, both the entities should reverse the entries that were made at the origination.



At origination			
Loan to YK Ltd. A/c	Dr.	Rs. 10,00,000	
To Bank A/c			Rs. 10,00,000
On repayment			
Bank A/c	Dr.	Rs. 10,00,000	
To Loan to YK Ltd. A/c			Rs. 10,00,000

Journal entries in the books of YK Ltd.

At origination			
Bank A/c	Dr.	Rs. 10,00,000	
To Loan from KK Ltd. A/c			Rs. 10,00,000
On repayment			
Loan from KK Ltd. A/c	Dr.	Rs. 10,00,000	
To Bank A/c			Rs. 10,00,000

In the consolidated financial statements, there will be no entry in this regard since loan receivable and loan payable will get set off.

Scenario (ii)

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

If a long-term loan or receivable that carries no interest while similar instruments if exchange d between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. The difference in fair value and transaction cost will treated as investment in Subsidiary YK Ltd.

Both KK Ltd. and YK Ltd. should recognise financial asset and liability, respectively, at fair value on initial recognition, i.e., the present value of Rs. 10,00,000 payable at the end of 3 years using discounting factor of 10%. Since the question mentions fair value of the loan at initial recognition as Rs. 8,10,150, the same has been considered. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Journal entries in the books of KK Ltd. (for one year)

At origination			
Loan to YK Ltd. A/c	Dr.	Rs. 8,10,150	
Investment in YK Ltd. A/c	Dr.	Rs. 1,89,850	
To Bank A/c			Rs. 10,00,000
During periods to repayment- to recognise interest			
Year 1 – Charging of Interest			
Loan to YK Ltd. A/c	Dr.	Rs. 81,015	
To Interest income A/c			Rs. 81,015
Transferring of interest to Profit and Loss			
Interest income A/c	Dr.	Rs. 81,015	
To Profit and Loss A/c			Rs. 81,015
On repayment			



Bank A/c	Dr.	Rs. 10,00,000	
	To Loan to YK Ltd. A/c		Rs. 10,00,000
Note- Interest needs to be recognized in statement of profit and loss. The same cannot be adjusted against capital contribution recognized at origination.			

Journal entries in the books of YK Ltd. (for one year)

At origination			
Bank A/c	Dr.	Rs. 10,00,000	
	To Loan from KK Ltd. A/c		Rs. 8,10,150
	To Equity Contribution in KK Ltd. A/c		Rs. 1,89,850
During periods to repayment- to recognise interest			
Year 1			
Interest expense A/c	Dr.	Rs. 81,015	
	To Loan from KK Ltd. A/c		Rs. 81,015
On repayment			
Loan from KK Ltd. A/c	Dr.	Rs. 10,00,000	
	To Bank A/c		Rs. 10,00,000

In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

Scenario (iii)

Generally, a loan which is repayable when funds are available, cannot be stated as loan repayable on demand. Rather the entity needs to estimate the repayment date and determine its measurement accordingly by applying the concept prescribed in Scenario (iv).

In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

In case the subsidiary YK Ltd. is planning to grant interest free loan to KK Ltd., then the difference between the fair value of the loan on initial recognition and its nominal value should be treated as dividend distribution by YK Ltd. and dividend income by the parent KK Ltd.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question dealt with the accounting treatment of Financial Instruments under various scenarios. Many examinees explained the accounting treatment without passing the journal entries or incomplete journal entries were provided by some of the examinees.

Question 10

An entity purchases a debt instrument with a fair value of Rs. 1,000 on 15th March, 20X1 and measures the debt instrument at fair value through other comprehensive income. The instrument has an interest rate of 5% over the contractual term of 10 years, and has a 5% effective interest rate. At initial recognition, the entity determines that the asset is not a purchased or original credit-impaired asset.

On 31st March 20X1 (the reporting date), the fair value of the debt instrument has decreased to Rs. 950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition and that ECL should be measured at an amount equal to 12 month ECL, which amounts to Rs. 30.

On 1st April 20X1, the entity decides to sell the debt instrument for Rs. 950, which is its fair value at that date.



Pass journal entries for recognition, impairment and sale of debt instruments as per Ind AS 109. Entries relating to interest income are not to be provided.

(MTP 5 Marks March '21, RTP Nov '19)

Answer 10

On Initial recognition

	Debit (Rs.)	Credit (Rs.)
Financial asset-FVOCI Dr. To Cash	1,000	1,000

On Impairment of debt instrument

	Debit (Rs.)	Credit (Rs.)
Impairment expense (P&L) Dr. Other comprehensive income Dr. To Financial asset-FVOCI	30 20	50

The cumulative loss in other comprehensive income at the reporting date was Rs. 20. That amount consists of the total fair value change of Rs. 50 (that is, Rs. 1,000-Rs. 950) offset by the change in the accumulated impairment amount representing 12-month ECL, that was recognized (Rs. 30).

On Sale of debt instrument

	Debit (Rs.)	Credit (Rs.)
Cash To Financial asset –FVOCI	950	950
Loss on sale (P&L) To Other comprehensive income	20	20

Question 11

- (a) On 1st April, 2017, XYZ Ltd., a company incorporated in India enters into a contract to buy solar panels from Good Associates, a firm domiciled in UAE, for which delivery is due after 6 months i.e. on 30th September, 2017.

The purchase price for solar panels is US\$ 50 million.

The functional currency of XYZ is Indian Rupees (INR) and of Good Associates is Dirhams.

The obligation to settle the contract in US Dollars has been evaluated to be an embedded derivative which is not closely related to the host purchase contract.

Exchange rates:

1. Spot rate on 1st April 2017: USD 1 = Rs. 60
2. Six-month forward rate on 1st April, 2017: USD 1 = Rs. 65
3. Spot rate on 30th September, 2017: USD 1 = Rs. 66

Analyze the contract and pass the necessary journal entries.(MTP 14 Marks April '18)

Answer 11

- (a) This contract comprises of two components:

- Host contract to purchase solar panels denominated in Rs. i.e. a notional payment in Rs. at 6-month forward rate (Rs. 3,250 million or Rs. 325 crores)

- Forward contract to pay US Dollars and receive Rs. i.e. a notional receipt in Rs. In other words,



a forward contract to sell US Dollars at Rs. 65 per US Dollar.

It may be noted that the notional Rupees payment in respect of host contract and the notional Rupees receipt in respect of embedded derivative create an offsetting position.

Subsequently, the host contract is not accounted for until delivery. The embedded derivative is recorded at fair value through profit or loss. This gives rise to a gain or loss on the derivative, and a corresponding derivative asset or liability.

On delivery XYZ records the inventory at the amount of the host contract (Rs. 325 crores). The embedded derivative is considered to expire. The derivative asset or liability (i.e. the cumulative gain or loss) is settled by becoming part of the financial liability that arises on delivery.

In this case the carrying value of the currency forward at 30th September 2017 on maturity is Rs. 50 million X (66 minus 65) = Rs. 5 crores (liability/loss). The loss arises because XYZ has agreed to sell US Dollars at ` 65 per US Dollar whereas in the open market, US Dollar can be sold at Rs. 66 per US Dollar.

No accounting entries are passed on the date of entering into purchase contract. On that date, the forward contract has a fair value of zero (refer section “option and non- option based derivatives” below).

Subsequently, say at 30th September 2017, the accounting entries are as follows:

(all Rs. in crores):

1. Loss on derivative contract	5	
		5
To Derivative liability		
(Being loss on currency forward)		
2. Inventory	325	
		325
To Trade payables (financial liability)		
(Being inventory recorded at forward exchange rate determined on date of contract)		
3. Derivative liability	5	
		5
To Trade payables (financial liability)		
(Being reclassification of derivative liability to trade payables upon settlement)		

The effect is that the financial liability at the date of delivery is Rs. 330 crores (Rs. 325 crores + Rs. 5 crores), equivalent to US\$ 50 million at the spot rate on 30th September 2017.

Going forward, the financial liability is a US\$ denominated financial instrument. It is retranslated at the dollar spot rate in the normal way, until it is settled.

Question 12

ABC Bank gave loans to a customer – Target Ltd. that carry fixed interest rate @ 10% per annum for a 5 year term and 12% per annum for a 3 year term. Additionally, the bank charges processing fees @1% of the principal amount borrowed. Target Ltd borrowed loans as follows:

10 lacs for a term of 5 years

8 lacs for a term of 3 years.

Compute the fair value upon initial recognition of the loan in books of Target Ltd. and how will loan processing fee be accounted? (4 Marks April '21, Old & New SM)



Answer 12

The loans from ABC Bank carry interest @ 10% and 12% for 5 year term and 3 year term respectively. Additionally, there is a processing fee payable @ 1% on the principal amount on date of transaction. It is assumed that ABC Bank charges all customers in a similar manner and hence this is representative of the market rate of interest.

Amortized cost is computed by discounting all future cash flows at market rate of interest. Further, any transaction fees that are an integral part of the transaction are adjusted in the effective interest rate and recognized over the term of the instrument.

Hence loan processing fees shall be reduced from the principal amount to arrive the value on day 1 upon initial recognition.

Fair value (5-year term loan) = 10,00,000 – 10,000 (1% x 10,00,000) = 9,90,000

Fair value (3-year term loan) = 8,00,000 – 8,000 (1% x 8,00,000) = 7,92,000.

Now, effective interest rate shall be higher than the interest rate of 10% and 12% on 5 year loan and 3 year loan respectively, so that the processing fees gets recognized as interest over the respective term of loans.

Question 13

Besides construction activity, Buildings & Co. Limited is also engaged in the trading of Copper. On 1st April, 20X1, it had 100 kg of copper costing Rs. 70 per kg - totalling Rs. 7000. The Company has a scheduled delivery of these 100 kgs of copper to its customer on 30th September, 20X1 at the rate of USD 100 on that date. To protect itself from decline in currency exchange rate (USD to Rs.), the entity hedges its position by entering into currency futures contract for equivalent currency units at Rs. 76 / USD. The future contract mature on 30th September, 20X1. The management performed an assessment of hedge effectiveness and concluded that the hedging relationship qualifies for cash flow hedge accounting. The entity determines and documents that changes in fair value of the currency futures contract will be highly effective in offsetting variability in cash flow of currency exchange. On 30th September, 20X1, the entity closes out its currency futures contract. On the same day, it also sells its inventory of copper at USD 100 when the spot rate is Rs. 72 / USD.

You are required to prepare detailed working and pass necessary journal entries for the sale of copper and the corresponding hedge instrument taken by the company. Pass the journal entries as on the initial date (i.e. 1st April 20X1), first quarter end reporting (i.e. 30th June 20X1) and date of sale of copper and settlement of forward contract (i.e. 30th September 20X1).

Assume the exchange rates as follows and yield @ 6% per annum.

Date	Future price for 30th September 20X1 delivery (Rs. / USD)
1st April, 20X1	76
30th June, 20X1	74
30th September, 20X1	71

(10 Marks April '21)

Answer 13

Calculation of discounting factor based on yield @ 6% p.a.

Date	Spot rate at indicated date	Forward rate for 30th September 20X1	Discount factor @ 6% p.a. on quarter basis
1st April, 20X1		76	0.971
30th June 20X1		74	0.985
30th September, 20X1	72	71	1



Determination of fair value change

		1st April, 20X1	30th June, 20X1	30th September, 20X1
a	Nominal value in Rs. @ Rs. 76 / USD	7,600	7,600	7,600
b	Nominal value in USD (100 kg for USD 100)	100	100	100
c	Forward rate for 30th September, 20X1	76	74	71
d	Value in Rs. (b x c)	7,600	7,400	7,100
e	Difference (a-d)	0	200	500
f	Discount factor (as calculated in the above table)	0.971	0.985	1
g	Fair value (e x f)		197	500
h	Fair value change for the period		197	303*
	* 500 – 197 = 303			

Journal Entries

Date	Particulars	Dr.	Cr.
1st April, 20X1	No entry as initial fair value is zero		
30th June, 20X1	Future Contract Dr. To Cash Flow Hedge Reserve (Other Equity)- OCI (Being Change in Fair Value of Hedging Instrument recognised in OCI accumulated in a separate component in Equity)	197	197
30th September, 20X1	Future Contract Dr. To Cash Flow Hedge Reserve (Other Equity) - OCI (Being change in fair value of the hedging instrument recognised in OCI)	303	303
30th September, 20X1	Bank/Trade Receivable Dr. To Revenue from Contracts with Customers (Being sale of 100 kgs. of copper for USD 100 recognised at spot rate of Rs. 72 for USD 1)	7,200	7,200
30th September, 20X1	Cash Flow Hedge Reserve (Other Equity) - OCI Dr. To Revenue from Contracts with Customers (Being fair value change in forward contract reclassified to profit and loss and recognised in the line item affected by the hedge item)	500	500
30th September, 20X1	Bank / Cash Dr. To Future Contract	500	500

Question 14

A Ltd. (the 'Company') makes a borrowing for Rs. 10 lacs from RBC Bank, with bullet repayment of Rs. 10 lacs and an annual interest rate of 12% per annum. Now, Company defaults at the end of 5th year and consequently, a rescheduling of the payment schedule is made beginning 6th year onwards. The Company is required to pay Rs. 1,300,000 at the end of 6th year for one time settlement, in lieu of defaults in payments made earlier.

- Does the above instrument meet definition of financial liability? Please explain.
- Analyze the differential amount to be exchanged for one-time settlement (MTP 4 Marks April '21, Old & New SM)



Answer 14

- a) A Ltd. has entered into an arrangement wherein against the borrowing, A Ltd. has contractual obligation to make stream of payments (including interest and principal). This meets definition of financial liability.
- b) Let's compute the amount required to be settled and any differential arising upon one time settlement at the end of 6th year –
 - Loan principal amount = Rs. 10,00,000
 - Amount payable at the end of 6th year = Rs. 12,54,400 [10,00,000 x 1.12 x 1.12 (Interest for 5th & 6th year in default plus principal amount)]
 - One time settlement = INR 13,00,000
 - Additional amount payable = Rs. 45,600

The above represents a contractual obligation to pay cash against settlement of a financial liability under conditions that are unfavorable to A Ltd. (owing to additional amount payable in comparison to amount that would have been paid without one time settlement). Hence the rescheduled arrangement meets definition of 'financial liability'.

Question 15

On 1 January 20X0, Preet Ltd. issues 10 year bonds for Rs. 10,00,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for Rs. 10,00,000. No costs or fees are incurred. The effective interest rate is 10%. On 1 January 20X5 (i.e. after 5 years) Preet Ltd. and the bondholders agree to a modification in

accordance with which:

- the term is extended to 31 December 20Y1;
- interest payments are reduced to 5% p.a.;
- the bonds are redeemable on 31 December 20Y1 for Rs. 15,00,000; and
- legal and other fees of Rs. 1,00,000 are incurred.

Preet Ltd. determines that the market interest rate on 1 January 20 X5 for borrowings on similar terms is 11%.

Analyse whether the extinguishment accounting will apply or not as per Ind AS. If yes, determine the fair value of the modified liability and compute the gain or loss on modification. (MTP 14 Marks March '18)

Answer 15

- (a) The repayment schedule for the original debt till the date of renegotiation is as below:

Date / year ended	Opening balance	Interest accrual	Cash flows	Closing balance
1 January 20X0	10,00,000			10,00,000
31 December 20X0	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X1	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X2	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X3	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X4	10,00,000	1,00,000	(1,00,000)	10,00,000

On 1 January 20X5, the discounted present value of the remaining cash flows of the original financial liability is Rs. 10,00,000.

On this date, Preet Ltd. will compute the present value of:



- cash flows under the new terms – i.e. Rs. 15,00,000 payable on 31 December 20Y1 and Rs. 50,000 payable for each of the 7 years ending 31 December 20Y1.
- any fee paid (net of any fee received) – i.e. Rs. 1,00,000 using the original effective interest rate of 10%.

The total of these amounts to Rs. 11,13,158 (Refer Working Note). This differs from the discounted present value of the remaining cash flows of the original financial liability by 11.32% i.e. by more than 10%. Hence, extinguishment accounting applies.

The next step is to estimate the fair value of the modified liability. This is determined as the present value of the future cash flows (interest and principal), using an interest rate of 11% (the market rate at which Preet Ltd. could issue new bonds with similar terms). The estimated fair value on this basis is Rs. 958,097 (Refer Working Note). A gain or loss on modification is then determined as:

Gain (loss) = carrying value of existing liability - fair value of modified liability - fees and costs incurred i.e. Rs. 10,00,000 – Rs. 9,58,097 – Rs. 1,00,000 = Loss of Rs. 58,097

Working Note:

Year	Discount factor @ 10%	Discount factor @ 11%
1	0.909091	0.900901
2	0.826446	0.811622
3	0.751315	0.731191
4	0.683013	0.658731
5	0.620921	0.593451
6	0.564474	0.534641
7	0.513158	0.481658
Annuity	4.868418	4.712195

Amount	Discounting factor @ 10%	Present value	Discounting factor @ 11%	Present value
15,00,000	0.513158	7,69,737	0.481658	7,22,487
1,00,000		1,00,000		
50,000 for 7 years	4.868418	2,43,421	4.712195	2,35,610
		11,13,158		9,58,097
PV of original cash flows @ original EIR		(10,00,000)		
Difference		1,13,158		
Difference %		11.32%		

Question 16

Discuss the need of hedge accounting and types of various hedges? (MTP 8 Marks Oct '18)

Answer 16

Hedge accounting may be required due to accounting mismatches in:

- **Measurement** – some financial instruments (non-derivative) are not measured at fair value with changes being recognised in the statement of profit and loss whereas all derivatives, which commonly are used as hedging instruments, are measured at fair value
- **Recognition** – unsettled or forecast transactions that may be hedged are not recognised on the



whereas all derivatives are recognised at inception.

Recognition mismatches include the hedge of a contracted or expected but not yet recognised sale, purchase or financing transaction in a foreign currency and future committed variable interest payments.

Types of hedge accounting

1. Fair value hedge accounting model

- A fair value hedge seeks to offset the risk of changes in the fair value of an existing asset or liability or an unrecognised firm commitment that may give rise to a gain or loss being recognised in the statement of profit and loss.
- A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect the statement of profit and loss.

2. Cash flow hedge accounting model

- A cash flow hedge seeks to offset certain risks of the variability of cash flows in respect of an existing asset or liability or a highly probable forecast transaction that may be reflected in the statement of profit and loss in a future period.
- A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction or a firm commitment in respect of foreign currency and (ii) could affect the statement of profit and loss.

3. Net investment hedging

- An investor in a non-integral operation is exposed to changes in the carrying amount of the net assets of the foreign operation (the net investment) arising from the translation of those assets into the reporting currency of the investor.

Question 17

Which of the following would meet and not meet the definition of financial instruments and fall outside the scope of Ind AS 32?

- (1) Cash deposited in banks
- (2) Gold deposited in banks
- (3) Trade receivables
- (4) Investments in debt instruments
- (5) Investments in equity instruments
- (6) Prepaid expenses
- (7) Inter-corporate loans and deposits
- (8) Deferred revenue
- (9) Tax liability
- (10) Provision for estimated litigation losses. (MTP 4 Marks Oct '21)

Answer 17

Table showing classification of various items:



S. No.	Item	Classification
(1)	Cash deposited in banks	Financial Instrument
(2)	Gold deposited in banks	Not a financial instrument
(3)	Trade receivables	Financial Instrument
(4)	Investments in debt instruments	Financial Instrument
(5)	Investments in equity instruments	Financial Instrument
(6)	Prepaid expenses	Not a financial instrument
(7)	Inter-corporate loans and deposits	Financial Instrument
(8)	Deferred revenue	Not a financial instrument
(9)	Tax liability	Not a financial instrument
(10)	Provision for estimated litigation losses	Not a financial instrument

Question 18

Company A, an Indian company whose functional currency is ₹, enters into a contract to purchase machinery from an unrelated local supplier, company B. The functional currency of company B is also ₹. However, the contract is denominated in USD, since the machinery is sourced by company B from a US based supplier. Payment is due to company B on delivery of the machinery.

Key terms of the contract:

Contractual features	Details
Contract / order date	9th September 20X1
Delivery / payment date	31st December 20X1
Purchase price	USD 1,000,000
USD / ₹ Forward rate on 9th September, 20X1 for 31st December, 20X1 maturity	67.8
USD / ₹ Spot rate on 9th September, 20X1	66.4
USD / ₹ Forward rates for 31st December, on: 30th September 31st December (spot rate)	67.5 67.0

Company A is required to analyse if the contract for purchase of machinery (a capital asset) from company B contains an embedded derivative and whether this should be separately accounted for on the basis of the guidance in Ind AS 109. Also give necessary journal entries for accounting the same. (8 Marks Sep '23)

Answer 18

The USD contract for purchase of machinery entered into by company A includes an embedded foreign currency derivative due to the following reasons:

- The host contract is a purchase contract (non-financial in nature) that is not classified as, or measured at FVTPL.
- The embedded foreign currency feature (requirement to settle the contract by payment of USD at a future date) meets the definition of a stand-alone derivative – it is akin to a USD - ₹ forward contract maturing on 31st December, 20X1.
- USD is not the functional currency of either of the substantial parties to the contract (i.e., neither company A nor company B).
- Machinery is not routinely denominated in USD in commercial transactions around the world. In

currency only if such currency was used in a large majority of similar commercial transactions around the world. For example, transactions in crude oil are generally considered routinely denominated in USD. A transaction for acquiring machinery would not qualify for this exemption.

- USD is not a commonly used currency for domestic commercial transactions in the economic environment in which either company A or B operate. This exemption generally applies when the business practice in a particular economic environment is to use a more stable or liquid foreign currency (such as the USD), rather than the local currency, for a majority of internal or cross-border transactions, or both. Here, companies A and B are companies operating in India and the purchase contract is an internal/domestic transaction. USD is not a commonly used currency for internal trade within this economic environment and therefore the contract would not qualify for this exemption.

Accordingly, company A is required to separate the embedded foreign currency derivative from the host purchase contract and recognise it separately as a derivative.

The separated embedded derivative is a forward contract entered into on 9 th September, 20X1, to exchange USD 10,00,000 for ` at the USD / ` forward rate of ` 67.8 on 31st December, 20X1. Since the forward exchange rate has been deemed to be the market rate on the date of the contract, the embedded forward contract has a fair value of zero on initial recognition.

Subsequently, company A is required to measure this forward contract at its fair value, with changes in fair value recognised in the statement of profit and loss. The following is the accounting treatment at quarter-end and on settlement:

Accounting treatment:

Date	Particulars	Amount (')	Amount (')
09-Sep-X1	On initial recognition of the forward contract		
	(No accounting entry recognised since initial fair value of the forward contract is considered to be nil)	Nil	Nil
30-Sep-X1	Fair value change in forward contract		
	Derivative asset (company B) Dr. [(67.8-67.5) x10,00,000]	3,00,000	
	To Profit or loss		3,00,000
31-Dec-X1	Fair value change in forward contract		
	Forward contract asset (company B) Dr. [{(67.8-67) x 10,00,000} - 3,00,000]	5,00,000	
	To Profit or loss		5,00,000
31-Dec-X1	Recognition of machinery acquired and on settlement		
	Property, plant and equipment Dr. (at forward rate)	6,78,00,000	
	To Forward contract asset (company B)		8,00,000
	To Creditor (company B) / Bank		6,70,00,000

Question 19

On 1 April 20X1, Sun Limited guarantees a Rs.10,00,000 loan of Subsidiary – Moon Limited, which Bank STDK has provided to Moon Limited for three years at 8%.

Interest payments are made at the end of each year and the principal is repaid at the end of the loan term.



If Sun Limited had not issued a guarantee, Bank STDK would have charged Moon Limited an interest rate of 11%. Sun Limited does not charge Moon Limited for providing the guarantee.

On 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

On 31 March 20X3, there is 3% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

Analyze and provide the accounting treatment of financial guarantee along with journal entries as per Ind AS 109 in the books of Sun Ltd., on initial recognition and in subsequent periods till 31 March 20X3. (MTP 12 Marks Nov 21, MTP 10 Marks Sep'22, 8 Marks Oct '23, RTP May'21, Old & New SM) (Same concept different figures- PYP 12 Marks Nov'22)

Answer 19

1 April 20X1

A financial guarantee contract is initially recognised at fair value. The fair value of the guarantee will be the present value of the difference between the net contractual cash flows required under the loan, and the net contractual cash flows that would have been required without the guarantee.

Particulars	Year 1 (₹)	Year 2 (₹)	Year 3 (₹)	Total (₹)
Cash flows based on interest rate of 11% (A)	1,10,000	1,10,000	1,10,000	3,30,000
Cash flows based on interest rate of 8% (B)	80,000	80,000	80,000	2,40,000
Interest rate differential (A-B)	30,000	30,000	30,000	90,000
Discount factor @ 11%	0.901	0.812	0.731	
Interest rate differential discounted at 11%	27,030	24,360	21,930	73,320
Fair value of financial guaranteed contract (at inception)				73,320

Journal Entry

Particulars	Debit (₹)	Credit (₹)
Investment in subsidiary Dr.	73,320	
To Financial guarantee (liability)		73,320
(Being financial guarantee initially recorded)		

31 March 20X2

Subsequently at the end of the reporting period, financial guarantee is measured at the higher of:

- the amount of loss allowance; and
- the amount initially recognised less cumulative amortization, where appropriate.

At 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore ₹10,000 (₹10,00,000 x 1%).

The initial amount recognised less amortisation is ₹51,385 (₹73,320 + ₹8,065(interest accrued based on EIR)) – ₹30,000 (benefit of the guarantee in year 1) Refer table below. The unwound amount is recognised as income in the books of Sun Limited, being the benefit derived by Moon Limited not defaulting on the loan during the period.



Year	Opening balance	EIR @ 11%	Benefits provided	Closing balance
1	73,320	8,065	(30,000)	51,385
2	51,385	5,652	(30,000)	27,037
3	27,037	2,963	(30,000)	-

* Difference is due to approximation

The carrying amount of the financial guarantee liability after amortisation is therefore ₹ 51,385, which is higher than the 12-month expected credit losses of ₹ 10,000. The liability is therefore adjusted to ₹ 51,385 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	21,935	
To Profit or loss		21,935
(Being financial guarantee subsequently adjusted)		

31 March 20X3

At 31 March 20X3, there is 3% probability that Moon Limited will default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore ₹ 30,000 (₹ 10,00,000 x 3%).

The initial amount recognised less accumulated amortisation is ₹ 27,037, which is lower than the 12-month expected credit losses (₹ 30,000). The liability is therefore adjusted to ₹ 30,000 (the higher of the two amounts) as follows:

Particulars	Debit (₹)	Credit (₹)
Financial guarantee (liability) Dr.	21,385*	
To Profit or loss (Note)		21,385
(Being financial guarantee subsequently adjusted)		

* The carrying amount at the end of 31 March 20X2 = ₹ 51,385 less 12-month expected credit losses of ₹ 30,000.

Question 20

XYZ issued Rs. 4,80,000 4% redeemable preference shares on 1st April 20X5 at par. Interest is paid annually in arrears, the first payment of interest amounting Rs. 19,200 was made on 31st March 20X6 and it is debited directly to retained earnings by accountant. The preference shares are redeemable for a cash amount of Rs. 7,20,000 on 31st March 20X8. The effective rate of interest on the redeemable preference shares is 18% per annum. The proceeds of the issue have been recorded within equity by accountant as this reflects the legal nature of the shares. Board of directors intends to issue new equity shares over the next two years to build up cash resources to redeem the preference shares.

Mukesh, Accounts manager of XYZ has been told to review the accounting of aforesaid issue. CFO has asked from Mukesh the closing balance of preference shares at the year end. If you were Mukesh, then how much balance you would have shown to CFO on analysis of the stated issue. Prepare necessary adjusting journal entry in the books of account, if required. Analyze. (MTP 5 Marks March '21, RTP May 20)

Answer 20

The preference shares provide the holder with the right to receive a predetermined amount of annual dividend out of profits of the company, together with a fixed amount on redemption. Whilst the legal form is equity, the shares are in substance debt. The fixed level of dividend is interest and the redemption amount is equivalent to the repayment of a loan.



financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortized cost using the effective interest rate of 18%.

Year	1 April, 20X5	Interest @18%	Paid at 4%	31 March, 20X6
	Rs.	Rs.	Rs.	Rs.
20X5-20X6	480,000	86,400	(19,200)	547,200

Accordingly, the closing balance of Preference shares at year end i.e. 31st March, 20X6 would be Rs. 5,47,200. Accountant has inadvertently debited interest of Rs. 19,200 in the profit and loss. However, the interest of Rs. 86,400 should have been debited to profit and loss as finance charge. Similarly, amount of Rs. 5,47,200 should be included in borrowings (non-current liabilities) and consequently, Equity should be reduced by Rs. 480,000 proceeds of issue and Rs. 67,200 (86,400 – 19,200) i.e. total by 5,47,200.

Necessary adjusting journal entry to rectify the books of accounts will be:

	Rs.	Rs.
Preference share capital (equity) (Balance sheet) Dr.	4,80,000	
Finance costs (Profit and loss) Dr.	86,400	
To Equity – Retained earnings (Balance sheet)		19,200
To Preference shares (Long-term Borrowings) (Balance sheet)		5,47,200

Question 21

On 1st April, 20X3, Charming Ltd issued 1,00,000 ` 10 bonds for ` 10,00,000. On 1st April, each year, interest at the fixed rate of 8% per year is payable on outstanding capital amount of the bonds (ie the first payment will be made on 1st April, 20X4). On 1st April each year (i.e from 1st April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at ` 10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements? (2 Marks March '22)

Answer 21

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 1st April, 20X4) as current liabilities. The ` 9,00,000 due later than 12 months after the end of the reporting period shall be presented as a non-current liability.

Question 22

A Company invested in Equity shares of another entity on 15 th March for ` 20,000. Transaction Cost = ` 400 (not included in ` 20,000)

Fair Value on Balance Sheet date i.e. 31st March, 20X1 = ` 24,000. Pass necessary Journal Entries when Financial Asset is accounted as FVTPL. (MTP 4 Marks March '22)

Answer 22

Date	Particulars		(`)	(`)
15/3/20X1	Investment A/c Transaction Cost A/c	Dr.	20,000	
	To Bank	Dr.	400	
				20,400
31/3/20X1	Investment A/c	Dr.	4,000	
	To Fair Value Gain A/c			4,000
31/3/20X1	P&L A/c	Dr.	400	
	To Transaction Cost A/c			400
31/3/20X1	Fair Value Gain A/c	Dr.	4,000	
	To P&L A/c			4,000



Question 23

On 1st April, 20X1, S Ltd. issued 30,000 6% convertible debentures of face value of ₹ 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31st March, 20X5 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10%. The date of transition to Ind AS is 1st April, 20X3. Suggest how should S Ltd. account for this compound financial instrument on the date of transition. The present value of ₹ 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

End of year	6%	10%
1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

(MTP 6 Marks March '22) (Same concept different figures- PYP 8 Marks Nov'18)

Answer 23

The carrying amount of the debenture on the date of transition under previous GAAP, assuming that all interest accrued other than premium on redemption have been paid, will be ₹ 31,50,000 $[(30,000 \times 100) + (30,000 \times 100 \times 10/100 \times 2/4)]$. The premium payable on redemption is being recognised as borrowing costs as per para 4(b) of AS 16 i.e. under previous GAAP on straight-line basis.

As per para D18 of Ind AS 101, Ind AS 32, Financial Instruments: Presentation, requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of Ind AS 32 would involve separating two portions of equity. The first portion is recognised in retained earnings and represents the cumulative interest accreted on the liability component.

The other portion represents the original equity component. However, in accordance with this Ind AS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind AS.

In the present case, since the liability is outstanding on the date of transition, S Ltd. will need to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, we will first measure the liability component by discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option).

	(₹)
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment for years 1 to 4 (6×3.17) (Note 1)	19.02
PV of principal repayment (including premium) 110×0.68 (Note 2)	74.80
Total liability component per debenture	93.82
Equity component per debenture (Balancing figure)	6.18
Face value of debentures	100.00
Total equity component for 30,000 debentures	1,85,400
Total debt amount $(30,000 \times 93.82)$	28,14,600

Thus, on the date of initial recognition, the amount of ₹ 30,00,000 being the amount of debentures will be split as under:

Debt	₹ 28,14,600
Equity	₹ 1,85,400



However, on the date of transition, unwinding of ₹ 28,14,600 will be done for two years as follows:

Year	Opening balance	Finance cost @ 10%	Interest paid	Closing balance
1	28,14,600	2,81,460	1,80,000	29,16,060
2	29,16,060	2,91,606	1,80,000	30,27,666

Therefore, on transition date, S Ltd. shall –

- recognise the carrying amount of convertible debentures at ₹ 30,27,666;
- recognise equity component of compound financial instrument of ₹ 1,85,400;
- debit ₹ 63,066 to retained earnings being the difference between the previous GAAP amount of ₹ 31,50,000 and ₹ 30,27,666 and the equity component of compound financial instrument of ₹ 1,85,400; and
- derecognise the debenture liability in previous GAAP of ₹ 31,50,000.

Notes:

- 3.17 is present value of annuity factor of ₹ 1 at a discount rate of 10% for 4 years.
- On maturity, ₹ 110 will be paid (₹ 100 as principal payment + ₹ 10 as premium)

Question 24

Wheel Co. Limited borrowed ₹ 50,00,00,000 from a bank on 1st April, 20X1. The original terms of the loan were as follows:

- Interest rate: 11%
- Repayment of principal in 5 equal instalments
- Payment of interest annually on accrual basis
- Upfront processing fee: ₹ 58,70,096
- Effective interest rate on loan: 11.50%

On 31st March, 20X3, Wheel Co. Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

- Interest rate 15%
- Repayment of outstanding principal in 10 equal instalments starting 31st March, 20X4
- Payment of interest on an annual basis

Record journal entries in the books of Wheel Co. Limited till 31st March, 20X4, after giving effect of the changes in the terms of the loan on 31st March, 20X3. (MTP 14 Marks March '22, MTP 14 Marks Oct '18)

Answer 24

On the date of initial recognition, the effective interest rate of the loan shall be computed keeping in view the contractual cash flows and upfront processing fee paid. The following table shows the amortisation of loan based on effective interest rate:

Date	Cash flows (principal)	Cash flows (interest and fee)	Amortised cost (opening + interest – cash flows)	Interest @ EIR (11.50%)
1 April, 20X1	(500,000,000)	5,870,096	494,129,904	
31 Mar 20X2	100,000,000	55,000,000	395,954,843	56,824,939
31 Mar 20X3	100,000,000	44,000,000	297,489,650	45,534,807



31 Mar 20X4	100,000,000	33,000,000	198,700,959	34,211,310
31 Mar 20X5	100,000,000	22,000,000	99,551,570	22,850,610
31 Mar 20X6	100,000,000	11,000,000	(0)	11,448,430

a. 1st April, 20X1

Particulars	Dr. Amount (')	Cr. Amount (')
Bank A/c Dr. To Loan from bank A/c (Being loan recorded at its fair value less transaction costs on the initial recognition date)	494,129,904	494,129,904

b. 31st March, 20X2

Particulars	Dr. Amount (')	Cr. Amount (')
Loan from bank A/c Dr. Interest expense (profit and loss) Dr. To Bank A/c (Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised cost of loan)	98,175,061 56,824,939	155,000,000

c. 31st March, 20X3 – Before Wheel Co. Limited approached the bank –

Particulars	Dr. Amount (')	Cr. Amount (')
Interest expense (profit and loss) Dr. To Loan from bank A/c To Bank A/c (Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)	45,534,807	1,534,807 44,000,000

Upon receiving the new terms of the loan, Wheel Co. Limited, re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

Date	Cash flows (principal)	Interest outflow @15%	Discount factor	PV of cash flows
31 Mar 20X3	(400,000,000)			
31 Mar 20X4	40,000,000	60,000,000	0.8969	89,686,099
31 Mar 20X5	40,000,000	54,000,000	0.8044	75,609,805
31 Mar 20X6	40,000,000	48,000,000	0.7214	63,483,092
31 Mar 20X7	40,000,000	42,000,000	0.6470	53,053,542
31 Mar 20X8	40,000,000	36,000,000	0.5803	44,100,068
31 Mar 20X9	40,000,000	30,000,000	0.5204	36,429,133
31 Mar 20Y0	40,000,000	24,000,000	0.4667	29,871,422
31 Mar 20Y1	40,000,000	18,000,000	0.4186	24,278,903
31 Mar 20Y2	40,000,000	12,000,000	0.3754	19,522,235
31 Mar 20Y3	40,000,000	6,000,000	0.3367	15,488,493
Present Value (PV) of new contractual cash flows discounted at 11.50%				451,522,791
Carrying amount of loan				397,489,650
Difference				54,033,141



Percentage of carrying amount

13.59%

Note: Calculation above done on full decimal, though in the table discount factor is limited to 4 decimals.

Considering a more than 10% change in PV of cash flows compared to the carrying value of the loan, the existing loan shall be considered to have been extinguished and the new loan shall be accounted for as a separate financial liability. The accounting entries for the same are included below:

d. 31st March, 20X3 – Accounting for extinguishment

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Loan from bank (old) A/c	Dr.	397,489,650	
Finance cost (profit and loss)	Dr.	2,510,350	
To Loan from bank (new) A/c			400,000,000
(Being new loan accounted for at its principal amount in absence of any transaction costs directly related to such loan and correspondingly a de-recognition of existing loan)			

e. 31st March, 20X4

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Loan from bank A/c	Dr.	40,000,000	
Interest expense (profit and loss)	Dr.	60,000,000	
To Bank A/c			100,000,000
(Being first instalment of the new loan and payment of interest accounted for as an adjustment to the amortised cost of loan)			

Question 25

Evaluate whether the following items are financial assets or not.

S. No.	Particulars
1	Investment in bonds debentures
2	Loans and receivables
3	Deposits given
4	Trade & other receivables
5	Cash and cash equivalents
6	Bank balance
7	Investments in equity shares
8	Perpetual debt instruments like perpetual bonds, debentures and capital notes.
9	Physical assets like inventories, property, plant and equipment etc.
10	Right to use assets like lease vehicle etc.
11	Intangibles like patents, trademark etc.
12	Prepaid expenses like prepaid insurance, prepaid rent etc.
13	Advance given for goods and services

(MTP 7 Marks Oct '23)

Answer 25



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

Question 26

On 1st April 2017, A Ltd. lent Rs. 2 crores to a supplier in order to assist them with their expansion plans. The arrangement of the loan cost the company Rs. 10 lakhs. The company has agreed not to charge interest on this loan to help the supplier's short-term cash flow but expected the supplier to repay Rs. 2.40 crores on 31st March 2019. As calculated by the finance team of the company, the effective annual rate of interest on this loan is 6.9% On 28th February 2018, the company received the information that poor economic climate has caused the supplier significant problems and in order to help them, the company agreed to reduce the amount repayable by them on 31st March 2019 to Rs. 2.20 crores. Suggest the accounting entries as per applicable Ind AS.(RTP Nov 18)

Answer 26

The loan to the supplier would be regarded as a financial asset. The relevant accounting standard Ind AS 109 provides that financial assets are normally measured at fair value.

If the financial asset in which the only expected future cash inflows are the receipts of principal and interest and the investor intends to collect these inflows rather than dispose of the asset to a third party, then Ind AS 109 allows the asset to be measured at amortised cost using the effective interest method.

If this method is adopted, the costs of issuing the loan are included in its initial carrying value rather than being taken to profit or loss as an immediate expense. This makes the initial carrying value Rs. 2,10,00,000.



Under the effective interest method, part of the finance income is recognised in the current period rather than all in the following period when repayment is due. The income recognised in the current period is Rs. 14,49,000 (Rs. 2,10,00,000 x 6.9%)

In the absence of information regarding the financial difficulties of the supplier the financial asset at 31st March, 2018 would have been measured at Rs. 2,24,49,000 (Rs. 2,10,00,000 + 14,49,000). The information regarding financial difficulty of the supplier is objective evidence that the financial asset suffered impairment at 31st March 2018.

The asset is re-measured at the present value of the revised estimated future cash inflows, using the original effective interest rate. Under the revised estimates the closing carrying amount of the asset would be Rs. 2,05,79,981 (Rs. 2,20,00,000 / 1.069). The reduction in carrying value of Rs. 18,69,019 (Rs. 2,24,49,000 – 2,05,79,981) would be charged to profit or loss in the current period as an impairment of a financial asset.

Therefore, the net charge to profit or loss in respect of the current period would be Rs. 4,20,019 (18,69,019 – 14,49,000).

Question 27

ABC Ltd. issues 4% 1,00,000 OCPS at a face value of ` 100 per share on 1 st April, 20X1 and these are redeemable after 5 years, ie, on 31st March, 20X6. Dividend is non- cumulative. Each preference shares entitles the holders to 10 equity shares and the preference shares are optionally convertible by the holder at any time until maturity. How will the preference shares be classified at initial recognition assuming that a comparable instrument carries a market interest rate of 7%? Provide journal entries for year 1. Will this classification be changed subsequently in case there is likelihood that OCPS will be encashed at the end of the maturity period? (RTP May '22)

Answer 27

The OCPS is redeemable at the end of the 5 th year. Hence, the preference share contains a liability component. Further the dividend payable on the preference shares is non-cumulative. The holder may also be able to convert the preference shares at his option any time until maturity. Paragraph AG 37 of Ind AS 32, Financial Instruments: Presentation states that non- cumulative dividends paid at the discretion of the issuer entity is part of equity element.

Paragraph 29 of Ind AS 32, Financial Instruments: Presentation, requires separate recognition of components of a financial instrument that (a) creates a financial liability of the entity; and (b) grants an option to the holder of the instrument to convert it into fixed number of equity instruments of the entity.

From the above paragraphs it is clear that OCPS issued by ABC Ltd. has a financial liability component as well as an equity component, making it a compound financial instrument.

As per paragraph 32, in case of compound financial instruments, the issuer first determines the carrying amount of the financial liability component by measuring the fair value of a similar liability that does not have an associated equity component. The carrying amount of the equity represented by (a) non-cumulative dividend feature and (b) option to convert the preference shares for fixed number of pre-determined ordinary shares is then determined by deducting the fair value of the financial liability component from the fair value of the compound financial instrument as a whole.

Measurement and recognition (Calculations have been done at full scale):

At 7% market rate of interest, the fair value of the financial liability component of the OCPS is ` 71,29,862 [100,000 OCPS x ` 100 x (1/ (1+7%)) 5]

The fair value of the equity component is (residual value) ` 28,70,138 [ ` 1,00,00,000 - ` 71,29,862]

Journal Entries

1 st April, 20X1	On Initial recognition		
	Bank	Dr.	1,00,00,000



	To OCPS (Financial liability)		71,29,862
	To OCPS (Equity) (Being OCPS issued and recognized)		28,70,138
31 st March, 20X2	Interest expense – unwinding of discount		
	Interest expense @7% (Refer Dr. W.N.)	4,99,090	
	To OCPS (Financial liability) (Being interest recorded as per EIR)		4,99,090
	Interest entry will be passed every year till conversion option is not exercised Whenever the option is exercised by the holder to convert to equity Shares OCPS (Financial liability) Dr. To OCPS (Equity)	Balance on date of exercise of the option	

As per paragraph 30, in case of a convertible financial instrument, the classification of the liability and equity components is not revised as a result of change in the likelihood that a conversion option will be exercised.

In other words, the amount attributable to equity component on initial recognition shall remain in equity and will not be reclassified even if the OCPS are ultimately redeemed in cash by the issuer.

31 st March, 20X6	If redeemed in cash on maturity		
	OCPS (financial liability) (Refer W.N.) Dr.	1,00,00,000	
	To Bank (Being OCPS redeemed on maturity)		1,00,00,000

Working Note:

Calculation of the amortised cost of the financial liability (at full scale):

Year	Opening Balance (₹)	Interest @ 7%	Repayment	Closing Balance (₹)
1	71,29,862	4,99,090	-	76,28,952
2	76,28,952	5,34,027		81,62,979
3	81,62,979	5,71,409		87,34,388
4	87,34,388	6,11,407		93,45,795
5	93,45,795	6,54,206	10,00,000	-

Question 28

On 1st April, 20X1 an entity granted an interest-free loan of ₹ 5,00,000 to an employee for a period of three years. The market rate of interest for similar loans is 5% per year.

On 31st March, 20X3, because of financial difficulties, the employee asked to extend the interest-free loan for further three years. The entity agreed. Under the restructured terms, repayment will take place



on 31st March, 20X7. However, the entity only expects to receive a payment of ₹ 2,50,000, given the financial difficulty of the employee.

Explain the accounting treatment on initial recognition of loan and after giving effect of the changes in the terms of the loan as per Ind AS 109. Support your answer with Journal entries and amortised cost calculation, as on the date of initial recognition and on the date of change in terms of loan. (RTP Nov'22)

Answer 28

As the loan is not at a market interest rate, hence it is not recorded at the transaction price of ₹ 5,00,000. Instead, the entity measures the loan receivable at the present value of the future cash inflows discounted at a market rate of interest available for a similar loan. The present value of the loan receivable (financial asset) discounted at 5% per year is $₹ 5,00,000 \div (1.05)^3 = ₹ 4,32,000$. Therefore, ₹ 4,32,000 is recorded on initial measurement of the loan receivable. This amount will accrete to ₹ 5,00,000 over the three-year term using the effective interest method.

The difference between ₹ 5,00,000 and ₹ 4,32,000 i.e., ₹ 68,000 is accounted for as prepaid employee cost in accordance with Ind AS 19 'Employee Benefits', which will be deferred and amortised over the period of loan on straight line basis.

The journal entries on initial recognition are:

		₹	₹
Loan receivable (financial asset)	Dr.	4,32,000	
Prepaid employee cost (asset)	Dr.	68,000	
To Cash / Bank (financial asset) (Being loan granted to the employee recognised)			5,00,000

The amortised cost calculation at 1st April, 20X1 is as follows:

Period	Carrying amount at 1st April	Interest at 5%	Cash inflow	Carrying amount at 31st March
20X1-20X2	4,32,000	21,600	—	4,53,600
20X2-20X3	4,53,600	22,680	—	4,76,280
20X3-20X4	4,76,280	23,720*	(5,00,000)	—

*Difference of ₹ 94 (₹ 23,814 – ₹ 23,720) is due to approximation.

On 31st March, 20X3, the carrying amount of the loan receivable is ₹ 4,76,280.

As a result of that modification, on 31st March, 20X3, the present value of estimated cash flows is recalculated to be ₹ 2,05,750 using the asset's original effective interest rate of 5% ($₹ 2,50,000 \div (1.05)^4$).

An impairment loss of ₹ 2,70,530 (₹ 4,76,280 – ₹ 2,05,750) is recognised in profit or loss in the year 20X2-20X3.

The carrying amount of the loan receivable may be reduced directly, as follows:

		₹	₹
Profit or loss - impairment loss	Dr.	2,70,530	
To Loan receivable			2,70,530
(Being impairment loss recognised)			

In this case, the loan receivable will be measured at ₹ 2,05,750 at 31st March, 20X3. The revised amortised cost calculation at 1st April, 20X3 is as follows:

Period	Carrying amount at 1st April	Interest at 5% (the original effective interest rate)	Cash inflow	Carrying amount at 31st March



20X3-20X4	2,05,750	10,288	—	2,16,038
20X4-20X5	2,16,038	10,802	—	2,26,840
20X5-20X6	2,26,840	11,342	—	2,38,182
20X6-20X7	2,38,182	11,818	(2,50,000)	—

Question 29

To encourage entities to expand their operations in a specified development zone, the government provides interest-free loans to fund the purchase of manufacturing equipment. In accordance with the development scheme, an entity receives an interest-free loan of ₹ 5,00,000 from the government for a period of three years. The market rate of interest for similar loans for 3 years is 5% per year.

There are no future performance conditions attached to the interest-free loan.

Discuss how to account for the above loan. Pass necessary journal entries in the entity's books of accounts from year 1 to year 3, as per relevant Ind AS. (RTP Nov'22)

Answer 29

The entity measures the loan on initial recognition at ₹ 4,32,000, which is the present value of the loan (financial liability) — ₹ 5,00,000/(1.05)³. ₹ 68,000, the difference between the loan proceeds received ₹ 5,00,000 (the loan's face value) and present value of the loan ₹ 4,32,000, is a government grant and is recognised immediately as there are no specified future performance conditions. The amount recognised on day one will accrete to ₹ 5,00,000 over the three-year term using the effective interest method.

Journal Entries

On initial recognition:

		₹	₹
Cash/Bank (financial asset)	Dr.	5,00,000	
To Loan (financial liability)			4,32,000
To Income (profit or loss)			68,000
(Being interest-free loan recognised at fair value and the receipt of a government grant)			

At the end of Year 1:

		₹	₹
Finance cost (profit or loss)	Dr.	21,600	
To Loan (financial liability)			21,600
(Being accretion of time value recognised on the financial liability)			

Year 2

		₹	₹
Finance cost (profit or loss)	Dr.	22,680	
To Loan (financial liability)			22,680
(Being accretion of time value recognised on the financial liability)			

Year 3

		₹	₹
Finance cost (profit or loss)	Dr.	23,720	
To Loan (financial liability)			23,720
(Being accretion of time value recognised on the financial liability)			



Immediately after all the accretions are recognised, the carrying amount of the loan is equal to its face value of ₹ 5,00,000, which is also the amount payable to the government.

Loan (financial liability)	Dr.	5,00,000	
To Cash/Bank			5,00,000
(Being loan repaid to the government)			

Working Note:

Calculation of Amortised Cost

Year	Opening balance (A)	Interest at 5% (B) = (A) x 5%	Cash flow (C)	Closing balance (A) + (B) – (C)
1	4,32,000	21,600	–	4,53,600
2	4,53,600	22,680	–	4,76,280
3	4,76,280	23,720*	(5,00,000)	–

* Difference is due to approximation.

Question 30 (Includes concepts of Ind AS 27- Separate Financial Statements)

A company, AB Ltd. holds investments in subsidiaries and associates. In its separate financial statements, AB Ltd. wants to elect to account its investments in subsidiaries at

cost and the investments in associates as financial assets at fair value through profit or loss (FVTPL) in accordance with Ind AS 109, Financial Instruments.

Whether AB Limited can carry investments in subsidiaries at cost and investments in associates in accordance with Ind AS 109 in its separate financial statements? (RTP Nov '21)

Answer 30

Paragraph 10 of Ind AS 27 'Separate Financial Statements' inter-alia provides that, when an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109 'Financial Instruments' in its separate financial statements. Further, the entity shall apply the same accounting for each category of investments.

It may be noted that although the 'category' is used in number of Standards, it is not defined in any of the Ind AS. It seems that subsidiaries, associates and joint ventures would qualify as separate categories. Thus, the same accounting policies are applied for each category of investments - i.e. each of subsidiaries, associates and joint ventures. However, paragraph 10 of Ind AS 27 should not be read to mean that, in all circumstances, all investments in associates are one 'category' of investment and all investments in joint ventures or an associate are one 'category' of investment. These categories can be further divided into sub-categories provided the sub-category can be defined clearly and objectively and results in information that is relevant and reliable. For example, an investment entity parent can have investment entity subsidiary (at fair value through profit or loss) and non-investment entity subsidiary (whose main purpose is to provide services that relate to the investment entity's investment activities) as separate categories in its separate financial statements.

In the present case, investment in subsidiaries and associates are considered to be different categories of investments. Further, Ind AS 27 requires to account for the investment in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109 for each category of Investment. Thus, AB Limited can carry its investment in subsidiaries at cost and its investments in associates as financial assets in accordance with Ind AS 109 in its separate financial statements.

Question 31

State whether the following items meet the definition of Financial Asset or Financial Liability for an entity:



- (i) A bank advances an entity a five-year loan. The bank also provides the entity with an overdraft facility for a number of years.
- (ii) Entity A owns preference shares in Entity B. The preference shares entitle Entity A to dividends, but not to any voting rights.
- (iii) An entity has a present obligation in respect of income tax due for the prior year.
- (iv) In a lawsuit brought against an entity, a group of people is seeking compensation for damage to their health as a result of land contamination believed to be caused by waste from the entity's production process. It is unclear whether the entity is the source of the contamination since many entities operate in the same area and produce similar waste. (RTP May '23)

Answer 31

- (i) The entity has two financial liabilities namely (a) the obligation to repay the five- year loan and (b) the obligation to repay the bank overdraft to the extent that it has borrowed using the overdraft facility. Both the loan and the overdraft result in contractual obligations for the entity to pay cash to the bank for the interest incurred and for the return of the principal.
- (ii) For Entity B: The preference shares may be equity instruments or financial liabilities of Entity B, depending on their terms and conditions.

For Entity A: Irrespective of Entity B's treatment, the preference shares are a financial asset because the investment satisfies the definition of a financial asset.
- (iii) An income tax liability is created as a result of statutory requirements imposed by the government. The rights and obligations are not created by a contract. Hence, the liability for income-tax dues is not a financial liability.
- (iv) The fact that a lawsuit may result in the payment of cash does not create a financial liability for the entity because there is no contract between the entity and the affected group. The entity will need to consider providing for the payment as per Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets'.

Question 32

In an arm's length transaction, Entity X buys 10,000 convertible preference shares in Company Z for cash payments of ₹ 40,000, with ₹ 25,000 payable immediately and ₹ 15,000 payable in two years. The market rate of annual interest for a two-year loan to the entity would be 6%. Explain the accounting treatment for the said transaction. (RTP May '23)

Answer 32

Since payment of ₹ 15,000 is deferred for two years, the fair value of the consideration given for the shares is equal to ₹ 25,000 plus the present value of ₹ 15,000. The present value of ₹ 15,000 deferred payment is ₹ 13,350 ($₹ 15,000 \div 1.062$). Entity X will initially measure the shares purchased at ₹ 38,350 (i.e., ₹ 25,000 + ₹ 13,350).

Since this transaction took place at an arm's length, this is considered to be fair value for initial recognition in the absence of evidence to the contrary.

The difference between the ₹ 40,000 cash paid out and the ₹ 38,350, i.e. ₹ 1,650, will be recognised as interest expense in profit or loss over the two year period of deferred payment.

Question 33 (Includes concepts of Ind AS 24-Related Party Disclosures)

SEL has applied for a term loan from a bank for business purposes. As per the loan agreement, the loan required a personal guarantee of one of the directors of SEL to be executed. In case of default by SEL, the director will be required to compensate for the loss that bank incurs. Mr. Pure Joy, one of the directors had given guarantee to the bank pursuant to which the loan was sanctioned to SEL. SEL does not pay premium or fees to its director for providing this financial guarantee.

**Whether SEL is required to account for the financial guarantee received from its director? Will there be any disclosures under Ind AS 24? (RTP May '23)****Answer 33**

Ind AS 109 'Financial Instruments', defines a financial guarantee contract as 'a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Based on this definition, an evaluation is required to be done to ascertain whether the contract between director and Bank qualifies as a financial guarantee contract as defined in Appendix A to Ind AS 109. In the given case, it does qualify as a financial guarantee contract as:

- the reference obligation is a debt instrument (term loan);
- the holder i.e. Bank is compensated only for a loss that it incurs (arising on account of non-repayment); and
- the holder is not compensated for more than the actual loss incurred.

Ind AS 109 provides principles for accounting by the issuer of the guarantee. However, it does not specifically address the accounting for financial guarantees by the beneficiary. In an arm's length transaction between unrelated parties, the beneficiary of the financial guarantee would recognise the guarantee fee or premium paid as an expense.

It is also pertinent to note that the entity needs to exercise judgment in assessing the substance of the transaction taking into consideration relevant facts and circumstances, for example, whether the director is being compensated otherwise for providing guarantee. Based on such an assessment, an appropriate accounting treatment based on the principles of Ind AS should be followed.

In the given case, SEL is the beneficiary of the financial guarantee and it does not pay a premium or fees to its director for providing this financial guarantee. Accordingly, SEL will not be required to account for such financial guarantee in its financial statements considering the unit of account as being the guaranteed loan, in which case the fair value would be expected to be the face value of the loan proceeds that SEL received.

In the given case based on the limited facts provided, SEL will be required to make necessary disclosures of such financial guarantee in accordance with Ind AS 24 as follows:

- (a) the amount of the transactions;
- (b) the amount of outstanding balances, including commitments, and:
 - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
 - (ii) details of any guarantees given or received;
- (c) provisions for doubtful debts related to the amount of outstanding balances; and
- (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

Question 34

On 1 st April, 2X01, Entity X issued a 10% convertible debenture with a face value of ` 1,000 maturing on 31st March, 2X11. The debenture is convertible into ordinary shares of Entity X at a conversion price of ` 50 per share. Interest is payable yearly in cash. On 1st April, 2X02, to induce the holder to convert the convertible debenture promptly, Entity X reduces the conversion price to ` 40 if the debenture is converted before 1st June, 2X02 (ie, within 60 days). The market price of Entity X's ordinary shares on the date the terms are amended is ` 80 per share. How will the revised terms be accounted? (RTP May '22)



Answer 34

The fair value of the incremental consideration paid by Entity X is calculated as follows:

Number of ordinary shares to be issued to debenture holders under amended terms			
Particulars			
Face value		₹	1,000
New conversion price		₹	40 per share
Number of ordinary shares to be issued to debenture holders under amended terms	1,000 / ₹ 40		25 Shares
Number of ordinary shares to be issued to debenture holders under original terms			
Face value		₹	1,000
Original conversion price		₹	50 per share
Number of ordinary shares to be issued to debenture holders under original terms	1,000 / ₹ 50		20 Shares
Number of additional shares to be issued to debenture holders under amended terms			5 Shares
Value of additional shares upon conversion (to be recognised as loss in P&L)			
5 shares x ₹ 80 per share		₹	400

Question 35

On 1st April, 20X1, a bank provides an entity with a four-year loan of ₹ 5,000 on normal market terms, including charging interest at a fixed rate of 8% per year. Interest is payable at the end of each year. The figure of 8% is the market rate for similar four - year fixed-interest loans with interest paid annually in arrears. Transaction cost of ₹ 100 is incurred on originating the loan. Effective interest rate in this case is 8.612%.

In 20X1-20X2, the entity experienced financial difficulties. On 31st March, 20X2, the bank agreed to modify the terms of the loan. Under the new terms, the interest payments in 20X2-20X3 to 20X4-20X5 will be reduced from 8% to 5%. The entity paid the bank a fee of ₹ 50 for paperwork relating to the modification.

Analyse whether the modification of the loan terms constitutes an extinguishment of the original financial liability or not. (RTP Nov '23)

Answer 35

Since the interest was initially set at the market rate, on 1st April, 20X1 the entity on initial recognition will measure the loan at the transaction price, less transaction costs i.e. at ₹ 4,900.

The following is the original amortised cost calculation at 1st April, 20X1:

Time	Carrying amount at 1st April	Effective Interest @ 8.612%	Cash outflow	Carrying amount at 31st March
	(a)	(b=a x 8.612%)	(c=5000 x 8%)	(d = a + b - c)
20X1-20X2	4,900.00	421.99	(400.00)	4,921.99
20X2-20X3	4,921.99	423.88	(400.00)	4,945.87
20X3-20X4	4,945.87	425.94	(400.00)	4,971.81
20X4-20X5	4,971.81	428.19	(5,400.00)	—

On 31st March, 20X2:



1. The present value of the remaining cash flows of the original financial liability is ₹ 4,921.99 discounted at the original effective interest rate of 8.612%.
2. The present value of the cash flows under the new terms discounted using the original effective interest rate is ₹ 4,537.25 (Refer W.N.). Including the ₹ 50 fee, the present value of the total cash flows is ₹ 4,587.25.
3. The difference between ₹ 4,921.99 and ₹ 4,587.25 is ₹ 334.74 which is only 6.8% ($₹ 334.74 \div ₹ 4,921.99$) of the present value of the remaining cash flows of the original financial liability.

The entity applies its judgement to decide whether the terms of the instruments exchanged are substantially different. Since the difference of the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is less than 10% of the present value of the remaining cash flows of the original financial liability, this modification should not be considered a substantial modification of the terms of the existing loan. Therefore, the modification would not be accounted for as an extinguishment of the original financial liability.

Working Note:

The calculation of the present value of the cash flows under the new terms discounted using the original effective interest rate is as follows:

Time	Cash outflow	Discounting factor @ 8.612%	Present value at 31st March
31st March, 20X3	250.00	0.921	230.25
31st March, 20X4	250.00	0.848	212.00
31st March, 20X5	5,250.00	0.780	4,095.00
Total present value			4,537.25

Question 36

S Limited issued redeemable preference shares to its Holding Company -H Limited. The terms of the instrument have been summarized below. Analyze the given situation, applying the guidance in Ind AS 109 'Financial Instruments', and account for this in the books of H Limited.

Nature	Non-cumulative redeemable preference shares
Repayment	Redeemable after 3 years
Date of Allotment	1 st April 2015
Date of Repayment	31 st March 2018
Total Period	3 Years
Value of Preference Shares issued	5,00,00,000
Dividend Rate	0.0001% Per Annum
Market rate of interest	12% Per Annum
Present value factor	0.7118

(PYP 8 Marks May'18) (Same concept different figures Old & New SM)

Answer 36

1. **Analysis of the financial instrument issued by S Ltd. to its holding company H Ltd.**
Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

For example, a long-term loan or receivable that carries no interest while similar instruments if



exchanged between market participants carry interest, then fair value

for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument.

In the above case, since S Ltd has issued preference shares to its Holding Company– H Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by H Ltd. in its subsidiary. This can further be substantiated by the nominal rate of dividend i.e. . 0.0001% mentioned in the terms of the instrument issued.

Computations on initial recognition:

Rs.

Transaction value of the Redeemable preference shares	5,00,00,000
Less: Present value of loan component @ 12% (5,00,00,000 x .7118)	(3,55,90,000)
Investment in subsidiary	1,44,10,000

Subsequently, such preference shares shall be carried at amortized cost at each reporting date as follows:

Date	Opening Balance	Interest @ 12%	Closing balance
1st April, 2015	3,55,90,000	-	3,55,90,000
31st March, 2016	3,55,90,000	42,70,800	3,98,60,800
31st March, 2017	3,98,60,800	47,83,296	4,46,44,096
31st March, 2018	4,46,44,096	53,55,904*	5,00,00,000

* Rs. 4,46,44,096 x 12% = Rs. 53,57,292. The difference of Rs. 1,388 (Rs. 53,57,292 – Rs. 53,55,904) is due to approximation in present value factor.

2.

In the books of H Ltd.

Journal Entries to be done at every reporting date

Date	Particulars	Amount	Amount
1st April, 2015	Investment (Equity portion)	1,44,10,000	
	Redeemable Preference Shares	3,55,90,000	
	To Bank		5,00,00,000
	(Being initial recognition of transaction recorded)		
31st March, 2016	Redeemable Preference Shares	42,70,800	
	To Interest income		42,70,800
	(Being interest income on loan component recognized)		
31st March, 2017	Redeemable Preference Shares	47,83,296	
	To Interest income		47,83,296
	(Being interest income on loan component recognized)		
31st March, 2018	Redeemable Preference Shares	53,55,904	
	To Interest income		53,55,904



	(Being interest income on loan component recognized)			
31st March, 2018	Bank		5,00,00,000	
	To Redeemable Preference Shares			5,00,00,000
	(Being settlement of transaction done at the end of the third year)			

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Many examinees were unable to analyse the financial instruments issued by S Ltd. to its holding company H Ltd. Moreover, they were unable to pass correct or all the Journal Entries at every reporting date.

Question 37

On 1st January 2017, Expo Limited agreed to purchase USD (\$) 40,000 from E&I Bank in future on 31st December 2017 for a rate equal to Rs. 65 per USD. Expo Limited did not pay any amount upon entering into the contract. Expo Limited is a listed company in India and prepares its financial statements on a quarterly basis.

Using the definition of derivative included in Ind AS 109 and following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchases of USD.

For the purpose of accounting, use the following information representing marked to market fair value of forward contracts at each reporting date: (RTP 8 Marks May'18) (Same concept different figures- Old & New SM)

As at 31st March, 2017	Rs. (50,000)
As at 30th June, 2017	Rs. (30,000)
As at 30th September, 2017	Rs. 24,000
Spot rate of USD on 31st December, 2017	Rs. 62 per USD

Answer 37

Assessment of the arrangement using the definition of derivative included under Ind AS 109.

Derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

- Its value changes in response to the change in foreign exchange rate (emphasis laid)
- It requires no initial net investment or an initial net investment is smaller than would be required for other types of contracts with similar response to changes in market factors.
- It is settled at a future date.

Upon evaluation of contract in question, on the basis of the definition of derivative, it is noted that the contract meets the definition of a derivative as follows:

- The value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.
- The initial amount paid to enter into the contract is zero. A contract which would give the holder a similar response to foreign exchange rate changes would have required an investment of USD 40,000 on inception.
- The contract is settled in future

The derivative is a forward exchange contract.

As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.



Accounting in each Quarter

(i) Accounting on 1st January 2017

As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recorded on the date of entering into the contract.

(ii) Accounting on 31st March 2017

Particulars	Dr. (Rs.)	Cr. (Rs.)
Profit and loss A/c Dr.	50,000	
To Derivative financial liability		50,000
(Being mark to market loss on forward contract recorded)		

(iii) Accounting on 30th June 2017

Particulars	Dr. (Rs.)	Cr. (Rs.)
Derivative financial liability A/cDr.	20,000	
To Profit and Loss A/c		20,000
(Being partial reversal of mark to market loss on forward contract recorded)		

(iv) Accounting on 30th September 2017

Particulars	Dr. (Rs.)	Cr. (Rs.)
Derivative financial liability A/cDr.	30,000	
Derivative financial asset A/c Dr.	24,000	
To Profit and Loss A/c		54,000
(Being gain on mark to market of forward contract booked as derivative financial asset and reversal of derivative financial liability)		

(v) Accounting on 31st December 2017

The settlement of the derivative forward contract by actual purchase of USD 40,000

Particulars	Dr. (Rs.)	Cr. (Rs.)
Cash (USD Account) (USD 40,000 x Rs. 62) Dr.	24,80,000	
Profit and loss A/c Dr.	1,44,000	
To Cash (USD 40,000 x Rs. 65)		26,00,000
To Derivative financial asset A/c		24,000
(Being loss on settlement of forward contract booked on actual purchase of USD)		

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees were not able to state whether the contract met the definition of derivative and hence were not able to record the correct entries for each quarter.

Question 38

NAV Limited granted a loan of Rs. 120 lakh to OLD Limited for 5 years @ 10% p.a. which is Treasury bond yield of equivalent maturity. But the incremental borrowing rate of OLD Limited is 12%. In this case, the loan is granted to OLD Limited at below market rate of interest. Ind AS 109 requires that a financial asset or financial liability is to be measured at fair value at the initial recognition. Should



the transaction price be treated as fair value? If not, find out the fair value. What is the accounting treatment of the difference between the transaction price and the fair value on initial recognition in the book of NAV Ltd.?

Present value factors at 12%:

Year	1	2	3	4	5
PVF	0.892	0.797	0.712	0.636	0.567

(RTP 4 Marks Nov'18)

Answer 38

Since the loan is granted to OLD Ltd at 10% i.e below market rate of 12%. It will be considered as loan given at off market terms. Hence the Fair value of the transaction will be lower from its transaction price & not the transaction price.

Calculation of fair value

Year	Future cash flow (in lakh)	Discounting factor @ 12%	Present value (in lakh)
1	12	0.892	10.704
2	12	0.797	9.564
3	12	0.712	8.544
4	12	0.636	7.632
5	120+12=132	0.567	74.844
			111.288

The fair value of the transaction be Rs. 111.288 lakh.

Since fair value is based on level 1 input or valuation technique that uses only data from observable markets, difference between fair value and transaction price will be recognized in Profit and Loss as fair value loss i.e Rs. 120 lakh– Rs. 111.288 lakh= Rs. 8.712 lakh.

Note: One may also calculate the above fair value by the way of annuity on interest amount rather than separate calculation.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Many examinees fumbled in providing the accounting treatment for the difference between transaction price and the fair value of the loan on initial recognition.

Question 39

Perfect Ltd. issued 50,000 Compulsory Cumulative Convertible Preference Shares (CCCPS) as on 1st April, 2017 @ Rs. 180 each. The rate of dividend is 10% payable at the end of every year. The preference shares are convertible into 12,500 equity shares (Face value Rs. 10 each) of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion option is 15% per annum.

Transaction cost on the date of issuance is 2% of the value of the proceeds. Effective Interest Rate is 15.86%. (Round off the figures to the nearest multiple of Rupee)

Discounting Factor @ 15%

Year	1	2	3	4	5
Discount Factor	0.8696	0.7561	0.6575	0.5718	0.4971

You are required to compute Liability and Equity Component and Pass Journal Entries for entire term of arrangement i.e. from the issue of Preference Shares till their conversion into Equity Shares. Keeping



in view the provisions of relevant Ind AS (PYP 12 Marks, May'19)(Same concepts but different figures- MTP 12 Marks Oct'21, MTP 12 Marks Oct'19, MTP 12 Marks Apr'23, Old & New SM)

Answer 39

This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

Total proceeds = 50,000 Shares x Rs. 180 each = Rs. 90,00,000 Dividend @ 10%
= Rs.9,00,000

a. Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-2017		0	1	0.00
31-Mar-2018	Dividend	9,00,000	0.8696	7,82,640
31-Mar-2019	Dividend	9,00,000	0.7561	6,80,490
31-Mar-2020	Dividend	9,00,000	0.6575	5,91,750
31-Mar-2021	Dividend	9,00,000	0.5718	5,14,620
31-Mar-2022	Dividend	9,00,000	0.4971	4,47,390
Total Liability Component				30,16,890
Total Proceeds				90,00,000
Total Equity Component (Bal fig)				59,83,110

b. Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
	a	b	a-b
Liability Component	30,16,890	60,338	29,56,552
Equity Component	59,83,110	1,19,662	58,63,448
Total Proceeds	90,00,000	1,80,000	88,20,000

c. Accounting for liability at amortized cost

- Initial accounting = Present value of cash outflows less transaction costs
- Subsequent accounting = At amortized cost, ie initial fair value adjusted for interest and repayments of the liability.

	Opening Financial Liability A	Interest @ 15.86% B	Cash Flow (Dividend payment) C	Closing Financial Liability A+B-C
01-Apr-2017	29,56,552			29,56,552
31-Mar-2018	29,56,552	4,68,909	9,00,000	25,25,461
31-Mar-2019	25,25,461	4,00,538	9,00,000	20,25,999
31-Mar-2020	20,25,999	3,21,323	9,00,000	14,47,322
31-Mar-2021	14,47,322	2,29,545	9,00,000	7,76,867
31-Mar-2022	7,76,867	1,23,133*	9,00,000	-

*Difference of Rs. 78 (adjusted in the interest value of 31st March, 2022) is due to approximation of figures in the earlier years.

d. Journal Entries to be recorded for entire term of arrangement are as follows:



Date	Particulars	Debit	Credit
		Rs.	Rs.
01-Apr-2017	Bank A/c Dr.	88,20,000	
	To Preference Shares A/c		29,56,552
	To Equity Component of Preference shares A/c		58,63,448
	(Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)		
31-Mar-2018	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2018	Finance cost A/c Dr.	4,68,909	
	To Preference Shares A/c		4,68,909
	(Being interest as per EIR method recorded)		
31-Mar-2019	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2019	Finance cost A/c Dr.	4,00,538	
	To Preference Shares A/c		4,00,538
	(Being interest as per EIR method recorded)		
31-Mar-2020	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2020	Finance cost A/c Dr.	3,21,323	
	To Preference Shares A/c		3,21,323
	(Being interest as per EIR method recorded)		
31-Mar-2021	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2021	Finance cost A/c Dr.	2,29,545	
	To Preference Shares A/c		2,29,545
	(Being interest as per EIR method recorded)		
31-Mar-2022	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2022	Finance cost A/c Dr.	1,23,133	



	To Preference Shares A/c		1,23,133
	(Being interest as per EIR method recorded)		
31-Mar-2022	Equity Component of Preference shares A/c Dr.	58,63,448	
	To Equity Share Capital A/c		1,25,000
	To Securities Premium A/c		57,38,448
	(Being preference shares converted in equity shares and remaining equity component is recognised as securities premium)		

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

The performance of the examinees in this question was not good. Many examinees failed to pass correct journal entries. Some erred in the allocation of transaction cost into equity and liability components. Many examinees solve the question by taking dividend value as ` 5,00,000 instead of ` 9,00,000.

Question 40

Vedika Ltd. issued 80,000 8% convertible debentures of Rs. 100 each on 1st April, 2015. The debentures are due for redemption on 31st March, 2019 at a premium of 20%, convertible into equity shares to the extent of 50% and balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion right was 12%. The conversion to equity qualifies as fixed for fixed.

You are required to separate the debt and equity components at the time of issue and show the accounting entries in Vedika Ltd.'s books at initial recognition only. The following present values of Rupee 1 at 8% and 12% are provided for a period of 5 years.

Interest rate	Year 1	Year 2	Year 3	Year 4	Years 5
8%	0.923	0.853	0.789	0.731	0.677
12%	0.887	0.788	0.701	0.625	0.557

(PYP 10 Marks, Nov 19) (Same concept different figures Old & New SM)

Answer 40

Computation of debt component of convertible debentures on 1st April, 2015

Particulars	Amount (Rs.)
Present value of principal amount repayable after 4 years (A) $80,00,000 \times 50\% \times 120\% \times 0.625$ (12% discount factor)	30,00,000
(B) Present value of interest $[8,00,000 \times 80\% \times 3.001]$ (4 years cumulative 10% discount factor)	19,20,640
Total present value of debt component (A) + (B)	49,20,640
Issue proceeds from convertible debentures	80,00,000
Value of equity component	30,79,360



Journal entry at initial recognition

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Bank A/c Dr.	80,00,000	
To 8% Debentures A/c (liability component)		49,20,640
To 8% Debentures A/c (equity component)		30,79,360
(Being disbursement recorded at fair value)		

Note: The question has been solved on the basis of the discounting factors given in the question.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Overall performance of the examinees in this question was good. A few examinees failed to notice that 8% convertible debentures of ₹ 100 each issued on 1st April, 2015 are due for redemption on 31st March, 2019 ie after 4 years and solved the questions considering 5 years maturity period.

Question 41

Make necessary journal entries for accounting of the security deposit made by Admire Ltd., whose details are described below. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of Security Deposit (Starting Date)	1 st April, 2014
Date of Security Deposit (Finishing Date)	31 st March, 2019
Description	Lease
Total Lease Period	5 years
Discount rate	12%
Security deposit (A)	20,00,000
Present value factor at the 5 th year	0.567427

(PYP 4 Marks, Nov 19)

Answer 41

The above security deposit is an interest free deposit redeemable at the end of lease term for Rs. 20,00,000. Hence, this involves collection of contractual cash flows and shall be accounted at amortized cost.

Upon initial measurement

Particulars	Details
Security deposit (A)	20,00,000
Total lease period (Years)	5
Discount rate	12.00%
Present value annuity factor	0.567427
Present value of deposit at beginning (B)	11,34,854
Prepaid lease payment at beginning (A-B)	8,65,146

Journal entry at initial recognition

Particulars	Amount	Amount
Security deposit A/c Dr.	11,34,854	
Prepaid lease expenses A/c Dr.	8,65,146	
To Bank A/c		20,00,000



Subsequently, every annual reporting year, interest income shall be accrued @ 12% per annum and prepaid expenses shall be amortized on straight line basis over the lease term.

Following table shows the amortization of security deposit based on discount rate:

Year	Opening balance (A)	Interest @ 12% (B)	Closing balance (A) = (A) + (B)
1	11,34,854	1,36,183	12,71,037
2	12,71,037	1,52,524	14,23,561
3	14,23,561	1,70,827	15,94,388
4	15,94,388	1,91,327	17,85,715
5	17,85,315	2,14,685*	20,00,000

*Difference is due to approximation.

Journal entries for Year 1-5

For – Year 1

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,36,183	
To Interest income			1,36,183
Lease expense (8,65,146 / 5 years)	Dr.	1,73,029	
To Prepaid lease expenses			1,73,029

For – Year 2

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,52,524	
To Interest income			1,52,524
Lease expense (8,65,146 / 5 years)	Dr.	1,73,029	
To Prepaid lease expenses			1,73,029

For – Year 3

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,70,827	
To Interest income			1,70,827
Lease expense (8,65,146 / 5 years)	Dr.	1,73,029	
To Prepaid lease expenses			1,73,029

For – Year 4

Particulars		Amount	Amount
Security deposit A/c	Dr.	1,91,327	
To Interest income			1,91,327
Lease expense (8,65,146 / 5 years)	Dr.	1,73,029	
To Prepaid lease expenses			1,73,029

For – Year 5

Particulars		Amount	Amount
Security deposit A/c	Dr.	2,14,685	
To Interest income			2,14,685
Lease expense (8,65,146 / 5 years)	Dr.	1,73,030	
To Prepaid lease expenses			1,73,030



Journal entry for realisation of security deposit at the end of 5th year

Particulars	Amount	Amount
Bank A/c Dr.	20,00,000	
To Security deposit Ac		20,00,000

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees did not account for prepaid lease rent at the beginning and thereby erred in the journal entries for accounting of security deposit.

Question 42

Jewels Ltd. entered into a transaction to purchase 1,000 gms of platinum on 15th January, 2020. The transaction provides for a price payable which is equal to market value of 1,000 gms of platinum on 15th April 2020 and shall be settled by issue of such number of equity shares as is required to settle the aforementioned transaction, at a price of ` 100 per share on 15th April 2020. Whether this is to be classified as liability or equity as on 31st March 2020 as per Ind AS 109?

You are required to explain with reasons. (PYP 5 Marks, Jan 21)

Answer 42

There is a contract for purchase of 1,000 gms of platinum whose consideration varies in response to changing value of platinum. Analysing this contract as a derivative with all three of the following characteristics:

- (a) Value of contract changes in response to change in market value of platinum;
- (b) There is no initial net investment
- (c) It will be settled at a future date, i.e. 15th April 2020. Since the above criteria are met, this is a derivative contract.

Now, a derivative contract that is settled in own equity other than exchange of fixed amount of cash for fixed number of shares is classified as 'liability'. In this case, since the contract results in issue of variable number of shares based on transaction price to be determined in future, hence, this shall be classified as 'derivative financial liability' as per Ind AS 109.

Question 43

Softech Limited has a policy of providing subsidized loans to its employees for the purpose of buying or construction of residential houses. Mrs. B is a Senior Manager in the Company. The Company granted a loan to her on the following terms:

- Principal amount : ` 25 lakh
- Interest rate: 4% for the first ` 10 lakh and 7% for the next ` 15 lakh
- Loan disbursed on: 1st January, 2019
- Tenure: 5 years
- Pre-payment: Full or partial pre-payment at the option of the employee.
- The principal amount of loan shall be recovered in 5 equal installments and will be first applied to 7% interest bearing principal.
- The accrued interest shall be paid on an annual basis.
- Mrs. B must remain in service till the term of the loan ends.
- The market rate of a comparable loan available to Mrs. B, is 12% per annum.

Q. Give your calculations by adopting the present value factor as :



31.12.2019	31.12.2020	31.12.2021	31.12.2022	31.12.2023
0.8929	0.7972	0.7118	0.6355	0.5674

Following table shows the contractually expected cash flows from the loan given to Mrs. B.

(Amount in `)

Date	Outflows	Inflows			Principal outstanding
		Principal	Interest income (7%)	Interest income (4%)	
1 st January 2019	(25,00,000)				25,00,000
31 st December 2019		5,00,000	1,05,000	40,000	20,00,000
31 st December 2020		5,00,000	70,000	40,000	15,00,000
31 st December 2021		5,00,000	35,000	40,000	10,00,000
31 st December 2022		5,00,000	-	40,000	5,00,000
31 st December 2023		5,00,000	-	20,000	-

Mrs. B pre-pays ` 5,00,000 on 31st December 2020, reducing the outstanding principal as on date to ` 10,00,000.

Following table shows the actual cash flows from the loan given to Mrs. B, considering the pre-payment event on 31st December, 2020: (Amount in `)

Date	Outflows	Inflows			Principal outstanding
		Principal	Interest income (7%)	Interest income (4%)	
1 st January 2019	(25,00,000)				25,00,000
31 st December 2019		5,00,000	1,05,000	40,000	20,00,000
31 st December 2020		10,00,000	70,000	40,000	10,00,000
31 st December 2021		5,00,000	-	40,000	5,00,000
31 st December 2022		5,00,000	-	20,000	-
31 st December 2023		-	-	-	-

Record the journal entries (up to 31st December, 2020) in the books of Softech Limited considering the requirements of Ind AS 109. (PYP 14 Marks July 21) (Same concept different figures- MTP 15 Marks Oct'22 & PYP 14 Marks Jan'21)

Answer 43

As per Ind AS 109, a financial instrument is initially measured and recorded at its fair value. Therefore, considering the market rate of interest of similar loan available to Mrs. B is 12%, the fair value of the contractual cash flows shall be as follows:

Date	Inflows			Discount factor @12%	PV
	Principal	Interest income @ 7%	Interest income @ 4%		
31 st December 2019	5,00,000	1,05,000	40,000	0.8929	5,75,921
31 st December 2020	5,00,000	70,000	40,000	0.7972	4,86,292
31 st December 2021	5,00,000	35,000	40,000	0.7118	4,09,285
31 st December 2022	5,00,000	-	40,000	0.6355	3,43,170
31 st December 2023	5,00,000	-	20,000	0.5674	2,95,048
Total (fair value)					21,09,716



Benefit to Mrs. B, to be considered a part of employee cost for Softech Limited ` 3,90,284 (` 25,00,000 – ` 21,09,716).

The deemed employee cost is to be amortised over the period of loan i.e. the minimum period that Mrs. B must remain in service.

The amortization schedule of ` 21,09,716 loan is shown in the following table:

Date	Opening outstanding loan	Total cash inflows (principal repayment + interest)	Interest @ 12%	Closing outstanding loan
1 st January 2019	21,09,716	-	-	21,09,716
31 st December 2019	21,09,716	6,45,000	2,53,166	17,17,882
31 st December 2020	17,17,882	6,10,000	2,06,146	13,14,028
31 st December 2021	13,14,028	5,75,000	1,57,683	8,96,711
31 st December 2022	8,96,711	5,40,000	1,07,605	4,64,316
31 st December 2023	4,64,316	5,20,000	55,684*	-

* Difference of ` 34 (55,718 – 55,684) is due to approximation.

Journal Entries in the books of Softech Limited

a. 1st January 2019

Particulars	Dr. (₹)	Cr. (₹)
Loan to Mrs. B A/c Dr.	21,09,716	
Pre-paid employee cost A/c Dr.	3,90,284	
To Bank A/c		25,00,000
(Being loan asset recorded at initial fair value)		

b. 31st December 2019

Particulars	Dr. (₹)	Cr. (₹)
Bank A/c Dr.	6,45,000	
To Interest income (profit and loss) @ 12% A/c To Loan to Mrs. B A/c		2,53,166
(Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)		3,91,834
Employee benefit (profit and loss) A/c Dr.	78,057	
To Pre-paid employee cost A/c		78,057
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

On 31st December 2020, due to pre-payment of a part of loan by Mrs. B, the carrying value of the loan shall be re-computed by discounting the future remaining cash flows by the original effective interest rate.

There shall be two sets of accounting entries on 31st December 2020, first the realisation of the contractual cash flow as shown in (c) below and then the accounting for the pre-payment of ` 5,00,000 included in (d) below:

c. 31st December 2020

Particulars	Dr. (₹)	Cr. (₹)



Bank A/c	Dr.	6,10,000	
To Interest income (profit and loss) @ 12% A/c To Loan to Mrs. B A/c			2,06,146 4,03,854
(Being second instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)			
Employee benefit (profit and loss) A/c	Dr.	78,057	
To Pre-paid employee cost A/c			78,057
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)			

d. Computation of new carrying value of loan to Mrs. B:

	Inflows				
Date	Principal	Interest income 7%	Interest income 4%	Discount factor @ 12%	PV
31 st December 2021	5,00,000	-	40,000	0.8929	4,82,166
31 st December 2022	5,00,000	-	20,000	0.7972	4,14,544
Total (revised carrying value)					8,96,710
Less: Current carrying value					(13,14,028)
Adjustment required					4,17,318

The difference between the amount of pre-payment and adjustment to loan shall be considered a gain, though will be recorded as an adjustment to pre-paid employee cost, which shall be amortised over the remaining tenure of the loan.

e. 31st December 2020 prepayment

Particulars	Dr. (₹)	Cr. (₹)
Bank A/c	5,00,000	
To Pre-paid employee cost A/c To Loan to Mrs. B A/c		82,682 4,17,318
(Being gain to Softech Limited recorded as an adjustment to pre-paid employee cost)		

Amortisation of employee benefit cost shall be as follows:

Date	Opening Balance	Amortised to P&L	Adjustment	Closing Balance
1 st January 2019	3,90,284			3,90,284
31 st December 2019	3,90,284	78,057		3,12,227
31 st December 2020	3,12,227	78,057	82,682	1,51,488

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some examinees erred in computing the revised carrying value and adjustment amount relating to pre-payment of loan by the employee which led to passing of wrong journal entry in the year of pre-payment.

Question 44

On 1st October, 2017 Axe Limited issues preference shares to B Limited for a consideration of ₹ 18 lakh. The holder has an option to convert these preference shares to a fixed number of equity instruments of



the issuer any time up to a period of 4 years. If the holder does not exercise the option, the preference shares are redeemable at the end of 4 years. The preference shares carry a fixed coupon of 5.5% per annum and is payable every year. The prevailing market rate for similar preference shares without the conversion feature is 8% per annum. Axe Limited has an early redemption option to prepay the instrument at ₹ 20 lakh and on 30th September, 2020, it exercised that option. The interest rate has changed on that date.

At that time, Axe Limited could have issued a 1 year (that is maturity 30th September, 2021) non-convertible instrument at 6%. Calculate the value of liability and equity components at the date of initial recognition. Also give amortization schedule. (Limit discounting factor to 3 decimal places for calculation purpose). (PYP 5 Marks July 21)

Answer 44

The values of the liability and equity components are calculated as follows:

Present value of principal payable at the end of 4 years (₹ 18,00,000 discounted at 8% for 4 years i.e. ₹ 18,00,000 x 0.735)	₹ 13,23,000
Present value of interest payable in arrears for 4 years (₹ 99,000 (₹ 18,00,000 x 5.5%) discounted at 8% for each of 4 years (i.e. ₹ 99,000 x 3.312))	₹ 3,27,888
Total financial liability	₹ 16,50,888
Consideration amount	(₹ 18,00,000)
Residual – equity component	₹ 1,49,112

Therefore, equity component = fair value of compound instrument, say, ₹ 18,00,000 less financial liability component i.e. ₹ 16,50,888 = ₹ 1,49,112.

The amortisation schedule of the instrument is set out below:

Dates	Cash flows	Finance cost at effective interest rate	Liability
1 st October 2017	18,00,000	-	16,50,888
30 th September 2018	(99,000)	1,32,071	16,83,959
30 th September 2019	(99,000)	1,34,717	17,19,676
30 th September 2020	(99,000)	1,37,574	17,58,250
30 th September 2021	(18,99,000)	1,40,750*	-

*Note: The difference in amount of finance cost is due to approximation of discounting factor to 3 decimal places.

Question 45

KUPA Ltd. borrowed ₹ 95 lakh as loan from XYZ Bank on 1st April, 2018 at an interest rate of 10% p.a. KUPA Ltd. spent ₹ 1,80,912 as loan processing charges. Principal amount of loan is to be repaid in 5 equal instalments and the interest to be paid annually on accrual basis. Effective interest rate on loan is 10.8%.

On 31st March, 2020, KUPA Ltd. faced challenges in business because of sudden change in the technology. It approached XYZ Bank and renegotiated the terms of the loan. Interest rate changed to 15% p.a. Principal amount of loan is to be repaid in 8 equal instalments payable annually starting 31st March, 2021 and the interest is to be paid annually on accrual basis. Before approaching bank, KUPA Ltd. made the interest payment on 31st March, 2020.

You are required to record Journal entries in the books of KUPA Ltd. till 31st March, 2021, after giving effect of the changes in the terms of the loan on 31st March, 2020. Workings should form part of the answer.

PV of ₹ 1	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
10% 0.909132070	0.909	0.826	0.751	0.683	0.621	0.564	0.513	0.467



10.8%	0.903	0.815	0.735	0.664	0.599	0.540	0.488	0.440
15%	0.870	0.756	0.658	0.572	0.497	0.432	0.376	0.327

(PYP 12 Marks Dec '21, MTP 13 Marks Mar'23)

Answer 45

The following table shows the amortisation of loan based on effective interest rate:

Date (1)	Opening Amortised cost (2)	Cash flows (Principal) (3)	Cash outflows (Interest @ 10% and fee) (4)	Total cash flows (3 + 4 = 5)	Interest @ EIR 10.80% (2 x 10.80% = 6)	Closing Amortised cost (2- 5 + 6 = 7)
1st April, 2018		(95,00,000)	1,80,912			93,19,088
31st March, 2019	93,19,088	19,00,000	9,50,000	28,50,000	10,06,462	74,75,550
31st March, 2020	74,75,550	19,00,000	7,60,000	26,60,000	8,07,359	56,22,909
31st March, 2021	56,22,909	19,00,000	5,70,000	24,70,000	6,07,274	37,60,183
31st March, 2022	37,60,183	19,00,000	3,80,000	22,80,000	4,06,100	18,86,283
31st March, 2023	18,86,283	19,00,000	1,90,000	20,90,000	2,03,717*	

* Difference of ` 2 (2,03,719 – 2,03,717) is due to approximation.

(i) **On 1st April, 2018**

Particulars	Dr. (₹)	Cr. (₹)
Bank A/c Dr. To Loan from bank A/c (Being loan recorded at its fair value less transaction costs on the initial recognition date)	93,19,088	93,19,088

(ii) **On 31st March, 2019**

Particulars	Dr. (₹)	Cr. (₹)
Loan from bank A/c Dr. Interest expense Dr. To Bank A/c (Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised cost of loan)	18,43,538 10,06,462	28,50,000

(iii) **On 31st March, 2020– Before KUPA Ltd. approached the bank**

Particulars	Dr. (₹)	Cr. (₹)
Interest expense Dr. To Loan from bank A/c To Bank A/c (Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)	8,07,359	47,359 7,60,000

Reason for treating the modification as a fresh loan:

Upon receiving the new terms of the loan, KUPA Ltd., re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan.

The following table shows the present value (PV) of new contractual cash flows and percentage of



variation:

Date	Cash flows (principal)	Interest outflow @ 15%	Total cash outflow	Discounting factor @ 10.80%	PV of cash flows
31st March, 2020	(76,00,000)				
31st March, 2021	9,50,000	11,40,000	20,90,000	0.903	18,87,270
31st March, 2022	9,50,000	9,97,500	19,47,500	0.815	15,87,213
31st March, 2023	9,50,000	8,55,000	18,05,000	0.735	13,26,675
31st March, 2024	9,50,000	7,12,500	16,62,500	0.664	11,03,900
31st March, 2025	9,50,000	5,70,000	15,20,000	0.599	9,10,480
31st March, 2026	9,50,000	4,27,500	13,77,500	0.540	7,43,850
31st March, 2027	9,50,000	2,85,000	12,35,000	0.488	6,02,680
31st March, 2028	9,50,000	1,42,500	10,92,500	0.440	4,80,700
PV of new contractual cash flows discounted @ 10.80%					86,42,768
Carrying amount of loan (93,19,088 - 18,43,538 + 47,359)					(75,22,909)
Difference					11,19,859
Percentage of carrying amount					14.89%

Decision Making:

Considering a more than 10% change in PV of cash flows compared to the carrying value of the loan, the existing loan shall be considered to have been extinguished and the new loan shall be accounted for as a separate financial liability.

The accounting entries for the same are included below:

(i) On 31st March, 2020 – Accounting for extinguishment

Particulars	Dr. (₹)	Cr. (₹)
Loan from bank (old) A/c Dr.	75,22,909	
Finance cost Dr.	77,091	
To Loan from bank (new) A/c		76,00,000
(Being new loan accounted for at its principal amount in absence of any transaction costs directly related to such loan and corresponding derecognition of existing loan)		

(ii) On 31st March, 2021

Particulars	Dr. (₹)	Cr. (₹)
Loan from bank A/c Dr.	9,50,000	
Interest expense Dr.	11,40,000	
To Bank A/c		20,90,000
(Being first instalment of the new loan and payment of interest accounted for as an adjustment to the amortised cost of loan)		

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

The question tested accounting for financial instruments wherein examinees were required to pass journal entries by giving effect to the changes in the terms of the loan. Most of the examinees erred either in using the correct discounting factor, or in calculation of correct amount of interest which led to other wrong calculations. Some of the examinees failed to provide correct journal entries or missed to give the amortization schedule.

Question 46

Jakob Ltd. entered into a contract for lease of machinery with Jason Ltd. on 1.1.2018. The initial term of the lease is 6 years with a renewal option of further 2 years.

- The annual payments for initial term and renewal term are ` 2,80,000 and ` 3,50,000 respectively.
- The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year. For example, the payment due on 1.1.2019 will be based on the CPI available at 31.12.2018.
- Jakob Ltd.'s incremental borrowing rate at the lease inception date and as at 1.1.2021 is 8% and 10% respectively and the CPI at lease commencement date and as at 1.1.2021 is 250 and 260 respectively.
- At the lease commencement date, Jakob Ltd. did not think that it will be a viable option to renew the lease but in the first quarter of 2021, Jakob Ltd. made some major changes in the retail store which increases its economic life by five years.
- Jakob Ltd. determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.
- Jakob Ltd. asked your opinion whether remeasurement of lease is required in the first quarter of 2021. (10 Marks Dec '21)

Answer 46

Since in the first quarter of 2021, Jakob Ltd. is reasonably certain that it will exercise its renewal option, it is required to re-measure the lease in the first quarter of 2021.

The following table summarizes information pertinent to the lease re-measurement:

Re-measured lease term	5 years (3 years remaining in the initial term plus 2 years in the renewal period)
Jakob Ltd.'s incremental borrowing rate on the re-measurement date	10%
CPI available on the re-measurement date	260
Right-of-use asset immediately before the re-measurement	` 6,99,019 (Refer note 2)
Lease liability immediately before the re-measurement	` 7,79,417 (Refer note 2)

Procedure to re-measure the lease liability:

To re-measure the lease liability, Jakob Ltd. would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 10%).

Since the initial lease payments were based on a CPI of 250, the CPI has increased by 4% $[(260-250)/250 \times 100]$. As a result, Jakob Ltd. would increase the future lease payments by 4%.

Computation of present value of the future lease payments based on an updated CPI of 260:

	Year					Total
	4	5	6	7	8	
Lease payment	2,91,200	2,91,200	2,91,200	3,64,000	3,64,000	16,01,600
Discount @ 10%	1	0.909	0.826	0.751	0.683	
Present value	2,91,200	2,64,701	2,40,531	2,73,364	2,48,612	13,18,408

Calculation of the adjustment to the lease liability on re-measurement by comparing the recalculated and original lease liability balances on the re-measurement date:

Revised lease liability	13,18,408
Original lease liability	(7,79,417)
Adjustment to the lease liability on re-measurement	5,38,991

Based on above calculations, it is clear that re-measurement of lease is required and accordingly



adjustment to lease liability and ROU asset is required in the first quarter of 2021.

Journal entry to adjust the lease liability

ROU Asset	Dr.	5,38,991	
To Lease liability			5,38,991
(Being lease liability and ROU asset adjusted on account of re-measurement)			

Working Notes:

1. Calculation of ROU asset before the date of re-measurement

Year beginning	Lease Payment (A)	Present value factor @ 8% (B)	Present value of lease payments (A x B = C)
1	2,80,000	1.000	2,80,000
2	2,80,000	0.926	2,59,280
3	2,80,000	0.857	2,39,960
4	2,80,000	0.794	2,22,320
5	2,80,000	0.735	2,05,800
6	2,80,000	0.681	1,90,680
Lease liability as at the commencement date			13,98,040

Or

(2,80,000 x Sum of PV (4.993) @ 8% for 5 years = 13,98,040)

2. Calculation of Lease Liability and ROU asset at each year end

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 8%	Closing balance	Initial Value	Depreciation for 6 years	Closing balance
	a	b	c = (a-b) x 8%	d = a-b+c			
1	13,98,040	2,80,000	89,443	12,07,483	13,98,040	2,33,007	11,65,033
2	12,07,483	2,80,000	74,199	10,01,682	11,65,033	2,33,007	9,32,026
3	10,01,682	2,80,000	57,735	7,79,417	9,32,026	2,33,007	6,99,019
4	7,79,417				6,99,019		

As per the information given in the third bullet point at page 10, it is inferred that annual lease payments are due at the beginning of the year. Hence, it can be inferred that the annual lease payment of 2021 had been paid on 1.1.2021. Accordingly lease liability considered for the purpose of remeasurement would be of 5 th, 6th, 7th and 8th year only i.e. for 4 years. However, since remeasurement has been decided in the first quarter of 2021, ROU asset balance before remeasurement will be after depreciation of 3 years i.e. till 2020.

Based on the above contention, following alternative solution is also possible:

Since in the first quarter of 2021, Jakob Ltd. is reasonably certain that it will exercise its renewal option, it is required to re-measure the lease in the first quarter of 2021.

The following table summarizes information pertinent to the lease re-measurement:

Re-measured lease term	4 years (2 years remaining in the initial term plus 2 years in the renewal period)
Jakob Ltd.'s incremental borrowing rate on the re-measurement date	10%
CPI available on the re-measurement date	260
Right-of-use asset immediately before the re-measurement	` 6,99,019 (Refer note 2)
Lease liability immediately before the re-measurement	` 5,39,370 (Refer note 2)



Procedure to re-measure the lease liability:

To re-measure the lease liability, Jakob Ltd. would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 10%).

Since the initial lease payments were based on a CPI of 250, the CPI has increased by 4% $\{[(260-250)/250] \times 100\}$. As a result, Jakob Ltd. would increase the future lease payments by 4%.

Computation of present value of the future lease payments based on an updated CPI of 260:

	Year				Total
	5	6	7	8	
Lease payment	2,91,200	2,91,200	3,64,000	3,64,000	13,10,400
Discount @ 10%	1	0.909	0.826	0.751	
Present value	2,91,200	2,64,701	3,00,664	2,73,764	11,30,329

Calculation of the adjustment to the lease liability on re-measurement by comparing the recalculated and original lease liability balances on the re-measurement date:

Revised lease liability	11,30,329
Original lease liability	(5,39,370)
Adjustment to the lease liability on re-measurement	5,90,959

Based on above calculations, it is clear that re-measurement of lease is required and accordingly adjustment to lease liability and ROU asset is required in the first quarter of 2022.

Journal entry to adjust the lease liability

ROU Asset	Dr.	5,90,959	
To Lease liability			5,90,959
(Being lease liability and ROU asset adjusted on account of re-measurement)			

Working Notes:

1. Calculation of ROU asset before the date of re-measurement

Year beginning	Lease Payment (A)	Present value factor @ 8% (B)	Present value of lease payments (A x B = C)
1	2,80,000	1.000	2,80,000
2	2,80,000	0.926	2,59,280
3	2,80,000	0.857	2,39,960
4	2,80,000	0.794	2,22,320
5	2,80,000	0.735	2,05,800
6	2,80,000	0.681	1,90,680
Lease liability as at commencement		t date	13,98,040

Or

(2,80,000 x sum of PV (4.993) @ 8% for 5 years = 13,98,040)

2. Calculation of Lease Liability and ROU asset at each year end

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 8%	Closing balance	Initial Value	Depreciation for 6 years	Closing balance
	a	b	c = (a-b) x 8%	d = a-b+c			
1	13,98,040	2,80,000	89,443	12,07,483	13,98,040	2,33,007	11,65,033
2	12,07,483	2,80,000	74,199	10,01,682	11,65,033	2,33,007	9,32,026



3	10,01,682	2,80,000	57,735	7,79,417	9,32,026	2,33,007	6,99,019
4	7,79,417	2,80,000	39,953	5,39,370	6,99,019		
5	5,39,370						

Question 47

M Limited has made a security deposit whose details are given below:

Particulars	Details
Date of security deposit (starting date)	1st April, 2016
Date of security deposit (finishing date)	31st March, 2021
Description	Lease
Total lease period	5 years
Security deposit	₹ 20,00,000
Present value factor at the end of the 5th year	0.6499

Determine, how above financial asset should be measured and briefly explain measurement determined as such. Make necessary journal entries for accounting of the security deposit in the first year and last year. Assume market rate for a deposit for similar period to be 9% p.a. (PYP 5 Marks Dec '21)

Answer 47

The given security deposit is an interest free deposit redeemable at the end of lease term for ₹ 20,00,000. Hence, this involves collection of contractual cash flows and shall be accounted at amortised cost.

Upon initial measurement

Particulars	₹
Security deposit (A)	20,00,000
Present value of deposit at beginning (20,00,000 x 0.6499) (B)	(12,99,800)
Prepaid lease payment at beginning (A-B)	7,00,200

Journal Entries

Year 1 - beginning

Particulars		₹	₹
Security deposit A/c	Dr.	12,99,800	
Prepaid lease rent (ROU Asset)	Dr.	7,00,200	
To Bank A/c			20,00,000
(Recognised present value of security deposit and prepaid lease)			

Subsequently, every annual reporting year, interest income shall be accrued @ 9% per annum and prepaid expenses shall be amortised on straight line basis over the lease term.

Year 1 - end

Particulars		₹	₹
Security deposit A/c (12,99,800 x 9%)	Dr.	1,16,982	
To Interest income A/c			1,16,982
(Recognised interest on security deposit)			
Depreciation (7,00,200 / 5 years)	Dr.	1,40,040	
To Prepaid lease rent (ROU Asset)			1,40,040
(Prepaid lease depreciated for the year)			

Year 5 - end

At the end of 5th year, the security deposit shall accrue ₹ 20,00,000 and prepaid lease expenses shall



be fully amortised (i.e. depreciated as per Ind AS 116, this prepaid lease rent would be shown as ROU asset).

Journal entry for realization of security deposit

Particulars			
Security deposit A/c (Refer W.N.) Dr.	1,65,227		
To Interest income A/c (Recognised interest on security deposit)		1,65,227	
Depreciation (7,00,200 / 5 years) Dr.	1,40,040		
To Prepaid lease rent (ROU Asset) (Prepaid lease depreciated for the year)		1,40,040	
Bank A/c Dr.	20,00,000		
To Security deposit A/c (Security deposit paid back at the end of the lease term)		20,00,000	

Working Note:

Amortization schedule

Year end	Opening balance	Interest income	Closing balance
1	12,99,800	1,16,982	14,16,782
2	14,16,782	1,27,510	15,44,292
3	15,44,292	1,38,986	16,83,278
4	16,83,278	1,51,495	18,34,773
5	18,34,773	1,65,227*	20,00,000

* Difference is due to approximation.

Question 48

X Ltd. issues ` 1.5 crore convertible bonds on 1st April, 2018. The bonds have a life of 8 years and a face value of ` 10 each and offer interest @ 5.5% p.a. payable at the end of each financial year.

Bonds are issued at their face value and each bond can be converted into one ordinary share of X Ltd. at any time in the next eight years.

Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 7% p.a.

You are required to:

- Provide the journal entries from financial year 2018-2019 to financial year 2021-2022;
- Calculate the interest expenses across all eight years of the life of the convertible bonds;
- Give the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the fourth year (after receiving interest for the fourth year). (PYP 14 Marks May '22,) (Same concept different figures- PYP 8 Marks Nov'18)

Answer 48

(a) (i) Journal Entries

	Dr. (₹)	Cr. (₹)
1st April, 2018		
Bank A/c Dr.	1,50,00,000	
To Convertible bonds A/c (liability) (Refer W.N.)		1,36,56,075
To Convertible bonds A/c (equity) (Refer W.N.)		13,43,925
(Being recognition of convertible bonds at the date of issuance into liability and equity components)		



31st March, 2019			
Interest expense A/c	Dr.	9,55,925	
To Bank A/c			8,25,000
To Convertible bonds A/c (liability)			1,30,925
(Being interest expense recorded at market rate of 7% and actual interest paid @ 5.5%)			
31st March, 2020			
Interest expense A/c	Dr.	9,65,090	
To Bank A/c			8,25,000
To Convertible bonds A/c (liability)			1,40,090
(Being interest expense recorded at market rate of 7% and actual interest paid @ 5.5%)			
31st March, 2021			
Interest expense A/c	Dr.	9,74,896	
To Bank A/c			8,25,000
To Convertible bonds A/c (liability)			1,49,896
(Being interest expense recorded at market rate of 7% and actual interest paid @ 5.5%)			
31st March, 2022			
Interest expense A/c	Dr.	9,85,389	
To Bank A/c			8,25,000
To Convertible bonds A/c (liability)			1,60,389
(Being interest expense recorded at market rate of 7% and actual interest paid @ 5.5%)			

(ii) Table showing computation of interest expense at market rate and actual interest outflow @ 5.5%

Year	Date	Opening bond liability	Actual interest outflow @ 5.5%	Interest expense @ 7%	Increase in liability	Closing bond liability
		a	b = 1.5 cr x 5.5%	c = a x 7%	d = c-b	e = a+d
0	1 st April, 2018					1,36,56,075
1	31 st March, 2019	1,36,56,075	8,25,000	9,55,925	1,30,925	1,37,87,000
2	31 st March, 2020	1,37,87,000	8,25,000	9,65,090	1,40,090	1,39,27,090
3	31 st March, 2021	1,39,27,090	8,25,000	9,74,896	1,49,896	1,40,76,986
4	31 st March, 2022	1,40,76,986	8,25,000	9,85,389	1,60,389	1,42,37,375
5	31 st March, 2023	1,42,37,375	8,25,000	9,96,616	1,71,616	1,44,08,991
6	31 st March, 2024	1,44,08,991	8,25,000	10,08,629	1,83,629	1,45,92,620
7	31 st March, 2025	1,45,92,620	8,25,000	10,21,483	1,96,483	1,47,89,103
8	31 st March, 2026	1,47,89,103	8,25,000	10,35,897*	2,10,897	1,50,00,000

*Difference of ₹ 660 (10,35,897 - 10,35,237) is due to rounding off

(iii) When holders of the bonds elect to convert the bonds to ordinary shares at the end of the fourth year (after receiving their interest payments), the entries would be:

	Dr. (₹)	Cr. (₹)
31st March, 2022		



Convertible bonds A/c (liability)	Dr.	1,42,37,375	
Convertible bonds A/c (equity)	Dr.	13,43,925	
To Ordinary share capital A/c			1,55,81,300
(Being bonds converted into ordinary shares of X Ltd.)			

Working Note:

Computation of equity and liability component of convertible bond at 7% market rate

	₹
Present value of principal to be received at the end of eight year discounted at 7% (1,50,00,000 x 0.582)	87,30,000
Annuity of annual interest discounted at 7% for 8 years (1,50,00,000 x 5.5% x 5.971)	49,26,075
Total present value (a)	1,36,56,075
Equity component (balancing figure) (a-b)	13,43,925
Total proceeds received from issuance of convertible bonds (b)	1,50,00,000

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A small number of examinees failed in calculating the stream of interest expense and giving correct accounting entries.

Question 49

X Ltd. has made a borrowing from RGD Bank for ₹ 20,000 at a fixed interest of 12% per annum. Loan processing fees were paid additionally amounting to ₹ 1,000 and the loan is payable in 4 half-yearly installments of ₹ 5,000 each.

Details are as follows:

Particulars	Details
Loan amount	₹ 20,000
Date of loan (Starting Date)	1 st April, 2020
Date of loan (Finishing Date)	31 st March, 2022
Description of repayment	Repayment of loan starts from 30 th September, 2020 (To be paid on half yearly basis)
Installment amount	₹ 5,000
Interest rate	12% per annum
Interest charge	Interest to be charged and paid quarterly
Upfront fees	₹ 1,000

Compute the interest to be charged to the statement of profit & loss every quarter over the period of loan. The effective interest rate is 16.60% per annum. (PYP 5 Marks May '22) (Same concept different figures- Old & New SM)

Answer 49

The loan taken by X Ltd. shall be measured at amortised cost as follows:

Initial measurement = At transaction price less processing fee ie. ₹ 19,000 (20,000 – 1,000)

Subsequent measurement = Interest to be accrued using effective rate of interest as follows:

Quarter	Opening balance (A)	Interest @ 16.60% (B)=[(A) x 16.60%/4]	Cash flows (C) = [Refer column of D of W.N.]	Closing balance (A) + (B) - (C)



1	19,000.00	789.00	600.00	19,189.00
2	19,189.00	796.00	5,600.00	14,385.00
3	14,385.00	597.00	450.00	14,532.00
4	14,532.00	603.00	5,450.00	9,685.00
5	9,685.00	402.00	300.00	9,787.00
6	9,787.00	406.00	5,300.00	4,893.00
7	4,893.00	203.00	150.00	4,946.00
8	4,946.00	204.00*	5,150.00	-

* Difference is due to approximation.

Working Note:

Quarter	Opening balance (A)	Interest @ 12% p.a. (B) = [(A) x 12%/4]	Principal repayment at quarter end (C)	Total Cash flow (D) = (B) + (C)	Closing balance (E) = (A) - (C)
1	20,000.00	600.00	-	600.00	20,000.00
2	20,000.00	600.00	5,000.00	5,600.00	15,000.00
3	15,000.00	450.00	-	450.00	15,000.00
4	15,000.00	450.00	5,000.00	5,450.00	10,000.00
5	10,000.00	300.00	-	300.00	10,000.00
6	10,000.00	300.00	5,000.00	5,300.00	5,000.00
7	5,000.00	150.00	-	150.00	5,000.00
8	5,000.00	150.00	5,000.00	5,150.00	-

Question 50

ENG Ltd. has developed model to measure the expected credit loss based on the lifetime expected credit loss model. Accordingly, the company has estimated the following provisioning matrix:

	Current	1-30 days past due	31-60 days past due	61-90 days past due	More than 90 days past due
Default Rate	0.3%	1.6%	3.6%	6.6%	10.6%

The Company has a portfolio of trade receivables of ₹ 6 crores as on 31st March, 2022 and operates in only one geographical region. The customer base of the company consists of large number of small clients and trade receivables are categorized by common risk characteristics that are representative of customer's abilities to pay all amounts due as per the contractual terms.

The trade receivables do not have significant financing component. The above provision matrix is based on its historically observed default rate over the expected life of the trade receivables and is adjusted for forward looking estimate.

The company has asked you to suggest whether the above system of making the provision for the expected credit loss is in accordance with the applicable Ind AS? If yes, then determine the expected credit loss for the Trade Receivables outstanding as on 31st March, 2022 on the following basis:

	Current	1-30 days past due	31-60 days past due	61-90 days past due	More than 90 days past due
% of Trade Receivables	50%	25%	13%	8%	4%

(PYP 5 Marks Nov 22)

Answer 50

To determine the expected credit losses for the portfolio, ENG Ltd. should use a provision matrix. The provision matrix will be based on its historical observed default rates over the expected life of the trade receivables and shall be adjusted for forward-looking estimates. At every reporting date the historical observed default rate shall be updated and changes in the forward-looking estimates shall be analysed. In this case, it is forecast that economic conditions will deteriorate over the next year. Therefore, as per para 5.5.15 of Ind AS 109, the loss allowance for trade receivables shall be measured at an amount equal to lifetime expected credit losses. On that basis, ENG Ltd. estimates the provision matrix.

The trade receivables from the large number of small customers amount to ₹ 6,00,00,000 and are measured using the provision matrix:

	Provision % age	Gross carrying amount	Default rate	Lifetime expected credit loss allowance (Gross carrying amount x lifetime expected credit loss rate)
a	b	C = ₹ 6 crore x b	d	e = c x d
		₹		₹
Current	50%	3,00,00,000	0.3%	₹ 90,000
1–30 days past due	25%	1,50,00,000	1.6%	₹ 2,40,000
31–60 days past due	13%	78,00,000	3.6%	₹ 2,80,800
61–90 days past due	8%	48,00,000	6.6%	₹ 3,16,800
More than 90 days past due	4%	24,00,000	10.6%	₹ 2,54,400
		6,00,00,000		₹ 11,82,000

Question 51

Autumn Limited has a policy of providing subsidized loans to its employees for their personal purposes. Mrs. Jama Bai, a senior HR manager in the Company, took a loan of ₹ 12.00 lakhs on the following terms:

- Interest rate 4% per annum
- Loan disbursement date: 1st April, 2019
- The principal amount of the loan shall be recovered in 4 equal annual installments commencing from 31st March, 2020
- The accumulated interest computed on reducing balance at simple interest is collected in 3 equal annual installments after collection of the principal amount
- Mrs. Jama Bai must remain in service till the principal and interest are paid
- The market rate of a comparable loan to Mrs. Jama Bai is 9% per annum
- The present value of ₹ 1 at 9% per annum at the end of respective years is as follows:

Year ending 31st March	2020	2021	2022	2023	2024	2025	2026
Present Value	0.9174	0.8417	0.7722	0.7084	0.6499	0.5963	0.5470

Under the assumption that no probable future economic benefits except the return of loan has been guaranteed by the employee, you are required to:

- Provide the journal entries at the time of initial recognition of loan on 1st April, 2019 and as at 31st March, 2020; and
 - Prepare ledger account of 'Loan to Mrs. Jama Bai' from the inception of the loan till its final payment.
- (PYP 14 Marks May '23)



Answer 51

i) Journal Entry

Date	Particulars	Dr.	Cr.
1/4/2019	Loan to Mrs. Jama Bai A/c Dr. Pre-paid employee cost A/c Dr. To Bank A/c (Being loan to employee recorded at fair value)	10,43,638 1,56,362	12,00,000
31/3/2020	Loan to Mrs. Jama Bai A/c Dr. To Finance Income A/c (Being finance income @ 9% recorded in the books)	93,927	93,927
31/3/2020	Bank A/c Dr. To Loan to Mrs. Jama Bai A/c (Being installment received at the end of the year)	3,00,000	3,00,000

**ii) In the books of Autumn Ltd.
Loan to Mrs. Jama Bai A/c**

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
1.4.2019	To Bank A/c	10,43,638	31.3.2020	By Bank A/c	3,00,000
31.3.2020	To Finance income (W.N.3)	93,927	31.3.2020	By Balance c/d	8,37,565
		11,37,565			11,37,565
1.4.2020	To Balance b/d	8,37,565	31.3.2021	By Bank A/c	3,00,000
31.3.2021	To Finance income (W.N.3)	75,381	31.3.2021	By Balance c/d	6,12,946
		9,12,946			9,12,946
1.4.2021	To Balance b/d	6,12,946	31.3.2022	By Bank A/c	3,00,000
31.3.2022	To Finance income (W.N.3)	55,165	31.3.2022	By Balance c/d	3,68,111
		6,68,111			6,68,111
1.4.2022	To Balance b/d	3,68,111	31.3.2023	By Bank A/c	3,00,000
31.3.2023	To Finance income (W.N.3)	33,130	31.3.2023	By Balance c/d	1,01,241
		4,01,241			4,01,241
1.4.2023	To Balance b/d	1,01,241	31.3.2024	By Bank A/c	40,000



31.3.2024	To Finance income (W.N.3)	9,112	31.3.2024	By Balance c/d	70,353
		1,10,353			1,10,353
1.4.2024	To Balance b/d	70,353	31.3.2025	By Bank A/c	40,000
31.3.2025	To Finance income (W.N.3)	6,332	31.3.2025	By Balance c/d	36,685
		76,685			76,685
1.4.2025	To Balance b/d	36,685	31.3.2026	By Bank A/c	40,000
31.3.2026	To Finance income (W.N.3)	3,315* 40,000			40,000

*Difference of ₹ 13 (₹ 3,315 – ₹ 3,302) is due to approximation.

Working Notes:

1. Calculation of initial recognition amount of loan to employee

Year	Estimated Cash Flows	PV Factor @9%	Present Value
	₹		₹
31/3/2020	3,00,000	0.9174	2,75,220
31/3/2021	3,00,000	0.8417	2,52,510
31/3/2022	3,00,000	0.7722	2,31,660
31/3/2023	3,00,000	0.7084	2,12,520
31/3/2024	40,000 (W.N.2)	0.6499	25,996
31/3/2025	40,000 (W.N.2)	0.5963	23,852
31/3/2026	40,000 (W.N.2)	0.5470	21,880
Fair Value of loan			10,43,638

2. Computation of Interest to be paid

Year	Opening outstanding balance a	Cash Flows b	Principal outstanding at year end c	Interest @ 4% on a d	Cumulative Interest e
		₹	₹	₹	₹
31/3/2020	12,00,000	3,00,000	9,00,000	48,000	48,000
31/3/2021	9,00,000	3,00,000	6,00,000	36,000	84,000
31/3/2022	6,00,000	3,00,000	3,00,000	24,000	1,08,000
31/3/2023	3,00,000	3,00,000	Nil	12,000	1,20,000
31/3/2024	1,20,000	40,000 (1,20,000/3)			
31/3/2025		40,000 (1,20,000/3)			



31/3/2026		40,000 (1,20,000/3)			

3. Computation of finance cost as per amortization table

Year	Opening Balance (1)	Interest @ 9% (2)	Repayment (3)	Closing Balance (1+2-3)
	`	`	`	`
1/4/2019				10,43,638
31/3/2020	10,43,638	93,927	3,00,000	8,37,565
31/3/2021	8,37,565	75,381	3,00,000	6,12,946
31/3/2022	6,12,946	55,165	3,00,000	3,68,111
31/3/2023	3,68,111	33,130	3,00,000	1,01,241
31/3/2024	1,01,241	9,112	40,000	70,353
31/3/2025	70,353	6,332	40,000	36,685
31/3/2026	36,685	3,315*	40,000	Nil

*Difference of ` 13 (` 3,315 – ` 3,302) is due to approximation.

Question 52

Weak Limited, which is a fully owned subsidiary company of Strong Limited approached Strong Limited for an interest free loan for mitigation of its financial difficulties. Strong Limited provided the loan to Weak Limited on the following terms & conditions:

Nature of loan	Interest Free
Amount of loan	` 60,00,000
Date of disbursement of loan	1st April, 2021
Loan period	3 years
Loan repayable by Weak Ltd.	On 31st March, 2024
Market rate of interest for similar loan	8% (both for holding and subsidiary) per annum
P.V. factor of ` 1 at the end of 3rd year at 8% per annum is	0.7938

Assuming that there are no transaction costs, you are required to pass necessary accounting entries in the books of Weak Limited for all the three years. (PYP 5 Marks May '23)

Answer 52

Accounting in the books of Weak Ltd (Subsidiary)

Date	Particulars	Amount	Amount
	On the date of loan		
1.4.2021	Bank A/c Dr.	60,00,000	
	To Loan from Strong Ltd. (Payable)		47,62,800
	To Equity (Deemed capital contribution from ABC Ltd.) (Being the loan taken from Strong Ltd. recognised at fair value)		12,37,200



	At the end of Year 1		
31.3.2022	Interest expense (Finance cost) Dr.	3,81,024	
	To Loan from Strong Ltd. (Payable) (Being interest expense recognised)		3,81,024
	At the end of Year 2		
31.3.2023	Interest expense (Finance cost) Dr.	4,11,506	
	To Loan from Strong Ltd. (Payable) (Being interest expense recognised)		4,11,506
	At the end of Year 3		
31.3.2024	Interest expense (Finance cost) Dr.	4,44,670*	
	To Loan from Strong Ltd. (Payable) (Being interest expense recognised)		4,44,670
	On repayment of loan		
31.3.2024	Loan from Strong Ltd. (Payable) Dr.	60,00,000	
	To Bank A/c (Being loan repaid by Weak Ltd.)		60,00,000

*Difference is due to approximation.

Working Notes:

1. Present Value of Loan = ` 60,00,000 x 0.7938 = ` 47,62,800
2. Amortisation table for computation of interest:

Year end	Opening balance (1)	Interest @ 8% (2)	Repayment (3)	Closing balance (1) + (2) - (3)
1	47,62,800.00	3,81,024.00	-	51,43,824.00
2	51,43,824.00	4,11,506.00	-	55,55,330.00
3	55,55,330.00	4,44,670.00*	60,00,000.00	-

*Difference is due to approximation.

Question 53 Illustration

A Ltd has made a security deposit whose details are described below. Make necessary journal entries for accounting of the deposit in the first year and last year. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of Security Deposit (Starting Date)	1-Apr-20X1
Date of Security Deposit (Finishing Date)	31-Mar-20X6
Description	Lease
Total Lease Period	5 years
Discount rate	12.00%
Security deposit (A)	10,00,000
Present value factor at the 5 th year	0.567427

(Old & New SM) (MTP 5 Marks Oct '23)

Answer 53

The above security deposit is an interest free deposit redeemable at the end of lease term



for ₹10,00,000. Hence, this involves collection of contractual cash flows and shall be accounted at amortised cost.

Upon initial measurement –

Particulars	Details
Security deposit (A)	10,00,000
Total Lease Period (Years)	5
Discount rate	12.00%
Present value factor of 5 th year end	0.56743
Present value of deposit at beginning (B)	5,67,427
Prepaid lease payment at beginning (A-B)	4,32,573

Journal Entries

Year – 1 beginning

Particulars	Amount	Amount
Security deposit A/c Dr.	5,67,427	
Prepaid lease expenses Dr.	4,32,573	
To Bank A/c		10,00,000

Subsequently, every annual reporting year, interest income shall be accrued @ 12% per annum and prepaid expenses shall be amortised on straight line basis over the lease term.

Year 1 end

Particulars	Amount	Amount
Security deposit A/c (5,67,427 x 12%) Dr.	68,091	
To Interest income A/c		68,091
Depreciation (4,32,573 / 5 years) Dr.	86,515	
To Prepaid lease expenses		86,515

At the end of 5th year, the security deposit shall accrue ₹10,00,000 and prepaid lease expenses shall be fully amortised (i.e. depreciated as per Ind AS 116, this prepaid lease rent would be shown as ROU asset). Journal entry for realisation of security deposit –

Particulars	Amount	Amount
Security deposit A/c Dr.	1,07,143	
To Interest income A/c		1,07,143
Depreciation (4,32,573 / 5 years) Dr.	86,515	
To Prepaid lease expenses (ROU Asset)		86,515
Bank A/c Dr.	10,00,000	
To Security deposit A/c		10,00,000

Question 54

Company Z is engaged in the business of importing oil seeds for further processing as well as trading purposes. It enters into the following types of contracts as on 1 October 20X1:

Particulars	Contract 1	Contract 2	Contract 3
Nature of Contract	Import of oil seeds from a foreign supplier	Purchase of oil seeds from a domestic producer / supplier	Contract to sell oil seeds on the commodity exchange



Quantity and rate	100 MT at USD 400 per MT to be delivered as on 31 March 20X2	50 MT at `30,000 per MT to be delivered as on 31 January 20X2	50 MT at USD 450 per MT, maturing as on 15 January 20X2
Net settlement clause included in the contract	Yes	Yes	Yes
Net settlement in practice for similar contracts	There have also been several instances of the oil seeds being sold prior to or shortly after taking delivery. These instances of net settlement constitute approximately 30 per cent of the value of total import contracts.	Yes – company Z has net settled some of the domestic purchase contracts. However, these instances constitute only 1 per cent of the total domestic purchase contracts in value. The remaining contracts are settled by taking delivery of oil seeds which are used for further processing.	Yes – these contracts are required to be net settled with the exchange on the maturity date. Company Z enters into these types of derivative contracts to hedge the risks on its domestic oil seeds purchase contracts

Company Z is required to determine if the contracts entered into for purchase and sale of oil seeds are derivatives within the scope of Ind AS 109 or are executory contracts outside the scope of Ind AS 109. (Old & New SM) (MTP 8 Marks Sep '23)

Answer 54

Contract 1:

The following factors indicate that this contract does not meet the 'own use' exemption:

- The contract permits net settlement, and
- There is a past practice of a significant proportion (30 per cent in this illustration) of similar contracts being settled on a net basis either in cash or by sale of the oil seeds prior to delivery/shortly after taking delivery.

Therefore, this contract would fall within the scope of Ind AS 109 and should be recognised as a derivative instrument as on 1 October 20X1. The contract would be in the nature of a forward contract to buy 100 MT of oil seeds as on 31 March 20X2 at USD 400 per MT. Company Z would have to recognise the fair value changes (based on change in forward purchase rate) on this contract in the statement of profit and loss at each reporting date.

Contract 2

Contract 2 also permits net settlement in cash. Further, there have been some instances of similar domestic purchase contracts being settled net in cash in the past. However, these have been infrequent in nature and insignificant in proportion to the total value of similar contracts (i.e. 1 percent in this illustration).

Company Z is in the practice of taking delivery of the oil seeds purchased under similar contracts and using them for further processing in its plants.

This indicates that the domestic purchase contract meets the criteria for the 'own-use' exemption and should be considered as an executory contract.

Therefore, this contract would not fall within the scope of Ind AS 109.

Contract 3

This contract is in the nature of a derivative contract transacted on a commodity exchange and is required to be net settled in cash on maturity. Therefore, this derivative contract would be covered by Ind AS 109 and required to be classified and measured at FVTPL

Chapter 12

Business Combination and Corporate Restructuring

Question 1

In March 2018, Pharma Ltd. acquires Dorman Ltd. in a business combination for a total cost of Rs. 12,000 lakhs. At that time Dorman Ltd.'s assets and liabilities are as follows:

Item	Rs. in lakhs
Assets	
Cash	780
Receivables (net)	5,200
Plant and equipment	7,000
Deferred tax asset	360
Liabilities	
Payables	1,050
Borrowings	4,900
Employee entitlement liabilities	900
Deferred tax liability	300

The plant and equipment has a fair value of Rs. 8,000 lakhs and a tax written down value of Rs. 6,000 lakhs. The receivables are short-term trade receivables net of a doubtful debts allowance of Rs. 300 lakhs.

Bad debts are deductible for tax purposes when written off against the allowance account by Dorman Ltd. Employee benefit liabilities are deductible for tax when paid.

Dorman Ltd. owns a popular brand name that meets the recognition criteria for intangible assets under Ind AS 103 'Business Combinations'. Independent valuers have attributed a fair value of Rs. 4,300 lakhs for the brand. However, the brand does not have any cost for tax purposes and no tax deductions are available for the same.

The tax rate of 30% can be considered for all items. Assume that unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts at the acquisition date.

You are required to:

- (i) Calculate deferred tax assets and liabilities arising from the business combination (do not offset deferred tax assets and liabilities)
- (ii) Calculate the goodwill that should be accounted on consolidation. (MTP 10 Marks Aug' 18)

Answer 1

Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

Item	Rs. In lakhs				
	Book value	Fair value	Tax base	Taxable (deductible) temporary difference	Deferred tax asset (liability) @ 30%
Cash	780	780 ¹⁾	780 ¹⁾	-	-
Receivables	5,200	5,200 ¹⁾	5,500 ³⁾	(300)	90
Plant and equipment	7,000	8,000 ²⁾	6,000 ⁴⁾	2,000	(600)
Brands		4,300 ²⁾	- ⁵⁾	4,300	(1,290)
Goodwill (Balancing figure)		2,100 ⁹⁾			

Deferred tax asset	360	3,607)			
Total assets		20,740			
Payables	(1,050)	(1,050) ¹⁾	(1,050) ¹⁾		
Borrowings	(4,900)	(4,900) ¹⁾	(4,900) ¹⁾		
Employee Entitlement liabilities	(900)	(900) ¹⁾	-6)	(900)	270
Deferred tax liability	(300)	(1,890) ⁸⁾			
Total liabilities		(8,740)			
Consideration paid		12,000			

Notes

- (1) This amount has been derived from Dorman Ltd.'s Balance Sheet as it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in Dorman Ltd.'s Balance Sheet at the acquisition date'.
- (2) Stated fair value in the fact pattern (different to the carrying amount in Dorman Ltd.'s Balance Sheet at the acquisition date).
- (3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (Rs. 5,200 + Rs. 300) lakhs allowance account.
- (4) Tax written down value of the plant and equipment as stated in the fact pattern.
- (5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.
- (6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.
- (7) The aggregate deferred tax asset is Rs. 360 lakhs, comprised of Rs.90 lakhs in relation to the receivables and Rs.270 lakhs in relation to the employee entitlement liabilities.
- (8) The aggregate deferred tax liability is Rs. 1,890 lakhs calculated as follows:

Rs. In lakhs	DTL amount in Dorman Ltd.'s Balance Sheet	Deferred tax impact of fair value adjustments	Total DTL in Pharma Ltd's consolidated financial statements
Plant and equipment	300 $([7,000-6,000] \times 30\%)$	300 $([1,000 \times 30\%])$	600
Brand names	0	1,290 $(4,300 \times 30\%)$	1,290
TOTAL	300	1,590	1,890

- (9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements of Ind AS 103, para 32. The consideration transferred is Rs. 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is Rs. 9,900 lakhs.

Question 2

H Ltd. acquired equity shares of S Ltd., a listed company, in two tranches as mentioned in the below table:

Date	Equity stake purchased	Remarks
1 st November, 2016	15%	The shares were purchased based on



1 st January, 2017	45%	the quoted price on the stock exchange on the relevant dates.

Both the above-mentioned companies have INR as their functional currency. Consequently, H Ltd. acquired control over S Ltd. on 1st January, 2017. Following is the Balance Sheet of S Ltd. as on that date:

Particulars	Carrying value (Rs. in crore)	Fair value (Rs. in crore)
ASSETS:		
Non-current assets		
(a) Property, plant and equipment	40.0	90.0
(b) Intangible assets	20.0	30.0
(c) Financial assets	100.0	350.0
- Investments		
Current assets		
(a) Inventories	20.0	20.0
(b) Financial assets		
- Trade receivables	20.0	20.0
- Cash held in functional currency	4.0	4.5
(c) Other current assets		
Non-current asset held for sale	4.0	4.5
TOTAL ASSETS	208	
EQUITY AND LIABILITIES:		
Equity		
(a) Share capital (face value Rs.100)	12.0	50.4
(b) Other equity	141.0	Not applicable
Non-current liabilities		
(a) Financial liabilities		
- Borrowings	20.0	20.0
Current liabilities		
(a) Financial liabilities	28.0	28.0
- Trade payables	3.0	3.0
(b) Provision for warranties	4.0	4.0
(c) Current tax liabilities		
TOTAL EQUITY AND LIABILITIES	208.0	

Other information:

Property, plant and equipment in the above Balance Sheet include leasehold motor vehicles having carrying value of Rs. 1 crore and fair value of Rs. 1.2 crore. The date of inception of the lease was 1st April, 2010. On the inception of the lease, S Ltd. had correctly classified the lease as a finance lease. However, if facts and circumstances as on 1st April, 2017 are considered, the lease would be classified as an operating lease. Following is the statement of contingent liabilities of S Ltd. as on 1st January, 2017:

Particulars	Fair value (Rs. in crore)	Remarks
Law suit filed by a customer for a claim of Rs. 2 crore	0.5	It is not probable that an outflow of resources embodying economic benefits will be required to settle them claim. Any amount which would be paid in respect of



		law suit will be tax deductible.
Income tax demand of Rs. 7 crore raised by tax authorities; S Ltd. has challenged the demand in the court.	2.0	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim.

In relation to the above-mentioned contingent liabilities, S Ltd. has given an indemnification undertaking to H Ltd. up to a maximum of Rs. 1 crore.

Rs. 1 crore represents the acquisition date fair value of the indemnification undertaking.

Any amount which would be received in respect of the above undertaking shall not be taxable. The tax bases of the assets and liabilities of S Ltd. is equal to their respective carrying values being recognised in its Balance Sheet.

Carrying value of non-current asset held for sale of Rs. 4 crore represents its fair value less cost to sell in accordance with the relevant Ind AS.

In consideration of the additional stake purchased by H Ltd. on 1st January, 2017, it has issued to the selling shareholders of S Ltd. 1 equity share of H Ltd. for every 2 shares held in S Ltd. Fair value of equity shares of H Ltd. as on 1st January, 2017 is Rs. 10,000 per share.

On 1st January, 2017, H Ltd. has paid Rs. 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 2019, H Ltd. will pay Rs. 30 crore to the selling shareholders of S Ltd. if return on equity of S Ltd. for the year ended 31st March, 2019 is more than 25% per annum. H Ltd. has estimated the fair value of this obligation as on 1st January, 2017 and 31st March, 2017 as Rs. 22 crore and Rs. 23 crore respectively. The change in fair value of the obligation is attributable to the change in facts and circumstances after the acquisition date.

Quoted price of equity shares of S Ltd. as on various dates is as follows:

As on November, 2016 Rs. 350 per share

As on 1st January, 2017 Rs. 395 per share

As on 31st March, 2017 Rs. 420 per share

On 31st May, 2017, H Ltd. learned that certain customer relationships existing as on

1st January, 2017, which met the recognition criteria of an intangible asset as on that date, were not considered during the accounting of business combination for the year ended 31st March, 2017. The fair value of such customer relationships as on 1st January, 2017 was Rs. 3.5 crore (assume that there are no temporary differences associated with customer relations; consequently, there is no impact of income taxes on customer relations).

On 31st May, 2017 itself, H Ltd. further learned that due to additional customer relationships being developed during the period 1st January, 2017 to 31st March, 2017, the fair value of such customer relationships has increased to Rs. 4 crore as on 31st March, 2017.

On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and that more information is not obtainable.

H Ltd. and S Ltd. are not related parties and follow Ind AS for financial reporting. Income tax rate applicable is 30%.

You are required to provide your detailed responses to the following, along with reasoning and computation notes:

- What should be the goodwill or bargain purchase gain to be recognised by H Ltd. in its financial statements for the year ended 31st March, 2017. For this purpose, measure non- controlling

interest using proportionate share of the fair value of the identifiable net assets of S Ltd.

- (b) Will the amount of non-controlling interest, goodwill, or bargain purchase gain so recognised in (a) above change subsequent to 31st March, 2017? If yes, provide relevant journal entries.
- (c) What should be the accounting treatment of the contingent consideration as on 31st March, 2017? (MTP 20 Marks Mar '19, Old & New SM, RTP Nov'19)

Answer 2

- (i) As an only exception to the principle of classification or designation of assets as they exist at the acquisition date is that for lease contract and insurance contracts classification which will be based on the basis of the conditions existing at inception and not on acquisition date.

Therefore, H Ltd. would be required to retain the original lease classification of the lease arrangements and thereby recognise the lease arrangements as finance lease.

- (ii) The requirements in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', do not apply in determining which contingent liabilities to recognise as of the acquisition date as per Ind AS 103 'Business Combination'. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Hence H Ltd. will recognize contingent liability of Rs. 2.5 cr.

Since S Ltd. has indemnified for Rs. 1 cr., H Ltd. shall recognise an indemnification asset at the same time for Rs. 1 cr.

As per the information given in the question, this indemnified asset is not taxable. Hence, its tax base will be equal to its carrying amount. No deferred tax will arise on it.

- (iii) As per Ind AS 103, non-current assets held for sale should be measured at fair value less cost to sell in accordance with Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'. Therefore, its carrying value as per balance sheet has been considered in the calculation of net assets.
- (iv) Any equity interest in S Ltd. held by H Ltd. immediately before obtaining control over S Ltd. is adjusted to acquisition-date fair value. Any resulting gain or loss is recognised in the profit or loss of H Ltd.

- (i) Calculation of purchase consideration as per Ind AS 103 Rs. in lakh

Investment in S Ltd.			
On 1 st Nov. 2016	15%	$[(12/100) \times 395 \times 15\%]$	7.11
On 1 st Jan. 2017	45%		
Own equity given		$10,000 \times 12\% \times 45\% \times 1/2$	270
Cash			50
Contingent consideration			22
			349.11

- (ii) Calculation of defer tax on assets and liabilities acquired as part of the business combination, including current tax and goodwill.

Item	Rs. in crore				
	Book value	Fair value	Tax base	Taxable (deductible) temporary difference	Deferred tax assets (liability) @ 30%
Property, plant and equipment	40	90	40	50	(15)
Intangible assets	20	30	20	10	(3)
Investments	100	350	100	250	(75)
Inventories	20	20	20	-	-
Trade receivables	20	20	20	-	-
Cash held in functional currency	4	4	4	-	-
Non-current asset held for sale	4	4	4	-	-
Indemnified asset	-	1	1	-	-
Borrowings	20	20	20	-	-
Trade payables	28	28	28	-	-
Provision for warranties	3	3	3	-	-
Current tax liabilities	4	4	4	-	-
Contingent liability		0.5	-	(0.5)	0.15
Deferred tax Liability					(92.85)

- (iii) Calculation of identifiable net assets acquired

	Rs. in crore	Rs. in crore
Property, plant and equipment	90	
Intangible assets	30	
Investments	350	
Inventories	20	
Trade receivables	20	
Cash held in functional currency	4	
Non-current asset held for sale	4	
Indemnified asset	1	
Total asset		519
Less: Borrowings	20	
Trade payables	28	
Provision for warranties	3	
Current tax liabilities	4	
Contingent liability (2 + 0.5)	2.50	
Deferred tax liability (W.N.2)	92.85	(150.35)
Net identifiable assets		368.65

- (a) Calculation of NCI by proportionate share of net assets

Net identifiable assets of S Ltd. on 1.1.2017 (Refer W.N.3) = 372.85 crore NCI

on 1.1.2017 = 368.65 crore x 40% = 147.46 crore

Calculation of Goodwill as per Ind AS 103

Goodwill on 1.1.2017 = Purchase consideration + NCI – Net assets

$$= 349.11 + 147.46 - 368.65$$

$$= 127.92 \text{ crore}$$

- (b) As per para 45 of Ind AS 103 'Business Combination', if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date.

During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date.

The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

Further, as per para 46 of Ind AS 103, the measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Ind AS:

- (a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;
- (b)
- (c); and
- (d) the resulting goodwill or gain on a bargain purchase.

Para 48 states that the acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill.

Para 49 states that during the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date.

Para 50 states that after the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and the more information is not obtainable. Therefore, the measurement period for acquisition of S Ltd. ends on 31st December, 2017.

On 31st May, 2017 (ie within the measurement period), H Ltd. learned that certain customer



relationships existing as on 1st January, 2017 which met the recognition criteria of an intangible asset as on that date were not considered during the accounting of business combination for the year ended 31st March, 2017. Therefore, H Ltd. shall account for the acquisition date fair value of customer relations existing on 1st January, 2017 as an identifiable intangible asset. The corresponding adjustment shall be made in the amount of goodwill.

Accordingly, the amount of goodwill will be changed due to identification of new asset from retrospective date for changes in fair value of assets and liabilities earlier recognised on provisional amount (subject to meeting the condition above for measurement period). NCI changes would impact the consolidated retained earnings (parent's share). Also NCI will be increased or decreased based on the profit during the post-acquisition period.

Journal entry

Customer relationship..... Dr.	3.5 crore	
To NCI		1.4 crore
To Goodwill	2.1 crore	

However, the increase in the value of customer relations after the acquisition date shall not be accounted by H Ltd., as the customer relations developed after 1st January, 2017 represents internally generated intangible assets which are not eligible for recognition on the balance sheet.

- (c) Since the contingent considerations payable by H Ltd is not classified as equity and is within the scope of Ind AS 109 'Financial Instruments', the changes in the fair value shall be recognised in profit or loss. Change in Fair value of contingent consideration (23 -22) Rs. 1 crore will be recognized in the Statement of Profit and Loss.

Question 3

- (a) How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:

- i) On 1 April 2016, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:
- an immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;
 - a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds INR 1 crore.

The fair value of the shares of A Ltd. on the date of acquisition is INR 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is Rs. 25 lakhs.

During the year ended 31 March 2017, the profit before interest and tax of B Ltd. exceeded Rs. 1 crore. As on 31 March 2017, the fair value of shares of A Ltd. is Rs. 25 per share.

- ii) Continuing with the fact pattern in (a) above except for:
- The number of shares to be issued after one year is not fixed.
 - Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to Rs. 40 lakhs after one year, if the profit before interest and tax for the first year following



acquisition exceeds Rs. 1 crore. A Ltd. issued shares with Rs. 40 lakhs after an year.(MTP 12 Marks Oct '19 , April '18, RTP May '19, RTP Nov'22, Old & New SM)

Answer 3

- (a) Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of (a) the acquisition-date fair values of the assets transferred by the acquirer,
- (b) the liabilities incurred by the acquirer to former owners of the acquiree and
- (c) the equity interests issued by the acquirer.

Further, paragraph 39 of Ind AS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, Financial Instruments: Presentation. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

- i) In the given case the amount of purchase consideration to be recognised on initial recognition shall be as follows:

Fair value of shares issued (10,00,000 x Rs. 20)	Rs. 2,00,00,000
Fair value of contingent consideration	Rs. 25,00,000
Total purchase consideration	Rs. 2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

- There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).
- If the instrument will or may be settled in the issuer's own equity instruments, then it is:
 - a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or
 - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

Here, the obligation to pay contingent consideration amounting to Rs. 25,00,000 is recognized as a part of equity and therefore not re-measured subsequently or on issuance of shares.

- ii) The amount of purchase consideration to be recognised on initial recognition is shall be as follows:

Fair value shares issued (10,00,000 x Rs. 20)	Rs. 2,00,00,000
Fair value of contingent consideration	Rs. 25,00,000
Total purchase consideration	Rs. 2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognised in profit or loss.

As at 31 March 2017, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of Rs. 15,00,000 (Rs. 40,00,000 - Rs. 25,00,000) should be recognised in the profit or loss for the period. A Ltd. would recognise issuance of 160,000 (Rs. 40,00,000/ 25) shares at a premium of Rs. 15 per share.

Question 4

On September 30, 20X1, Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B. The fair value of each ordinary share of Entity B at September 30, 20X1 is ₹ 40. The quoted market price of Entity A's ordinary shares at that date is ₹ 16.

The fair values of Entity A's identifiable assets and liabilities at September 30, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non-current assets at September 30, 20X1 is 1,500.

The draft statements of financial position of Entity A and Entity B immediately before the business combination are:

	Entity A (legal parent, accounting acquiree)	Entity B (legal subsidiary, accounting acquirer)
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		
Retained earnings	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		600
Total shareholders' equity	1,100	2,000
Total liabilities and shareholders' equity	1,800	3,700

Entity B's earnings for the annual period ended December 31, 20X0 were 600 and that the consolidated earnings for the annual period ended December 31, 20X1 were 800. Also there was no change in the number of ordinary shares issued by Entity B during the annual period ended December 31, 20X0 and during the period from January 1, 20 X1 to the date of the reverse acquisition on September 30, 20X1.

Required:

Calculate the fair value of the consideration transferred, measure goodwill and prepare the consolidated balance sheet as on September 30, 20X1 as per Ind AS. Also compute Earnings per share as on December 31, 20X1. (MTP 12 Marks Mar '18, Old & New SM)

Answer 4
Identifying the acquirer

As a result of Entity A issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A's shareholders. Thus, the transaction is determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer while Entity A is the legal acquirer.

Calculating the fair value of the consideration transferred

If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B — 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is 1,600 (40 shares with a fair value per share of 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. Here, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares — 100 shares with a fair value per share of 16.

Measuring goodwill

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

Consideration effectively transferred		1,600
Net recognized values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated statement of financial position at September 30, 20X1

The consolidated statement of financial position immediately after the business combination is:

Current assets [700 + 500]	Total assets	1,200
Non-current assets [3,000 + 1,500]		4,500
Goodwill		300
		6,000
Current liabilities [600 + 300]	Total liabilities	900
Non-current liabilities [1,100 + 400]		1,500
Shareholders' equity		2,400
Issued equity 250 ordinary shares [600 + 1,600]		2,200
Retained earnings		1,400
Total shareholders' equity		3,600

Total liabilities and shareholders' equity	6,000

The amount recognised as issued equity interests in the consolidated financial statements (2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share

Earnings per share for the annual period ended December 31, 20X1 is calculated as follows:

Number of shares deemed to be outstanding for the period from January 1, 20X1 to the acquisition date (i.e., the number of ordinary shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to December 31, 20X1	250
Weighted average number of ordinary shares outstanding $[(150 \times 9/12) + (250 \times 3/12)]$	175
Earnings per share $[800 / 175]$	4.57

Restated earnings per share for the annual period ended December 31, 20X0 is 4.00 [calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)].

Question 5

X Ltd. and Y Ltd. amalgamated on and from 1st April, 2017. A new company XY Ltd. with shares of Rs. 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31st March, 2018

INR in '000

ASSETS	Note No.	X Ltd	Y Ltd
Non-current assets			
Property, Plant and Equipment		8,500	7,500
Financial assets			
Investment		1,050	550
Current assets			
Inventories		1,250	2,750
Trade receivables		1,800	4,000
Cash and Cash equivalents		450	400
		13,050	15,200
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of INR 10 each)		6,000	7,000
Other equity	1	3,050	2,700
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings (12% Debentures)		3,000	4,000

Current liabilities			
Trade payables		1,000	1,500
		13,050	15,200

Notes to Accounts:

1. Other equity	X Ltd	Y Ltd
General Reserve	1,500	2,000
Profit & Loss	1,000	500
Investment Allowance Reserve	500	100
Export Profit Reserve	50	100
	3,050	2,700

XY Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also the new debentures were issued in exchange of the old series of both the companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of XY Ltd:

- (i) Assuming that both the entities are under common control
- (ii) Assuming Y Ltd is a larger entity and their management will take the control of the entity XY Ltd. The fair value of net assets of X and Y limited are as follows:

Assets	X Ltd. ('000)	Y Ltd. ('000)
Property, Plant and Equipment	9,500	1,000
Inventories	1,300	2,900
Fair value of the business	11,000	14,000

(MTP 20 Marks Oct '18, Old & New SM)

Answer 5

- i) (Assumption: Common control transaction)

1. Calculation of Purchase Consideration

		X Ltd.		Y Ltd.
		Rs. '000		Rs. '000
Assets taken over:				
Property, Plant and Equipment		85,00		75,00
Investment		10,50		5,50
Inventory		12,50		27,50
Trade receivables				
Cash & Cash equivalent		18,00		40,00
Gross Assets		4,50		4,00
Less: Liabilities		130,50		152,00
12% Debentures				
Trade payables	30,00		40,00	
Net Assets taken over				
Less: Reserves and Surplus:	10,00	(40,00)	15,00	(55,00)
		90,50		97,00



General Reserve P & L A/c	15,00		20,00	
Investment Allowance Reserve	10,00		5,00	
Export Profit Reserve	5,00		1,00	
Purchase Consideration	50	(30,50)	1,00	(27,00)
		60,00		70,00

Total Purchase Consideration = 130,00 (60,00 of AX Ltd. & 70,00 of BX Ltd.)

2. Discharge of Purchase Consideration

No. of shares to be issued to X Ltd =

$$\frac{\text{Net Assets taken over of X Ltd.}}{\text{Net Assets taken over of X Ltd. and Y Ltd.}} \times \text{Purchase Consideration}$$

No. of shares to be issued to Y Ltd =

$$\frac{\text{Net Assets taken over of Y Ltd.}}{\text{Net Assets taken over of X Ltd. and Y Ltd.}} \times \text{Purchase Consideration}$$

	X Ltd.	Y Ltd.
	Rs. '000	Rs. '000
$130,00 \times \frac{90.50}{187.50} = 6,27,500^*$ Equity shares of Rs. 10 each	62,75	
$130,00 \times 97,00 / 187,50 = 6,27,500$ Equity shares of Rs. 10 each		67,25

3. Balance Sheet of XY Ltd. as on 1st April, 2018

INR in '000

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		16,000
Financial assets		
Investment		1,600
Current assets		
Inventories		4,000
Trade receivables		5,800
Cash and Cash equivalents		850
		28,250
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of INR 10 each)	1	13,000
Other equity	2	5,750
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings	3	7,000



Current liabilities			
Trade payables			2,500
			28,250

Notes to Accounts

		(Rs. 000)	(Rs. 000)
1. Share Capital			
	13,00,000 Equity Shares of Rs. 10 each		130,00
2. Reserves and surplus			
	General Reserve (15,00 + 20,00)	35,00	
	Profit & Loss (10,00 + 5,00)	15,00	
	Investment Allowance Reserve (5,00 + 1,00)	6,00	
	Export Profit Reserve (50 + 1,00)	1,50	57,50
3. Long Term Borrowings			
	12% Debentures		70,00

ii) Assuming Y Ltd is a larger entity and their management will take the control of the entity XY Ltd.

In this case Y Ltd. and X Ltd. are not under common control and hence accounting prescribed under Ind AS 103 for business combination will be applied. A question arises here is who is the accounting acquirer XY Ltd which is issuing the shares or X Ltd. or Y Ltd. As per the accounting guidance provided in Ind AS 103, sometimes the legal acquirer may not be the accounting acquirer. In the given scenario although XY Ltd. is issuing the shares but Y Ltd. post-merger will have control and is bigger in size which is a clear indicator that Y Ltd. will be an accounting acquirer. This can be justified by the following table:(In '000s)

	X Ltd.	Y Ltd.
Fair Value	11,000	14,000
Value per share	10	10
No. of shares	1,100	1,400
i.e. Total No. of shares in XY Ltd. = 2,500 thousand shares		
Thus, % Held by each Company in Combined Entity	44%	56%

Note: It is a case of Reverse Acquisition.

Accordingly, Y Ltd.'s assets will be recorded at historical cost in the merged financial statements.

(1) Calculation and discharge of Purchase Consideration (All figures are in thousands)

We need to calculate the number of shares to be issued by Y Ltd. to X Ltd. to maintain the same percentage i.e. 56%:

Thus, 700 thousand shares of Y Ltd. (given in the balance sheet) represents 56%. This means that total no. of shares would be 1,250 thousand shares ie 700 thousand shares / 56%.

This implies Y Ltd. would need to issue 550 thousand shares (1,250 - 700) to X Ltd.

Purchase Consideration = 550 thousand shares x Rs. 20 per share (ie. 14,000 thousand / 700 thousand shares) = Rs. 11,000 thousand.

(2) Balance Sheet of XY Ltd. as on 1st April, 2018

INR in '000		
ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment (9500+7500)		17,000

Goodwill (Refer Working Note)			900
Financial assets			
Investment (1050+550)			1,600
Current assets			
Inventories (1300+2750)			4,050
Trade receivables (1800+4000)			5,800
Cash and Cash equivalents (450+400)			850
			30,200
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of INR 10 each)	1		12,500
Other equity	2		8,200
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings (12% Debentures)		3	7,000
Current liabilities			
Trade payables			2,500
			30,200

Notes to Accounts

		(Rs. 000)	(Rs. 000)
1. Share Capital			
	1,250,000 Equity Shares of Rs. 10 each (700,000 to BX Ltd and 550,000 as computed above to AX LTD)		1,25,00
2. Reserves and Surplus			
	General reserve of BX Ltd	20,00	
	P&L of BX Ltd	5,00	
	Export Profit Reserve of BX Ltd	1,00	
	Investment Allowance Reserve of BX Ltd	1,00	
	Security Premium (550 shares x Rs. 10)	5,500	8,200
3. Long Term Borrowings			
	12% Debentures (Assumed that new debentures were issued in exchange of the old series)		70,00

Working Note: Computation of Goodwill:

Assets:	Rs. in 000s
Property, Plant and Equipment	9,500
Investment	1,050
Inventories	1,300
Trade Receivables	1,800
Cash & Cash Equivalents	450
Total Assets	14,100
Less : Liabilities:	
Borrowings	3,000
Trade Payables	1,000
Net Assets	10,100
Purchase Consideration	11,000
Goodwill	900

Question 6

On 1st April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of Rs. 25 Cr. It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in B Ltd. at 1st April 20X1 can be used for this purpose. On 1st April 20X1, the market value of a B Ltd. share was Rs. 2.00 On 1st April 20X1, the individual financial statements of B Ltd. showed the net assets at Rs. 23 Cr.

The directors of A Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of B Ltd. at 1st April 20X1. The following matters emerged:

- Property having a carrying value of Rs. 15 Cr at 1st April 20X1 had an estimated market value of Rs. 18 Cr at that date.
- Plant and equipment having a carrying value of Rs. 11 Cr at 1st April 20X1 had an estimated market value of Rs. 13 Cr at that date.
- Inventory in the books of B Ltd. is shown at a cost of Rs. 2.50 Cr. The fair value of the inventory on the acquisition date is Rs. 3 Cr.

The fair value adjustments have not been reflected in the individual financial statements of B Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Calculate the deferred tax impact on above and calculate the goodwill arising on acquisition of B Ltd. (MTP 6 Marks Oct 21)

Answer 6

Purchase Consideration:	Rs. 25 Cr
Non-Controlling Interest $\{[(12 \text{ Cr} \times (20\% / 80\%))] \times \text{Rs. 2 per share}\}$	Rs. 6 Cr
Computation of Net Assets of B Ltd.	
As per books	Rs. 23.00 Cr
<i>Add:</i> Fair value differences not recognized in books of B Ltd.:	
Property (18 Cr – 15 Cr)	Rs. 3.00 Cr
Plant and Equipment (13 Cr – 11 Cr)	Rs. 2.00 Cr
Inventory (3 Cr – 2.5 Cr)	Rs. 0.50 Cr
	Rs. 28.5 Cr
<i>Less:</i> Deferred tax liability on fair value difference @ 20%	
$[(3 \text{ Cr} + 2 \text{ Cr} + 0.50 \text{ Cr}) \times 20\%]$	(Rs. 1.10 Cr)
Total Net Assets at Fair Value	Rs. 27.40 Cr
Computation of Goodwill:	
Purchase Consideration	Rs. 25.00 Cr
<i>Add:</i> Non-Controlling Interest	Rs. 6.00 Cr
	Rs. 31.00 Cr
<i>Less:</i> Net Assets at Fair Value	(Rs. 27.40 Cr)
Goodwill on acquisition date	Rs. 3.60 Cr

Question 7

Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.

On 31st March, 20X2, the division-wise draft extract of the Balance Sheet was: (Rs. in crores)

	Laptops	Mobiles	Total
Property, Plant and Equipment cost	250	500	750
Depreciation	(225)	(400)	(625)
Net Property, Plant and Equipment (A)	25	100	125
Current assets:	200	500	700
Less: Current liabilities	(25)	(400)	(425)
(B)	175	100	275
Total (A+B)	200	200	400
Financed by:			
Loan funds	-	300	300
Capital : Equity Rs. 10 each	25	-	25
Surplus	175	(100)	75
	200	200	400

Division Mobiles along with its assets and liabilities was sold for Rs. 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Enterprise Ltd. was holding 52% shareholding of the Company.

Assuming that there are no other transactions, you are asked to:

- Pass journal entries in the books of Enterprise Ltd.
- Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).
- Prepare the Balance Sheet of Turnaround Ltd. (MTP 10 Marks March '21) (Same amount different figures- PYP 10 Marks May'18, Old & New SM)

Answer 7

Journal of Enterprise Ltd. (Rs. in crores)

		Dr.	Cr.
(1)	Loan Funds	Dr. 300	
	Current Liabilities	Dr. 400	
	Provision for Depreciation	Dr. 400	
	To Property, Plant and Equipment		500
	To Current Assets		500
	To Capital Reserve		100
	(Being division Mobiles along with its assets and liabilities sold to Turnaround Ltd. for Rs. 25 crores)		

Notes :

- Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.
- In the given scenario, this demerger will meet the definition of common control transaction. Accordingly, the transfer of assets and liabilities will be derecognized and recognized as per book value and the resultant loss or gain will be recorded as capital reserve in the books of demerged entity (Enterprise Ltd).

Enterprise Ltd.
Balance Sheet after reconstruction **(Rs. R in crores)**

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		25
Current assets		
Other current assets		200
		225
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of Rs. 10 each)		25
Other equity (Surplus)		175
Liabilities		
Current liabilities		
Current liabilities		25
		225

Notes to Accounts

	(Rs. in crores)
1. Other Equity	
Surplus (175-100)	75
Add: Capital Reserve on reconstruction	100
	175

Notes to Accounts: Consequent on transfer of Division Mobiles to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Turnaround Ltd. (Rs. in crores)

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		100
Current assets		
Other current assets		500
		600
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of Rs. 10 each)	1	10
Other equity	2	(110)
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		300
Current liabilities		



Current liabilities		400
		600

Notes to Accounts

		(Rs. in crores)
1. Share Capital:		
Issued and Paid-up capital		
1 crore Equity shares of Rs. 10 each fully paid up		10
(All the above shares have been issued for consideration other than cash, to the members of Enterprise Ltd. on takeover of Division		
Mobiles from Enterprise Ltd.)		
2. Other Equity:		
Securities Premium		15
Capital reserve [25- (600 – 700)]		(125)
		(110)

Working Note:

In the given case, since both the entities are under common control, this will be accounted as follows:

- All assets and liabilities will be recorded at book value
- Identity of reserves to be maintained.
- No goodwill will be recorded.
- Securities issued will be recorded as per the nominal value.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees were not able to give correctly the Notes to Accounts as regard 'Share Capital' and 'Other Equity'.

Question 8

Company X is engaged in the business of exploration & development of Oil & Gas Blocks. It currently holds participating interest (PI) along with other companies in below mentioned producing Block as follows:

Block Name	Company X	Company Y	Company Z	Total
AWM/01	30%	60%	10%	100%

For the above Block, Company X, Y & Z has entered into unincorporated Joint Venture.

Company Y is the Operator of the Block AWM/01. Company X and Company Z are the Joint Operators. Company Y incurs all the expenditure on behalf of Joint Venture and raise cash call to Company X and Company Z at each month end in respect of their share of expenditure incurred in Joint Venture. All the manpower and requisite facilities / machineries owned by the Joint venture and thereby owned by all the Joint Operators.

For past few months, due to liquidity issues, Company Z defaulted in payment of cash calls to operators. Therefore, company Y (Operator) has issued notice to company Z for withdrawal of their participating right from on 1.4.20X1. However, company Z has filed the appeal with arbitrator on 30.4.20X1.

Financial performance of company Z has not been improved in subsequent months and therefore company Z has decided to withdraw participating interest rights from Block AWM/01 and entered into sale agreement with Company X and Company Y. As per the terms of the agreement, dated 31.5.20X1, Company X will receive 33.33% share & Company Y will receive 66.67% share of PI rights owned by Company Z.

Company X is required to pay ₹ 1,00,000 against 33.33% share of PI rights owned by Company Z.

After signing of sale agreement, Operator (company Y) approach Government of India for modification in PSC (Production Sharing Contract) i.e. removal of Company Z from PSC of AWM/01 and government has approved this transaction on 30.6.20X1. Government approval for the modification in PSC is essential for the given industry in which the joint-operators operate.

Balance Sheet of Company X and Company Z

Particulars	Company X		Company Z	
	31.5.20X1	30.6.20X1	31.5.20X1	30.6.20X1
	₹	₹	₹	₹
Assets				
Non-Current Assets				
Property, Plant & Equipment	5,00,000	10,00,000	1,50,000	3,00,000
Right of Use Asset	1,00,000	2,00,000	10,000	20,000
Development CWIP	50,000	1,00,000	50,000	1,00,000
Financial Assets				
Loan receivable	25,000	50,000	25,000	50,000
Total Non-Current Assets	6,75,000	13,50,000	2,35,000	4,70,000
Current assets				
Inventories	1,00,000	2,00,000	15,000	30,000
Financial Assets				
Trade receivables	1,50,000	3,00,000	50,000	1,00,000
Cash and cash equivalents	2,00,000	4,00,000	1,00,000	2,00,000
Other Current Assets	2,25,000	50,000	25,000	50,000
Total Current Assets	6,75,000	9,50,000	1,90,000	3,80,000
Total Assets	13,50,000	23,00,000	4,25,000	8,50,000
Equity and Liabilities				
Equity				
Equity share capital	3,00,000	3,00,000	1,00,000	1,00,000
Other equity	2,00,000	3,00,000	75,000	2,50,000
Total Equity	5,00,000	6,00,000	1,75,000	3,50,000
Liabilities				
Non-Current Liabilities				
Provisions	4,00,000	8,00,000	1,00,000	2,00,000
Other Liabilities	1,50,000	3,00,000	50,000	1,00,000
Total Non-Current Liabilities	5,50,000	11,00,000	1,50,000	3,00,000
Current Liabilities				
Financial Liabilities				
Trade Payables	3,00,000	6,00,000	1,00,000	2,00,000
Total Current Liabilities	3,00,000	6,00,000	1,00,000	2,00,000
Total Liabilities	13,50,000	23,00,000	4,25,000	8,50,000

Additional Information:

1. Fair value of PPE & Development CWIP owned by Company Z as per market participant approach is ₹ 5,00,000 & ₹ 2,00,000 respectively.
2. Fair value of all the other assets and liabilities acquired are assumed to be at their carrying values (except cash & cash equivalent). Cash and cash equivalents of Company Z are not to be acquired by

Company X as per the terms of agreement.

3. Tax rate is assumed to be 30%.
4. As per Ind AS 28, all the joint operators are joint venturers whereby each parties that have joint control of the arrangement have rights to the net assets of the arrangement and therefore every operator records their share of assets and liabilities in their books.

You need to determine the following:

1. Whether the above acquisition falls under business or asset acquisition as defined under business combination standard Ind AS 103?
2. Determine the acquisition date in the above transaction?
3. Prepare Journal entries for the above-mentioned transaction?
4. Draft the Balance Sheet for Company X based on your analysis in Part 1 above as at acquisition date.
5. Is this a case of step acquisition? Explain. (MTP 20 Mark Sep'22, RTP Nov'21, Old & New SM)

Answer 8

1. Ind AS 103 defines business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

For a transaction to meet the definition of a business combination (and for the acquisition method of accounting to apply), the entity must gain control of business that is more than a collection of assets or a combination of assets and liabilities.

To be capable of being conducted and managed for the purpose identified in the definition of a business, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs.

Therefore, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.

In the aforesaid transaction, Company X acquired share of participating rights owned by Company Z for the producing Block (AWM/01). The output exist in this transaction (Considering AWM/01) is a producing block. Also all the manpower and requisite facilities / machineries are owned by Joint venture and thereby all the Joint Operators. Hence, acquiring participating rights tantamount to acquire inputs (Expertise Manpower & Machinery) and it is critical to the ability to continue producing outputs. Thus, the said acquisition will fall under 'Business Acquisition' and hence standard Ind AS 103 is to be applied for the same.

2. As per paragraph 8 of Ind AS 103, acquisition date is the date on which the acquirer obtains control of the acquiree. Further, paragraph 9 of Ind AS 103 clarifies that the date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree —the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date

An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date. Since Government of India (GOI) approval is a substantive approval for Company X to acquire control of Company Z's operations, the date of acquisition cannot be earlier than the date on which approval is obtained from GOI. This is pertinent given that the approval from GOI is considered to be a substantive process and accordingly, the acquisition is considered to be completed only on receipt of such approval. Hence, acquisition date in the above scenario is 30.6.20X1.

3. Journal entry for acquisition

Particulars		Amount (₹)	Amount (₹)
Property Plant & Equipment (W.N.1)	Dr.	1,66,650	



Right-of-use Asset	Dr.	6,666	
Development CWIP (W.N.2)	Dr.	66,660	
Financial Assets - Loan Receivables	Dr.	16,665	
Inventories	Dr.	9,999	
Trade Receivables	Dr.	33,330	
Other Current Assets	Dr.	16,665	
To Provisions			66,660
To Other Liabilities			33,330
To Trade Payables			66,660
To Deferred Tax Liability (W.N.4)			29,997
To Cash & Cash Equivalent (purchase consideration)			1,00,000
To Gain on bargain purchase (Other Comprehensive Income) (W.N.3) (Bal. fig.)			19,988
(Being assets acquired and liabilities assumed from Company Z recorded at fair value along gain on bargain purchase)			

4. Balance Sheet of Company X as at 30.6.20X1 (Pre & Post Acquisition of PI rights pertaining to Company Z)

Particulars	Pre-Acquisition	Adjustments	Post-Acquisition
	30.6.20X1	33.33% Share	30.6.20X1
Assets			
Non-Current Assets			
Property Plant & Equipment	10,00,000	1,66,650	11,66,650
Right of Use Asset	2,00,000	6,666	2,06,666
Development CWIP	1,00,000	66,660	1,66,660
Financial Assets			
Loan receivable	50,000	16,665	66,665
Total Non-Current Assets	13,50,000	2,56,641	16,06,641
Current assets			
Inventories	2,00,000	9,999	2,09,999
Financial Assets			
Trade receivables	3,00,000	33,330	3,33,330
Cash and cash equivalents	4,00,000	(1,00,000)	3,00,000
Other Current Assets	50,000	16,665	66,665
Total Current Assets	9,50,000	(40,006)	9,09,994
Total Assets	23,00,000	2,16,635	25,16,635
Equity and Liabilities			
Equity			
Equity share capital	3,00,000		3,00,000
Other equity	3,00,000		3,00,000
Capital Reserve (OCI)		19,988	19,988
Total Equity	6,00,000	19,988	6,19,988
Liabilities			
Non-Current Liabilities			
Provisions	8,00,000	66,660	8,66,660
Other Liabilities	3,00,000	33,330	3,33,330
Deferred Tax Liability		29,997	29,997

Total Non-Current Liabilities	11,00,000	1,29,987	12,29,987
Current Liabilities			
Financial liabilities			
Trade Payables	6,00,000	66,660	6,66,660
Total Current Liabilities	6,00,000	66,660	6,66,660
Total Equity and Liabilities	23,00,000	2,16,635	25,16,635

5. As per Ind AS 103, in case an entity acquires another entity step by step through series of purchase then the acquisition date will be the date on which the acquirer obtains control. Till the time the control is obtained the investment will be accounted as per the requirements of other Ind AS 109, if the investments are covered under that standard or as per Ind AS 28, if the investments are in Associates or Joint Ventures.

If a business combination is achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

Since in the above transaction, company X does not hold any prior interest in Company Z and company holds only 30% PI rights in Block AWM/01 through unincorporated joint venture, this is not a case of step acquisition.

Working Notes:

1. Fair Value of Property, plant and equipment

Fair Value of PPE in Company Z Books	₹ 5,00,000
33.33% Share acquired by Company X	₹ 1,66,650

2. Fair Value of Development CWIP:

Fair Value of PPE in Company Z Books	₹ 2,00,000
33.33% Share acquired by Company X	₹ 66,660

3. Computation Goodwill/Bargain Purchase Gain

Particulars	As at 30.6.20X1 (₹)
Total Non - Current Assets	2,56,641
Total Current Assets (Except Cash & Cash Equivalent of ₹ 66,660) (1,26,654 – 66,660)	59,994
Total Non-Current Liabilities	(99,990)
Total Current Liabilities	(66,660)
Total Deferred Tax Liability (Refer Working note 3)	(29,997)
Net Assets acquired	1,19,988
Less: Consideration Paid	(1,00,000)
Gain on Bargain Purchase* (To be transferred to OCI)	19,988

*In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the value of net assets acquired in a business combination exceeds the purchase consideration. The acquirer shall recognise the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve, if the reason for bargain purchase gain is clear and evidence exist. If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognised directly in equity as capital reserve. Since in above scenario it is clearly evident that due to liquidity issues, Company Z has to withdraw their participating right from AWM/01. The

said bargain purchase gain should be transferred to other comprehensive income on the acquisition date.

4. Computation of Deferred Tax Liability arising on Business Combination

Particulars	Acquisition Date Value (₹)
Total Non - Current Assets	2,56,641
Total Current Assets (Except Cash & Cash Equivalent of ₹ 66,660)	59,994
Total Non-Current Liabilities	(99,990)
Total Current Liabilities	(66,660)
Net Assets Acquired at Fair Value	1,49,985
Book value of Net Assets Acquired	49,995
Temporary Difference	99,990
DTL @ 30% on Temporary Difference	29,997

Question 9

The Balance Sheet of David Ltd. and Parker Ltd. as of 31st March, 20X1 is given below:

(Rs. in lakh)		
Assets	David Ltd.	Parker Ltd.
Non-current assets:		
Property, plant and equipment	400	600
Investment	300	200
Current assets:		
Inventories	300	100
Financial assets		
Trade receivables	400	200
Cash and cash equivalents	150	200
Others	300	300
Total	1,850	1,600
Equity and Liabilities		
Equity		
Share capital - Equity shares of Rs. 100 each for Parker Ltd. & Rs. 10 each for David Limited	500	400
Other Equity	700	275
Non-current liabilities:		
Long term borrowings	200	300
Long term provisions	100	80
Deferred tax	20	55
Current liabilities:		
Short term borrowings	130	170
Trade payables	200	320
Total	1,850	1,600

Other Information:

- (i) David Ltd. acquired 70% shares of Parker Ltd. on 1st April, 20X1 by issuing its own shares in the ratio of 1 share of David Ltd. for every 2 shares of Parker Ltd. The fair value of the shares of David Ltd. was Rs. 50 per share.
- (ii) The fair value exercise resulted in the following :
- (1) Fair value of property, plant and equipment (PPE) on 1st April, 20X1 was Rs. 450 lakh.
 - (2) David Ltd. agreed to pay an additional payment as consideration that is higher of Rs. 30 lakh and 25% of any excess profits in the first year after acquisition, over its profits in the preceding 12 months made by Parker Ltd. This additional amount will be due after 3 years. Parker Ltd. has earned Rs. 20 lakh profit in the preceding year and expects to earn another Rs. 10 lakh.
 - (3) In addition to above, David Ltd. also has agreed to pay one of the founder shareholder-Director a payment of Rs. 25 lakh provided he stays with the Company for two years after the acquisition.
 - (4) Parker Ltd. had certain equity settled share-based payment award (original award) which got replaced by the new awards issued by David Ltd. As per the original term, the vesting period was 4 years and as of the acquisition date the employees of Parker Ltd. have already served 2 years of service. As per the replaced awards, the vesting period has been reduced to one year (one year from the acquisition date). The fair value of the award on the acquisition date was as follows:
 Original award - Rs. 6 lakh Replacement award - Rs. 9 lakh
 - (5) Parker Ltd. had a lawsuit pending with a customer who had made a claim of Rs. 35 lakh. Management reliably estimated the fair value of the liability to be Rs. 10 lakhs.
 - (6) The applicable tax rate for both entities is 40%.

You are required to prepare opening consolidated balance sheet of David Ltd. as on 1 st April, 20X1 along with workings. Assume discount rate of 8%. (MTP 16 Marks April '21)(Similar concepts but different figures 20 Marks Apr'19) (PYP 16 Marks Nov 19)(Old & New SM)

Answer 9

Consolidated Balance Sheet of David Ltd as on 1st April, 20X1(Rs. in lakh)

		Amount
Assets		
Non-current assets:		
Property, plant and equipment		850.00
Investment		500.00
Current assets:		
Inventories		400.00
Financial assets:		
Trade receivables		600.00
Cash and cash equivalents		350.00
Others		600.00
Total		3,300.00
Equity and Liabilities		
Equity		
Share capital - Equity shares of Rs. 100 each		514.00
Other Equity		1,067.49

Non-Controlling Interest		173.70
Non-current liabilities:		
Financial liabilities:		
Long term borrowings		500.00
Long term provisions (100+80+23.81)		203.81
Deferred tax		11.00
Current liabilities:		
Financial liabilities:		
Short term borrowings		300.00
Trade payables		520.00
Provision for law suit damages		10.00
	Total	3,300.00

Working Notes:

- Fair value adjustment- As per Ind AS 103, the acquirer is required to record the assets and liabilities at their respective fair value. Accordingly, the PPE will be recorded at Rs. 450 lakh.
- The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, Rs. 3 lakh (6 x 2/4) is considered as a part of purchase consideration and is credited to David Ltd equity as this will be settled in its own equity. The balance of Rs. 3 lakh will be recorded as employee expense in the books of Parker Ltd over the remaining life, which is 1 year in this scenario.
- There is a difference between contingent consideration and deferred consideration. In the given case, Rs. 30 lakh is the minimum payment to be paid after 3 years and accordingly will be considered as deferred consideration. The other element is if company meet certain target then they will get 25% of that or Rs. 30 lakh whichever is higher. In the given case, since the criteria is the minimum what is expected to be paid, the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 8%.
- The additional consideration of Rs. 25 lakh to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as employee compensation and will be recorded as post combination expenses in the income statement of Parker Ltd.

Working Notes:
1. Computation of Purchase Consideration
Rs. in lakh

Particulars		Amount
Share capital of Parker Ltd.		400
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value per share		50
Purchase consideration (2,00,000x70%xRs. 50 per share) (A)		70.00
Deferred consideration after discounting Rs. 30 lakh for 3 years @ 8%	(B)	23.81
Replacement award - Market based measure of the acquiree award		
ie Fair value of original award (6) x ratio of the portion of the		

vesting period completed (2) / greater of the total vesting period (3)		
or the original vesting period (4) of the acquiree award ie (6 x 2 / 4)		
(C)		3.00
Purchase consideration (A+B+C)		96.81

2. Allocation of Purchase consideration

Particulars	Book value (A)	Fair value (B)	FV adjustment (A-B)
Property, plant and equipment	600	450	(150)
Investment	200	200	-
Inventories	100	100	-
Financial assets:			-
Trade receivables	200	200	-
Cash and cash equivalents	200	200	-
Others	300	300	
Less: Financial Liabilities			
Long term borrowings	(300)	(300)	-
Long term provisions	(80)	(80)	-
Deferred tax	(55)	(55)	-
Financial Liabilities			
Short term borrowings	(170)	(170)	-
Trade payables	(320)	(320)	-
Contingent liability	-	(10)	(10)
Net assets (X)	675	515	(160)
Deferred tax asset on fair value adjustment (160 x 40%) (Y)		64	160
Net assets (X+Y)		579	
Non-controlling interest (NCI) (579 x 30%) rounded off		173.70	
Capital reserve (Net assets – NCI – PC)		308.49	
Purchase consideration (PC)		96.81	

3. Computation of Consolidated amounts of consolidated financial statements

	David Ltd.	Parker Ltd. (preacquisition)	PPA Allocation	Total
Assets				
Non-current assets:				
Property, plant and equipment	400	600	(150)	850
Investment	300	200		500
Current assets:				
Inventories	300	100		400

Financial assets:				
Trade receivables	400	200		600
Cash and cash equivalents	150	200		350
Others	300	300		600
Total	1,850	1,600	(150)	3300
<i>Equity and Liabilities</i>				
Equity				
Share capital- Equity shares of Rs. 100 each Shares allotted to Parker Ltd. (2,00,000 x 70% x Rs. 10 per share)	500		14	514
Other Equity				
Other Equity	700			700
Replacement award			3	3
Security premium (2,00,000 shares x 70% x Rs. 40)			56	56
Capital reserve			308.49	308.49
Non-controlling interest	0		173.70	173.70
Non-current liabilities:				
Financial Liabilities				
Long term borrowings	200	300		500
Long term provisions	100	80	23.81	203.81
Deferred tax	20	55	(64)	11
Current liabilities:				
Financial Liabilities				
Short term borrowings	130	170		300
Trade payable	200	320	0	520
Liability for lawsuit damages		—	10	10
Total	1,850	925	525	3,300

Question 10

Sun Ltd. is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31st March. On 1st July 2015 Sun Ltd acquired an 80% interest in Pluto Ltd. Details of the acquisition were as follows:

- Sun Ltd. acquired 800,000 shares in Pluto Ltd. by issuing two equity shares for every five acquired. The fair value of Sun Ltd.'s share on 1st July 2015 was Rs. 4 per share and the fair value of a Pluto's share was Rs. 1.40 per share. The cost of issue was 5% per share.
- Sun Ltd incurred further legal and professional costs of Rs. 100,000 that was directly related to the acquisition.
- The fair values of the identifiable net assets of Pluto Ltd at 1st July 2015 were measured at Rs. 1.3 million. Sun Ltd. initially measured the non-controlling interest in Pluto Ltd. at fair value. They used the market value of a Pluto Ltd. share for this purpose. No impairment of goodwill

arising on the acquisition of Pluto Ltd. was required at 31st March 2016 or 2017.

Pluto Ltd comprises three cash generating units A, B and C. When Pluto Ltd. was acquired the directors of Sun Ltd. estimated that the goodwill arising on

acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	Carrying value (before goodwill allocation)	Recoverable amount
	Rs. '000	Rs. '000
A	600	740
B	550	650
C	450	400

Compute the carrying value of the goodwill arising on acquisition of Pluto Ltd. in the consolidated Balance Sheet of Sun Ltd. at 31st March 2018 following the impairment review. Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Pluto Ltd. (MTP 6 Marks Oct '18, MTP 8 Marks April '18)

Answer 10

1. Computation of goodwill on acquisition

Particular	Amount (Rs. '000)
Cost of investment (8,00,000 x 2/5 x Rs. 4)	1,280
Fair value of non-controlling interest (2,00,000 x Rs. 1.4)	280
Fair value of identifiable net assets at date of acquisition	(1,300)
So goodwill equals	260

Acquisition costs are not included as part of the fair value of the consideration given under Ind AS 103, Business Combination.

2. Calculation of impairment loss

Unit	Carrying value			Recoverable Amount	Impairment Loss
	Before Allocation	Allocation of goodwill (2:2:1)	After Allocation		
A	600	104	704	740	Nil
B	550	104	654	650	4
C	400	52	452	400	52
	*				

* After writing down assets in the individual CGU to recoverable amount.

3. Calculation of closing goodwill

Goodwill arising on acquisition (W1)	260
Impairment loss (W2)	(56)
So closing goodwill equals	204

4. Calculation of overall impairment loss

On goodwill (W3)	56
On assets in unit C (450 – 400)	50
So total loss equals	106

Rs. 21.2 (20%) of the above is allocated to the NCI with the balance allocated to the shareholders of Sun Ltd.

Question 10

On 1st April, 20X1, Johansen Ltd. acquired a new subsidiary, Bosman Ltd., purchasing all 150 million shares of Bosman Ltd. The terms of the sale agreement included the exchange of four shares in Johansen Ltd. for every three shares acquired in Bosman Ltd. On 1st April, 20X1, the market value of a share in Johansen Ltd. was ₹ 10 and the market value of a share in Bosman Ltd. ₹ 12.

The terms of the share purchase included the issue of one additional share in Johansen Ltd. for every five acquired in Bosman Ltd., if the profits of Bosman Ltd. for the two years ending 31st March, 20X3 exceeded a target figure. Current estimates are that it is 80% probable that the management of Bosman Ltd. will achieve this target.

Legal and professional fees associated with the acquisition of Bosman Ltd. shares were ₹ 12,00,000, including ₹ 2,00,000 relating to the cost of issuing shares. The senior management of Johansen Ltd. estimates that the cost of their time that can be fairly allocated to the acquisition is ₹ 2,00,000. This figure of ₹ 2,00,000 is not included in the legal and professional fees of ₹ 12,00,000 mentioned above.

The individual Balance Sheet of Bosman Ltd. at 1st April, 20X1 comprised net assets that had a fair value at that date of ₹ 1,200 million. Additionally, Johansen Ltd. considered Bosman Ltd. possessed certain intangible assets that were not recognized in its individual Balance Sheet:

- Customer relationships – reliable estimate of value ₹ 100 million. This value has been derived from the sale of customer databases in the past.
- An in-process research and development project that had not been recognised by Bosman Ltd. since the necessary conditions laid down in Indian Accounting Standards for capitalisation were only just satisfied at 31st March, 20X2. However, the fair value of the whole project (including the research phase) is estimated at ₹ 50 million.
- Employee expertise – estimated value of Director employees of Bosman Ltd. is ₹ 80 million.
- The market value of a share in Johansen Ltd. on 31st March, 20X2 was ₹ 11.

Compute the goodwill on consolidation of Bosman Ltd. that will appear in the consolidated Balance Sheet of Johansen Ltd. at 31st March, 20X2 with necessary explanation of adjustments therein. Also state the treatment of contingent consideration as on 31st March, 20X2 (12 Marks Sep '23)

Answer 10
Calculation of purchase consideration:

Particulars	₹ in million
Market value of shares issued (150 million x $\frac{4}{3}$ x ₹ 10)	2,000
Initial estimate of market value of shares to be issued (150 million x $\frac{1}{5}$ x ₹ 10)	300
Total consideration	2,300

Contingent consideration is recognized in full if payment is probable.

As per para 53 of Ind AS 103, acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109.

Statement of fair value of identifiable net assets at the date of acquisition

Particulars	₹ in million
As per Bosman Ltd.'s Balance Sheet	1,200
Fair value of customer relationships	100



Fair value of research and development project	50
Total net assets acquired	1,350

As per Ind AS 38 'Intangible assets', intangible assets can be recognized separately from goodwill provided they are identifiable, are under the control of the acquiring entity, and their fair value can be measured reliably.

Customer relationships that are similar in nature to those previously traded, pass these tests but employee expertise fail the 'control' test. Both the research and development phases of in process project can be capitalised provided their fair value can be measured reliably.

Statement of computation of goodwill

Particulars	` in million
Fair value of consideration given	2,300
Fair value of net assets acquired	(1,350)
Goodwill on acquisition	950

Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration. In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

- There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).
- If the instrument will or may be settled in the issuer's own equity instruments, then it is:
 - a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or
 - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfillment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

Question 11

Smart Technologies Inc. is a Company incorporated in India in 1998 having business in the field of development and installation of softwares, trading of computer peripherals and other IT related equipment and provision of cloud computing services along with other services incidental thereto. It is one of the leading brands in India.

After witnessing immense popularity and support in its niche market, Smart Technologies further grew by bringing its subsidiaries namely:

Company Name	Principle Activity
Cloudustries India Private Limited	Provision of cloud computing services.
Micro Fly India Private Limited	Trading of computer peripherals like mouse, keyboard, printer etc.

Smart Technologies started preparing its financial statements based on Ind AS from 1st April, 2015 on voluntary basis. The Microfly India Pvt. Ltd. is planning to merge the business of Clouds tries India

Pvt. Ltd. with its own for which it presented before the members in the meeting the below extract of latest audited Balance Sheet of Cloudustries (prepared on the basis of Ind AS) for the year ended 31st March, 2017:

Balance Sheet as at March 31, 2017

(Rs. in Crores)

Assets	
Non-current assets	
Property, plant and Equipment	15.00
	15.00
Current Assets	
(a) Financial assets	
Trade Receivables	10.00
Cash and cash equivalents	10.00
Other current assets	8.00
	28.00
Total	43.00

Equity and Liabilities	
Equity	
Equity Share Capital	45.00
Other Equity	
Reserves and Surplus (Accumulated Losses)*	(24.80)
	20.20
Liabilities	
Non-current Liabilities	
Financial liabilities	
Borrowings	2.80
Current Liabilities	20.00
	22.80
Total	43.00

*The Tax Loss carried forward of the company is Rs. 27.20 crores

On September 5, 2017, the merger got approved by the Directors. The purchase consideration payable by MicroFly to Cloudustries was fixed at Rs. 18.00 crores payable in cash and that MicroFly take over all the assets and liabilities of Cloudustries.

Present the statement showing the calculation of assets/liabilities taken over as per Ind AS. Also mention the accounting of difference between consideration and assets/liabilities taken over. (RTP Nov 18)

Answer 11

Before the merger, Cloudustries and MicroFly are the subsidiary of Smart Technologies Inc. As the control is not transitory, the proposed merger will fall under the category of Business combination of entities under common control, it will be accounted as per Appendix C of Ind AS 103 "Business Combination" and Pooling of Interest Method would be applied.

Statement showing the calculation of assets/liabilities taken over and treatment of difference between

consideration and assets/liabilities taken over:

Net asset taken over: (Rs. in crore)

Assets taken over:	
Property, Plant and Equipment	15.00
Cash and cash equivalents	10.00
Other current assets	8.00
Trade Receivables	10.00
Total - A	43.00
Less: Liabilities taken over:	
Borrowings	2.80
Current Liabilities	20.00
Total - B	22.80
Net Asset taken over (A-B)	20.20

Treatment of difference between consideration and assets/liabilities taken over: (Rs. in crore)

Net Asset taken over - A	20.20
Less: Purchase Consideration - B	18.00
Difference (A – B)	1.80

The difference between consideration and assets/liabilities taken over of Rs. 1.80 crore shall be transferred to capital reserve

Question 12

Veera Limited and Zeera Limited are both in the business of manufacturing and selling of Lubricant. Veera Limited and Zeera Limited shareholders agree to join forces to benefit from lower delivery and distribution costs. The business combination is carried out by setting up a new entity called Meera Limited that issues 100 shares to Veera Limited's shareholders and 50 shares to Zeera Limited's shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also respective company's shareholders gets the voting rights in Meera Limited based on their respective shareholding.

Determine the acquirer by applying the principles of Ind AS 103 'Business Combinations'. (RTP Nov'20, Old & New SM)

Answer 12

As per para B15 of Ind AS 103, in a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree.

Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

The relative voting rights in the combined entity after the business combination - The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity.

Based on above mentioned para, acquirer shall be either of the combining entities (i.e. Veera Limited or Zeera Limited), whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity.

Hence, in the above scenario Veera Limited's shareholder gets 66.67% share ($100 / 150 \times 100$) and Zeera Limited's shareholder gets 33.33% share in Meera Limited. Hence, Veera Limited is acquirer as per the principles of Ind AS 103.

Question 13

Bima Ltd. acquired 65% of shares on 1 June, 20X1 in Nafa Ltd. which is engaged in production of components of machinery. Nafa Ltd. has 1,00,000 equity shares of Rs. 10 each. The quoted market price of shares of Nafa Ltd. was Rs. 12 on the date of acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 20X1 was

Rs. 80,00,000.

Bima Ltd. wired Rs. 50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of shares of Bima Ltd. on the date of issue was Rs. 25 per share.

Bima Ltd. also agrees to pay additional consideration of Rs. 15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds Rs. 1 crore over the next three years. On the date of acquisition, Nafa Ltd. assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is Rs. 9,80,000. Nafa Ltd. incurred Rs. 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

How will the acquisition of Nafa Ltd. be accounted by Bima Ltd., under Ind AS 103? Prepare detailed workings and pass the necessary journal entry. (RTP May'21)

Answer 13
Computation of Goodwill / Capital reserve on consolidation as per Ind AS 103

Particulars	Rs.
Cost of investment:	
Share exchange (50,000 x 25)	12,50,000
Cash consideration	50,00,000
Contingent consideration	9,80,000
Consideration transferred at date of acquisition [A]	72,30,000
Fair value of non-controlling interest at date of acquisition [B] (1,00,000 x 35% x 12)	4,20,000
Total [C] = [A] + [B]	76,50,000
Net assets acquired at date of acquisition [D]	(80,00,000)
Capital Reserve [D] – [C]	3,50,000

In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. Therefore, Rs. 1,50,000 incurred by Nafa Ltd. in relation to acquisition, will be ignored by Bima Ltd.

Journal entry at the date of acquisition by Bima Limited as per Ind AS 103:

	Rs.	Rs.
Identifiable net assets	Dr. 80,00,000	
To Equity share capital (50,000 x 10)		5,00,000
To Securities Premium (50,000 x 15)		7,50,000
To Cash		50,00,000
To Provision for contingent consideration to Nafa Ltd.		9,80,000
To Non-controlling Interest		4,20,000
To Capital Reserve		3,50,000

Question 14

Entity A acquires entity B. Entity A agrees with the former shareholders of entity B to pay ₹ 900, with an additional payment of ₹ 500 if the subsequent earnings of entity B reach a specified target in three years. The former shareholders also become employees. On the acquisition date, the fair value of the net assets of entity B amount to ₹ 850, and the fair value of additional payment is estimated at ₹ 200. At the acquisition date, the outflow of additional payment is not probable. Over the next three years, the cumulative earnings of entity B (before considering the effects of the additional payments) amount to ₹ 1,050. At the end of year three, entity A pays ₹ 500 as the conditions were met. State the impact on the financial position and results of classifying the payments as remuneration and contingent consideration. (RTP May '22)

Answer 14

The impact on the financial position and results of classifying the payments as remuneration and contingent consideration is tabulated as follows:

	Additional Payment is classified as	
	Remuneration	Contingent consideration
Consideration	900	900
Fair value of additional payment	0	200
Total consideration	900	1,100
Fair value of net assets	(850)	(850)
Goodwill at acquisition date	50	250
Subsequent changes in additional payment	0	0
Total Goodwill	50	250
Cumulative earnings (before considering additional payment)	1,050	1,050
Impact of additional payment	(500)	(300)
Reported results across three years	550	750

Question 15

On 1 April 20X1, Alpha Ltd. acquires 80 percent of the equity interest of Beta Pvt. Ltd. in exchange for cash of ₹ 300. Due to legal compulsion, Beta Pvt. Ltd. had to dispose of their investments by a specified date. Therefore, they did not have sufficient time to market Beta Pvt. Ltd. to multiple potential buyers. The management of Alpha Ltd. initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirement of Ind AS 103. The identifiable assets are measured at ₹ 500 and the liabilities assumed are measured at ₹ 100. Alpha Ltd. engages an independent consultant, who determined that the fair value of 20 per cent non-controlling interest in Beta Pvt. Ltd. is ₹ 84.

Alpha Ltd. reviewed the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non controlling interest in Beta Pvt. Ltd. and the consideration transferred. After the review, it decided that the procedures and resulting measures were appropriate.

Calculate the gain or loss on acquisition of Beta Pvt. Ltd. and also show the journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest in Beta Pvt. Ltd. on the basis of proportionate interest method, if alternatively applied? (RTP May '18, Old & New SM)

Answer 15

The amount of Beta Pvt. Ltd. identifiable net assets [` 400, calculated as ` 500 - ` 100) exceeds the fair value of the consideration transferred plus the fair value of the non controlling interest in Beta Pvt. Ltd. [ ` 384 calculated as 300 + 84]. Alpha Ltd. measures the gain on its purchase of the 80 per cent interest as follows:

		₹ in lakh
Amount of the identifiable net assets acquired (` 500 - ` 100)		400
Less: Fair value of the consideration transferred for Alpha Ltd.	300	
80 per cent interest in Beta Pvt. Ltd.		
Add: Fair value of non controlling interest in Beta Pvt. Ltd.	84	(384)
Gain on bargain purchase of 80 per cent interest		16

Journal Entry

	₹ in lakhs	₹ in lakhs
Identifiable assets acquired Dr.	500	
To Cash		300
To Liabilities assumed		100
To OCI/Equity-Gain on the bargain purchase		16
To Equity-non controlling interest in Beta Pvt Ltd.		84

If the acquirer chose to measure the non controlling interest in Beta Pvt. Ltd. on the basis of its proportionate interest in the identifiable net assets of the acquire, the recognized amount of the non controlling interest would be ` 80 ( ` 400 x 0.20). The gain on the bargain purchase then would be ` 20 ( ` 400- (` 300 + ` 80))

Question 16

In October 20X1, IHL acquired 75% of Very Relevant Limited by paying cash consideration of ₹ 0.80 million. The fair value of non-controlling interest on the date of acquisition is ₹ 0.20 million. The value of Very Relevant Limited's identifiable net assets as per Ind AS 103 is ₹ 1.10 million.

With respect to acquisition of Very Relevant Limited, determine the value of gain on bargain purchases, when NCI is measured as per:

- Fair value method
- Proportionate share of net identifiable assets method. (RTP May '23)

Answer 16

- When NCI is measured as per fair value method

	₹ in million
Fair value of consideration transferred	0.80
Fair value of non-controlling interest	0.20
	1.00
Value of Very Relevant Limited's identifiable net assets as per Ind AS 103	(1.10)
Gain on bargain purchase	0.10

- When NCI is measured as per proportionate share method

	₹ in million
Fair value of consideration transferred	0.80
Proportional share of non-controlling interest in the net identifiable assets of acquiree (1.10 x 25%)	0.275

	1.075
Value of Very Relevant Limited's identifiable net assets as per Ind AS 103	(1.10)
Gain on bargain purchase	0.025

Question 17

Mini Limited is a manufacturing entity in textile industry. Mini Limited decided to reduce the cost of manufacturing by setting up its own power plant for their captive consumption. As per market research report, there was non-operational power plant in nearby area. Hence, it decided to acquire that power plant which was having capacity of 80MW along with all entire labour force. This Power entity was owned by another entity Max Limited. Mini Limited approached Max Limited for acquisition of 80MW power plant at following terms:

- Mini Limited will seek an independent valuation for determining fair value of 80MW power plant.
- Value of other Non-current assets acquired, and Non-current financial liabilities assumed is ₹ 11.10 million and ₹ 32 million respectively.
- Consideration agreed between both the parties is at ₹ 51 million.

Both the parties agreed to the terms and entered into agreement on 1st April, 20X1 with immediate effect.

Due to unavoidable circumstances, valuation could not be completed by the time Max Limited finalizes its financial statements for the year ending 31st March, 20X1. Max Limited's annual financial statements records the fair value of 80 MW Power Plant at ₹ 46.90 million with remaining useful life at 40 years.

Max Limited also has license to operate that power plant unrecorded in books. As on 31st March, 20X1, it has fair value of ₹ 5 million.

Six months after acquisition date, Mini Limited received the independent valuation, which estimated the fair value of 80MW Power Plant as ₹ 54.90 million.

CFO of Mini Limited, wants you to work upon following aspects of the transaction:

- Determine whether transaction should be accounted as asset acquisition or business combination.
- Calculate Goodwill / Bargain Purchase due to the above acquisition.
- Pass necessary journal entries in the books of Mini Limited as per Ind AS 103 and prepare balance sheet as on date of acquisition.
- Determine whether any adjustment is required in case of valuation received subsequent to acquisition. If yes, pass the necessary entries in the books of Mini Limited. (RTP Nov '23)

Balance Sheet of Mini Limited as at 31st March, 20X1

Particulars	(₹ in Million)
ASSETS	
Non-current assets	
Property, plant and equipment	2,158
Capital work-in-progress	12
Deferred Tax Assets (Net)	324
Other non-current assets	25

Total non-current assets	2,519
Current assets	
Inventories	368
Financial assets	
(i) Investments	45
(ii) Trade Receivables	762
(iii) Cash and Cash Equivalents	110
(iv) Bank balances other than (iii) above	28
(v) Other financial assets	267
Total current assets	1,580
Total assets	4,099
EQUITY AND LIABILITIES	
Equity	
Equity Share Capital	295
Other equity	
Equity component of compound financial instruments	717
Reserves and surplus	2,481
Total equity	3,493
Liabilities	268
Non-current liabilities	
Financial Liabilities	
Borrowings	
Total non-current liabilities	268
Current liabilities	
Financial Liabilities	
(i) Trade payables	302
Other current liabilities	36
Total current liabilities	338
Total liabilities	606
Total equity and liabilities	4,099

Answer 17

- (a) Ind AS 103 defines business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods and services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

In the given scenario, acquisition of power plant along with its labour force will be considered as integrated set of activity as it is capable of being generating power. Hence, transaction will be considered as business combination and not asset acquisition and acquisition method of accounting will be applied.

Thus, following will be the case:

- (i) Acquirer – Mini Ltd;
 - (ii) Acquiree – Max Ltd;
 - (iii) Acquisition date – 1st April, 20X1
- (b) Calculation of Goodwill:

Particulars	₹ in Million
Purchase consideration (A)	51
Fair Value of Power Plant – PPE	46.90
Fair Value of other non-current assets	11.10
Fair Value of Intangible Asset (License) – Refer Note 1 below	5
Non-Current Liabilities assumed	(32)
Value of net assets acquired (B)	31
Goodwill	20

Note 1:

The licence to operate power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill though acquirer cannot sell or transfer it separately from the acquired power plant. Intangible Assets needs to be recorded by the acquirer at the time of accounting for acquisition though not recorded by the acquiree in its book.

(c) Journal Entries for acquiring power plant

Particulars		₹ in Million	₹ in Million
Fair Value of Power Plant	Dr.	46.90	
Fair Value of other assets	Dr.	11.10	
Fair Value of License acquired	Dr.	5	
Goodwill	Dr.	20	
To Liabilities assumed			32
To Bank (PC paid)			51

Balance Sheet of Mini Limited as at 1st April, 20X1

Particulars	Notes to Accounts	₹ in Million
ASSETS		
Non-current assets		
Property, plant and equipment	1	2,204.90
Intangible Asset (License acquired in business combination)		5.00
Capital work-in-progress		12.00
Goodwill on acquisition		20.00
Deferred Tax Assets (Net)		324.00
Other non-current assets	2	36.10
Total non-current assets		2,602.00
Current assets		
Inventories		368.00
Financial assets		
(i) Investments		45.00
(ii) Trade Receivables		762.00
(iii) Cash and Cash Equivalents	3	59.00
(iv) Bank balances other than (iii) above		28.00



(v) Other financial assets		267.00
Total current assets		1,529.00
Total assets		4,131.00
EQUITY AND LIABILITIES		
Equity		
Equity Share Capital		295.00
Other equity		
Equity component of compound financial instruments		717.00
Reserves and surplus		2,481.00
Total equity		3,493.00
Liabilities		
Non-current liabilities		
Financial Liabilities		
Borrowings	4	300.00
Total non-current liabilities		300.00
Current liabilities		
Financial Liabilities		
(i) Trade payables		302.00
Other current liabilities		36.00
Total current liabilities		338.00
Total liabilities		638.00
Total equity and liabilities		4,131.00

Notes to Accounts

1. Property, Plant and Equipment

Particulars	₹ in Million
PPE value as on 1st April, 20X1	2,158.00
Add: Fair Value of Power Plant acquired	46.90
Total	2,204.90

2. Other Non-current Assets

Particulars	₹ in Million
Other non-current assets value as on 1st April, 20X1	25.00
Add: Fair Value of Non-current assets acquired	11.10
Total	36.10

3. Cash and Cash equivalents

Particulars	₹ in Million
Cash and Cash equivalents as on 1st April, 20X1	110
Less: Payment of Purchase consideration transferred	(51)
Total	59

4. Non-current Liabilities

Particulars	₹ in Million
Non-current Liabilities value as on 1st April, 20X1	268
Add: Non-current liabilities assumed in acquisition	32
Total	300

- (d) Subsequent Accounting: Ind AS 103 provides a measurement period window, wherein if all the required information is not available on the acquisition date, then entity can do price allocation on provisional basis. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as on the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. Any change i.e. increase or decrease in the net assets acquired due to new information available during the measurement period which existed on the acquisition date will be adjusted against goodwill.

Accordingly, in the financial statements for half year ending 30th September, 20X1, Mini Limited will retrospectively adjust the prior year information as follows:

- (i) the carrying amount of PPE (including power plant) as of 1st April, 20X1 is increased by ₹ 8 million (i.e. ₹ 54.90 million minus ₹ 46.90 million). The adjustment is measured as the fair value adjustment at the acquisition date less the additional depreciation that would have been recognised if the asset's fair value at the acquisition date had been recognised from that date $[(80,00,000/40) \times (6/12) = 0.1 \text{ million}]$
- (ii) the carrying amount of goodwill as of 1st April, 20X1 is decreased by ₹ 8 million; and
- (iii) depreciation expense for the period ending 30th September, 20X1 will increase by ₹ 0.1 million
- (iv) disclose in its financial statements of 1st April, 20X1, that the initial accounting for the business combination has not been completed because the valuation of property, plant and equipment has not yet been received;
- (v) disclose in its financial statements of 30th September, 20X1, the amounts and explanation of the adjustments to the provisional values recognised during the current reporting period. Therefore, Mini Limited discloses that comparative information is adjusted retrospectively to increase the fair value of the item of property, plant and equipment at the acquisition date by ₹ 8 million, offset by decrease in goodwill of ₹ 8 million.

Journal Entries

(1) PPE (Power Plant)	Dr.	₹ 8 Million	
To Goodwill			₹ 8 Million
(2) Depreciation	Dr.	₹ 0.1 Million	
To Provision for Depreciation			₹ 0.1 Million

Question 18

Moon Ltd. acquires 75% of Star Limited on 1st April, 2017 for consideration transferred Rs. 60 lakh. Moon Limited intends to recognize the Non-Controlling Interest (NCI) at proportionate share of fair value of identifiable assets. With the assistance of a suitably qualified valuation professional, Moon Limited measures the identifiable net assets of Star Limited at Rs. 90 lakh. Moon Limited performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.

State whether the procedures followed by Moon Limited and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process. (PYP 4 Marks, Nov'18), (Same concept different figures- Old & New SM)

Answer 18

The amount of Star Ltd.'s identifiable net assets exceeds the fair value of the consideration transferred plus the fair value of the NCI in Star Ltd.'s, resulting in an initial indication of a gain on a bargain purchase. Accordingly, Moon Ltd. reviews the procedures it used to identify and measure the identifiable net assets acquired, to measure the fair value of both the NCI and the consideration transferred, and to identify transactions that were not part of the business combination. Following that review, Moon Ltd. can conclude that the procedures followed and the resulting measurements were appropriate. (Rs.)

Identifiable net assets	90,00,000
Less: Consideration transferred	(60,00,000)
NCI (90,00,000 x 25%)	(22,50,000)
Gain on bargain purchase	7,50,000

Question 19

Deepak Ltd., an automobile group acquires 25% of the voting ordinary shares of Shaun Ltd., another automobile business, by paying, Rs. 4,320 crores on 01.04.2017. Deepak Ltd. accounts its investment in Shaun Ltd. using equity method as prescribed under Ind AS 28. At 31.03.2018, Deepak Ltd. recognized its share of the net asset changes of Shaun Ltd. using equity accounting as follows:

(Rs. in crore)

Share of Profit or Loss	378
Share of Exchange difference in OCI	54
Share of Revaluation Reserve of PPE in OCI	27

The carrying amount of the investment in the associate on 31.03.2018 was therefore

Rs. 4,779 crores (4,320 + 378 + 54 + 27).

On 01.04.2018, Deepak Ltd. acquired remaining 75% of Shaun Ltd. for cash Rs. 13,500 crore. Fair value of the 25% interest already owned was Rs. 4,860 crore and fair value of Shaun Ltd.'s identifiable net assets was Rs. 16,200 crores as on 01.04.2018.

How should such business combination be accounted for in accordance with the applicable Ind AS? (PYP 8 Marks, May'19), (MTP 8 Marks Oct '20, Old & New SM)

Answer 19

Paragraph 42 of Ind AS 103 provides that in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognized on the same basis as would be required if the acquirer had disposed of directly the previously held equity interest. Applying the above, Deepak Ltd. records the following entry in its consolidated financial statements:

		(Rs. in crore)	
		Debit	Credit
Identifiable net assets of Shaun Ltd.	Dr.	16,200	
Goodwill (W.N.1)	Dr.	2,160	
Foreign currency translation reserve	Dr.	54	

PPE revaluation reserve	Dr.	27	
To Cash			13,500
To Investment in associate -Shaun Ltd.			4,779
To Retained earnings (W.N.2)			27
To Gain on previously held interest in Shaun Ltd. recognised in Profit or loss (W.N.3)			135
(Recognition of acquisition of Shaun Ltd.)			

Working Notes:
1. Calculation of Goodwill

	Rs. in crore
Cash consideration	13,500
Add: Fair value of previously held equity interest in Shaun Ltd.	4,860
Total consideration	18,360
Less: Fair value of identifiable net assets acquired	(16,200)
Goodwill	2,160

2. The credit to retained earnings represents the reversal of the unrealized gain of Rs. 27 crore in Other Comprehensive Income related to the revaluation of property, plant and equipment. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

3. The gain on the previously held equity interest in Shaun Ltd. is calculated as follows:
Rs. in crore

Fair Value of 30% interest in Shaun Ltd. at 1 st April, 2018	4,860
Carrying amount of interest in Shaun Ltd. at 1 st April, 2018	(4,779)
	81
Unrealised gain previously recognised in OCI	54
Gain on previously held interest in Shaun Ltd. recognised in profit or loss	135

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Many examinees have only calculated goodwill but have not calculated gain on the previously held equity interest in Shaun Ltd. recognized in Profit and Loss. Some of the examinees were not able to pass correct journal entry for the given business combination.

Question 20

MNC Ltd. is in process of setting up a medicine manufacturing business which is at very initial stage. For this purpose, MNC Ltd. as part of its business expansion strategy acquired on 1st April, 2019, 100% shares of Akash Ltd., a company that manufactures pharmacy products. The purchase consideration for the same was by way of a share exchange valued at Rs. 38 crore. The fair value of Akash Ltd.'s assets and liabilities were Rs. 68 crore and Rs. 50 crore respectively, but the same does not include the following:

- (i) A patent owned by Akash Ltd. for an established successful new drug that has a remaining life of 6 years. A consultant has estimated the value of this patent to be Rs. 8 crore. However, the outcome of clinical trials for the same are awaited. If the trials are successful, the value of the drug would fetch the estimated Rs. 12 crore.



- (ii) **Akash Ltd. has developed and patented another new drug which has been approved for clinical use. The cost of developing the drug was Rs. 13 crore. Based on early assessment of its sales success, a reputed valuer has estimated its market value at Rs. 19 crore. However, there is no active market for the patent.**
- (iii) **Akash Ltd.'s manufacturing facilities have received a favourable inspection by a government department. As a result of this, the company has been granted an exclusive five-year license on 1st April, 2018 to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is valuable asset which assures guaranteed sales and the cost to acquire the license is estimated at Rs. 7 crore of remaining period of life. It is expected to generate at least equivalent revenue.**

Suggest the accounting treatment of the above transactions with reasoning under applicable Ind AS in the books of MNC Ltd. (PYP 8 Marks Nov'19)(Same amount different figures- PYP 5 Marks Jul'21, Old & New SM, RTP May'19)

Answer 20

As per para 13 of Ind AS 103 'Business Combination', the acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. This may be the case when the asset is developed by the entity internally and charged the related costs to expense. Based on the above, the company can recognise following Intangible assets while determining Goodwill / Bargain Purchase for the transaction:

- (i) **Patent owned by Akash Ltd.:** The patent owned will be recognised at fair value by MNC Ltd. even though it was not recognised by Akash Ltd. in its financial statements. The patent will be amortised over the remaining useful life of the asset i.e. 6 years. Since the company is awaiting the outcome of the trials, the value of the patent should be valued at Rs. 8 crore. It cannot be estimated at Rs. 12 crore and the extra Rs. 4 crore should only be disclosed as a contingent asset and not recognised.
- (ii) **Patent internally developed by Akash Ltd.:** As per para 18 of Ind AS 103 'Business Combination', the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition date fair values. Since the patent developed has been approved for clinical use, it is an identifiable asset, hence the same will be measured at fair value ie Rs. 19 crore on the acquisition date.
- (iii) **Grant of Licence to Akash Ltd. by the Government:** As regards to the five-year license, applying para 18 of Ind AS 103, grant asset will be recognised at fair value on the acquisition date by MNC Ltd. On acquisition date, the fair value of the license asset is Rs. 7 crore. However, since the question does not mention about the fair value of the identifiable liability with respect to grant of license for the acquirer, it is assumed that the fair value of the liability with respect to grant, for acquirer is nil. Therefore, only, the grant asset (license) would be recognised at Rs. 7 crore in the books of acquirer MNC Ltd.

Hence the revised working would be as follows:

Fair value of net assets of Akash Ltd. (68-50)	Rs. 18 crore
Add: Patent (8 + 19)	Rs. 27 crore
Add: License	Rs. 7 crore
Less: Grant for License	(Nil)
	Rs. 52 crore
Purchase Consideration	(Rs. 38 crore)
Capital Reserve	Rs. 14 crore

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees failed to present required accounting treatment as per relevant Ind AS.

**Question 21**

Parent A holds 100% in its subsidiary B. Parent A had acquired B, 10 years back and had decided to account for the acquisition under the purchase method using fair values of the subsidiary B in its consolidated financial statements. During the current year, A decides to merge B with itself. For the purpose of this proposed merger, what values of B should be used for accounting under the Ind AS? (PYP 4 Marks Nov'19)

Answer 21

The acquisition of B Ltd. by A Ltd. is business combination under common control. In such a situation, pooling of interest method should be applied. However, B Ltd. is 100% subsidiary of A Ltd. and A Ltd. in its Consolidated financial statements use to give the carrying values of assets and liabilities of B Ltd. at fair value (as per acquisition under purchase method). Hence the carrying value for the purpose of pooling of interest method will be the values given in Consolidated financial statements and not in Separate financial statements.

In other words, since B Ltd. is merging with A Ltd. (i.e. parent) nothing has changed and the transaction only means that the assets, liabilities and reserves of B Ltd. which were appearing in the consolidated financial statements of Group A immediately before the merger would now be a part of the separate financial statements of A Ltd. Accordingly, it would be appropriate to recognise the carrying value of the assets, liabilities and reserves pertaining to B Ltd as appearing in the consolidated financial statements of A Ltd.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question is based on Ind AS 103. Many examinees were not conceptually clear as to which values should be considered for business combination under common control.

Question 22

P Limited and S Limited are in business of manufacturing garments. P Limited holds 30% of equity shares of S Limited for last several years. P Limited obtains control of S Limited when it acquires further 65% stake of S Limited's shares, thereby resulting in a total holding of 95% on 31 December 2019. The acquisition had the following features:

- (i) P Limited transfers cash of Rs. 50,00,000 and issues 90,000 shares on 31 December 2019. The market price of P Limited's shares on the date of issue was Rs. 10 per share. The equity shares issued as per this transaction will comprise 5% of the post-acquisition capital of P Limited.
- (ii) P Limited agrees to pay additional consideration of Rs. 4,00,000, if the cumulative profits of S Limited exceeds Rs. 40,00,000 over the next two years. At the acquisition date, it is not considered probable that extra consideration will be paid. The fair value of contingent consideration is determined to be Rs. 2,00,000 at the acquisition date.
- (iii) P Limited spent acquisition-related costs of Rs. 2,00,000.
- (iv) The fair value of the NCI is determined to be Rs. 5,00,000 at the acquisition date based on market price. P Limited decided to measure non-controlling interest at fair value for this transaction.
- (v) P Limited has owned 30% of the shares in S Limited for several years. At 31 December 2019, the investment is included in P Limited's consolidated balance sheet at Rs. 8,00,000. The fair value of previous holdings accounted for using the equity method is arrived at Rs. 18,00,000.

The fair value of S Limited's net identifiable assets at 31 December 2019 is Rs. 45,00,000, determined in accordance with Ind AS 103.

Analyze the transaction and determine the accounting under acquisition method for the business combination by P Limited. (PYP 8 Marks, Nov'20)

Answer 22

Identify the acquirer

In this case, P Limited has paid cash consideration to shareholders of S Limited. Further, the shares issued to S Limited pursuant to the acquisition do not transfer control of P Limited to erstwhile shareholders of S Limited. Therefore, P Limited is the acquirer and S Limited is the acquiree.

Determine acquisition date

As the control over the business of S Limited is transferred to P Limited on 31 December 2019, that date is considered as the acquisition date.

Determine the purchase consideration

The purchase consideration in this case will comprise of the following:

Cash consideration	Rs. 50,00,000
Equity shares issued (90,000 x 10 i.e., at fair value)	Rs. 9,00,000
Contingent consideration (at fair value)	Rs. 2,00,000
Fair value of previously held interest	Rs. 18,00,000
Total purchase consideration	Rs. 79,00,000

Acquisition cost incurred by and on behalf of P Limited for acquisition of S Limited should be recognized in the Statement of Profit and Loss. As such, an amount of Rs. 2,00,000 should be recognised in the Statement of Profit and Loss.

Fair value of identifiable assets and liabilities

The fair value of identifiable net assets (as given in the question) Rs. 45,00,000.

Non-Controlling Interest

The management has decided to recognise NCI at its fair value, which is given in the question as Rs. 5,00,000.

Re-measure previously held interests in case business combination is achieved in stages

In this case, the control has been acquired in stages i.e., before acquisition to control, P Limited exercised significant influence over S Limited. As such, the previously held interest should be measured at fair value and the difference between the fair value and the carrying amount as at the acquisition date should be recognised in the Statement of Profit and Loss. As such, an amount of Rs. 10,00,000 (i.e. 18,00,000 – 8,00,000) will be recognised in the Statement of Profit and Loss.

Determination of goodwill or gain on bargain purchase

Goodwill should be calculated as follows:

(Rs.)

Total consideration	79,00,000
Recognized amount of any non-controlling interest	5,00,000
Less: Fair value of net identifiable assets	(45,00,000)
Goodwill	39,00,000

Question 23

Sun Limited and Moon Limited amalgamated from 1st April, 2021. A new company Sunmoon Limited with shares of ` 10 each was formed to take over the businesses of the existing companies.



Summarised Balance Sheet as on 31st March, 2021

Particulars	Note No.	Sun Limited (₹)	Moon Limited (₹)
ASSETS			
Non-current assets			
Property, plant and equipment		1,70,00,000	1,50,00,000
Financial assets			
Investment		21,00,000	11,00,000
Current assets			
Inventory		25,00,000	55,00,000
Financial assets			
Trade receivables		36,00,000	80,00,000
Cash and cash equivalent		9,00,000	8,00,000
Total		2,61,00,000	3,04,00,000
EQUITY AND LIABILITIES			
Equity			
Equity share capital (FV ₹ 10 each)		1,20,00,000	1,40,00,000
Other equity	1	61,00,000	54,00,000
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings (12% Debentures)		60,00,000	80,00,000
Current liabilities			
Financial liabilities			
Trade payables		20,00,000	30,00,000
Total		2,61,00,000	3,04,00,000

Notes to Accounts:

	Sun Limited (₹)	Moon Limited (₹)
Other equity		
General reserve	30,00,000	40,00,000
Profit & Loss	20,00,000	10,00,000
Investment allowance reserve	10,00,000	2,00,000
Export profit reserve	1,00,000	2,00,000
	61,00,000	54,00,000

Sunmoon Limited issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also, the new debentures were issued in exchange of the old series of both the companies. Compute purchase consideration and advice discharge thereof by preparing a note and draft the Balance Sheet of Sunmoon Limited assuming that Sun Limited and Moon Limited are not under common control and management of larger entity out of Sun Limited and Moon Limited will take over the control of the entity Sunmoon Limited.

The fair value of net assets as at 31st March, 2021 of Sun Limited and Moon Limited are as follows:

Assets	Sun Limited (₹)	Moon Limited (₹)
Property, Plant and Equipment	1,90,00,000	1,70,00,000
Inventory	26,00,000	58,00,000



Fair value of the Business	2,20,00,000	2,80,00,000

(PYP 14 Marks Dec '21, MTP 14 Marks Mar'23)

Answer 23

1. Determination of larger entity out of Sun Ltd. and Moon Ltd.

The management of a larger entity (out of Sun Limited and Moon Limited) will take the control of the Sunmoon Ltd. Since, here Sun Ltd. and Moon Ltd. are not under common control and hence accounting prescribed under Ind AS 103 for business combination will be applied. As per the accounting guidance provided in Ind AS 103, sometimes the legal acquirer may not be the accounting acquirer. In the given scenario although Sunmoon Ltd. is issuing the shares but management of a larger entity out of Sun Ltd. and Moon Ltd. will have control of Sunmoon Ltd.

This can be determined by the following table: (₹)

		Sun Ltd.	Moon Ltd.
Fair Value	A	2,20,00,000	2,80,00,000
Value per share	B	10	10
Number of shares	A/B = C	22,00,000	28,00,000
Total number of shares in Sunmoon Ltd. will be 50,00,000 shares (22,00,000 + 28,00,000)			
Thus, % held by each company in Sunmoon Ltd.	[(C/50,00,000) x 100]	44%	56%

Note: It is a case of Reverse Acquisition. Since post-merger, Moon Ltd. is bigger in size which is a clear indicator that Moon Ltd. will have control of Sunmoon Ltd. and will be considered as an accounting acquirer. Accordingly, Moon Ltd.'s assets and liabilities will be recorded at historical cost in the merged financial statements.

2. Computation of Purchase Consideration and the manner in which it will be discharged Number of shares to be issued by Moon Ltd. to Sun Ltd. to maintain the same percentage i.e. 56%

Since 14,00,000 shares of Moon Ltd. (given in the balance sheet) represent 56%, the total number of shares would be 25,00,000 shares (14,00,000 shares / 56%).

This implies Moon Ltd. would need to issue 11,00,000 shares (25,00,000 – 14,00,000) to Sun Ltd.

Purchase Consideration = 11,00,000 shares x ₹ 20 per share (ie. 2,80,00,000 / 14,00,000 shares) = ₹ 2,20,00,000.

3. Balance Sheet of Sunmoon Ltd. as on 1.4.2021

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment (1,90,00,000 + 1,50,00,000)		3,40,00,000
Goodwill (Refer Working Note)		18,00,000
Financial assets		
Investment (21,00,000 + 11,00,000)		32,00,000
Current assets		
Inventory (26,00,000 + 55,00,000)		81,00,000
Financial assets		
Trade receivables (36,00,000 + 80,00,000)		1,16,00,000

Cash and Cash equivalent (9,00,000 + 8,00,000)		17,00,000
EQUITY AND LIABILITIES		6,04,00,000
Equity		
Equity share capital (of face value of ` 10 each)	1	2,50,00,000
Other equity	2	1,64,00,000
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings (12% Debentures) (60,00,000 + 80,00,000)	3	1,40,00,000
Current liabilities		
Financial liabilities		
Trade payables (20,00,000 + 30,00,000)		50,00,000
		6,04,00,000

Notes to Accounts

		(`)	(`)
1.	Share Capital		
	25,00,000 Equity Shares of ` 10 each (14,00,000 to Moon Ltd. and 11,00,000 as computed above, to Sun Ltd.)		2,50,00,000
2.	Other Equity		
	General reserve of Moon Ltd.	40,00,000	
	Profit and loss of Moon Ltd.	10,00,000	
	Export profit reserve of Moon Ltd.	2,00,000	
	Investment allowance reserve of Moon Ltd.	2,00,000	
	Security premium (11,00,000 shares x ` 10)	1,10,00,000	1,64,00,000
3.	Long Term Borrowings		
	12% Debentures		1,40,00,000

Working Note:
Computation of Goodwill

Assets:		
Property, plant and equipment		1,90,00,000
Investment		21,00,000
Inventory		26,00,000
Trade receivables		36,00,000
Cash & cash equivalent		9,00,000
Total assets		2,82,00,000
Less: Liabilities:		
Borrowings (12% Debentures)		(60,00,000)
Trade payables		(20,00,000)
Net assets	A	2,02,00,000
Purchase consideration	B	2,20,00,000



Goodwill	(B-A)	18,00,000

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question was on reverse acquisition under Business Combinations. Many examinees failed to determine the larger entity, incorrectly computed the amount of purchase consideration, goodwill and number of shares. A few examinees drew the Balance Sheet after combination in wrong format.

Question 24

(a) The draft Balance Sheet of JAY Ltd. and KAY Ltd. as at 31st March 2021 is given below:

PARTICULARS	JAY Limited (₹ in lakh)	KAY Limited (₹ in lakh)
ASSETS		
NON-CURRENT ASSETS		
Property, Plant & Equipment	400	500
Investments	450	120
CURRENT ASSETS		
Inventories	180	130
Financial Assets		
- Trade Receivables	520	270
- Cash & Cash Equivalents	260	145
- Others	350	175
TOTAL	2,160	1,340
EQUITY AND LIABILITIES		
EQUITY		
Share Capital		
- JAY Limited: Equity Shares of ₹ 10 each	600	
- KAY Limited: Equity Shares of ₹ 100 each		450
OTHER EQUITY	725	210
NON-CURRENT LIABILITIES		
Financial Liabilities		
- Long Term Borrowings	350	250
Long Term Provisions	70	80
Deferred Tax	40	20
CURRENT LIABILITIES		
Financial Liabilities		
- Short Term Borrowings	125	145
- Trade Payables	250	185
TOTAL	2,160	1,340

Other information:

- JAY Ltd. acquired 75% shares of KAY Ltd. on 1st April, 2021 by issuing its own shares in the ratio of 2 shares of JAY Ltd. for every 3 shares of KAY Ltd. The fair value of the shares of JAY Ltd. was ₹ 50 per share.
- The fair value exercise resulted in the following:
 - Fair value of Property, Plant & Equipment of KAY Ltd. on 1st April, 2021 was ₹ 425 lakh;

- ii. JAY Ltd. also agreed to pay an additional payment as consideration that is higher of ₹ 45 lakh and 30% of any excess profits in the first year, after acquisition, over its profits in the preceding 12 months made by KAY Ltd. This additional amount will be due after 3 years. KAY Ltd. has earned ₹ 15 lakh profit in the preceding year and expects to earn another ₹ 20 lakh;
- iii. In addition to the above, JAY Ltd. also had agreed to pay one of the founder shareholder a payment of ₹ 22 lakh provided he stays with the Company for 3 years after acquisition;
- iv. KAY Ltd. had certain equity settled share based payment award (original award) which got replaced by the new awards issued by JAY Ltd. As per the original terms, the vesting period was 5 years and as of the acquisition date the employees of KAY Ltd. have already served 2 years of service. As per the replaced awards, the vesting period has been reduced to 1 year (1 year from the acquisition date). The fair value of the award on the acquisition date was as follows:
 - Original award - ₹ 6 lakh
 - Replacement award - ₹ 9 lakh
- v. KAY Ltd. had a lawsuit pending with a customer who made a claim of ₹ 70 lakh. Management reliably estimated the fair value of the liability to be ₹ 7.5 lakh;
- vi. The applicable tax rate for both entities is 30%.

You are required to prepare consolidated balance sheet of JAY Ltd. as on 1st April, 2021. Assume 10% per annum discount rate. Management notes and working notes should form part of your answer. (15 Marks May '22)

Answer 24

(a) Consolidated Balance Sheet of JAY Ltd. as on 1st April, 2021 (₹ in lakh)

	Amount
Assets	
Non-Current Assets:	
Property, plant and equipment	825.00
Financial assets	
Investment	570.00
Current assets:	
Inventories	310.00
Financial assets	
Trade receivables	790.00
Cash and cash equivalents	405.00
Others	525.00
Total	3,425.00
Equity and Liabilities	
Equity	
Share capital - Equity shares of ₹ 10 each	622.50
Other Equity	1,120.38
Non-controlling Interest	150.56
Non-Current liabilities:	
Financial Liabilities	
Long term borrowings	600.00
Long term provisions	183.81
Deferred tax	35.25
Current Liabilities:	

Financial Liabilities	
Short term borrowings	270.00
Trade payables	435.00
Provision for Lawsuit damages	7.50
Total	3,425.00

Management Notes:

- As per Ind AS 103, the acquirer is required to record the assets and liabilities acquired at their respective fair value. Accordingly, the PPE of KAY Ltd. will be recorded at ₹ 425 lakh.
- The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, ₹ 2.4 lakh (6 x 2/5) is considered as a part of purchase consideration and is credited to JAY Ltd. equity as this will be settled in its own equity. The balance of ₹ 6.60 lakh (₹ 9 lakh – ₹ 2.4 lakh) will be recorded as compensation expense in the post combination financial statements over the remaining life, which is 1 year in this scenario.
- There is a difference between contingent consideration and deferred consideration. In the given case ₹ 45 lakh is the minimum payment to be paid after 3 years and accordingly will be considered as deferred consideration. The other element is if company meet certain target, then they will get 30% of that or ₹ 45 lakh whichever is higher. In the given case, the minimum what is expected to be paid has been considered and the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 10%.
- The additional consideration of ₹ 22 lakh to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as employee compensation and will be recorded as post combination expenses in the income statement of JAY Ltd.

Working Notes:
1. Computation for Purchase consideration

Particulars		Amount (₹)
Share capital of KAY Ltd.		4,50,00,000
Number of shares	4,50,000	
Shares to be issued 3:2	3,00,000	
Fair value ₹ per share		50
		₹ in lakh
PC (3,00,000 x 75% x ₹ 50 per share) (A)		112.50
Deferred consideration after discounting ₹ 45 lakh for 3 years @ 10% (P.V. Factor 0.7513) (B)		33.81
Replacement award market-based measure of the acquiree award (6) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (5) of the acquiree award ie (6 x 2/5) (C)		2.40
PC in lakh (A+B+C)		148.71

2. Allocation of Purchase price

Particulars	Book value (A)	Fair value (B)	FV adjustment (A-B)
Property, plant and equipment	500.00	425.00	(75.00)

Investment	120.00	120.00	
Inventories	130.00	130.00	
Financial assets:			
Trade receivables	270.00	270.00	
Cash and cash equivalents	145.00	145.00	
Others	175.00	175.00	
	1,340.00	1,265.00	(75.00)
Less: Long term borrowings	(250.00)	(250.00)	
Long term provisions	(80.00)	(80.00)	
Deferred tax	(20.00)	(20.00)	
Short term borrowings	(145.00)	(145.00)	
Trade payables	(185.00)	(185.00)	
Contingent liability	-	(7.50)	(7.50)
Net assets (X)	660.00	577.50	(82.50)
Deferred tax asset on FV adjustment (82.50 x 30%) (Y)		24.75	
Net assets (X+Y)		602.25	
Non-controlling interest (602.50 x 25%) rounded off		150.56	
Purchase consideration (PC)		148.71	
Capital Reserve (Net assets – NCI – PC)		302.98	

3. Computation of consolidated amounts of consolidated financial statements

(' in lakh)

	JAY Ltd.	KAY Ltd. (pre-acquisition)	PPA Allocation	Total
Assets				
Non-current assets:				
Property, plant and equipment	400.00	500.00	(75.00)	825.00
Investment	450.00	120.00		570.00
Current assets:				
Inventories	180.00	130.00		310.00
Financial assets:				
Trade receivables	520.00	270.00		790.00
Cash and cash equivalents	260.00	145.00		405.00
Others	350.00	175.00	-	525.00
Total	2,160.00	1,340.00	(75.00)	3,425.00
Equity and Liabilities				
Equity				
Share capital - Equity shares of ` 10 each Shares allotted to KAY Ltd. (W.N.1) (3,00,000 x 75% x ` 10 per share)	600.00		22.50	622.50



Other Equity	725.00			1,120.38
Replacement award (W.N.1)			2.40	
Security Premium (W.N.1) (3,00,000 shares x 75% x ` 40)			90.00	
Capital Reserve (W.N.2)			302.98	
Non-controlling interest (W.N.2)	-		150.56	150.56
Non-current liabilities:				
Financial liabilities Long term borrowings	350.00	250.00		600.00
Long term provisions (W.N.1)	70.00	80.00	33.81	183.81
Deferred tax (W.N.2)	40.00	20.00	(24.75)	35.25
Current liabilities:				
Financial liabilities Short term borrowings	125.00	145.00		270.00
Trade payable	250.00	185.00		435.00
Liability for lawsuit damages	-	-	7.50	7.50
Total	2,160.00	680.00	585.00	3,425.00

Question 25

RST Ltd. prepares consolidated financial statements as at 31st March each year. On 1st July, 2021, RST Ltd. acquired 75% of the equity shares of DHF Ltd. and gained control of DHF Ltd. The issued shares of DHF Ltd. are 1,20,00,000 equity shares. Details of the purchase consideration are as follows:

On 1st July 2021, RST Ltd. issued two shares for every three shares acquired in DHF Ltd. On 1st July 2021, the market value of an equity share in RST Ltd. was ` 6.50 and the market value of an equity share in DHF Ltd. was ` 5.50.

On 30th June 2022, RST Ltd. will make cash payment of ` 71,50,000 to the former shareholders of DHF Ltd. who sold their shares to RST Ltd. on 1st July 2021. On 1st July, 2021, RST Ltd. would have to pay interest at an annual rate of 10% on borrowings.

On 30th June 2023, RST Ltd. may make a cash payment of ` 3,00,00,000 to the former shareholders of DHF Ltd. who sold their shares to RST Ltd. on 1st July 2021. This payment is contingent upon the revenues of RST Ltd. growing by 15% over the two-year period from 1st July, 2021 to 30th June, 2023. On 1st July 2021, the fair value of this contingent consideration was ` 2,50,00,000. On 31st March 2022, the fair value of the contingent consideration was ` 2,20,00,000.

On 1st July 2021, the carrying values of the identifiable net assets of DHF Ltd. in the books of that company was ` 6,00,00,000. On 1st July 2021, the fair values of these net assets was ` 7,00,00,000. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 31st March 2022, DHF Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 2022 it was necessary for RST Ltd. to recognize an impairment of the goodwill arising on acquisition of DHF Ltd. amounting to 12.50% of its total computed value.

Compute the impairment of goodwill in the consolidated financial statements of RST Ltd. under the methods permitted by Ind AS 103 for the initial computation of the non- controlling interest in DHF Ltd. at the acquisition date. (PYP 5 Marks May '22), (MTP 8 Marks May'20), (RTP Nov'18, Old & New SM)

Answer 25

Computation of goodwill impairment

	NCI at fair value	NCI at proportionate share of net assets
	₹ in 000	₹ in 000
Cost of investment		
Share exchange (12,000 x 75% x 2/3 x ₹ 6.50)	39,000	39,000
Deferred consideration (7,150 / 1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Total Purchase Consideration (a)	70,500	70,500
Non-controlling interest on the date of acquisition: (b)		
Fair value – 3,000 x ₹ 5.50	16,500	
% of net assets – 68,000 (Refer W.N.) x 25%		17,000
Net assets on the acquisition date (Refer W.N.) (c)	(68,000)	(68,000)
Goodwill on acquisition (a+b-c)	19,000	19,500
Impairment @ 12.50%	2,375.00	2,437.50

Working Note:

Net assets on the acquisition date	₹ in 000
Fair value at the acquisition date	70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]	(2,000)
	68,000

Question 26

The draft balance sheets of Swan Limited and Duck Limited as at 31st March 2023 is as under:

	Amount ₹ in lakhs	
Particulars	Swan Limited	Duck Limited
Assets		
Non-Current Assets		
Property, Plant and Equipment	800	1,000
Investments	900	240
Current Assets		
Inventories	360	260
Financial Assets		
- Trade Receivables	1,040	540
- Cash & Cash Equivalents	520	290
Other Current Assets	700	350
Total	4,320	2,680

	Swan Limited	Duck Limited
Equity and Liabilities		
Equity		
Share Capital		
- Swan Limited: Equity Shares of ` 10 each	1,200	-
- Duck Limited: Equity Shares of ` 100 each	-	900
Other Equity	1,450	420
Non-Current Liabilities		
Financial Liabilities		
- Long-Term Borrowings	700	500
Long-Term Provisions	140	200
Deferred Tax	80	-
Current Liabilities		
Financial Liabilities		
- Short-Term Borrowings	250	290
- Trade Payables	500	370
Total	4,320	2,680

On 1st April 2023, Swan Limited acquired 80% equity shares of Duck Limited. Swan Limited agreed to pay to each shareholder of Duck Limited, ` 20 per equity share in cash and to issue five equity shares of ` 10 each of Swan Limited in lieu of every six shares held by the shareholders of Duck Limited. The fair value of the shares of Swan Limited was ` 100 per share as on the date of acquisition.

Swan Limited also agreed to pay an additional consideration being higher of ` 90 lakhs and 30% of any excess profits in the first year, after acquisition, over Duck Limited's profits in the preceding 12 months (financial year 2022-2023) made by Duck Limited. The additional amount will be due in 3 years post the date of acquisition. Duck Limited earned ` 30 lakhs profit in the preceding year and expects to earn ` 40 lakhs in financial year 2023-2024.

The fair value exercise resulted in the following:

- Fair value of Property, Plant and Equipment and Investments of Duck Limited on 1st April, 2023 was ` 1,200 lakhs and ` 300 lakhs respectively.
- Duck Limited owns a popular brand name that meets the recognition criteria for Intangible Assets under Ind AS 103 'Business Combinations'. Independent valuers have attributed a fair value of ` 250 lakhs for the brand. However, the brand does not have any cost for tax purposes and no tax deductions are available for the same.
- Following is the statement of contingent liabilities of Duck Limited as on 1st April, 2023:

Particulars	Fair Value (` in lakhs)	Remarks
Lawsuit filed by a customer for a claim of ` 20 lakhs	5	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim. Any amount which would be paid in respect of lawsuit will be tax deductible.
Income tax demand of ` 70 lakhs raised by tax authorities. Duck Limited has challenged the demand in the High	20	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim.



Court		

- iv. Duck Limited had certain equity settled share-based payment awards (original award) which were replaced by the new awards issued by Swan Limited. As per the terms of original awards, the vesting period was 5 years and as of the acquisition date the employees of Duck Limited had already served 2 years of service. As per the new awards, the vesting period has been reduced to 1 year (1 year from the acquisition date). The fair value of the award on acquisition date was as follows:

Original Awards: ₹ 12 lakhs

New Awards: ₹ 18 lakhs.

- v. Further, Swan Limited has also agreed to pay one of the founder shareholder of Duck Limited a sum of ₹ 15 lakhs provided he stays with the Company for two years after the acquisition.
- vi. The acquisition cost of Swan Limited for Duck Limited was ₹ 26 lakhs. vii. The applicable tax rate for both the companies is 30%. viii. Assume 10% per annum discount rate.
- vii. ix. Also, assume, unless stated otherwise, all items have a fair value and tax base equal to their carrying amounts at the acquisition date.
- viii. You are required to prepare opening Consolidated Balance Sheet of Swan Limited as on 1st April 2023. Working Notes should form part of your answer. (PYP 15 Marks May '23)

Answer 26

Consolidated Balance Sheet of Swan Ltd as on 1st April, 2023

	Notes No.	₹ in lakhs
Assets		
Non-current assets		
Property, plant and equipment	9	2,000.00
Intangible assets	10	250.00
Financial assets		
Investment	11	1,200.00
Current assets		
Inventories	12	620.00
Financial assets:		
Trade receivables	13	1,580.00
Cash and cash equivalents	14	640.00
Other current assets	15	
Total		1,050.00
		7,340.00
Equity and Liabilities		
Equity		
Share capital - Equity shares of ₹ 10 each	1	1,260.00
Other equity	2	2,475.18
Non-controlling interest (W.N.4)		330.70
Non-current liabilities		
Financial liabilities		
Long-term borrowings	3	1,200.00
Long-term provisions	4	407.62
Deferred tax liability	5	231.50
Current Liabilities		
Financial liabilities		
Short-term borrowings	6	540.00

Trade payables	7	870.00
Short-term provision	8	25.00
Total		7,340.00

Notes to Accounts (All figures are ` in lakhs)
1. Equity Share capital

Equity shares of ` 10 each as per the balance sheet before acquisition of Duck Ltd.	1,200	
Shares allotted to Duck Ltd. (7,50,000 x 80% x ` 10)	60	1,260

2. Other Equity

As per the balance sheet before acquisition of Duck Ltd.		
1,450	1,424	
Less: Acquisition cost (26)		
Replacement award	4.80	
Security Premium (7,50,000 shares x 80% x ` 90)	540	
Capital Reserve (W.N.5)	506.38	2,475.18

3. Long-term borrowings

As per the balance sheet before acquisition of Duck Ltd.	700	1200
Duck Ltd.	500	

4. Long-term provisions

As per the balance sheet before acquisition of Duck Ltd.	140	
Deferred consideration	67.62	
Duck Ltd.	200	407.62

5. Deferred tax liability

As per the balance sheet before acquisition of Duck Ltd.	80	
Deferred tax impact due to acquisition of Duck Ltd. (W.N.2)	151.50	231.50

6. Short term borrowings

As per the balance sheet before acquisition of Duck Ltd.	250	
Duck Ltd.	290	540

7. Trade payables

As per the balance sheet before acquisition of Duck Ltd.	500	
Duck Ltd.	370	870

8. Short-term provisions

Lawsuit damages	5	
Income-tax demand	20	25

9. Property, plant and equipment

As per the balance sheet before acquisition of Duck Ltd.	800	
Duck Ltd.	1200	2000

10. Intangible assets



Brand of Duck Ltd. acquired		250

11. Investment

As per the balance sheet before acquisition of Duck Ltd.	900	
Duck Ltd.	300	1200

12. Inventories

As per the balance sheet before acquisition of Duck Ltd.	360	
Duck Ltd.	260	620

13. Trade receivables

As per the balance sheet before acquisition of Duck Ltd.	1040	
Duck Ltd.	540	1580

14. Cash and cash equivalents

As per the balance sheet before acquisition of Duck Ltd.	520		
Less: Acquisition cost paid	(26)		
Less: Paid to Duck Ltd.	(144)	350	
Duck Ltd.		290	640

15. Other current assets

As per the balance sheet before acquisition of Duck Ltd.	700	
Duck Ltd.	350	1050

Working Notes:

1. Computation of Purchase Consideration

Particulars	No. of shares	₹ in lakhs
Share capital of Duck Ltd.		900
Number of shares	9,00,000	
Shares to be issued (5 shares against 6 shares of Duck Ltd.)	7,50,000	
Fair value of Swan Ltd.'s share is ₹ 100 per share		
Purchase consideration		
Shares issued (7,50,000 x 80% x ₹ 100 per share) (A)		600
Cash payment (₹ 20 x 9,00,000 x 80%) (B)		144
Deferred consideration (discounting ₹ 90 lakhs for 3 years @10%) (C)		67.62
Replacement award [Market based measure of the acquiree award (12) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (5) of the acquiree award (ie 12 x 2/5)] (D)		4.80
Purchase consideration for 70% shares (A + B + C + D)		816.42

2. Computation of deferred tax impact due to change in fair value of asset and liabilities acquired

Particulars	Book value (A)	Fair value (B)	FV adjustment (A-B)
Property, plant and equipment	1,000	1,200	200
Intangible assets (Brand)	-	250	250
Investment	240	300	60
		1,750	510
Less: Contingent liability acquired			
Provision for lawsuit damages			(5)
Net difference in fair value			505
Deferred tax liability @ 30%			151.5

3. Computation of fair value of net identifiable assets acquired from Duck Ltd.

Particulars	Book value
Total assets as per the balance sheet	2,680
Add: Fair value adjustment in PPE and Investment (200+60)	260
Add: Intangible assets (Brand)	250
Fair value of total identifiable assets	3,190
Less: Total liabilities as per the balance sheet (500+200+290+370)	(1,360)
Less: Contingent liability acquired	
Lawsuit damages	5
Income tax demand	20
	(25)
Less: Defer tax liability (W.N.2)	<u>(151.50)</u>
Fair value of net identifiable assets (100%)	<u>1,653.50</u>

4. Computation of non-controlling interest in Duck Ltd. (Proportionate share basis)

Non-controlling interest (1,653.50 x 20%) = 330.70

5. Computation of capital reserve on acquisition of Duck Ltd.

Particulars	Book value
Fair value of net identifiable assets	1,653.50
Less: Purchase consideration	(816.42)
Less: NCI (W.N.4)	(330.70)
Capital reserve	506.38

Notes:

The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to

- (a) purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, ` 4.8 lakh (12 x 2/5) is considered as a part of purchase consideration and is credited to Swan Ltd.'s equity as this will be settled in its own equity. Since the fair value of the award on the acquisition date is ` 18

lakh the balance of (18 - 4.8) ` 13.2 lakh will be recorded as employee expense in the books of Duck Ltd. over the remaining life, which is 1 year in this scenario.

- (b) With respect to deferred consideration, ` 90 lakh is the minimum payment to be paid after 3 years. The other element is if company meet certain target then they will get 30% of that or ` 90 lakh whichever is higher. In the given case, since the minimum what is expected to be paid the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 10%.
- (c) The additional consideration of ` 15 lakhs to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as employee compensation and will be recorded as post combination expenses in the statement of profit and loss of Duck Ltd.

Question 27

On 1st April 20X1, A Limited acquired 80% of the share capital of S Limited. On acquisition date the share capital and reserves of S Ltd. stood at ` 5,00,000 and ` 1,25,000 respectively. A Limited paid initial cash consideration of ` 10,00,000. Additionally, A Limited issued 2,00,000 equity shares with a nominal value of ` 1 per share at current market value of ` 1.80 per share. It was also agreed that A Limited would pay a further sum of ` 5,00,000 after three years. A Limited's cost of capital is 10%. The appropriate discount factor for ` 1 @ 10% receivable at the end of

1st year: 0.91

2nd year: 0.83

3rd year: 0.75

The shares (issued in the year 20X2-20X3) and deferred consideration have not yet been recorded by A limited.

Below are the Balance Sheet of A Limited and S Limited as at 31st March, 20X3:

	A Limited (` 000)	S Limited (` 000)
Non-current assets:		
Property, plant & equipment	5,500	1,500
Investment in S Limited at cost	1,000	
Current assets:		
Inventory	550	100
Receivables	400	200
Cash	200	50
Equity:	7,650	1,850
Share capital	2,000	500
Retained earnings	1,400	300
	3,400	800
Non-current liabilities	3,000	400
Current liabilities	1,250	650
	7,650	1,850

Further information:



- (i) On the date of acquisition the fair values of S Limited's plant exceeded its book value by
` 2,00,000. The plant had a remaining useful life of five years at this date;
- (ii) The consolidated goodwill has been impaired by ` 2,58,000; and
- (iii) The A Limited Group, values the non-controlling interest using the fair value method. At the date of acquisition, the fair value of the 20% non-controlling interest was ` 3,80,000.

You are required to prepare Consolidated Balance Sheet of A Limited as at 31 st March, 20X3. (Notes to Account on Consolidated Balance Sheet is not required). (MTP 14 Marks March '22, MTP 15 Marks Oct 21, PYP 15 Marks Jan'21)

Answer 27

Consolidated Balance Sheet of A Ltd. and its subsidiary, S Ltd.
as at 31st March, 20X3

Particulars	` in 000s
I. Assets	
(1) Non-current assets	
(i) Property Plant & Equipment (W.N.4)	7,120.00
(ii) Intangible asset – Goodwill (W.N.3)	1,032.00
(2) Current Assets	
(i) Inventories (550 + 100)	650.00
(ii) Financial Assets	
(a) Trade Receivables (400 + 200)	600.00
(b) Cash & Cash equivalents (200 + 50)	250.00
Total Assets	9,652.00
II. Equity and Liabilities	
(1) Equity	
(i) Equity Share Capital (2,000 + 200)	2,200.00
(ii) Other Equity	
(a) Retained Earnings (W.N.6)	1190.85
(b) Securities Premium	160.00
(2) Non-Controlling Interest (W.N.5)	347.40
(3) Non-Current Liabilities (3,000 + 400)	3,400.00
(4) Current Liabilities (W.N.8)	2,353.75
Total Equity & Liabilities	9,652.00

Working Notes:

1. Calculation of purchase consideration at the acquisition date i.e. 1st April, 20X1

	` in 000s
Payment made by A Ltd. to S Ltd.	
Cash	1,000.00
Equity shares (2,00,000 shares x ` 1.80)	360.00
Present value of deferred consideration (` 5,00,000 x 0.75)	375.00

Total consideration	1,735.00

2. Calculation of net assets i.e. net worth at the acquisition date i.e. 1st April, 20X1

	₹ in 000s
Share capital of S Ltd.	500.00
Reserves of S Ltd.	125.00
Fair value increase on Property, Plant and Equipment	200.00
Net worth on acquisition date	825.00

3. Calculation of Goodwill at the acquisition date i.e. 1st April, 20X1 and 31st March, 20X3

	₹ in 000s
Purchase consideration (W.N.1)	1,735.00
Non-controlling interest at fair value (as given in the question)	380.00
	2,115.00
Less: Net worth (W.N.2)	(825.00)
Goodwill as on 1 st April 20X1	1,290.00
Less: Impairment (as given in the question)	258.00
Goodwill as on 31 st March 20X3	1,032.00

4. Calculation of Property, Plant and Equipment as on 31st March 20X3

		₹ in 000s
A Ltd.		5,500.00
S Ltd.	1,500.00	
Add: Net fair value gain not recorded yet	200.00	
Less: Depreciation $[(200/5) \times 2]$	(80.00)	
	120.00	1,620.00
		7,120.00

5. Calculation of Post-acquisition gain (after adjustment of impairment on goodwill) and value of NCI as on 31st March 20X3

	₹ in 000s	₹ in 000s
	NCI (20%)	A Ltd. (80%)
Acquisition date balance	380.00	Nil
Closing balance of Retained Earnings	300.00	
Less: Pre-acquisition balance	(125.00)	
Post-acquisition gain	175.00	
Less: Additional Depreciation on PPE $[(200/5) \times 2]$	(80.00)	
Share in post-acquisition gain	95.00	76.00
Less: Impairment on goodwill	258.00	(206.40)
	347.40	(130.40)

6. Consolidated Retained Earnings as on 31st March 20X3

	₹ in 000s
A Ltd.	1,400.00
Add: Share of post-acquisition loss of S Ltd. (W.N.5)	(130.40)
Less: Finance cost on deferred consideration (37.5 + 41.25) (W.N.7)	(78.75)



Retained Earnings as on 31 st March 20X3	1,190.85

7. Calculation of value of deferred consideration as on 31st March 20X3

	` in 000s
Value of deferred consideration as on 1 st April 20X1 (W.N.1)	375.00
Add: Finance cost for the year 20X1-20X2 (375 x 10%)	37.50
	412.50
Add: Finance cost for the year 20X2-20X3 (412.50 x 10%)	41.25
Deferred consideration as on 31 st March 20X3	453.75

8. Calculation of current Liability as on 31st March, 20X3

	` in 000s
A Ltd.	1,250.00
S Ltd.	650.00
Deferred consideration as on 31 st March, 20X3 (W.N.7)	453.75
Current Liability as on 31 st March, 20X3	2,353.75





Chapter 13

Consolidated and Separate Financial Statements of Group Entities

Question 1

Preet Pvt. Ltd. has a number of wholly-owned subsidiaries including Stuti Pvt. Ltd. at 31st March, 2018. Preet Pvt. Ltd.'s consolidated balance sheet and the carrying amount of assets and liabilities of Stuti Pvt. Ltd., included in the respective amount of respective grouped assets and liabilities of the consolidated balance sheet as at 31st March, 2018 are as follows:

Particulars	Consolidated (`in millions)	Group carrying amount of S Pvt. Ltd. asset and liabilities Ltd. (`in millions)
Assets		
Non-Current Assets		
Goodwill	380	180
Buildings	3,240	1,340
Current Assets		
Inventories	140	40
Trade Receivables	1,700	900
Cash	3,100	1000
Total Assets	8,560	3,460
Equities & Liabilities		
Equity		
Share Capital	1600	
Other Equity		
Retained Earnings	4,260	
Current liabilities		
Trade Payables	2,700	900
Total Equity & Liabilities	8,560	900

Prepare Consolidated Balance Sheet after disposal as on 31st March, 2018 when Preet Pvt. Ltd. group sold 100% shares of Stuti Pvt. Ltd. to independent party for Rs. 3,000 millions. (MTP 16 Marks Aug '18, Old & New SM) (Similar concept but different figures MTP 12 Marks Oct'18)

Answer 1

When 100% shares sold to independent party Consolidated Balance Sheet of Preet Pvt. Ltd. and its remaining subsidiaries as on 31st March, 2018.

Particulars	Note No.	(Rs. in million)
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	1,900
(ii) Goodwill	2	200
(2) Current Assets		
	3	100
	4	800
	5	5,100
		8,100
(i) Inventories		
(ii) Financial Assets	6	1,600
(a) Trade Receivables	7	4,700
(b) Cash & Cash equivalents		
Total Assets	8	1,800
		8,100



II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital		
(ii) Other Equity		
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables		
Total Equity & Liabilities		

Notes to Financial Statements:

			(Rs. in million)
1.	Property Plant & Equipment		
	Land & Building		
	Group	3,240	
	Less: Stuti Pvt. Ltd.	(1,340)	1,900
2.	Intangible Assets		
	Goodwill		
	Group	380	
	Less: Stuti Pvt. Ltd.	(180)	200
3.	Inventories		
	Group	140	
	Less: Stuti Pvt. Ltd.	(40)	100
4.	Trade Receivables		
	Group	1,700	
	Less: Stuti Pvt. Ltd.	(900)	800
5.	Cash & cash equivalents		
	Group (WN 2)	5,100	5,100
8.	Trade Payables		
	Group	2,700	
	Less: Stuti Pvt. Ltd.	900	1,800

Statement of Changes in Equity:

1. Equity Share Capital

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
1600	0	1600

2. Other Equity

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				4,260		4,260
Total comprehensive income for the year			0			
Dividend			0			

Total comprehensive income attributable to the parent			0			
Gain on disposal of Stuti Pvt. Ltd.				440		440
Balance at the end of the reporting period			0	4,700		4,700

Working Notes:

- When sold, the carrying amount of all assets and liabilities attributable to Stuti Pvt. Ltd. were eliminated from the consolidated statement of financial position.

- Cash in hand **(in million)**

Cash before disposal of Stuti Pvt. Ltd.	3,100
Less: Stuti Pvt. Ltd. Cash	(1,000)
Add: Cash realized from disposal	3,000
Cash in hand	5,100

- Gain / Loss on disposal of entity **(in million)**

Proceeds from disposal	3,000
Less: Net assets of Stuti Pvt. Ltd.	(2,560)
Gain on disposal	440

- Retained Earnings **(in million)**

Retained earnings before disposal	4,260
Add: Gain on disposal	440
Retained earnings after disposal	4,700

Question 2

Sumeru Limited holds 35% of total equity shares of Meru Limited, an associate company. The value of Investments in Meru Limited on March 31, 20X1 is Rs. 3 crores in the consolidated financial statements of Sumeru Limited.

Sumeru Limited sold goods worth Rs. 3,50,000 to Meru Limited. The cost of goods sold. is Rs. 3,00,000. Out of these, goods costing Rs. 1,00,000 to Meru Limited were in the closing stock of Meru Limited.

During the year ended March 31, 20X2 the profit and loss statement of Meru Limited showed a loss of Rs. 1 crore.

- What is the value of investment in Meru Limited as on March 31, 20 X2 in the consolidated financial statements of Sumeru Limited, if equity method is adopted for valuing the investments in associates?
- Will your answer be different if Meru Limited had earned a profit of Rs. 1.50 crores and declared a dividend of Rs. 75 lacs to the equity shareholders of the Company? (MTP 5 Marks Oct '19)

Answer 2

- Value of investment in Meru Ltd. as on 31st March, 20X2 as per equity method in the consolidated financial statements of Sumeru Ltd.

	Rs.
Cost of Investment	3,00,00,000
Less: Share in Post-acquisition Loss (1,00,00,000 x 35%)	(35,00,000)
Less: Unrealised gain on inventory left unsold with Meru Ltd.	



$\{(50,000/3,00,000) \times 1,00,000\} \times 35\%$	(5,833)
Carrying value as per Equity method	2,64,94,167

(B) Value of investment in Meru Ltd. as on 31st March, 20X2 as per equity method in the consolidated financial statements of Sumeru Ltd.

	Rs.
Cost of Investment	3,00,00,000
Add: Share in Post-Acquisition Profit $(1,50,00,000 \times 35\%)$	52,50,000
Less: Unrealised gain on inventory left unsold with Meru Ltd. $\{(50,000/3,00,000) \times 1,00,000\} \times 35\%$	(5,833)
Less: Dividend $(75,00,000 \times 35\%)$	(26,25,000)
Carrying value as per Equity method	3,26,19,167

Question 3

Tee Limited is carrying on the business of developing light weight and medium weight guns for the Indian defence industry. Tee Limited acquired 48% of shares in Kay Limited, a company engaged in advanced research in weapons. Tee Limited acquired shares in Kay Limited to substantiate their position in the industry.

The remaining 52% of shares are held by the key management personnel of the Company Kay Limited. The Kay management consists of eleven people who are experts in the fields of advanced weapons and the core of the Company.

Tee Limited has the option to purchase remaining 52% at any time by paying 6 times the market price of the share. But on purchase of the shares it is highly possible that the key management personnel will leave the company.

(A) State whether Tee Limited has control over Kay Limited.

(B) What will be your answer if Tee Limited had 51% of shares in Kay Limited and Kay Limited can start the research, development and production of weapon only with the stringent approval process of the defence ministry of the Central Government. (MTP 5 Marks Oct '19)

Answer 3

As per para 7 of Ind AS 110 / IFRS 10, an investor controls an investee if and only if the investor has all the following:

1. Power over the investee
Further, as per para 10 of the standard, an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, ie the activities that significantly affect the investee's returns.
2. Exposure, or rights, to variable returns from its involvement with the investee
As per para 15 of the standard, an investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance.
3. The ability to use its power over the investee to affect the amount of the investor's returns
An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

Based on the above guidance, following can be concluded:

- (A) Tee limited has acquired 48% in Kay Limited. The purpose of acquiring the shares by Tee limited in it is to substantiate their position in the industry. Kay Limited is a specialist entity that is engaged in advanced research in weapons. Acquiring Kay Limited will help Tee limited to gain access to their

research which would complement Tee limited's operations and business of developing light weight and medium weight guns.

The key management personnel who holds 52% shares of Kay Limited are key for running Kay Limited's business of advanced research and will help Tee limited to acquire the market through ground breaking advanced researches of Kay Limited. In case of acquisition of 52% stake of Kay Limited, the key management personnel may leave the organisation and in such a situation Tee limited will not enjoy any economic benefit or infact will lose the benefit of unique technical knowledge of those 11 experts.

Hence, Tee limited would not be able to use its power over Kay Limited to affect the amount of its returns which is one of the essential criteria to assess the control, so there is no control of Tee limited on Kay Limited.

- (B) Even though Tee limited has acquired 51% stake in Kay Limited yet it does not have power over Kay Limited as it would not be able to exercise its existing rights that give it the current ability to direct the relevant activities, ie the activities that significantly affect the investee's returns. In other words, the relevant activity of Kay Limited is advance research in weapons which will help Tee limited to substantiate their position. However, the research, development and production will start only after stringent approval process of the defence ministry of the Central Government. Thus regulations prevent Tee limited to direct the relevant activity of Kay Limited which ultimately lead to prevent Tee Limited to have control.

Question 4

DEF Ltd. acquired 100% ordinary shares of Rs. 100 each of XYZ Ltd. on 1st October 20X1. On 31st March, 20X2 the summarised Balance Sheets of the two companies were as given below:

	DEF Ltd.	XYZ Ltd.
Assets		
Property Plant Equipment		
Land & Buildings	15,00,000	18,00,000
Plant & Machinery	24,00,000	13,50,000
Investment in XYZ Ltd.	34,00,000	-
Inventory	12,00,000	3,64,000
Financial Assets		
Trade Receivable	5,98,000	4,00,000
Cash	1,45,000	80,000
Total	92,43,000	39,94,000
Equity & Liabilities		
Equity Capital (Shares of Rs. 100 each fully paid)	50,00,000	20,00,000
Other Equity		
Other reserves	24,00,000	10,00,000
Retained Earnings	5,72,000	8,20,000
Financial Liabilities		
Bank Overdraft	8,00,000	-
Trade Payable	4,71,000	1,74,000
Total	92,43,000	39,94,000

The retained earnings of XYZ Ltd. showed a credit balance of Rs. 3,00,000 on 1st April 20X1 out of which a dividend of 10% was paid on 1st November; 20X1 DEF Ltd. has recognised the dividend received to profit or loss account; Fair Value of Plant & Machinery as on 1st October 20X1 was Rs. 20,00,000. The rate of depreciation on plant & machinery is 10%.



Following are the increases on comparison of Fair value as per respective Ind AS with Book value as on 1st October 20X1 which are to be considered while consolidating the Balance Sheets.

Liabilities	Amount	Assets	Amount
Trade Payables	1,00,000	Land & Buildings	10,00,000
		Inventories	1,50,000

Notes:

1. It may be assumed that the inventory is still unsold on balance sheet date and the Trade Payables are also not yet settled.
2. Also assume that the Other Reserves of both the companies as on 31st March 20X2 are the same as was on 1st April 20X1.
3. All fair value adjustments have not yet started impacting consolidated post-acquisition profits.
4. Investment in XYZ Ltd is carried at cost in the separate financial statements of DEF Ltd.
5. Appreciation of Rs.10 lakhs in land & buildings is entirely attributable to land element only.
6. Depreciation on plant and machinery is on WDV method.
7. Acquisition-date fair value adjustment to inventories of XYZ Ltd. existing at the balance sheet date does not result in need for any write-down.

Prepare consolidated Balance Sheet as on 31st March, 20X2. (MTP 14 Marks Mar '21) (Same concept & figures but fewer adjustments- Old & New SM)

Answer 4

Consolidated Balance Sheet of DEF Ltd. and its subsidiary, XYZ Ltd. as on 31st March, 20X2

Particulars	Note No.	Rs.
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	86,00,000
(2) Current Assets		
(i) Inventories	2	17,14,000
(ii) Financial Assets		
(a) Trade Receivables	3	9,98,000
(b) Cash & Cash equivalents	4	2,25,000
Total Assets		1,15,37,000
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	5	50,00,000
(ii) Other Equity	6	49,92,000
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	7	7,45,000
(b) Short term borrowings	8	8,00,000
Total Equity & Liabilities		1,15,37,000

Notes to Accounts

		Rs.
1.	Property Plant & Equipment	
	Land & Building	43,00,000



	Plant & Machinery (W.N. 7)	43,00,000	86,00,000
2.	Inventories		
	DEF Ltd.	12,00,000	
	XYZ Ltd.	5,14,000	17,14,000
3.	Trade Receivables		
	DEF Ltd.	5,98,000	
	XYZ Ltd.	4,00,000	9,98,000
4.	Cash & Cash equivalents		
	DEF Ltd.	1,45,000	
	XYZ Ltd.	80,000	2,25,000
7.	Trade payable		
	DEF Ltd.	4,71,000	
	XYZ Ltd.	2,74,000	7,45,000
8.	Shorter-term borrowings		
	Bank overdraft		8,00,000

Statement of Changes in Equity:
1. Equity share Capital

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
50,00,000	0	50,00,000

2. Other Equity

	Share application money pending allotment	Equity component of compound financial instrument	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Other Reserves	
Balance at the beginning				0	24,00,000	24,00,000
Total comprehensive income for the year			0	5,72,000		5,72,000
Dividends			0	(2,00,000)		(2,00,000)
Total comprehensive income attributable to parent			0	3,35,000		3,35,000
Gain on Bargain purchase			18,85,000			18,85,000
Balance at the end of reporting period			18,85,000	7,07,000	24,00,000	49,92,000



It is assumed that there exists no clear evidence for classifying the acquisition of the subsidiary as a bargain purchase and, hence, the bargain purchase gain has been recognized directly in capital reserve. If, however, there exists such a clear evidence, the bargain purchase gain would be recognized in other comprehensive income and then accumulated in capital reserve. In both the cases, closing balance of capital reserve will be Rs. 18,85,000.

Working Notes:

1. Adjustments of Fair Value

The Plant & Machinery of XYZ Ltd. would stand in the books at Rs. 14,25,000 on 1st October, 20X1, considering only six months' depreciation on Rs. 15,00,000 total depreciation being Rs. 1,50,000. The value put on the assets being Rs. 20,00,000 there is an appreciation to the extent of Rs. 5,75,000.

2. Acquisition date profits of XYZ Ltd. Rs.

Reserves on 1.4. 20X1	10,00,000
Profit & Loss Account Balance on 1.4. 20X1	3,00,000
Profit for 20X2: Total Rs. 8,20,000 less Rs. 1,00,000 (3,00,000 – 2,00,000) i.e. Rs. 7,20,000; for 6 months i.e. up to 1.10.20X1	3,60,000
Total Appreciation including machinery appreciation (10,00,000 1,50,000 + 5,75,000 – 1,00,000)	16,25,000
Share of DEF Ltd.	32,85,000

3. Post-acquisition profits of XYZ Ltd. Rs.

Profit after 1.10. 20X1 [8,20,000-1,00,000]x 6/12	3,60,000
Less: 10% depreciation on Rs. 20,00,000 for 6 months less depreciation already charged for 2 nd half of 20X1-20X2 on Rs. 15,00,000 (1,00,000-75,000)	(25,000)
Share of DEF Ltd.	3,35,000

4. Consolidated total comprehensive income Rs.

DEF Ltd.	
Retained earnings on 31.3.20X2	5,72,000
Less: Retained earnings as on 1.4.20X1 Profits for the year 20X1-20X2	(0) 5,72,000
Less: Elimination of intra-group dividend	(2,00,000)
Adjusted profit for the year	3,72,000
XYZ Ltd.	
Adjusted profit attributable to DEF Ltd. (W.N.3)	3,35,000
Consolidated profit or loss for the year	7,07,000

5. No Non-controlling Interest as 100% shares of XYZ Ltd. are held by DEF Ltd.

6. Gain on Bargain Purchase Rs.

Amount paid for 20,000 shares Par value of shares	20,00,000	34,00,000
DEF Ltd.'s share in acquisition date profits of XYZ Ltd.	32,85,000	(52,85,000)
Gain on Bargain Purchase		18,85,000

7. Value of Plant & Machinery Rs.

DEF Ltd. XYZ Ltd.	13,50,000	24,00,000
Add: Appreciation on 1.10. 20X1	5,75,000	
	19,25,000	



Add: Depreciation for 2nd half charged on pre- revalued value	75,000	
Less: Depreciation on Rs. 20,00,000 for 6 months	(1,00,000)	19,00,000
		43,00,000

Question 5

X Ltd. owns 20% of the voting rights in Y Ltd. and is entitled to appoint one director to the board, which consist of five members. The remaining 80% of the voting rights are held by two entities, each of which is entitled to appoint two directors.

A quorum of four directors and a majority of those present are required to make decisions. The other shareholders frequently call board meeting at the short notice and make decisions in the absence of X Ltd's representative. X Ltd has requested financial information from Y Ltd, but this information has not been provided. X Ltd's representative has attended board meetings, but suggestions for items to be included on the agenda have been ignored and the other directors oppose any suggestions made by X Ltd. Is Y Ltd an associate of X Ltd.? (MTP 4 Marks Mar '19)

Answer 5

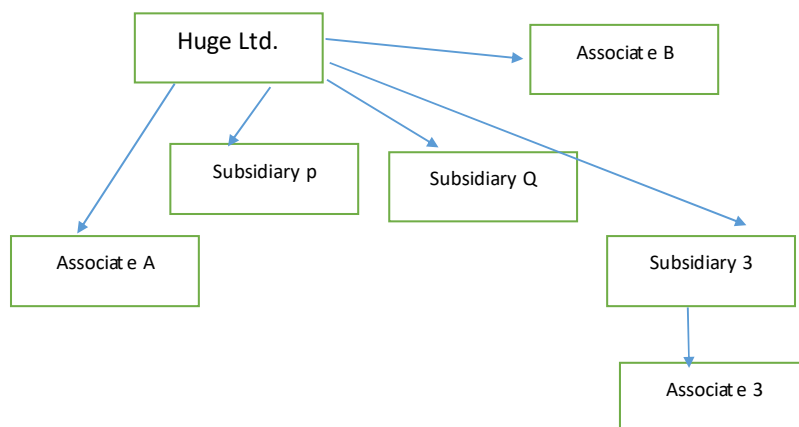
Despite the fact that the X Ltd owns 20% of the voting rights and has representations on the board, the existence of other shareholders holding a significant proportion of the voting rights prevent X Ltd. from exerting significant influence. Whilst it appears the X Ltd should have the power to participate in the financial and operating policy decision, the other shareholders prevent X Ltd's efforts and stop X Ltd from actually having any influence. In this situation, Y Ltd would not be an associate of X Ltd.

Question 6

Huge Ltd. has a controlling interest in Subsidiaries P, Q and R and has significant influence over Associates A and B. Subsidiary R has significant influence over Associate C. Determine the related party relationship, as per Ind AS 24, of the entities referred in the question in the following financial statements:

- In consolidated financial statements of Huge Ltd.
- In individual financial statements of Huge Ltd.
- In individual financial statements of Subsidiary P
- In individual financial statements of Subsidiary Q
- In individual financial statements of Subsidiary R
- In individual financial statements of Associates A, B and C (MTP 10 Marks April '18)

Answer 6



As per para 9 (b) (i) and (ii) of Ind AS 24,

“An entity is related to a reporting entity if any of the following conditions applies:

- The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).



- (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member)."

Accordingly,

- (i) **For Huge Ltd.'s consolidated financial statements-** Associates A, B and C are related to the Group.
- (ii) **For Huge Ltd.'s separate financial statements-** Subsidiaries P, Q and C and Associates A, B and C are related parties.
- (iii) **For Subsidiary P's financial statements-** Parent, Subsidiaries Q and R and Associates A, B and C are related parties.
- (iv) **For Subsidiary Q's separate financial statements-** Parent, Subsidiaries P and R and Associates A, B and C are related parties.
- (v) **For Subsidiary R's financial statements-** Parent, Subsidiaries P and Q and Associates A, B and C are related parties.
- (vi) **For the financial statements of Associates A, B and C-** Parent and Subsidiaries

Question 7

On 10th May, 2016, A Ltd. acquired 40% shares of B Ltd. for Rs. 45,00,000. By such an acquisition Rohtas Ltd. can exercise significant influence over B Ltd. During the financial year ending on 31st March, 2016, B Ltd. earned profits Rs. 11,54,000 and declared a dividend of Rs. 2,48,000 on 16th September, 2016. B Ltd. reported earnings of Rs. 26,26,000 for the financial year ending on 31st March, 2017 and declared dividend of Rs. 9,85,000 on 17th August, 2017.

You are required to calculate the carrying amount of investments in Separate Financial Statements of A Ltd. as on 31st March, 2017 and also in Consolidated Financial Statements of A Ltd. as on 31st March, 2017. What will be the carrying amount of Investments in Consolidated Financial Statements of A Ltd. if prepared on 31st August 2017 on the basis of Accounting Standards? (MTP 6 Marks April '18)(Same concept different figures MTP 6 Marks Apr'19)

Answer 7

- (i) **Carrying amount of investment in Separate Financial Statement of A Ltd. as on 31.03.2017**

	Rs.
Amount paid for investment in Associate (on 10.5.2016)	45,00,000
Less: Pre-acquisition dividend (` 2,48,000 x 40%)	(99,200)
Carrying amount as on 31.3.2017	44,00,800

- (ii) **Carrying amount of investment in Consolidated Financial Statements of A Ltd. as on 31.3.2017 as per AS 23**

	Rs.
Carrying amount as per separate financial statements	44,00,800
Add: Proportionate share of profit of investee as per equity method (40% of ` 26,26,000)	10,50,400
Carrying amount as on 31.3.2017 as per AS 23	54,51,200

- (iii) **Carrying amount of investment in Consolidated Financial Statement of A Ltd. as on 31.8.2017 as per AS 23**

	Rs.
Carrying amount as on 31.3.2017	54,51,200
Less: Dividend received (` 9,85,000 x 40%)	(3,94,000)



Carrying amount as on 31.8.2017 as per AS 23	50,57,200

Question 8

A parent purchased an 80% interest in a subsidiary for Rs. 1,60,000 On 1 April 20X1 when the fair value of the subsidiary's net assets was Rs. 1,75,000. Goodwill of Rs. 20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of Rs. 8,000 was charged in the consolidated financial statements to 31 March 20X3. No other impairment charges have been recorded. The parent sold its investment in the subsidiary on 31 March 20X4 for Rs. 2,00,000. The book value of the subsidiary's net assets in the consolidated financial statement on the date of the sale was Rs. 2,25,000 (not including goodwill of Rs. 12,000). When the subsidiary met the criteria to be classified as held for sale under Ind AS 105, no write down was required because the expected fair value less cost to sell (of 100% of the subsidiary) was greater than the carrying value.

The parent carried the investment in the subsidiary at cost, as permitted by Ind AS 27.

Calculate gain or loss on disposal of subsidiary in parents separate and consolidated financial statement as on 31st March 20X4. (MTP 6 Marks April 19, Old & New SM)

Answer 8

The parent's separate statement of profit and loss for 20X3-20X4 would show a gain on the sale of investment of Rs. 40,000 calculated as follow:

	Rs. '000
Sale proceeds	200
Less: Cost of investment in subsidiary	(160)
Gain on sale in parent's account	40

However, the group's statement of profit & loss for 20X3-20X4 would show a gain on the sale of subsidiary of Rs. 8,000 calculated as follows:

	Rs. '000	
Sale proceeds	200	
Less: share of net assets at date of disposal (Rs. 2,25,000 X 80%)	(180)	Goodwill
on consolidation at date of sale (W.N 1)	(12) (192)	
Gain on sale in the group's account	8	

Working Note

The goodwill on consolidation (assuming partial goodwill method) is calculated as follows:

	Rs.'000
Fair value of consideration at the date of acquisition	160
Non- controlling interest measured at proportionate share of the acquiree's identifiable net assets (1,75,000 X 20%)	35
Less: fair value of net assets of subsidiary at date of acquisition (175)	(140)
Goodwill arising on consolidation	20
Impairment at 31 March 20X3	(8)
Goodwill at 31 March 20X4	12

Question 9

The following information relates to the results of the parent and subsidiary (jointly) and the investment in associate and joint venture: (All figures are in rupees)

Summarized Balance Sheet as at 31.3.20X1



	Holding and subsidiary	Associate	Joint Venture
Equity and Liabilities			
Called up equity shares of Rs. 1 each	1,00,000	40,000	10,000
General reserve	40,000		-
Profit and loss account	37,000	27,000	83,000
Minority Interest	20,000	-	-
Current Liabilities			
Trade payables -Creditors	20,000	32,000	6,000
Provision for tax	19,000	11,000	11,000
	2,36,000	1,10,000	1,10,000
Assets			
Non-current assets			
Fixed assets- Tangible assets	1,95,000	74,000	41,000
Investments:			
8,000 shares in Associate	15,000	-	-
5,000 shares in Joint Venture	5,000	-	-
Current assets	21,000	36,000	69,000
	2,36,000	1,10,000	1,10,000

Details of Profit and Loss account for the year ended 31.3.20X1

	Holding and subsidiary	Associate	Joint Venture
Retained profit for the year	15,000	11,000	23,000
Add: Retained profit brought forward	22,000	16,000	60,000
Retained profit carried forward	37,000	27,000	83,000

You are given the following additional information:

- The parent company purchased its investment in the associate two years ago when the balance on the profit and loss account was Rs. 17,000. There are no signs of impairment of the goodwill.
- The parent company entered into a joint venture to access a lucrative market in the former East Germany. It set up a company two years ago and has 50 per cent of the voting rights of the company set up for this joint venture.

Prepare the consolidated balance sheet for the Group as per relevant Accounting Standards for the year ended 31.3.20X1. (MTP 16 Marks March '18)

Answer 9

(a) Consolidated Balance Sheet as on 31.3.20X1

Particulars	Note No.	Rs.
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,00,000
(b) Reserves and Surplus	2	1,20,700
(2) Minority Interest		20,000
(3) Current Liabilities	3	23,000



(a) Trade Payables		4	24,500
(b) Short Term Provisions			2,88,200
	Total		
II. Assets			
(1) Non-current assets			
(a) Fixed assets		5	2,15,500
Tangible assets		6	17,200
(b) Non-current investment		7	55,500
(2) Current assets	Total		2,88,200

Notes to Accounts

			Rs.
1.	Share Capital		
	Called up equity shares of Rs. 1 each		1,00,000
	Reserves and Surplus	40,000	
	General Reserve		
	Profit and Loss A/c (W.N.3)	80,700	1,20,700
3.	Trade Payables		
	Holding & Subsidiary	20,000	
	Joint Venture (50%)	3,000	23,000
4.	Short term provisions		
	Provisions for Tax		
	Holding & Subsidiary	19,000	
	Joint Venture (50%)	5,500	24,500
5.	Tangibles Assets		
	Holding & Subsidiary	1,95,000	
	Joint Venture (50%)	20,500	2,15,500
6.	Non-current investment		
	Investment in Associate (W.N.4)		17,200
7.	Current Asset		
	Holding & Subsidiary	21,000	
	Joint Venture (50%)	34,500	55,500

Working Notes:
1. Analysis of Profit & Loss of Associate / Joint Venture

	Pre-acquisition	Post-acquisition
	Rs.	Rs.
Profit as on 31.3.20X1	27,000	11,000
Share of Associate company (20%)	3,200	2,200
Analysis of Profit and Loss of Joint Venture	Nil	83,000
Share of Joint Venture (50%)		41,500

2. Calculation of Goodwill/Capital Reserve

	Associate	Joint Venture
	Rs.	Rs.



Investment		15,000		5,000
Less: Nominal Value	8,000		5,000	
Capital Profit	3,200	(11,200)	-	(5,000)
Goodwill		3,800		Nil

3. Calculation of Consolidated Profit and Loss Account

	Rs.
Profit and Loss Account of Holding & Subsidiary	37,000
Add: Share of Associate (W.N.1)	2,200
Joint Venture (W.N.1)	41,500
	80,700

4. Calculation of Investment in Associate

	Rs.
Goodwill (W.N.2)	3,800
Net worth	11,200
Cost	15,000
Add: Share of Revenue Profit	2,200
	17,200

Note: Out of Rs. 17,000 existed at the time of acquisition, only Rs. 16,000 (Opening Balance) is continuing in the books of the associate. Therefore, Rs. 16,000 is taken as capital profit assuming that it is a part of that Rs. 17,000 existed at the time of acquisition.

Question 10

Two parties structure a joint arrangement in an incorporated entity i.e. Entity A in which each party has a 50% ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties. The legal form of Entity A (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in Entity A are the assets and liabilities of Entity A. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of Entity A. There are following other relevant facts and circumstances applicable in this case:

- The parties agreed to purchase all the output produced by Entity A in a ratio of 50:50. Entity A cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material.
- The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by Entity A. Based on this operating model, the arrangement is intended to operate at a break-even level.

Based on the above fact pattern, determine whether the arrangement is a joint operation or a joint venture? Will your conclusion change in case Entity A sells all its output to third parties instead of its owners? (MTP 6 Marks April 22, Old & New SM)

Answer 10

The legal form of Entity A and the terms of the contractual arrangement indicate that the arrangement is a joint venture. However, the other relevant facts and circumstances mentioned above indicates that:

- the obligation of the parties to purchase all the output produced by Entity A reflects the exclusive dependence of Entity A upon the parties for the generation of cash flows and, thus, the parties have an



obligation to fund the settlement of the liabilities of Entity A.

- the fact that the parties have rights to all the output produced by Entity A means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of Entity A.

These facts and circumstances indicate that the arrangement is a joint operation.

The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in a subsequent manufacturing process, the parties sold their share of the output to third parties.

If the parties changed the terms of the contractual arrangement so that the arrangement was able to sell output to third parties, this would result in Entity A assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require

reassessment of the classification of the joint arrangement. Such facts and circumstances would indicate that the arrangement is a joint venture.

Question 11

High Speed Ltd. has entered into a Share Purchase Agreement ("SPA") with the shareholders of Fast Move Limited to purchase 30% stake in Fast Move Limited as at 1 st June, 20X1 at a price of ₹ 30 per share. As per the terms of SPA, High Speed Ltd. has an option to purchase additional 25% stake in Fast Move Limited on or before 15th June, 20X1 at a price of ₹ 30 per share. Similarly, the selling shareholder has an option to sell additional 25% stake in Fast Move Limited on or before 15.6.20X1 to High Speed Ltd. at a price of ₹ 30 per share. The decisions on relevant activities of Fast Move Limited are made in Annual General Meeting / Extraordinary General Meeting (AGM / EGM). A resolution in AGM / EGM is passed when more than 50% votes are casted in favor of the resolution. An AGM / EGM can be called by giving atleast 21 days advance notice to all shareholders.

With respect to the SPA entered by High Speed Ltd., you are required to determine whether High Speed Ltd. has control over Fast Move Limited as at 1st June, 20X1. (MTP 5 Marks Oct'22)

Answer 11

Paragraph 10 of Ind AS 110 'Consolidated Financial Statements', states that an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e. the activities that significantly affect the investee's returns.

As per the facts given in the question, High Speed Ltd. has 15 days to exercise the option to purchase 25% additional stake in Fast Move Ltd. which will give it majority voting rights of 55% (30% + 25%). This is a substantive potential voting rights which is currently exercisable.

Further, the decisions on relevant activities of Fast Move Ltd. are made in AGM / EGM. An AGM/ EGM can be called by giving atleast 21 days advance notice. A resolution in AGM / EGM is passed when more than 50% votes are casted in favour of the resolution. Thus, the existing shareholders of Fast Move Ltd. are unable to change the existing policies over the relevant activities before the exercise of option by High Speed Ltd.

High Speed Ltd. can exercise the option and get voting rights of more than 50% at the date of AGM/ EGM. Accordingly, the option contract gives High Speed Ltd. the current ability to direct the relevant activities even before the option contract is settled. Therefore, High Speed Ltd. controls Fast Move Ltd. as at 1st June, 20X1.

Question 12

On 1st April 20X1, Investor Ltd. acquires 35% interest in another entity, XYZ Ltd. Investor Ltd. determines that it is able to exercise significant influence over XYZ Ltd. Investor Ltd. has paid total consideration of ₹ 47,50,000 for acquisition of its interest in XYZ Ltd. At the date of acquisition, the book value of XYZ Ltd.'s net assets was ₹ 90,00,000 and their fair value was ₹ 1,10,00,000. Investor Ltd. has determined that



the difference of ₹ 20,00,000 pertains to an item of property, plant and equipment (PPE) which has remaining useful life of 10 years.

During the year, XYZ Ltd. made a profit of ₹ 8,00,000. XYZ Ltd. paid a dividend of ₹ 12,00,000 on 31st March, 20X2. XYZ Ltd. also holds a long-term investment in equity securities. Under Ind AS, investment is classified as at FVTOCI in accordance with Ind AS 109 and XYZ Ltd. recognized an increase in value of investment by ₹ 2,00,000 in OCI during the year. Ignore deferred tax implications, if any.

Calculate the closing balance of Investor Ltd.'s investment in XYZ Ltd. as at 31st March, 20X2 as per the relevant Ind AS. (MTP 8 Marks Oct'22, RTP Nov'20, Old & New SM) (Same concept different figures PYP 5 Marks Nov'22)

Answer 12

Calculation of Investor Ltd.'s investment in XYZ Ltd. under equity method:

	₹	₹
Cost of investment		47,50,000
Acquisition of investment in XYZ Ltd.		
Share in book value of XYZ Ltd.'s net assets (35% of ₹ 90,00,000)	31,50,000	
Share in fair valuation of XYZ Ltd.'s net assets [35% of (₹ 1,10,00,000 – ₹ 90,00,000)]	7,00,000	38,50,000
Goodwill on investment in XYZ Ltd. (balancing figure)		9,00,000
Cost of investment		47,50,000
Profit during the year		
Share in the profit reported by XYZ Ltd. (35% of ₹ 8,00,000)	2,80,000	
Adjustment to reflect effect of fair valuation [35% of (₹ 20,00,000/10 years)]	(70,000)	
Share of profit in XYZ Ltd. recognised in income by Investor Ltd.		2,10,000
Long term equity investment		
FVTOCI gain recognised in OCI (35% of ₹ 2,00,000)		70,000
Dividend received by Investor Ltd. during the year [35% of ₹ 12,00,000]		(4,20,000)
Closing balance of Investor Ltd.'s investment in XYZ Ltd.		46,10,000

Question 13

Blue Ltd. acquired 25% of the equity share capital of Green Ltd. on the first day of the financial year for ₹ 1,25,000. As of that date, the carrying value of the net assets of Green Ltd. was ₹ 3,00,000 and the fair value was ₹ 4,00,000. The excess of fair value over the carrying value was attributable to one of the buildings owned by Green Ltd. having a remaining useful life of 20 years. Green Ltd. earned profit of ₹ 40,000 and other comprehensive income of ₹ 10,000 during the year. Calculate the goodwill / capital reserve on the date of acquisition, Blue Ltd.'s share in the profit and other comprehensive income for the year and closing balance of investment at the end of the year. (MTP 8 Marks Nov 21, Old & New SM)

Answer 13

(1) Goodwill / capital reserve on the date of acquisition

The cost of the investment is higher than the net fair value of the investee's identifiable assets and liabilities. Hence there is goodwill. Amount of goodwill is calculated as follows

	₹
Cost of acquisition of investment	1,25,000



Blue Ltd.'s share in fair value of net assets of Green Ltd. on the date of acquisition (4,00,000 * 25%)	(1,00,000)
Goodwill	25,000

Above goodwill will be recorded as part of carrying amount of the investment.

(2) Share in profit and other comprehensive income of Gren Ltd.

	₹
Share in profit of Green Ltd. (40,000 x 25%)	10,000
Adjustment for depreciation based on fair value (1,00,000 ÷ 20) x 25%	(1,250)
Share in profit after adjustment	8,750
Share in other comprehensive income (10,000 x 25%)	2,500

(3) Closing balance of investment at the end of the year

	₹
Cost of acquisition of investment (including goodwill of ₹ 25,000)	1,25,000
Share in profit after adjustments	8,750
Share in other comprehensive income	2,500
Closing balance of investment	1,36,250

Question 14

On the first day of a financial year, A Ltd. invested in the equity share capital of B Ltd. at a cost of ₹ 1,00,000 to acquire 25% share in the voting power of B Ltd. A Ltd. has concluded that B Ltd. is an associate of A Ltd. At the end of the year, B Ltd. earned profit of ₹ 10,000 and other comprehensive income of ₹ 2,000. In that year, B Ltd. also declared dividend to the extent of ₹ 4,000. Pass necessary entries in the books of A Ltd. to account for the investment in associate. (MTP 4 Marks April '23, Old & New SM)

Answer 14

Following entries would be passed in the books of A Ltd.:

1) Initial entry to record investment done in associate

Investment in B Ltd. A/c	Dr.	1,00,000	
To Bank A/c			1,00,000

2) Recording of share in the profit of the associate

Investment in B Ltd. A/c	Dr.	2,500	
To Share in profit of investee (P&L)		2,500	

[A Ltd. share in profit would be ₹ 2,500 (₹ 10,000 x 25%)]

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

Investment in B Ltd. A/c	Dr.	500	
To Share in OCI of investee (OCI)			500

[A Ltd. share in OCI would be ₹ 500 (₹ 2,000 x 25%)]

4) Recording of dividend distributed by associate

Dividend Receivable A/c	Dr.	1,000	
To Investment in B Ltd. A/c			1,000



[A Ltd. share in dividend would be ₹ 1,000 (₹ 4,000 x 25%)]

Question 15

On 1st April, 20X1, Alpha Ltd. commenced joint construction of a property with Gama Ltd. For this purpose, an agreement has been entered into that provides for joint operation and ownership of the property. All the ongoing expenditure, comprising maintenance plus borrowing costs, is to be shared equally. The construction was completed on 30th September 20X1 and utilisation of the property started on 1st January 20X2 at which time the estimated useful life of the same was estimated to be 20 years.

Total cost of the construction of the property was ₹ 40 crores. Besides internal accruals, the cost was partly funded by way of loan of ₹ 10 crores taken on 1st January, 20X1. The loan carries interest at an annual rate of 10% with interest payable at the end of year on 31st December each year. The company has spent ₹ 4,00,000 on the maintenance of such property.

The company has recorded the entire amount paid as investment in Joint Venture in the books of accounts. Suggest the suitable accounting treatment of the above transaction as per applicable Ind AS. (MTP 6 Marks Sep '23)

Answer 15

As provided in Ind AS 111 'Joint Arrangements', this is a joint arrangement because two or more parties have joint control of the property under a contractual arrangement. The arrangement will be regarded as a joint operation because Alpha Ltd. and Gama Ltd. have rights to the assets and obligations for the liabilities of this joint arrangement. This means that the company and the other investor will each recognise 50% of the cost of constructing the asset in property, plant and equipment.

The borrowing cost incurred on constructing the property should under the principles of Ind AS 23 'Borrowing Costs', be included as part of the cost of the asset for the period of construction.

In this case, the relevant borrowing cost to be included is ₹ 50,00,000 (₹ 10,00,00,000 x 10% x 6/12).

The total cost of the asset is ₹ 40,50,00,000 (₹ 40,00,00,000 + ₹ 50,00,000)

₹ 20,25,00,000 crores is included in the property, plant and equipment of Alpha Ltd. and the same amount in the property, plant and equipment of Gama Ltd.

The depreciation charge for the year ended 31st March, 20X2 will therefore be ₹ 1,01,25,000 (₹ 40,50,00,000 x 1/20 x 6/12) ₹ 50,62,500 will be charged in the statement of profit and loss of the company and the same amount in the statement of profit and loss of Gama Ltd.

The other costs relating to the arrangement in the current year totalling ₹ 54,00,000 (finance cost for the second half year of ₹ 50,00,000 plus maintenance costs of ₹ 4,00,000) will be charged to the statement of profit and loss of Alpha Ltd. and Gama Ltd. in equal proportions - ₹ 27,00,000 each.

Question 16

On 1st April, 20X1, A Ltd. acquired 80% of the share capital of S Ltd. On acquisition date the share capital and reserves of S Ltd. stood at ₹ 5,00,000 and ₹ 1,25,000 respectively. A Ltd.'s paid initial cash consideration of ₹ 10,00,000. Additionally, A Ltd. issued 2,00,000 equity shares with a nominal value of ₹ 1 per share at current market value of ₹ 1.80 per share. It was also agreed that A Ltd. would pay a further sum of ₹ 5,00,000 after three years. A Ltd.'s cost of capital is 10%. The appropriate discount factor for ₹ 1 @ 10% receivable at the end of

1st year: 0.91

2nd year: 0.83

3rd year: 0.75

The shares and deferred consideration have not yet been recorded by A limited. Below are the Balance Sheet of A Ltd. and S Ltd. as at 31st March, 20X3:



	A Ltd. (` 000)	S Ltd. (` 000)
Non-current assets:		
Property, plant & equipment	5,500	1,500
Investment in S Ltd. at cost	1,000	
Current assets:		
Inventory	550	100
Receivables	400	200
Cash	200	50
	7,650	1,850
Equity:		
Share capital	2,000	500
Retained earnings	1,400	300
	3,400	800
Non-current liabilities	3,000	400
Current liabilities	1,250	650
	7,650	1,850

Further information:

- On the date of acquisition the fair values of S Ltd.'s plant exceeded its book value by ` 2,00,000. The plant had a remaining useful life of five years at this date;
- The consolidated goodwill has been impaired by ` 2,58,000; and
- A Ltd. Group values the non-controlling interest using the fair value method. At the date of acquisition, the fair value of 20% non-controlling interest was ` 3,80,000.

You are required to prepare Consolidated Balance Sheet of A Ltd. as at 31st March, 20X3. (Notes to Account on Consolidated Balance Sheet is not required). (15 Marks Oct '23)

Answer 16

Consolidated Balance Sheet of A Ltd. and its subsidiary, S Ltd.

as at 31st March, 20X3

Particulars	` in 000s
I. Assets	
(1) Non-current assets	
(i) Property Plant & Equipment (W.N.4)	7,120.00
(ii) Intangible asset – Goodwill (W.N.3)	1,032.00
(2) Current Assets	
(i) Inventories (550 + 100)	650.00
(ii) Financial Assets	
(a) Trade Receivables (400 + 200)	600.00
(b) Cash & Cash equivalents (200 + 50)	250.00
Total Assets	9,652.00
II. Equity and Liabilities	
(1) Equity	
(i) Equity Share Capital (2,000 + 200)	2,200.00
(ii) Other Equity	
(a) Retained Earnings (W.N.6)	1190.85
(b) Securities Premium	160.00



(2) Non-Controlling Interest (W.N.5)	347.40
(3) Non-Current Liabilities (3,000 + 400)	3,400.00
(4) Current Liabilities (W.N.8)	2,353.75
Total Equity & Liabilities	9,652.00

Notes:

1. Since the question required not to prepare Notes to Account, the column of Note to Accounts had not been drawn.
2. It is assumed that shares were issued during the year 20X2-20X3 and entries are yet to be made.

Working Notes:

1. Calculation of purchase consideration at the acquisition date i.e. 1 st April, 20X1

	₹ in 000s
Payment made by A Ltd. to S Ltd.	
Cash	1,000.00
Equity shares (2,00,000 shares x ₹ 1.80)	360.00
Present value of deferred consideration (₹ 5,00,000 x 0.75)	375.00
Total consideration	1,735.00

2. Calculation of net assets i.e. net worth at the acquisition date i.e. 1 st April, 20X1

	₹ in 000s
Share capital of S Ltd.	500.00
Reserves of S Ltd.	125.00
Fair value increase on Property, Plant and Equipment	200.00
Net worth on acquisition date	825.00

3. Calculation of Goodwill at the acquisition date i.e. 1st April, 20X1 and 31st March, 20X3

	₹ in 000s
Purchase consideration (W.N.1)	1,735.00
Non-controlling interest at fair value (as given in the question)	380.00
	2,115.00
Less: Net worth (W.N.2)	(825.00)
Goodwill as on 1st April, 20X1	1,290.00
Less: Impairment (as given in the question)	258.00
Goodwill as on 31st March, 20X3	1,032.00

4. Calculation of Property, Plant and Equipment as on 31st March, 20X3

		₹ in 000s
A Ltd.		5,500.00
S Ltd.	1,500.00	
Add: Net fair value gain not recorded yet	200.00	
Less: Depreciation [(200/5) x 2]	(80.00)	
	120.00	1,620.00
		7,120.00

5. Calculation of Post-acquisition gain (after adjustment of impairment on goodwill) and value of NCI as on 31st March, 20X3



		₹ in 000s	₹ in 000s
		NCI (20%)	A Ltd(80%)
Acquisition date balance		380.00	Nil
Closing balance of Retained Earnings	300.00		
Less: Pre-acquisition balance	(125.00)		
Post-acquisition gain	175.00		
Less: Additional Depreciation on PPE $[(200/5) \times 2]$ (80.00)			
Share in post-acquisition gain	95.00	19.00	76.00
Less: Impairment on goodwill	258.00	(51.60)	(206.40)
		347.40	(130.40)

6. Consolidated Retained Earnings as on 31st March, 20X3

	₹ in 000s
A Ltd.	1,400.00
Add: Share of post-acquisition loss of S Ltd. (W.N.5)	(130.40)
Less: Finance cost on deferred consideration $(37.5 + 41.25)$ (W.N.7)	(78.75)
Retained Earnings as on 31st March, 20X3	1,190.85

7. Calculation of value of deferred consideration as on 31st March, 20X3

	₹ in 000s
Value of deferred consideration as on 1st April, 20X1 (W.N.1)	375.00
Add: Finance cost for the year 20X1-20X2 $(375 \times 10\%)$	37.50
	412.50
Add: Finance cost for the year 20X2-20X3 $(412.50 \times 10\%)$	41.25
Deferred consideration as on 31st March, 20X3	453.75

8. Calculation of current Liability as on 31st March, 20X3

	₹ in 000s
A Ltd.	1,250.00
S Ltd.	650.00
Deferred consideration as on 31st March, 20X3 (W.N.7)	453.75
Current Liability as on 31st March, 20X3	2,353.75

Question 17

On 1st April 2017 Alpha Ltd. commenced joint construction of a property with Gama Ltd. For this purpose, an agreement has been entered into that provides for joint operation and ownership of the property. All the ongoing expenditure, comprising maintenance plus borrowing costs, is to be shared equally. The construction was completed on 30th September 2017 and utilisation of the property started on 1st January 2018 at which time the estimated useful life of the same was estimated to be 20 years.

Total cost of the construction of the property was Rs. 40 crores. Besides internal accruals, the cost was partly funded by way of loan of Rs. 10 crores taken on 1st January 2017. The loan carries interest at an annual rate of 10% with interest payable at the end of year on 31st December each year. The company has spent Rs. 4,00,000 on the maintenance of such property.

The company has recorded the entire amount paid as investment in Joint Venture in the books of accounts. Suggest the suitable accounting treatment of the above transaction as per applicable Ind AS. (RTP Nov '18, Old & New SM)

Answer 17

As provided in Ind- AS 111 - Joint Arrangements - this is a joint arrangement because two or more parties have joint control of the property under a contractual arrangement. The arrangement will be regarded as



a joint operation because Alpha Ltd. and Gama Ltd. have rights to the assets and obligations for the liabilities of this joint arrangement. This means that the company and the other investor will each recognise 50% of the cost of constructing the asset in property, plant and equipment.

The borrowing cost incurred on constructing the property should under the principles of Ind AS 23 'Borrowing Costs', be included as part of the cost of the asset for the period of construction.

In this case, the relevant borrowing cost to be included is Rs. 50,00,000 (Rs. 10,00,00,000 x 10% x 6/12).

The total cost of the asset is Rs. 40,50,00,000 (Rs. 40,00,00,000 + Rs. 50,00,000)

Rs. 20,25,00,000 crores is included in the property, plant and equipment of Alpha Ltd. and the same amount in the property, plant and equipment of Gama Ltd.

The depreciation charge for the year ended 31 March 2018 will therefore be Rs. 1,01,25,000 (Rs. 40,50,00,000 x 1/20 x 6/12) Rs. 50,62,500 will be charged in the statement of profit or loss of the company and the same amount in the statement of profit or loss of Gama Ltd.

The other costs relating to the arrangement in the current year totalling Rs. 54,00,000 (finance cost for the second half year of Rs. 50,00,000 plus maintenance costs of Rs. 4,00,000) will be charged to the statement of profit or loss of Alpha Ltd. and Gama Ltd. in equal proportions- Rs. 27,00,000 each.

Question 18

Angel Ltd. has adopted Ind AS with a transition date of 1st April, 2017. Prior to Ind AS adoption, it followed Accounting Standards notified under Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as "IGAAP").

It has made investments in equity shares of Pharma Ltd., a listed company engaged in the business of pharmaceuticals. The shareholding pattern of Pharma Ltd. is given below:

Shareholders (refer Note 1)	Percentage shareholding as on 1st April, 2017
Angel Ltd.	21%
Little Angel Ltd. (refer Note 2)	24%
Wealth Master Mutual Fund (refer Note 3)	3%
Individual public shareholders (refer Note 4)	52%

- (1) None of the shareholders have entered into any shareholders'
- (2) Little Angel Ltd. is a subsidiary of Angel Ltd. (under Ind AS) in which Angel Ltd. holds 51% voting power.
- (3) Wealth Master Mutual Fund is not related party of either Little Angel Ltd. or Pharma Ltd.
- (4) Individual public shareholders represent 17,455 individuals. None of the individual shareholders hold more than 1% of voting power in Pharma Ltd.

All commercial decisions of Pharma Ltd. are taken by its directors who are appointed by a simple majority vote of the shareholders in the annual general meetings ("AGM "). The following table shows the voting pattern of past AGMs of Pharma Ltd.:

Shareholders	AGM for the financial year:		
	2013-14	2014-15	2015-16
Angel Ltd.	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions
Little Angel Ltd.	Attended and voted as per directions of Angel Ltd.	Attended and voted as per directions of Angel Ltd	Attended and voted as per directions of Angel Ltd



Wealth Master Mutual Fund	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors
Individuals	7% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.	8% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the Resolution to appoint the retiring directors.	6% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.

Pharma Ltd. has obtained substantial long term borrowings from a bank. The loan is payable in 20 years from 1st April, 2017. As per the terms of the borrowing, following actions by Pharma Ltd. will require prior approval of the bank:

- **Payment of dividends to the shareholders in cash or kind;**
- **Buyback of its own equity shares;**
- **Issue of bonus equity shares;**
- **Amalgamation of Pharma Ltd. with any other entity; and**
- **Obtaining additional loans from any entity.**
- **Recently, the Board of Directors of Pharma Ltd. proposed a dividend of Rs. 5 per share. However, when the CFO of Pharma Ltd. approached the bank for obtaining their approval, the bank rejected the proposal citing concerns over the short-term cash liquidity of Pharma Ltd. Having learned about the developments, the Directors of Angel Ltd. along with the Directors of Little Angel Ltd. approached the bank with a request to re-consider its decision. The Directors of Angel Ltd. and Little Angel Ltd. urged the bank to approve a reduced dividend of at least Rs. 2 per share. However, the bank categorically refused to approve any payout of dividend.**
- **Under IGAAP, Angel Ltd. has classified Pharma Ltd. as its associate. As the CFO of Angel Ltd., you are required to comment on the correct classification of Pharma Ltd. on transition to Ind AS. (RTP May 19)**

Answer 18

To determine whether Pharma Limited can be continued to be classified as an associate on transition to Ind AS, we will have to determine whether Angel Limited controls Pharma Limited as defined under Ind AS 110.

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

- (a) Power over investee
- (b) Exposure, or rights, to variable returns from its involvement with the investee
- (c) Ability to use power over the investee to affect the amount of the investor's returns.

Since Angel Ltd. does not have majority voting rights in Pharma Ltd. we will have to determine whether the existing voting rights of Angel Ltd. are sufficient to provide it power over Pharma Ltd.

Analysis of each of the three elements of the definition of control:



Elements / conditions	Analysis
Power over investee	Angel Limited along with its subsidiary Little Angel Limited (hereinafter referred to as "the Angel group") does not have majority voting rights in Pharma Limited. Therefore, in order to determine whether Angel group have power over Pharma Limited. we will need to analyse whether Angel group, by virtue of its non- majority voting power, have practical ability to unilaterally direct the relevant activities of Pharma Limited. In other words, we will need to analyse whether Angel group has de facto power over Pharma Limited. Following is the analysis of de facto power of Angel over Pharma Limited: The public shareholding of Pharma Limited (that is, 52% represents thousands of shareholders none individually holding material shareholding, The actual participation of Individual public shareholders in the general meetings is minimal (that is, in the range of 6% to 8%). Even the public shareholders who attend the meeting do not consult with each other to vote. Therefore, as per guidance of Ind AS 110, the public shareholders will not be able to outvote Angel group (who is the largest shareholder group) in any general meeting. Based on the above-mentioned analysis, we can conclude that Angel group has de facto power over Pharma Limited.
Exposure, or rights, to variable returns from its involvement with the investee	Angel group has exposure to variable returns from its involvement with Pharma Limited by virtue of its equity stake.
Ability to use power over the investee to affect the amount of the investor's returns	nature as they do not relate to the relevant activities (that is, activities that significantly affect he Pharma Limited's returns) of Pharma Limited. As per Ind AS 110, protective rights are the rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. Therefore, the protective rights held by the bank should not be considered while evaluating whether or not Angel Group has control over Pharma Limited.
Conclusion: Since all the three elements of definition of control is present, it can be concluded that Angel Limited has control over Pharma Limited.	

Since it has been established that Angel Limited has control over Pharma Limited, upon transition to Ind AS, Angel Limited shall classify Pharma Limited as its subsidiary.

Question 19

An entity P (parent) has two wholly-owned subsidiaries - X and Y, each of which has an ownership interest in an 'associate', entity Z. Subsidiary X is a venture capital organization. Neither of the investments held in associate Z by subsidiaries X and Y is held for trading. Subsidiary X and Y account for their investment in associate Z at fair value through profit or loss in accordance with Ind AS 109 and using the equity method in accordance with Ind AS 28 respectively.

How should P account for the investment in associate Z in the following scenarios:

Scenario 1: Where both investments in the associate result in significant influence on a stand-alone basis - Subsidiary X and Y ownership interest in associate Z is 25% and 20% respectively.

Scenario 2: When neither of the investments in the associate results in significant influence on a stand-alone basis, but do provide the parent with significant influence on a combined basis - Subsidiary X and Y ownership interest in associate Z is 10% each.

Scenario 3: When one of the investments in the associate results in significant influence on a stand-alone basis and the other investment in the associate does not result in significant influence on a stand-alone basis - Subsidiary X and Y ownership interest in associate Z is 30% and 10% respectively. Assume there is significant influence if the entity has 20% or more voting rights.

(RTP May 20)

Answer 19

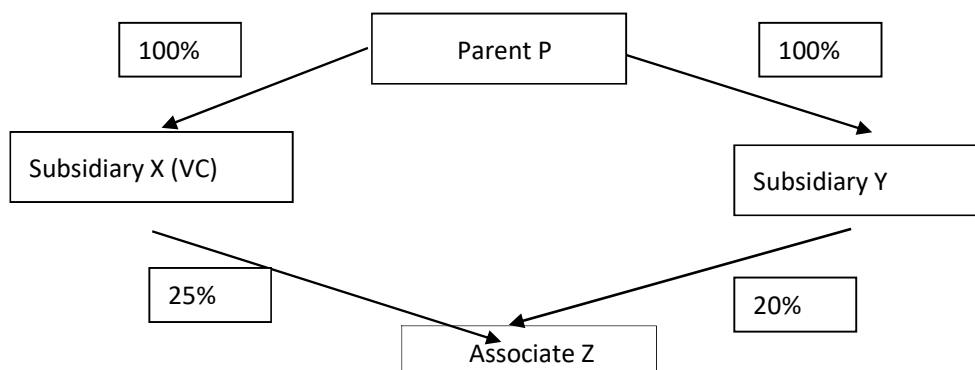
Paragraph 18 of Ind AS 28 states that, “when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with Ind AS 109. An entity shall make this election separately for each associate or joint venture, at initial recognition of the associate or joint venture.”

Paragraph 19 of Ind AS 28 provides that, “when an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109 regardless of whether the venture capital organisation has significant influence over that portion of the investment.

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

Therefore, fair value exemption can be applied partially in such cases.

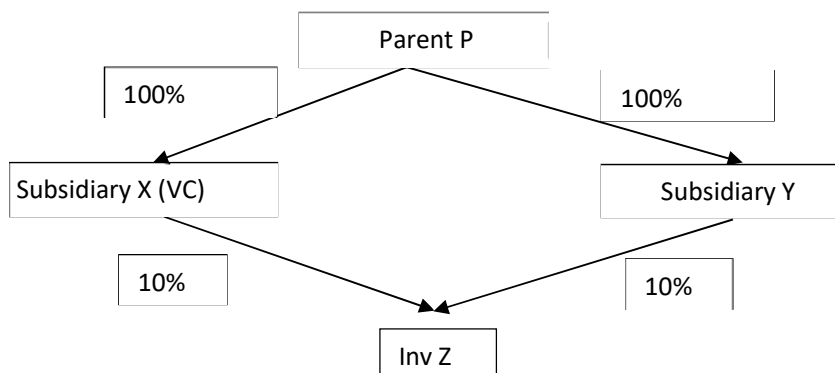
Scenario 1: Where both investments in the associate result in significant influence on a stand-alone basis.



In the present case, in accordance with paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 20% interest held by Y.

Under the partial use of fair value exemption, P may elect to measure the 25% interest held by X at fair value through profit or loss.

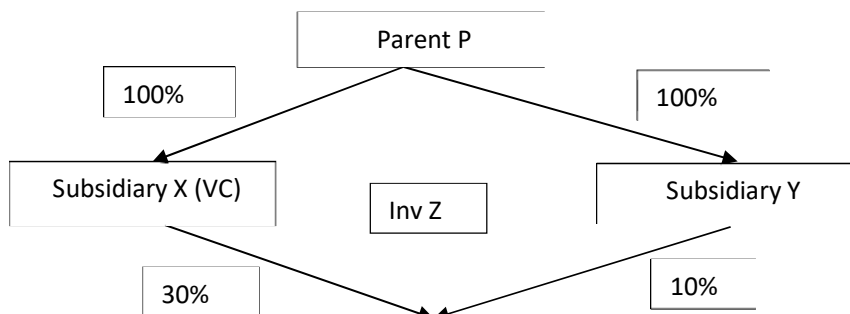
Scenario 2: When neither of the investments in the associate results in significant influence on a stand-alone basis, but do provide the parent with significant influence on a combined basis.



In the present case in accordance with the paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 10% interest held by Y, even though Y would not have significant influence on a stand-alone basis.

Under the partial use of fair value exemption, P may elect to measure the 10% interest held by X at fair value through profit or loss.

Scenario 3: When one of the investments in the associate results in significant influence on a stand-alone basis and the other investment in the associate does not result in significant influence on a stand-alone basis



In the present case, in accordance with paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 10% interest held by Y, even though Y would not have significant influence on a stand-alone basis. Under the partial use of fair value exemption, the P may elect to measure the 30% interest held by X at fair value through profit or loss.

Question 20

AB Limited and BC Limited establish a joint arrangement through a separate vehicle PQR, but the legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture.

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Limited has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owed by PQR to a lender XYZ. AB Limited and BC Limited have rights to all other assets in PQR, and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each). PQR's summarized balance sheet is as follows: (Rs. in crore)

	Amount
Building 1	240



Building 2	200
Cash	40
Total Assets	480
Equity	140
Debt owed to XYZ	240
Employee benefit plan obligation	100
Total Liabilities	480

How would AB Limited present its interest in PQR in its financial statements? (RTP May'20, Old & New SM)

Answer 20

8 Paragraph 20 of Ind AS 111 states that “a joint operator shall recognise in relation to its interest in a joint operation:

- its assets, including its share of any assets held jointly;
- its liabilities, including its share of any liabilities incurred jointly;
- its revenue from the sale of its share of the output arising from the joint operation;
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.”

The rights and obligations, as specified in the contractual arrangement, that an entity has with respect to the assets, liabilities, revenue and expenses relating to a joint operation might differ from its ownership interest in the joint operation. Thus a joint operator needs to recognize its interest in the assets, liabilities, revenue and expenses of the joint operation on the basis (bases) specified in the contractual arrangement, rather than in proportion of its ownership interest in the joint operation.

Thus, AB Limited would record the following in its financial statements, to account for its rights to the assets of PQR and its obligations for the liabilities of PQR.

	<i>Rs. in crore</i>
Assets	
Cash	20
Building 1*	240
Building 2	100
Liabilities	
Debt owed to XYZ (third party)**	240
Employees benefit plan obligation	50

* Since AB Limited has the rights to all of Building No. 1, it records the amount in its entirety.

** AB Limited has obligation for the debt owed by PQR to XYZ in its entirety.

Question 21

Gamma Limited, a parent company, is engaged in manufacturing and retail activities. The group holds investments in different entities as follows:

- Gamma Limited holds 100% Investment in G Limited and D Limited;
- G Limited and D Limited hold 60% and 40% in GD Limited respectively;
- Delta Limited is a 100% subsidiary of GD Limited

Firstly, Gamma Limited wants you to suggest whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements as per applicable Ind AS?



Secondly, if all other facts remain the same as above except that G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited, then explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements. (RTP May'20, Old & New SM)

Answer 21

As per paragraph 4(a) of Ind AS 110, an entity that is a parent shall present consolidated financial statements. This Ind AS applies to all entities, except as follows:

A parent need not present consolidated financial statements if it meets all the following conditions:

- (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
- (ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
- (iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
- (iv) its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Ind AS.

In accordance with the above, it may be noted that as per paragraph 4(a)(i) above, a parent need not present consolidated financial statements if it is a:

- wholly-owned subsidiary; or
- is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.

Although GD Limited is a partly-owned subsidiary of G Limited, it is the wholly-owned subsidiary of Gamma Limited (and therefore satisfies the condition 4(a)(i) of Ind AS 110 without regard to the relationship with its immediate owners, i.e. G Limited and D Limited). Thus, GD Limited being the wholly owned subsidiary fulfils the conditions as mentioned under paragraph 4(a)(i) and is not required to inform its other owner D Limited of its intention not to prepare the consolidated financial statements.

Thus, in accordance with the above, GD Limited may take the exemption given under paragraph 4(a) of Ind AS 110 from presentation of consolidated financial statements.

In Alternative Scenario, where both G Limited and D Limited are owned by an individual Mr. X, then GD Limited is ultimately wholly in control of Mr. X (i.e., an individual) and hence it cannot be considered as a wholly owned subsidiary of an entity.

This is because Ind AS 110 makes use of the term 'entity' and the word 'entity' includes a company as well as any other form of entity. Since, Mr. X is an 'individual' and not an 'entity', therefore, GD Limited cannot be considered as wholly owned subsidiary of an entity.

Therefore, in the given case, GD Limited is a partially-owned subsidiary of another entity. Accordingly, in order to avail the exemption under paragraph 4(a), its other owner, D Limited should be informed about and do not object to GD Limited not presenting consolidated financial statements. Further, for the purpose of consolidation of G Limited and D Limited, GD Limited will be required to provide relevant financial information as per Ind AS.

Question 22

A company, AB Ltd. holds investments in subsidiaries and associates. In its separate financial statements, AB Ltd. wants to elect to account its investments in subsidiaries at cost and the investments in associates as financial assets at fair value through profit or loss (FVTPL) in accordance with Ind AS 109, Financial Instruments. Whether AB Limited can carry investments in subsidiaries at cost and investments in associates in accordance with Ind AS 109 in its separate financial statements (RTP Nov'20)

Answer 22

Paragraph 10 of Ind AS 27, Separate Financial Statements inter-alia provides that, when an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109, Financial Instruments in its separate financial statements. Further, the entity shall apply the same accounting for each category of investments.

It may be noted that although the 'category' is used in number of Standards, it is not defined in any of the Ind AS. It seems that subsidiaries, associates and joint ventures would qualify as separate categories. Thus, the same accounting policies are applied for each category of investments - i.e. each of subsidiaries, associates and joint ventures. However, paragraph 10 of Ind AS 27 should not be read to mean that, in all circumstances, all investments in associates are one 'category' of investment and all investments in joint ventures or an associate are one 'category' of investment. These categories can be further divided into sub-categories provided the sub-category can be defined clearly and objectively and results in information that is relevant and reliable. For example, an investment entity parent can have investment entity subsidiary (at fair value through profit or loss) and non-investment entity subsidiary (whose main purpose is to provide services that relate to the investment entity's investment activities) as separate categories in its separate financial statements. In the present case, investment in subsidiaries and associates are considered to be different categories of investments. Further, Ind AS 27 requires to account for the investment in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109 for each category of Investment. Thus, AB Limited can carry its investments in subsidiaries at cost and its investments in associates as financial assets in accordance with Ind AS 109 in its separate financial statements.

Question 23

PP Ltd., a non-investment entity, is the parent of Praja Ltd. within the meaning of Ind AS 110 'Consolidated Financial Statements'. The investment in Praja Ltd. was carried in the separate financial statements of PP Ltd. at fair value with changes in fair value recognised in the other comprehensive income. On 1st April, 20X2, PP Ltd. qualifies as one that is an investment entity. Carrying amount of the investment on 1st April, 20X2 was ₹ 8,00,000. The fair value of its investment in Praja Ltd was ₹ 10,00,000 on that date. PP Ltd had recognised in OCI an amount of ₹ 1,00,000 as a previous fair value increase related to the investment in Praja Ltd.

How would PP Ltd account for the investment in Praja Ltd on the date of change of its classification/status as an investment entity, in its separate financial statements? (RTP Nov '21)

Answer 23

- (i) On the date of change, ie, 1st April, 20X2, PP Ltd (the parent) becoming an investment entity, its investment in Praja Ltd (the subsidiary) shall be at fair value through profit and loss in accordance with Ind AS 109. Accordingly, the new carrying amount will be ₹ 10,00,000.
- (ii) The difference between the new carrying amount and the carrying amount of the investment on the date of change will be recognised in the profit and loss. Hence, PP Ltd will recognise an amount of ₹ 2,00,000 (₹ 10,00,000 – ₹ 8,00,000) in profit and loss as gain.
- (iii) Any fair value adjustments previously recognised in OCI in respect of subsidiary ie Praja Ltd. shall be treated as if the investment entity had disposed off the subsidiary at the date of change in status, ie, amounts shall be reclassified from OCI to the profit and loss on the date of change of status. Therefore, ₹ 1,00,000 shall be reclassified from OCI to the profit and loss.

Particulars	₹	₹
Carrying amount of investment in Praja Ltd [as per (i) above]		10,00,000
Amounts recognised in profit and loss relating to investment in Praja Ltd		
As per (ii) above	2,00,000	
As per (iii)	1,00,000	3,00,000

**Question 24**

Solar Limited has an 80% interest in its subsidiary, Mars Limited. Solar Limited holds a direct interest of 25% in Venus Limited. Mars Limited also holds a 30% interest in Venus Limited. The decisions concerning relevant activities of Venus Limited require a simple majority of votes. How should Solar Limited account for its investment in Venus Limited in its consolidated financial statements? (RTP Nov '21, MTP 5 Marks Apr'22)

Answer 24

In the present case, Solar Limited controls Mars Limited (since it holds 80% of its voting rights). Consequently, it also controls the voting rights associated with 30% equity interest held by Mars Limited in Venus Limited. Solar Limited also has 25% direct equity interest and related voting power in Venus Limited. Thus, Solar Limited controls 55% (30% + 25%) voting power of Venus Limited. As the decisions concerning relevant activities of Venus Limited require a simple majority of votes. Solar Limited controls Venus Limited and should therefore consolidate it in accordance with Ind AS 110.

Although, Solar Limited controls Venus Limited, its entitlement to the subsidiary's economic benefits is determined on the basis of its actual ownership interest. For the purposes of the consolidated financial statements, Solar Limited's share in Venus Limited is determined as 49% [25% + (80% × 30%)]. As a result, 51% of profit or loss, other comprehensive income and net assets of Venus Limited shall be attributed to the non-controlling interests in the consolidated financial statements (this comprises 6% attributable to holders of non-controlling interests in Mars Limited [reflecting 20% interest of non-controlling shareholders of Mars Limited in 30% of Venus Limited] and 45% to holders of non-controlling interests in Venus Limited).

Question 25

Identify the type of joint arrangements in each of the following scenarios:

- (i) **X Ltd and Y Ltd, manufacturing similar type of mobile phones, form a joint arrangement to manufacture and sell mobile phones. Under the terms of the arrangement, both X Ltd and Y Ltd are to use their own assets to manufacture the mobile phones and both are responsible for liabilities related to their respective manufacture. The arrangement also lays down the distribution revenues from the sale of the mobile phones and expenses incurred thereof. X Ltd however has exclusive control over the marketing and distribution functions and does not require the consent of Y Ltd in this aspect. No separate entity is created for the arrangement.**
- (ii) **Continuing with (i) above, what would be the classification of the joint arrangement if X Ltd and Y Ltd both jointly control all the relevant activities of the Joint arrangement including the marketing and the distribution functions?**
- (iii) **What would be the classification of the joint arrangement if under the terms of the arrangement, a separate entity is created to manufacture the mobile phones.**
- (iv) **Continuing with (iii) above, the joint arrangement is a means of manufacturing mobile phones on a common platform but the output of the joint arrangement is purchased by both X Ltd and Y Ltd in the ratio of 50:50. The joint arrangement cannot sell output to third parties. The price of the output sold to X Ltd and Y Ltd is set by both the parties to the arrangement to cover the production costs and other administrative costs of the joint arrangement entity.**
- (v) **Would your answer in (iv) above be different if X Ltd and Y Ltd sold their respective share of output to third parties?**
- (vi) **Assume that in (iv) above, the contractual terms of the arrangement were modified so that the joint arrangement entity is not obliged to sell the output to X Ltd and Y Ltd but was able to sell the output to third parties. (RTP May '22, MTP 7 Marks Apr'23)**

Answer 25

For a joint arrangement to be either a joint operation or joint venture, it depends on whether the parties to the joint arrangement have rights to the assets and obligations for liabilities (will be a joint operation) OR whether the parties to the joint arrangement have rights to the net assets of the arrangement (will be joint venture).

- (i) In order to fit into the definition of a joint arrangement, the parties to the joint arrangement should have joint control over the arrangement. In the given case, decisions relating to relevant activities, ie, marketing and distribution, are solely controlled by X Ltd and such decisions do not require the consent of Y Ltd. Hence, the joint control test is not satisfied in this arrangement and the arrangement does not fit into the definition of a joint arrangement in accordance with the Standard.
- (ii) Where X Ltd and Y Ltd both jointly control all the relevant activities of the arrangement and since no separate entity is formed for the arrangement, the joint arrangement is in the nature of a *joint operation*.
- (iii) Where under a joint arrangement, a separate vehicle is formed to give effect to the joint arrangement, then the joint arrangement can either be a *joint operation* or a *joint venture*.

Hence in the given case, if:

- (a) The contractual terms of the joint arrangement, give both X Ltd and Y Ltd rights to the assets and obligations for the liabilities relating to the arrangement, and the rights to the corresponding revenues and obligations for the corresponding expenses, *then the joint arrangement will be in the nature of a joint operation*.
- (b) The contractual terms of the joint arrangement, give both X Ltd and Y Ltd. rights to the net assets of the arrangement, *then the joint arrangement will be in the nature of a joint venture*.
- (iv) Where the rights to assets and liabilities to obligations are not clear from the contractual arrangement, then other facts and circumstances also need to be considered to determine whether the joint arrangement is a joint operation or a joint venture.

When the provision of the activities of the joint venture is primarily to produce output and the output is available / distributed only to the parties to the joint arrangement in some pre-determined ratio, then this indicates that the parties have substantially all the economic benefits of the assets of the arrangement. The only source of cash flows to the joint arrangement is receipts from parties through their purchases of the output and the parties also have a liability to fund the settlement of liabilities of the separate entity. Such an arrangement indicates that the joint arrangement is in the nature of a *joint operation*.

In the given case, the output of the joint arrangement is exclusively used by X Ltd. and Y Ltd. and the joint arrangement is not allowed to sell the output to outside parties. Hence, the joint arrangement between X Ltd. and Y Ltd. is in the nature of a *joint operation*.

- (v) It makes no difference whether the output of the joint arrangement is exclusively for use by the parties to the joint arrangement or the parties to the arrangement sold their share of the output to third parties.

Hence, even if X Ltd. and Y Ltd. sold their respective share of output to third parties, the fact still remains that the joint arrangement cannot sell output directly to third parties. Hence, the joint arrangement will still be deemed to be in the nature of a *joint operation*.

- (vi) Where the terms of the contractual arrangement enable the separate entity to sell the output to third parties, this would result in the separate entity assuming demand, inventory and credit risks. Such facts and circumstances would indicate that the arrangement is a joint venture.



Question 26

'High Speed Limited' manufactures and sells cars. The Company wants to foray into the two-wheeler business and therefore it acquires 30% interest in Quick Bikes Limited for ₹ 5,00,000 as at 1st November, 20X1 and an additional 25% stake as at 1st January, 20X2 for ₹ 5,00,000 at its fair value.

Following is the Balance Sheet of Quick Bikes Limited as at 1st January, 20X2:

Liabilities	Carrying value	Fair value	Assets	Carrying value	Fair value
Share capital	1,00,000		Plant and equipment	3,50,000	7,50,000
Reserves	5,50,000		Investment in bonds	4,00,000	5,00,000
Trade payables	1,50,000	1,50,000	Trade Receivables	50,000	50,000
Total	8,00,000		Total	8,00,000	

Quick Bikes Limited sells the motorcycles under the brand name 'Super Start' which has a fair value of ₹ 3,50,000 as at 1st January, 20X2. This is a self-generated brand therefore Quick Bikes Limited has not recognized the brand in its books of accounts. Following is the separate balance sheet of High Speed Limited as at 1st January, 20X2:

Liabilities	Amount	Assets	Amount
Share capital	5,00,000	Plant and equipment	13,50,000
Reserves	15,00,000	Investment in Quick Bike	10,00,000
Short term loans	4,00,000	Trade Receivables	80,000
Trade payables	3,00,000	Cash and bank balances	5,20,000
Other liabilities	2,50,000		
Total	29,50,000	Total	29,50,000

In relation to the acquisition of Quick Bikes Limited, you are required to:

- Pass the necessary journal entries to give effect of business combination in accordance with Ind AS 103 as at acquisition date 1st January, 20X2. NCI is measured by the entity at fair value. Provide working notes, Ignore deferred tax implication; and
- Prepare a consolidated balance sheet of High Speed Limited as at 1st January, 20X2. (RTP May '23)

Answer 26

(i) Journal Entry

		₹	₹
Plant and Equipment	Dr.	7,50,000	
Investment in bonds	Dr.	5,00,000	
Trade Receivables	Dr.	50,000	
Brand	Dr.	3,50,000	
Goodwill (balancing figure)	Dr.	5,00,000	
	To Investment in Quick Bikes		10,00,000
	To Profit or loss A/c (W.N.1)		1,00,000
	To Trade Payables		1,50,000
	To NCI (W.N.3)		9,00,000
(Being assets and liabilities acquired at fair value and previous investment considered at fair value on the			



acquisition date)

Working Notes:

1. Calculation of fair value of shares on the acquisition date 1st January, 20X2

25% Shares purchase on 1st January, 20X2 (fair value)	₹ 5,00,000
30% Shares purchase on 1st November, 20X1 at ₹ 5,00,000	
Fair value = [(5,00,000 / 25%) x 30%]	₹ 6,00,000
Total consideration at fair value on acquisition date	₹ 11,00,000
Less: Cost of investment	(₹ 10,00,000)
Gain charged to Profit or Loss (5,00,000 + 5,00,000)	₹ 1,00,000

2. Computation of Net Identifiable Assets at fair value

	₹
Plant and Equipment	7,50,000
Investment in bonds	5,00,000
Trade Receivables	50,000
Self-generated Brand	3,50,000
	16,50,000
Less: Trade Payables	(1,50,000)
Net Identifiable Assets at fair value	15,00,000

3. Measurement of Non-controlling Interest (on fair value basis)

Share of NCI (100- 30-25)	45%
Taking fair value of shares on 1st January, 20X2 as a base [(11,00,000/ 55%) x 45%]	₹ 9,00,000

(ii) Consolidated Balance Sheet of High Speed Limited as at 1 st January, 20X2

	Note No.	₹
Assets		
Non-current assets		
(a) Property, plant and equipment	1	21,00,000
(b) Intangible asset	2	8,50,000
(c) Investment in bonds		5,00,000
Current Assets		
(a) Financial assets		
(i) Trade receivables	3	1,30,000
(ii) Cash and cash equivalents	4	5,20,000
		41,00,000
Equity and Liabilities		
Equity		
(a) Equity share capital		5,00,000
(b) Other Equity	5	16,00,000
Non-controlling Interest (W.N.3)		9,00,000
Current Liabilities		
(a) Financial liabilities		
(i) Borrowings	6	4,00,000
(ii) Trade Payables	7	4,50,000



(b) Other Current Liabilities	8	2,50,000
		41,00,000

Notes to Accounts

S. No.		₹	₹
1.	Property, plant, and equipment		
	High Speed Ltd.	13,50,000	
	Quick Bikes Ltd.	7,50,000	21,00,000
2.	Intangible asset		
	Goodwill	5,00,000	
	Brand value of Quick Bikes Ltd.	3,50,000	8,50,000
3.	Trade Receivables		
	High Speed Ltd.	80,000	
	Quick Bikes Ltd.	50,000	1,30,000
4.	Cash and cash equivalents		
	Quick Bikes Ltd.		5,20,000
5.	Other Equity - Reserves		
	High Speed Ltd.	15,00,000	
	Add: Gain on investment in Quick Bikes Ltd.	1,00,000	16,00,000
6.	Borrowings		
	Short term loans of High-Speed Ltd.		4,00,000
7.	Trade Payables		
	High Speed Ltd.	3,00,000	
	Quick Bikes Ltd.	1,50,000	4,50,000
8.	Other Current Liabilities		
	High Speed Ltd.		2,50,000

Question 27

Entity A owns all the share capital of Entity B and controls Entity B. On 1st April, 20X2, Entity A acquired a building from Entity B, for ₹ 600 lakhs, that the group plans to use as its new head office. Entity B had purchased the building from a third party on 1st April, 20X1 for ₹ 525 lakhs. At that time, the building was assessed to have a useful life of 21 years and a residual value of Nil. On 1st April, 20X2, the carrying amount of the building was ₹ 500 lakhs in Entity B's individual financial statements. The estimated remaining useful life of the building measured from 1st April, 20X2 is 20 years and the residual value of the building is still Nil. The method of depreciation followed is straight-line.

Pass necessary Journal Entries for recording the above transactions in the books of Entity B, Entity A and the Group's general ledger. (RTP Nov '23)

Answer 27

Journal Entries in the books of Entity B

	₹ in lakhs	₹ in lakhs
1st April, 20X1		
Building A/c (Property, plant and equipment) Dr.	525	
To Bank A/c		525
(To recognise the purchase of the building for cash)		



31st March, 20X2		
Depreciation (Refer W.N.) Dr.	25	
To Building A/c (Property, plant and equipment)		25
(To recognise depreciation on building for its use in the year 20X1-20X2)		
1st April, 20X2		
Bank A/c Dr.	600	
To Building A/c (Property, plant and equipment)		500
To Profit on sale of Building		100
(To recognise the sale of the building for cash)		

Journal Entries in the books of Entity A

	₹ in lakhs	₹ in lakhs
1st April, 20X2		
Building A/c (Property, plant and equipment) Dr.	600	
To Bank A/c		600
(To recognise the purchase of a building for cash from Entity B)		
31st March, 20X3		
Depreciation A/c (Refer W.N.) Dr.	30	
To Building A/c (Property, plant and equipment)		30
(To recognise depreciation on building for its use in the year 20X2-20X3)		

Journal Entries in the books of Group

	₹ in lakhs	₹ in lakhs
31st March, 20X3		
Profit on sale of Building Dr.	100	
To Building A/c (Property, plant and equipment)		100
(To eliminate the effects of the intragroup transaction)		
Building A/c (Property plant and equipment) Dr.	5	
To Depreciation A/c (W.N.)		5
(To eliminate the effects of the intragroup transaction)		

Working Note:

Computation of Depreciation and its Adjustment in the Group's Financial Statements

	In Individual Financial statements of Entity B/Entity A	For adjustment in the books of Group
Particulars	₹ in lakhs	₹ in lakhs
400000 Building on 1st April, 20X1 for Entity B	525	



Useful life	21 years	
Depreciation per year (₹ 525 lakhs / 21 years)	25	25
Cost of Building on 1st April, 20X2 for Entity A	600	
Useful life	20 years	
Depreciation per year (₹ 600 lakhs / 20 years)	30	30
Reversal of depreciation in the books of Group		(5)

Question 28

Ishwar Ltd. holds investments in Vinayak Ltd. The draft balance sheets of two entities at 31st March, 20X4 were as follows:

Particulars	Ishwar Ltd. ₹ in '000s	Vinayak Ltd. ₹ in '000s
Assets		
Non-current Assets		
Property, Plant and Equipment	26,20,000	18,50,000
Investment	21,15,000	NIL
Total non-current assets	47,35,000	18,50,000
Current Assets		
Inventories	6,00,000	3,75,000
Trade Receivables	4,50,000	3,30,000
Cash and Cash Equivalents	75,000	60,000
Total current assets	11,25,000	7,65,000
TOTAL ASSETS	58,60,000	26,15,000
Equity and Liabilities		
Equity		
Share Capital (₹ 1 shares)	7,00,000	5,00,000
Retained Earnings	28,65,000	10,50,000
Other Components of Equity	12,50,000	50,000
Total Equity	48,15,000	16,00,000
Non-current Liabilities		
Provisions	6,250	NIL
Long-term Borrowings	4,13,750	4,50,000
Deferred Tax	2,25,000	1,40,000
Total Non-current Liabilities	6,45,000	5,90,000
Current Liabilities		
Trade and Other Payables	3,00,000	2,50,000
Short-term Borrowings	1,00,000	1,75,000
Total Current Liabilities	4,00,000	4,25,000
TOTAL EQUITY AND LIABILITIES	58,60,000	26,15,000

Additional Information:

Ishwar Ltd.'s investment in Vinayak Ltd.

On 1st April, 20X1, Ishwar Ltd. acquired 400 million shares in Vinayak Ltd. by means of a share exchange of one share in Ishwar Ltd. for every two shares acquired in Vinayak Ltd. On 1st April, 20X1, the market value of one share of Ishwar Ltd. was ₹ 7.



Ishwar Ltd. appointed a professional firm for conducting due diligence for acquisition of Vinayak Ltd., the cost of which amounted to ₹ 15 million. Ishwar Ltd. included these acquisition costs in the carrying amount of the investment in Vinayak Ltd. in the draft balance sheet of Ishwar Ltd. There has been no change to the carrying amount of this investment in Ishwar Ltd.'s own balance sheet since 1 st April, 20X1.

On 1st April, 20X1, the individual financial statements of Vinayak Ltd. showed the following balances:

- Retained earnings ₹ 750 million
- Other components of equity ₹ 25 million

The directors of Ishwar Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of Vinayak Ltd. at 1st April, 20X1. The following matters emerged:

- Property having a carrying amount of ₹ 800 million (land component ₹ 350 million, buildings component ₹ 450 million) had an estimated fair value of ₹ 1,000 million (land component ₹ 400 million, buildings component ₹ 600 million). The buildings component of the property had an estimated useful life of 30 years at 1st April, 20X1.
- Plant and equipment having a carrying amount of ₹ 600 million had an estimated fair value of ₹ 700 million. The estimated remaining useful life of this plant at 1st April, 20X1 was four years. None of this plant and equipment had been disposed of between 1st April, 20X1 and 31st March, 20X4.
- On 1st April, 20X1, the notes to the financial statements of Vinayak Ltd. disclosed contingent liability. On 1st April, 20X1, the fair value of this contingent liability was reliably measured at ₹ 30 million. The contingency was resolved in the year ended 31st March, 20X2 and no payments were required to be made by Vinayak Ltd. in respect of this contingent liability.
- The fair value adjustments have not been reflected in the individual financial statements of Vinayak Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

The directors of Ishwar Ltd. used the proportion of net assets method when measuring the non-controlling interest in Vinayak Ltd. in the consolidated balance sheet.

Impairment review of goodwill on acquisition of Vinayak Ltd.

No impairment of the goodwill on acquisition of Vinayak Ltd. was evident when the reviews were carried out on 31st March, 20X2 and 20X3. On 31st March, 20X4, the directors of Ishwar Ltd. carried out a further review and concluded that the recoverable amount of the net assets of Vinayak Ltd. at that date was ₹ 2,000 million. Vinayak Ltd. is regarded as a single cash generating unit for the purpose of measuring goodwill impairment.

Provision

On 1st April, 20X3, Ishwar Ltd. completed the construction of a non-current asset with an estimated useful life of 20 years. The costs of construction were recognised in property, plant and equipment and depreciated appropriately. Ishwar Ltd. has a legal obligation to restore the site on which the non-current asset is located on 31st March, 2X43. The estimated cost of this restoration work, at 31st March, 2X43 prices, is ₹ 125 million. The directors of Ishwar Ltd. have made a provision of ₹ 6.25 million ($1/20 \times ₹ 125$ million) in the draft balance sheet at 31st March, 20X4.

An appropriate annual discount rate to use in any relevant calculations is 6% and at this rate the present value of ₹ 1 payable in 20 years is 31.2 paise.

Prepare the consolidated balance sheet of Ishwar Ltd. at 31 st March, 20X4. Consider deferred tax implications. (RTP Nov '23)



Answer 28

Consolidated Balance Sheet of Ishwar Ltd. at 31st March, 20X4

Particulars	₹ in '000s
Assets	
Non-current Assets:	
Property, Plant and Equipment	
[(26,20,000 + 18,50,000) + {(2,00,000 (W.N.1) – 15,000 (W.N.1)) + (1,00,000 (W.N.1) – 75,000 (W.N.1)) + (39,000 – 1,950) (WN 7)}]	47,17,050
Investment (21,15,000 – 14,00,000 – 15,000)	7,00,000
Goodwill (W.N.2)	1,85,600
Total non-current assets	56,02,650
Current Assets:	
Inventories (6,00,000 + 3,75,000)	9,75,000
Trade Receivables (4,50,000 + 3,30,000)	7,80,000
Cash and Cash Equivalents (75,000 + 60,000)	1,35,000
Total current assets	18,90,000
TOTAL ASSETS	74,92,650
Equity and Liabilities	
Equity attributable to equity holders of the parent	
Share Capital	7,00,000
Retained Earnings (W.N.5)	30,31,960
Other Components of Equity (W.N.6)	12,70,000
	50,01,960
Non-controlling Interest (W.N.4)	3,53,600
Total equity	53,55,560
Non-current Liabilities	
Provisions (39,000 + 2,340 (W.N.7))	41,340
Long-term Borrowings (4,13,750 + 4,50,000)	8,63,750
Deferred Tax (W.N.8)	4,07,000
Total non-current liabilities	13,12,090
Current Liabilities	
Trade and Other Payables (3,00,000 + 2,50,000)	5,50,000
Short-term Borrowings (1,00,000 + 1,75,000)	2,75,000
Total Current Liabilities	8,25,000
TOTAL EQUITY AND LIABILITIES	74,92,650

Working Notes:

1. Computation of Net Assets of Vinayak Ltd.

	1st April, 20X1 (Date of acquisition) ₹ in '000s	31st March, 20X4 (Date of consolidation) ₹ in '000s



Share Capital	5,00,000	5,00,000
Retained Earnings:		
Per accounts of Vinayak Ltd.	7,50,000	10,50,000
Fair Value Adjustments:		
Property (10,00,000 – 8,00,000)*	#2,00,000	\$2,00,000
Extra depreciation due to Buildings appreciation* ((6,00,000 – 4,50,000) x 3/30)		\$(15,000)
Plant and Equipment (7,00,000 – 6,00,000)*	#1,00,000	\$1,00,000
Extra depreciation due to Plant and Equipment appreciation* (1,00,000 x ¾)		\$(75,000)
Contingent Liability*	#(30,000)	\$NIL
Other Components of Equity	25,000	50,000
Deferred Tax on Fair Value Adjustments*:		
Date of acquisition (20% x #2,70,000 (from above))	(54,000)	
Date of Consolidation (20% x \$2,10,000 (from above))		(42,000)
Net Assets for Consolidation	14,91,000	17,68,000
The post-acquisition increase in Net Assets is ₹ 2,77,000 (₹ 17,68,000 – ₹ 14,91,000). ₹ 25,000 of this increase is due to changes in Other Components of Equity and the remaining ₹ 2,52,000 due to changes in retained earnings.		

2. Computation of Goodwill on Consolidation

	Vinayak Ltd. ₹ in '000s
Cost of Investment:	
Shares issued to acquire Vinayak Ltd. (4,00,000 x ½ x ₹ 7)	14,00,000
Non-controlling Interests at the date of acquisition:	
Vinayak Ltd. – 20% x ₹ 1,491,000 (from W.N.1)	2,98,200
	16,98,200
Net Assets at the date of acquisition:	
Vinayak Ltd. (W.N.1)	(14,91,000)
Goodwill before Impairment	2,07,200
Less: Impairment of Goodwill (refer W.N.3)	(21,600)
Goodwill reported in Consolidated Balance Sheet	1,85,600

3. Impairment of Goodwill on acquisition of Vinayak Ltd.

	Vinayak Ltd. ₹ in '000s
Net Assets of Vinayak Ltd. at 31st March, 20X4 (W.N.1)	17,68,000
Grossed up Goodwill on acquisition (100/80 x ₹ 2,07,200) (Refer Note 1 below)	2,59,000
	20,27,000
Recoverable amount of Vinayak Ltd. as a CGU	(20,00,000)
Therefore, gross impairment will be	27,000

Impairment attributed to Parent (refer Note 2 below)	21,600

Note 1: Grossing up of Goodwill

As per Para C4 of Appendix C to Ind AS 36 Impairment of Assets – If an entity measures non-controlling interests at its proportionate interest in the net identifiable assets of a subsidiary at the acquisition date, rather than at fair value, goodwill attributable to non-controlling interests is included in the recoverable amount of the related Cash Generating Unit but is not recognised in the parent's consolidated financial statements. As a consequence, an entity shall gross up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest. This adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.

Note 2: Allocation of Impairment of Goodwill

Since the non-controlling interests of Vinayak Ltd. are measured at proportionate share of identifiable net assets of Vinayak Ltd., the goodwill computed is entirely attributable only to the parent of Vinayak Ltd. Accordingly, the impairment also would be attributed entirely to the parent of Vinayak Ltd., and not to the non- controlling interest.

4. Computation of Non-controlling Interest (NCI)

	Vinayak Ltd. ₹ in '000s
NCI at the date of acquisition (W.N.2)	2,98,200
Share of post-acquisition increase in net assets (20% x ₹ 2,77,000 (from W.N.1))	55,400
	3,53,600

5. Computation of consolidated Retained Earnings

	₹ in '000s
Balance as per accounts of Ishwar Ltd.	28,65,000
Adjustments:	
Acquisition costs	(15,000)
Restoration Provision (W.N.7)	1,960
Share of Vinayak Ltd.'s post-acquisition profits (80% x ₹ 2,52,000 (W.N.1))	2,01,600
Impairment of Goodwill (W.N.3)	(21,600)
	30,31,960

6. Other Components of Equity

	₹ in '000s
Balance as per accounts of Ishwar Ltd.	12,50,000
Share of Vinayak Ltd.'s post-acquisition balance (80% x ₹ 25,000 (W.N.1))	20,000
	12,70,000

7. Computation of Restoration Provision

	₹ in '000s
Provision for Restoration originally required (₹ 1,25,000 x 0.312)	39,000
One year's unwinding of discount (₹ 39,000 x 6%) A	(2,340)



One year's depreciation of capitalized cost ($\text{₹ } 39,000 \times 1/20$) B	(1,950)
Original provision incorrectly made C	6,250
So retained earnings adjustment equals $[C - A - B]$	1,960

8. Computation of Deferred Tax

	₹ in '000s
Ishwar Ltd. + Vinayak Ltd.	3,65,000
Fair value adjustments in Vinayak Ltd. (from W.N.1)	42,000
	4,07,000

Question 29

Entities A and B establish a 50:50 joint operation in the form of a separate legal entity, Entity J, whereby each operator has a 50% ownership interest and takes 50% of the output.

On formation of the joint operation, Entity A contributes a property with fair value of ₹ 110 lakhs and intangible asset with fair value of ₹ 10 lakhs whereas Entity B contributes equipment with a fair value of ₹ 120 lakhs.

The carrying amounts of the assets contributed by Entities A and B are ₹ 100 lakhs and ₹ 80 lakhs, respectively.

What will be the amount of any gain or loss to be recognised by Entity A and Entity B in its separate financial statements as well as consolidated financial statements? (RTP Nov '23)

Answer 29

Paragraph B34 of Ind AS 111 states that when an entity enters into a transaction with a joint operation in which it is a joint operator, such as a sale or contribution of assets, it is conducting the transaction with the other parties to the joint operation and, as such, the joint operator shall recognise gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation.

The amount of gain or loss to be recognised by Entity A in its separate financial statements as well as consolidated financial statements will be computed as below:

(All amounts are ₹ in lakhs)

A's share of fair value of asset contributed by Entity B ($50\% \times \text{₹ } 120 \text{ lakhs}$)	60
Less: Asset contributed by Entity A to the joint operation – carrying amount of proportion ceded to Entity B ($50\% \times \text{₹ } 100 \text{ lakhs}$)	(50)
Gain to be recognised by Entity A	10

The gain can alternatively be calculated as:

Share acquired in fair value of net assets of joint operation ($50\% \times \text{₹ } 240 \text{ lakhs}$)	120
Less: Carrying amount of asset contributed	(100)
Less: Unrealised portion of gain on asset contributed ($50\% \times (\text{₹ } 120 \text{ lakhs} - \text{₹ } 100 \text{ lakhs})$)	(10)
Gain to be recognised by Entity A	10

The amount of gain or loss to be recognised by Entity B in its separate financial statements as well as consolidated financial statements will be computed as below:

(All amounts are ₹ in lakhs)

B's share of fair value of asset contributed by Entity A (50% x ₹ 120 lakhs)	60
Less: Asset contributed by Entity B to the joint operation – carrying amount of proportion ceded to Entity A (50% x ₹ 80 lakhs)	(40)
Gain to be recognised by Entity B	20

The gain can alternatively be calculated as:

Share acquired in fair value of net assets of joint operation (50% x ₹ 240 lakhs)	120
Less: Carrying amount of asset contributed	(80)
Less: Unrealised portion of gain on asset contributed (50% x (₹ 120 lakhs – ₹ 80 lakhs))	(20)
Gain to be recognised by Entity B	20

Question 30

Summarise d Balance Sheets of PN Ltd. and SR Ltd. as on 31st March, 2018 were given as below:

(Amount in Rs.)		
Particulars	PN Ltd.	SR Ltd.
Assets		
Land & building	4,68,000	5,61,600
Plant & Machinery	7,48,800	4,21,200
Investment in SR Ltd.	12,48,000	-
Inventories	3,74,400	1,13,600
Trade Receivables	1,86,500	1,24,800
Cash & Cash equivalents	45,200	24,900
Total Assets	30,70,900	12,46,100
Equity & Liabilities		
Equity Share Capital (Shares of Rs. 100 each fully paid)	15,60,000	6,24,000
Other Reserves	9,36,000	3,12,000
Retained Earnings	1,78,400	2,55,800
Trade Payables	1,46,900	34,300
Short-term borrowings	2,49,600	20,000
Total Equity & Liabilities	30,70,900	12,46,100

- PN Ltd. acquired 70% equity shares of Rs. 100 each of SR Ltd. on 1st October, 2017.
- The Retained Earnings of SR Ltd. showed a credit balance of Rs. 93,600 on 1st April, 2017 out of which a dividend of 12% was paid on 15th December, 2017.
- PN Ltd. has credited the dividend received to its Retained Earnings.
- Fair value of Plant & Machinery of SR Ltd. as on 1st October, 2017 was Rs. 6,24,000. The rate of depreciation on Plant & Machinery was 10% p.a.
- Following are the increases on comparison of Fair Value as per respective Ind AS with book value as on 1st October, 2017 of SR Ltd. which are to be considered while consolidating the



Balance Sheets:

- (a) Land & Buildings Rs. 3,12,000
- (b) Inventories Rs. 46,800
- (c) Trade Payables Rs. 31,200.

- (vi) The inventory is still unsold on Balance Sheet date and the Trade Payables are not yet settled.
- (vii) Other Reserves as on 31st March, 2018 are the same as was on 1st April, 2017.
- (viii) The business activities of both the company are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.

Prepare the Consolidated Balance Sheet as on 31st March, 2018 of the group of entities PN Ltd. and SR Ltd. as per Ind AS. (PYP 15 Marks ,May'19, MTP 16 Marks Oct'20)(Same concept different figures- MTP 16 Marks Nov'21, Old & New SM, PYP 15 Marks May'18)

Answer 30

Consolidated Balance Sheet of PN Ltd. and its subsidiary SR Ltd. as on 31st March, 2018

Particulars	Note No.	Rs.
I. Assets		
(1) Non-current assets		
(i) Property, Plant & Equipment	1	26,83,200
(ii) Goodwill	2	89,402
(2) Current Assets	3	5,34,800
(i) Inventories		
(ii) Financial Assets		
(a) Trade Receivables	4	3,11,300
(b) Cash & Cash equivalents	5	70,100
Total Assets		36,88,802
II. Equity and Liabilities		
(1) Equity	6	15,60,000
(i) Equity Share Capital	7	11,39,502
(ii) Other Equity		5,07,300
(2) Non-controlling Interest (W.N.3)		
(3) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	2,12,400
(b) Short term borrowings	9	2,69,600
Total Equity & Liabilities		36,88,802

Notes to accounts

		Rs.
1.	Property, Plant & Equipment	
	Land & Building (4,68,000 + 5,61,600 + 3,12,000)	13,41,600
	Plant & Machinery (W.N.5)	13,41,600
2.	Goodwill	89,402
3.	Inventories	
	PN Ltd.	3,74,400
	SR Ltd. (1,13,600 +46,800)	1,60,400
4.	Trade Receivables	
	PN Ltd.	1,86,500
	SR Ltd.	1,24,800
5.	Cash & Cash equivalents	



	PN Ltd.	45,200	
	SR Ltd.	24,900	70,100
8.	Trade Payables		
	PN Ltd.	1,46,900	
	SR Ltd. (34,300 + 31,200)	65,500	2,12,400
9.	Short-term borrowings		
	PN Ltd.	2,49,600	
	SR Ltd.	20,000	2,69,600

Statement of Changes in Equity:

Equity share Capital

Balance at the beginning of the reporting period Rs.	Changes in Equity share capital during the year Rs.	Balance at the end of the reporting period Rs.
15,60,000	0	15,60,000

Other Equity

	Share application money	Equity component	Reserves & Surplus			Total Rs.
			Capital reserve Rs.	Retained Earnings Rs.	Other Reserves Rs.	
Balance at the beginning of the reporting period				0	9,36,000	9,36,000
Total comprehensive income for the year			0	1,78,400		1,78,400
Dividends			0	(52,416)		(52,416)
Total comprehensive income attributable to parent			0	77,518		77,518
Gain on Bargain purchase				0		0
Balance at the end of reporting period				2,03,502	9,36,000	11,39,502

Working Notes:

1. Adjustments of Fair Value

The Plant & Machinery of SR Ltd. would stand in the books at Rs. 4,44,600 on 1st October, 2017, Considering only six months' Depreciation on Rs. $\left(\frac{4,21,200}{90\%}\right) = 4,68,000$; total depreciation being Rs. $4,68,000 \times 10\% \times \frac{6}{12} = 23,400$. The value put on the assets being Rs. 6,24,000 there is an appreciation to the extent of Rs. 1,79,400.

Acquisition date profits of SR Ltd.

Rs.

Reserves on 1.4.2017	3,12,000
Profit & Loss Account Balance on 1.4.2017	93,600



Profit for 2017-2018: Total [Rs. 2,55,800-(93,600-74,880)]x 6/12 i.e. Rs. 1,18,540 upto 1.10.2017	1,18,540
Total Appreciation Total	5,07,000*
Holding Co. Share (70%)	10,31,140
	7,21,798

*Appreciation = Land & Building Rs. 3,12,000 + Inventories Rs. 46,800 + Plant & Machinery Rs. 1,79,400 – Trade Payables Rs. 31,200 = Rs. 5,07,000

2. Post-acquisition profits of SR Ltd. Rs.

Profit after 1.10.2017 [2,55,800 - (93,600-74,880)] x 6/12	1,18,540
Less: 10% depreciation on Rs. 6,24,000 for 6 months less depreciation already charged for 2 nd half of 2017-2018 on Rs. 4,68,800 (ie 31,200 - 23,400)	(7,800)
Total	1,10,740
Share of holding Co. (70%) Share of	77,518
NCI (30%)	33,222

3. Non-controlling Interest Rs.

Par value of 1872 shares	1,87,200
Add: 30% Acquisition date profits [(10,31,140 – 74,880) x 30%] 30%	2,86,878
Post-acquisition profits [W.N.2]	33,222
	5,07,300

4. Goodwill Rs.

Amount paid for 4,368 shares		12,48,000
Less : Par value of shares	4,36,800	
Acquisition date profits-share of PN Ltd.	7,21,798	(11,58,598)
Goodwill		89,402

5. Value of Plant & Machinery: Rs.

PN Ltd. SR Ltd.	4,21,200	7,48,800
Add: Appreciation on 1.10.2017	1,79,400	
	6,00,600	
Add: Depreciation for 2nd half charged on pre- revalued value	23,400	
Less: Depreciation on Rs. 6,24,000 for 6 months	(31,200)	5,92,800
		13,41,600

6. Consolidated Profit & Loss account Rs.

PN Ltd. (as given)	1,78,400	
Less: Dividend	(52,416)	1,25,984
Share of PN Ltd. in post-acquisition profits (W.N.2)		77,518
		2,03,502

Note: Alternatively, the solution can be done on Net Assets approach on the date of acquisition. In such a situation, answer in substance will be same. However, presentation of working notes will be as below:

1. Net assets of SR Ltd. on the date of acquisition Rs.

Share Capital	6,24,000
Reserves on 1.4.2017	3,12,000
Profit & Loss Account Balance on 1.4.2017	93,600
Profit for 2017-2018: Total [Rs. 2,55,800-(93,600-74,880)] x 6/12 i.e. Rs. 1,18,540 upto 1.10.2017	1,18,540



Total Appreciation Total	5,07,000*
Holding Co. Share (70%)	16,55,140
Non-controlling Interest (30)	11,58,598
	4,96,542

*Appreciation = Land and Building Rs. 3,12,000 + Inventories Rs. 46,800+ Plant & Machinery Rs. 1,79,400 – Trade Payables Rs. 31,200 = Rs. 5,07,000

2. Non-controlling Interest Rs.

30% Share in net assets of SR Ltd on 1 st October, 2017	4,96,542
30% Post-acquisition profits [WN 2]	33,222
Less: Dividend received (30% x 12% x 6,24,000)	(22,464)
	5,07,300

3. Goodwill Rs.

Amount paid for 4,368 shares	12,48,000
Acquisition date profits share of PN Ltd.	(11,58,598)
Goodwill	89,402

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Some of the examinees erred in the calculation of additional depreciation on Plant and Machinery while others erred in Statement of Changes in Equity and Other Equity.

Question 31

Entity H holds a 20% equity interest in Entity S (an associate) that in turn has a 100% equity interest in Entity T. Entity S recognised net assets relating to Entity T of Rs. 10,000 in its consolidated financial statements. Entity S sells 20% of its interest in Entity T to a third party (a non-controlling shareholder) for Rs. 3,000 and recognises this transaction as an equity transaction in accordance with the provisions of Ind AS 110, resulting in a credit in Entity S's equity of Rs. 1,000.

The financial statements of Entity H and Entity S are summarised as follows before and after the transaction:

Before			
H's consolidated financial statements			
Assets	(Rs.)	Liabilities	(Rs.)
Investment in S	2,000	Equity	2,000
Total	2,000	Total	2,000

S's consolidated financial statements			
Assets	(Rs.)	Liabilities	(Rs.)
Assets (from T)	10,000	Equity	10,000
Total	10,000	Total	10,000

The financial statements of S after the transaction are summarised below:

After				
S's consolidated financial statements				
Assets	(Rs.)	Liabilities		(Rs.)
Assets (from T)	10,000	Equity	10,000	



Cash	3,000	Equity transaction Impact with non- controlling interest	1,000	
		Equity attributable to owners		11,000
		Non-controlling interest		2,000
Total	13,000	Total		13,000

Although Entity H did not participate in the transaction, Entity H's share of net assets in Entity S increased as a result of the sale of S's 20% interest in T. Effectively, H's share in S's net assets is now Rs. 2,200 (20% of Rs. 11,000) i.e., Rs. 200 in addition to its previous share.

How this equity transaction that is recognised in the financial statements of Entity S reflected in the consolidated financial statements of Entity H that uses the equity method to account for its investment in Entity S? (PYP 6 Marks ,Nov'20, Old & New SM)

Answer 31

Ind AS 28 defines the equity method as “a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post -acquisition change in the investor’s share of the investee’s net assets. The investor’s profit or loss includes its share of the investee’s profit or loss and the investor’s other comprehensive income includes its share of the investee’s other comprehensive income.”

Ind AS 28, states, inter alia, that when an associate or joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income, and net assets taken into account in applying the equity method are those recognised in the associate’s or joint venture’s financial statements (including the associate’s or joint venture’s share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies.

The change of interest in the net assets / equity of the associate as a result of the investee’s equity transaction is reflected in the investor’s financial statements as ‘share of other changes in equity of investee’ (in the statement of changes in equity) instead of gain in Statement of profit and loss, since it reflects the post-acquisition change in the net assets of the investee as per the provisions of Ind AS 28 and also faithfully reflects the investor’s share of the associate’s transaction as presented in the associate’s consolidated financial statements.

Thus, in the given case, Entity H recognises Rs. 200 as change in other equity instead of in statement of profit and loss and maintains the same classification as of its associate, Entity S, i.e., a direct credit to equity as in its consolidated financial statements.

Question 32

Entity K is owned by three institutional investors - M Limited, N Limited and C Limited - holding 40%, 40% and 20% equity interest respectively. A contractual arrangement between M Limited and N Limited gives them joint control over the relevant activities of Entity K. It is determined that Entity K is a joint operation (and not a joint venture). C Limited is not a party to the arrangement between M Limited and N Limited. However, like M Limited and N Limited, C Limited also has rights to the assets, and obligations for the liabilities, relating to the joint operation in proportion of its equity interest in Entity K. Would the manner of accounting to be followed by M Limited and N Limited on the one hand and C Limited on the other in respect of their respective interests in Entity K be the same or different?

You are required to explain in light of the relevant provisions in the relevant standard in this regard. (PYP 4 Marks Nov'20)

Answer 32

Ind AS 111 states that a joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

- (b) its liabilities, including its share of any liabilities incurred jointly;
- (c) its revenue from the sale of its share of the output arising from the joint operation;
- (d) its share of the revenue from the sale of the output by the joint operation; and
- (e) its expenses, including its share of any expenses incurred jointly.

A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the Ind AS applicable to the particular assets, liabilities, revenues and expenses.

Further, Ind AS 111 states that a party that participates in, but does not have joint control of a joint operation shall also account for its interest in the arrangement in accordance with above provisions of the standard, if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation.

In the given case, all three investors (M Limited, N Limited and C Limited) share in the assets and liabilities of the joint operation in proportion of their respective equity interest. Accordingly, both M Limited and N Limited (which have joint control) and C Limited (which does not have joint control but participates) shall recognise their interest in joint operation as per above guidance while accounting for their respective interests in Entity K in their respective separate financial statements as well as in the consolidated financial statements.

Question 33

From the following data, determine in each case:

- (i) Non-controlling interest at the date of acquisition (using proportionate share method) and at the date of consolidation.
- (ii) Goodwill or gain on bargain purchase.
- (iii) Amount of Holding Company's share of profit in the Consolidated Balance Sheet assuming Holding Company's own retained earnings to be ₹ 4,00,000 in each basis.

Case	Subsidiary Company	% of Shares Owned	Cost	Date of Acquisition 1.4.2020		Consolidation Date 31.3.2021	
				Share Capital (A)	Retained Earnings (B)	Share Capital (C)	Retained Earnings (D)
Case 1	P	90%	2,80,000	2,00,000	1,00,000	2,00,000	1,40,000
Case 2	Q	85%	2,08,000	2,00,000	60,000	2,00,000	40,000
Case 3	R	80%	1,12,000	1,00,000	40,000	1,00,000	40,000
Case 4	S	100%	2,00,000	1,00,000	80,000	1,00,000	1,12,000

The Company has adopted an accounting policy to measure non-controlling interest at NCI's proportionate share of the acquiree's Identifiable Net Assets. It may be assumed that the fair value of acquiree's net identifiable assets is equal to their book values. (PYP 5 Marks Dec '21, Old & New SM)

Answer 33

Non-controlling Interest = the equity in a subsidiary not attributable, directly or indirectly, to a parent. Equity is the residual interest in the assets of an entity after deducting all its liabilities i.e. in this given case Share Capital + Balance in Statement of Profit & Loss (Assuming it to be the net aggregate value of identifiable assets in accordance with Ind AS)

- (1) Calculation of amount of NCI at the date of acquisition and consolidation

	% of shares owned by NCI [E]	Non-controlling interest as at the date of acquisition [E] x [A + B]	Non-controlling interest as at the date of consolidation [E] x [C + D]
Case 1	[100-90] 10%	30,000	34,000
Case 2	[100-85] 15%	39,000	36,000
Case 3	[100-80] 20%	28,000	28,000
Case 4	[100-100] Nil	Nil	Nil

(2) Calculation of Goodwill or Gain on bargain purchase

Case	Consideration [G]	Non - controlling interest [H]	Net Identifiable assets [A] + [B] = [I]	Goodwill [G]+[H] - [I]	Gain on bargain purchase [I]-[G]-[H]
Case 1	2,80,000	30,000	3,00,000	10,000	Nil
Case 2	2,08,000	39,000	2,60,000	Nil	13,000
Case 3	1,12,000	28,000	1,40,000	Nil	Nil
Case 4	2,00,000	Nil	1,80,000	20,000	Nil

(3) In each case the following amount (shown in column No. O) shall be added or deducted from the balance of holding company's retained earnings of ` 4,00,000:

Case	% Share Holding [K]	Retained earnings as on 1.4.2020 [L]	Retained earnings as on consolidation date 31.3.2021 [M]	Retained earnings post-acquisition [N] = [M] - [L]	Amount to be added / (deducted) from holding's retained earnings [O] = [K] x [N]
Case 1	90%	1,00,000	1,40,000	40,000	36,000
Case 2	85%	60,000	40,000	(20,000)	(17,000)
Case 3	80%	40,000	40,000	Nil	Nil
Case 4	100%	80,000	1,12,000	32,000	32,000

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question deals with the computation of NCI, Goodwill / Gain on Bargain Purchase and Holding company's share of profit in Consolidated Balance Sheet. Only a few examinees were not able to add or subtract the amount from retained earnings of holding company. Some failed to provide NCI at the date of consolidated financial statements.

Question 34

On 1st April 2019, Big Limited acquired a 35% interest in Dig Limited and achieved a significant influence. The cost of the investment was ` 3,00,000. Dig Limited has net assets of ` 5,50,000 as on 1st April 2019. The fair value of those net assets is ` 6,50,000, since the fair value of property, plant and equipment is ` 1,00,000 higher than its book value. This property, plant and equipment have a remaining useful life of 8 years. For the financial year 2019-2020, Dig Limited earned a profit (after tax) of ` 1,00,000 and paid



a dividend of ₹ 11,000 out of these profits. Dig Ltd. has also recognized the loss of ₹ 15,000, that arose from re-measurement of defined benefit directly in 'Other Comprehensive Income'.

Calculate Big Ltd.'s interest in Dig Ltd. as at the year ended 31 st March 2020 under the relevant method.
(PYP 5 Marks Jan'21)

Answer 34

Calculation of Big Ltd.'s interest in Dig Ltd at the year ended 31 st March, 2020 as per Equity method:

	Amount (₹)
Cost of investment (35%)	3,00,000
Share in profit asfter adjustment (Refer Working Note)	30,625
Dividend received by Big Ltd from Dig Ltd (35% x ₹ 11,000)	(3,850)
Big Ltd.'s share of loss in OCI w.r.t Dig Ltd.'s loss from remeasurement of defined benefit liability (35% x ₹ 15,000)	(5,250)
Big Ltd.'s interest in Dig Ltd at the end of the year	3,21,525

Working Note: Computation of Share in profit after adjustment

	Amount (₹)
Big Ltd.'s share of Dig Ltd.'s after tax profit (35% x ₹ 1,00,000)	35,000
Less: Big Ltd.'s share of depreciation based on fair value (35% x ₹ 12,500)	(4,375)
Share in profit after adjustment	30,625

Question 35

Given below are the balance sheets of a group of companies comprising X Ltd., Y Ltd. and Z Ltd. as on 31st March, 2022:
(₹ in Lakhs)

	X Ltd.	Y Ltd.	Z Ltd.
Assets			
Non-current Assets			
Property, plant and equipment	1,120	1,260	1,050
Investment:			
112 lakh shares in Y Ltd.	1,190		
84 lakh shares in Z Ltd.		980	
Current assets			
Inventories	770	245	175
Financial assets:			
Trade receivables	910	350	770
Bills receivables	252	-	105
Cash in hand and at bank	798	140	140
	5,040	2,975	2,240
Equity and Liabilities			
Shareholder's equity			
Share capital (₹ 10 per share)	2,100	1,400	1,120
Other equity:			
Reserves	630	350	280
Retained earnings	560	175	210
Current liabilities			



Financial liabilities:			
Trade payables	1,645	805	630
Bills payable			
X Ltd.	-	245	-
Y Ltd.	105	-	-
	5,040	2,975	2,240

The following additional information is available:

- X Ltd. holds 80% shares in Y Ltd. and Y Ltd. holds 75% shares in Z Ltd. Their holdings were acquired on 30th September, 2021.
- The business activities of all the companies are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.
- On 1st April 2021, the following balances stood in the books of Y Ltd. and Z Ltd.

(₹ in lakhs)

	Y Limited	Z Limited
Reserve	280	210
Retained earnings	70	105

- ₹ 35 lakhs included in the inventory figure of Y Ltd. is inventory which has been purchased from Z Ltd. at cost plus 25%.
- The parent company has adopted an accounting policy to measure non-controlling interest at fair value (quoted market price) applying Ind AS 103. Assume that market price of the shares of Y Ltd. and Z Ltd. are the same as their respective face values.
- Y Ltd. purchased goods from Z Ltd. after acquiring the shares of Z Ltd.

You are required to prepare consolidated balance sheet, as at 31st March 2022, of the group of companies X Limited, Y Limited and Z Limited. (PYP 15 Marks Nov 22) (Same concept different figures- MTP 16 Marks May '20, MTP 16 Marks Apr'22, Old & New SM, PYP 16 Marks Jul'21, MTP 14 Marks Oct'22, PYP 16 Marks Nov'18)

Answer 35

(a) Consolidated Balance Sheet of the Group as on 31st March, 2022

Particulars	Note No.	₹ in lakh
ASSETS		
Non-current assets		
(a) Property, Plant and Equipment	1	3,430.00
Current Assets		
(a) Inventories	2	1,183.00
(b) Financial assets		
(i) Trade receivables	3	2,142.00
(ii) Cash and Cash equivalents	4	1,078.00
Total assets		7,833.00
EQUITY & LIABILITIES		
Equity attributable to owners of parent		
(a) Share Capital		2,100.00
(b) Other Equity	5	1,966.30
Non-controlling interests (W.N.4)		581.70

Total equity		4,648.00
LIABILITIES		
Non-current liabilities		Nil
Current liabilities		
(a) Financial Liabilities		
(i) Trade payables	6	3,185.00
Total liabilities		3,185.00
Total Equity and Liabilities		7,833.00

Notes to Accounts

(₹ in lakh)

1.	Property, Plant & Equipment		
	X Ltd.	1,120.00	
	Y Ltd.	1,260.00	
	Z Ltd.	1,050.00	3,430.00
2.	Inventories		
	X Ltd.	770.00	
	Y Ltd. (245 – 7)	238.00	
	Z Ltd.	175.00	1,183.00
3.	Trade Receivables		
	X Ltd.	910.00	
	Y Ltd.	350.00	
	Z Ltd.	770.00	
	(A)	2,030.00	
	Bills Receivables		
	X Ltd. (252 – 245)	7.00	
	Z Ltd.	105.00	
	(B)	112.00	
	Total Trade Receivables (A+B)		2,142.00
4.	Cash & Cash equivalents		
	X Ltd.	798.00	
	Y Ltd.	140.00	
	Z Ltd.	140.00	1,078.00
5.	Other Equity		
	Reserve (W.N.5)	679.00	
	Retained Earnings (W.N.5)	629.30	
	Capital Reserve (W.N.3)	658.00	1,966.30
6.	Trade Payables		
	X Ltd.	1,645.00	
	Y Ltd.	805.00	
	Z Ltd.	630.00	
	(A)	3,080.00	
	Bills payable		
	X Ltd.	105.00	
	Y Ltd. (245 - 245)	-	



	(B)	105.00	
	Total Trade Payables (A+B)		3,185.00

*Note: Bills Payable of X Ltd. is not reflecting as Bills Receivable of Y Ltd. This may happen since Y Ltd. may have discounted/endorsed the same to the bank/third party.

Working Notes:
1. Analysis of Reserves and Surplus

(₹ in lakh)

		Y Ltd.		Z Ltd.
Reserves as on 31.3.2021		280.00		210.00
Increase during the year 2021-2022	70.00		70.00	
Increase for the half year till 30.9.2021		35.00		35.00
Balance as on 30.9.2021 (A)		315.00		245.00
Total balance as on 31.3.2022		350.00		280.00
Post-acquisition balance of Reserves		35.00		35.00
Retained Earnings as on 31.3.2021		70.00		105.00
Increase during the year 2021-2022	105.00		105.00	
Increase for the half year till 30.9.2021		52.50		52.50
Balance as on 30.09.2021 (B)		122.50		157.50
Total balance as on 31.3.2022		175.00		210.00
Post-acquisition balance of RE		52.50		52.50
Less: Unrealised Gain on inventories [(35 ÷ 125) x 25]		-		(7.00)
Post-acquisition balance of RE for CFS		52.50		45.50
Total balance on the acquisition date ie.30.9.2021 (A+B)		437.50		402.50

2. Calculation of Effective Interest of X Ltd. in Z Ltd.

Acquisition by X Ltd. in Y Ltd.	= 80%
Non-controlling Interest of Y Ltd.	= 20%
Acquisition by Y Ltd. in Z Ltd.	= 75%
Acquisition by Group in Z Ltd. (80% x 75)	= 60% Non-controlling Interest of Z Ltd
	= 40%

3. Calculation of Goodwill / Capital Reserve on acquisition of subsidiaries

₹ in lakhs

	Y Ltd.	Z Ltd.
Investment or consideration	1,190.00	(980 x 80%) 784.00
Add: NCI at Fair value		
(1,400 x 20%)	280.00	
(1,120 x 40%)	-	448.00
	1,470.00	1,232.00
Less: Identifiable net assets (Share Capital + Increase in the Reserves and Surplus till acquisition date)	(1,400+437.50) (1,837.50)	(1,120+402.50) (1,522.50)



Capital Reserve	367.50	290.50
Total Capital Reserve (367.50 + 290.50)	658.00	

4. Calculation of Non-controlling Interest

₹ in lakhs

	Y Ltd.	Z Ltd.
At Fair Value (See Note 3)	280.00	448.00
Add: Post Acquisition Reserves (See Note 1)	(35 x 20%) 7.00	(35 x 40%) 14.00
Add: Post-acquisition retained earnings (See Note 1)	(52.50 x 20%) 10.50	(45.50 x 40%) 18.20
Less: NCI share of investment in Z Ltd.	(980 x 20%) (196.00)*	-
	101.50	480.20
Total (101.50 + 480.20)	581.70	

*Note: The non-controlling interest in Y Ltd. will take its proportion in Z Ltd. So, they have to bear their proportion in the investment by Y Ltd. (in Z Ltd.) also.

5. Calculation of Consolidated Other Equity

₹ in lakhs

	Reserves	Retained Earnings
X Ltd.	630.00	560.00
Add: Share in Y Ltd.	(35 x 80%) 28.00	(52.50 x 80%) 42.00
Add: Share in Z Ltd.	(35 x 60%) 21.00	(45.50 x 60%) 27.30
	679.00	629.30

In the above solution, it is assumed that profits of Z Ltd. has been earned evenly throughout the year irrespective of post-acquisition sale of goods to Y Ltd.

Alternatively, profit on sale of goods to Y Ltd. is deducted from total profit of Z Ltd. before distribution of total profit of Z Ltd. into pre-acquisition and post-acquisition. In such a case, the solution will be as follows:

Consolidated Balance Sheet of the Group as on 31st March, 2022

Particulars	Note No.	₹ in lakh
ASSETS		
Non-current assets		
(a) Property, plant and equipment	1	3,430.00
Current assets		
(c) Inventory	2	1,183.00
(d) Financial assets		
(i) Trade receivable	3	2,142.00
(ii) Cash and cash equivalents	4	1,078.00
Total assets		7,833.00
EQUITY & LIABILITIES		
Equity attributable to owners of parent		
Share Capital		2,100.00
Other Equity	5	1,964.90
Non-controlling interests (W.N.4)		583.10
Total equity		4,648.00
LIABILITIES		



Non-current liabilities	6	Nil
Current liabilities		
(b) Financial Liabilities		
(i) Trade payables		3,185.00
Total liabilities		3,185.00
Total equity and liabilities		7,833.00

Notes to Accounts

(₹ in lakh)

1.	Property, plant & equipment		
	X Ltd.	1,120.00	
	Y Ltd.	1,260.00	
	Z Ltd.	1,050.00	3,430.00
2.	Inventories		
	X Ltd.	770.00	
	Y Ltd. (245 – 7)	238.00	
	Z Ltd.	175.00	1,183.00
3.	Trade receivable		
	X Ltd.	910.00	
	Y Ltd.	350.00	
	Z Ltd.	770.00	
	(A)	2,030.00	
	Bills receivable		
	X Ltd. (252 – 245)	7.00	
	Z Ltd.	105.00	
	(B)	112.00	
	Total Trade Receivables (A+B)		2,142.00
4.	Cash & cash equivalents		
	X Ltd.	798.00	
	Y Ltd.	140.00	
	Z Ltd.	140.00	1,078.00
5.	Other equity		
	Reserve (W.N.5)	679.00	
	Retained Earnings (W.N.5)	631.40	
	Capital Reserve (W.N.3)	654.50	1,964.90
6.	Trade payable		
	X Ltd.	1,645.00	
	Y Ltd.	805.00	
	Z Ltd.	630.00	
	(A)	3,080.00	
	Bills payable		
	X Ltd.	105.00	
	Y Ltd. (245 - 245)	-	
	(B)	105.00	
	Total of Trade payable (A+B)		3,185.00



*Note: Bills Payable of X Ltd. is not reflecting as Bills Receivable of Y Ltd. This may happen since Y Ltd. may have discounted / endorsed the same to the bank/third party.

Working Notes:
1. Analysis of Reserves and Surplus

(₹ in lakh)

		Y Ltd.		Z Ltd.
Reserves as on 31.3.2021		280.00		210.00
Increase during the year 2021-2022	70.00		70.00	
Increase for the half year till 30.9.2021		35.00		35.00
Balance as on 30.9.2021 (A)		315.00		245.00
Total balance as on 31.3.2022		350.00		280
Post-acquisition balance of Reserves		35.00		35.00
Retained Earnings as on 31.3.2021		70.00		105.00
Increase during the year 2021-2022 for Y Ltd.	105.00			
Increase during the year 2021-22 for Z Ltd.				
105.00				
Less: Unrealised gain $[(35/125) \times 25]$ (7.00)				
Profit of the year earned evenly for Z Ltd. 98.00			98	
Increase for the half year till 30.9.2021		52.50		49.00
Balance as on 30.9.2021 (B)		122.50		154.00
Total balance as on 31.3.2022		(175.00)		(210.00)
Post-acquisition balance		52.50		56.00
Less: Unrealised gain on inventories $[(35/125) \times 25]$		-		(7.00)
Post-acquisition balance for CFS		52.50		49.00
Total balance on the acquisition date ie. 30.9.2021 (A+B)		437.50		399.00

1. Calculation of Effective Interest of X Ltd. in Z Ltd.

Acquisition by X Ltd. in Y Ltd. = 80%

Non-controlling Interest of Y Ltd. = 20%

Acquisition by Y Ltd. in Z Ltd. = 75%

Acquisition by Group in Z Ltd. $(80\% \times 75\%)$ = 60%

Non-controlling Interest of Z Ltd = 40%

2. Calculation of Goodwill / Capital Reserve on the acquisition

(₹ in lakhs)

	Y Ltd.	Z Ltd.
Investment or consideration	1,190	$(980 \times 80\%)$ 784
Add: NCI at Fair value		
$(1,400 \times 20\%)$	280	
$(1,120 \times 40\%)$	-	448
	1,470	1,232
Less: Identifiable net assets (Share Capital + Increase in the Reserves and Surplus till acquisition date)	$(1,400+437.50)$	$(1,120+399)$
	(1,837.50)	(1,519.00)
Capital Reserve	367.50	287.00



Total Capital Reserve (367.50 + 287.00)	654.50

3. Calculation of Non-controlling Interest (₹ in lakhs)

	Y Ltd.	Z Ltd.
At Fair Value (See Note 3)	280.00	448.00
Add: Post-acquisition Reserves (See Note 1)	(35 x 20%) 7.00	(35 x 40%) 14.00
Add: Post-acquisition Retained Earnings (See Note 1)	(52.50 x 20%) 10.50	(49.00 x 40%) 19.60
Less: NCI share of investment in Z Ltd.	(980 x 20%) (196.00)*	-
	101.50	481.60
Total (101.50 + 481.60)	583.10	

*Note: The non-controlling interest in Y Ltd. will take its proportion in Z Ltd. So, they have to bear their proportion in the investment by Y Ltd. (in Z Ltd.) also.

4. Calculation of Consolidated Other Equity (₹ in lakhs)

	Reserves	Retained Earnings
X Ltd.	630.00	560.00
Add: Share in Y Ltd.	(35 x 80%) 28.00	(52.50 x 80%) 42.00
Add: Share in Z Ltd.	(35 x 60%) 21.00	(49.00 x 60%) 29.40
	679.00	631.40

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

The question required to prepare a consolidated balance sheet for a chain of holding companies wherein examinees were required to find out the effective interest in the second subsidiary, analysis of reserves and surplus of both subsidiary companies, calculation of goodwill / capital reserves, Non-controlling interest, consolidated other equity and to prepare the notes to accounts. Most of the examinees failed to calculate the effective interest of ultimate holding in the sub-subsidiary company. Due to which they erred in the calculation of goodwill/capital reserve, non-controlling interest and consolidated other equity. Some examinees wrongly mentioned capital reserve as goodwill though the calculation was correct.

Question 36

Company P Ltd., a manufacturer of textile products, acquires 40,000 equity shares of Company X (a manufacturer of complementary products) out of 1,00,000 shares in issue. As part of the same agreement, the Company P purchases an option to acquire an additional 25,000 shares. The option is exercisable at any time in the next 12 months. The exercise price includes a small premium to the market price at the transaction date.

After the above transaction, the shareholdings of Company X's two other original shareholders are 35,000 and 25,000. Each of these shareholders also has currently exercisable options to acquire 2,000 additional shares. Assess whether control is acquired by Company P. (MTP 5 Marks April '23)

Answer 36

In assessing whether it has obtained control over Company X, Company P should consider not only the 40,000 shares it owns but also its option to acquire another 25,000 shares (a so-called potential voting



right). In this assessment, the specific terms and conditions of the option agreement and other factors are considered as follows:

- the options are currently exercisable and there are no other required conditions before such options can be exercised
- if exercised, these options would increase Company P's ownership to a controlling interest of over 50% before considering other shareholders' potential voting rights (65,000 shares out of a total of 1,25,000 shares)
- although other shareholders also have potential voting rights, if all options are exercised Company P will still own a majority (65,000 shares out of 1,29,000 shares)
- the premium included in the exercise price makes the options out-of-the-money. However, the fact that the premium is small and the options could confer majority ownership indicates that the potential voting rights have economic substance.

By considering all the above factors, Company P concludes that with the acquisition of the 40,000 shares together with the potential voting rights, it has obtained control of Company X.

Question 37

On 1st April 2021, P Limited acquired 100% interest in S Limited for ₹ 75.00 lakhs when the fair value of the net assets of S Limited was ₹ 60.00 lakhs. Goodwill of ₹ 15.00 lakhs arose on consolidation. On 31st March, 2023, P Limited disposed off 80% interest in S Limited for ₹ 114.00 lakhs. As on the date of disposal, the carrying value of the net assets of S Limited excluding goodwill was ₹ 1,20,00,000. The fair value of the remaining interest is ₹ 28,50,000.

You are required to:

- Calculate the gain or loss on sale of disposal, and
- Pass necessary journal entries on disposal of 80% interest in S Limited in P Limited's separate and consolidated financial statements as on 31st March, 2023. (PYP 5 Marks May '23)

Answer 37

In P Ltd.'s Separate Financial Statements

(i) Calculation of Gain or Loss on disposal in P Ltd.'s separate financial statements

	₹ in lakhs
Sales proceeds	114.0
Less: Cost of investment in subsidiary (75 x 80%)	(60.0)
Gain on sale in parent's account	54.00

(ii) Journal Entry in P Limited's separate financial statements ₹ in lakhs

Date	Particulars	Dr.	Cr.
31.3.2023	Bank A/c Dr.	114.00	
	Investment in Associates Dr.	15.00	
	To Investment in subsidiary A/c		75.00
	To Gain on sale of subsidiary A/c		54.00
31.3.2023	Gain on sale of subsidiary A/c Dr.	54	



	To Statement of Profit and Loss		54

Note: In case of partial disposal of investment leading to significant influence because of loss of control, the above solution has been provided by applying proportionate approach. However, cost of retained investment on the date of loss of control has not been defined in Ind AS 27 'Separate Financial Statements'. Therefore, paragraphs 10 and 11(a) of Ind AS 8 (i.e. in the absence of accounting policy that specifically applies to a transaction, management shall refer to, and consider the applicability of the requirements in Ind AS dealing with similar and related issues) have been applied. Further, para 25(b) of Ind AS 110 inter alia states that recognition of investment retained in the former subsidiary to be the fair value which shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture. Accordingly, following ALTERNATE solution may also be considered:

(i) Calculation of Gain or Loss on disposal in P Ltd.'s separate financial statements:

	`in lakhs
Sales proceeds	114.0
Fair value of 20% interest retained	28.50
	142.50
Less: Cost of investment in subsidiary	(75.0)
Gain on sale in parent's account	67.5

(ii) Journal Entry in P Limited's separate financial statements ` in lakhs

Date	Particulars	Dr.	Cr.
31.3.2023	Bank A/c Dr.	114.00	
	Investment in Associate at cost (as per para 25 Ind AS 110) Dr.	28.50	
	To Investment in subsidiary A/c		75.00
	To Gain on sale of subsidiary A/c		67.50
31.3.2023	Gain on sale of subsidiary A/c Dr.	67.50	
	To Statement of Profit and Loss		67.50

In P Ltd.'s Consolidated Financial Statements

i) Calculation of Gain or Loss on disposal in P Ltd.'s consolidated financial statements

	` in lakhs
Sales proceeds	114.00
Fair value of 20% interest retained	28.50
	142.50



Less: Net assets disposed, including goodwill (1,20,00,000 + 15,00,000)	(135.00)
Gain on sale in the group's financial statements	7.50

ii) Journal Entry in P Limited's consolidated financial statements ` in lakhs

Date	Particulars	Dr.	Cr.
31.3.2023	Bank A/c Dr. Fair value of Net identifiable assets Dr. To Net asset of subsidiary A/c To Goodwill To Gain on sale of subsidiary A/c	114.00 28.50	120.00 15.00 7.50
31.3.2023	Gain on sale of subsidiary A/c To Statement of Profit or Loss	7.50	7.50

Note:

The above solution has been drawn on the assumption that the retained investment had led to significant influence. Accordingly, investment in an associate has been accounted for on partial disposal of investment by P Ltd.

However, it may alternatively be assumed that the retained investment, after loss of control due to partial disposal of investment, does not lead to significant influence on S Ltd. In such a situation, retained interest will be measured at fair value in P Ltd.'s Separate Financial Statements as given in the alternate solution and main solution will not be applicable in such a case.



Chapter 14

Ind AS 101: First-time Adoption of Ind AS

Question 1

Shaurya Limited is the company having its registered and corporate office at New Delhi. 60% of the Shaurya Limited's shares are held by the Government of India and rest by other investors.

This is the first time that Shaurya limited would be applying Ind AS for the preparation of its financials for the current financial year 2019-2020. Following balance sheet is prepared as per earlier GAAP as at the beginning of the preceding period along with the additional information:

Balance Sheet as at 31 March 2018

(All figures are in '000, unless otherwise specified)

Particulars	Amount
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	10,00,000
(b) Reserves & Surplus	25,00,000
(2) Non-Current Liabilities	
(a) Long Term Borrowings	4,50,000
(b) Long Term Provisions	3,50,000
(c) Deferred tax liabilities	3,50,000
(3) Current Liabilities	
(a) Trade Payables	22,00,000
(b) Other Current Liabilities	4,50,000
(c) Short Term Provisions	12,00,000
TOTAL	85,00,000
ASSETS	
(1) Non-Current Assets	
(a) Property, Plant & Equipment (net)	20,00,000
(b) Intangible assets	2,00,000
(c) Goodwill	1,00,000
(d) Non-current Investments	5,00,000
(e) Long Term Loans and Advances	1,50,000
(f) Other Non-Current Assets	2,00,000
(2) Current Assets	
(a) Current Investments	18,00,000
(b) Inventories	12,50,000
(c) Trade Receivables	9,00,000
(d) Cash and Bank Balances	10,00,000
(e) Other Current Assets	4,00,000
TOTAL	85,00,000

Additional Information (All figures are in '000) :

- Other current liabilities include Rs. 3,90,000 liabilities to be paid in cash such as expense payable, salary payable etc. and Rs. 60,000 are statutory government dues.
- Long term loans and advances include Rs. 40,000 loan and the remaining amount consists Advance to staff of Rs. 1,10,000.

3. Other non-current assets of Rs. 2,00,000 consists Capital advances to suppliers.



4. Other current assets include Rs. 3,50,000 current assets receivable in cash and Prepaid expenses of Rs. 50,000.
5. Short term provisions include Dividend payable of Rs. 2,00,000. The dividend payable had been as a result of board meeting wherein the declaration of dividend for financial year 2017 -2018 was made. However, it is subject to approval of shareholders in the annual general meeting.

Chief financial officer of Shaurya Limited has also presented the following information against corresponding relevant items in the balance sheet:

- a) Property, Plant & Equipment consists a class of assets as office buildings whose carrying amount is Rs. 10,00,000. However, the fair value of said office building as on the date of transition is estimated to be Rs. 15,00,000. Company wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements.
- b) The fair value of Intangible assets as on the date of transition is estimated to be Rs. 2,50,000. However, the management is reluctant to incorporate the fair value changes in books of account .
- c) Shaurya Ltd. had acquired 80% shares in a company, Excel private limited few years ago thereby acquiring the control upon it at that time. Shaurya Ltd. recognised goodwill as per erstwhile accounting standards by accounting the excess of consideration paid over the net assets acquired at the date of acquisition. Fair value exercise was not done at the time of acquisition.
- d) Trade receivables include an amount of Rs. 20,000 as provision for doubtful debts measured in accordance with previous GAAP. Now as per latest estimates, the provision needs to be revised to Rs. 25,000.
- e) Company had given a loan of Rs.1,00,000 to an entity for the term of 10 years six years ago. Transaction costs were incurred separately for this loan. The loan carries an interest rate of 7%. The principal amount is to be repaid in equal installments over the period of ten years at the year end. Interest is also payable at each year end. The fair value of loan as on the date of transition is Rs. 50,000 as against the carrying amount of loan which at present amounts to Rs. 40,000. However, Ind AS 109 mandates to charge the interest expense as per effective interest method after the adjustment of transaction costs. Management says it is tedious task in the given case to apply the effective interest rate changes with retrospective effect and hence is reluctant to apply the same retrospectively in its first time adoption.
- f) In the long term borrowings, Rs. 4,50,000 of component is due towards the State Government. Interest is payable on the government loan at 4%, however the prevailing rate in the market at present is 8%. The fair market value of loan stands at Rs. 4,20,000 as on the relevant date.
- g) Under Previous GAAP, the mutual funds were measured at cost or market value, whichever is lower. Under Ind AS, the Company has designated these investments at fair value through profit or loss. The value of mutual funds as per previous GAAP is Rs. 2,00,000 as included in 'current investment'. However, the fair value of mutual funds as on the date of transition is Rs. 2,30,000.
- h) Ignore separate calculation of deferred tax on above adjustments. Assume the net deferred tax income to be Rs. 50,000 on account of Ind AS transition adjustments.

Requirements:

- Prepare transition date balance sheet of Shaurya Limited as per Indian Accounting Standards
- Show necessary explanation for each of the items presented by chief financial officer in the form of notes, which may or may not require the adjustment as on the date of transition.(MTP 20 Marks Oct'20, Old & New SM)

Answer 1

Transition date (opening) IND-AS BALANCE SHEET of SHAURYA LIMITED

As at 1 April 2018

(All figures are in '000, unless otherwise specified)



Particulars	Previous GAAP	Transitional Ind AS adjustments	Opening Ind AS Balance sheet
ASSETS			
Non-current assets			
Property, plant and equipment (Note 1)	20,00,000	5,00,000	25,00,000
Goodwill (Note 2)	1,00,000	-	1,00,000
Other Intangible assets (Note 3)	2,00,000	-	2,00,000
Financial assets:			
Investment	5,00,000	-	5,00,000
Loans (Note 4)	40,000	10,000	50,000
Other financial assets	1,10,000	-	1,10,000
Other non-current assets	2,00,000	-	2,00,000
Current assets			
Inventories	12,50,000	-	12,50,000
Financial assets			
Investment (Note 5)	18,00,000	30,000	18,30,000
Trade receivables (Note 6)	9,00,000	-	9,00,000
Cash and cash equivalents/Bank	10,00,000	-	10,00,000
Other financial assets	3,50,000	-	3,50,000
Other current assets	50,000	-	50,000
TOTAL ASSETS	85,00,000	5,40,000	90,40,000
EQUITY AND LIABILITIES			
Equity			
Equity share capital	10,00,000	-	10,00,000
Other equity	25,00,000	7,90,000	32,90,000
Non-current liabilities			
Financial liabilities			
Borrowings (Note-7)	4,50,000	-	4,50,000
Provisions	3,50,000	-	3,50,000
Deferred tax liabilities (Net)	3,50,000	(50,000)	3,00,000
Current liabilities			
Financial liabilities			
Trade payables	22,00,000	-	22,00,000
Other financial liabilities	3,90,000	-	3,90,000
Other current liabilities	60,000	-	60,000
Provisions (Note-8)	12,00,000	(2,00,000)	10,00,000
TOTAL EQUITY AND LIABILITIES	85,00,000	5,40,000	90,40,000

OTHER EQUITY

	Retained Earnings (Rs.)	Fair value reserve	Total
As at 31 March, 2018	27,90,000 (W.N.1)	5,00,000	32,90,000

Working Note 1:

Retained earnings balance:	
Balance as per Earlier GAAP	25,00,000
Transitional adjustment due to loan's fair value	10,000
Transitional adjustment due to increase in mutual fund's fair value	30,000
Transitional adjustment due to decrease in deferred tax liability	50,000
Transitional adjustment due to decrease in provisions (dividend)	2,00,000
Total	27,90,000

**Disclosure forming part of financial statements:**

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and should not be recognized as liability as at the Balance Sheet date.

Note 1: Property, plant & Equipment:

As per para D5 of Ind AS 101, an entity may elect to measure an item of property, plant and equipment at the date of transition to Ind AS at its fair value and use that fair value as its deemed cost at that date.

Note 2: Goodwill:

Ind AS 103 mandatorily requires measuring the assets and liabilities of the acquiree at its fair value as on the date of acquisition. However, a first-time adopter may elect to not apply the provisions of Ind AS 103 with retrospective effect that occurred prior to the date of transition to Ind AS. Hence, company can continue to carry the goodwill in its books of account as per the previous GAAP.

Note 3: Intangible assets:

Para D7 read with D6 of Ind AS 101 states that a first-time adopter may elect to use a previous GAAP revaluation at, or before, the date of transition to Ind AS as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

- (a) Fair value; or
- (b) Cost or depreciated cost in accordance with Ind AS, adjusted to reflect, for example, changes in a general or specific price index.

However, there is a requirement that Intangible assets must meet the definition and recognition criteria as per Ind AS 38. Hence, company can avail the exemption given in Ind AS 101 as on the date of transition to use the carrying value as per previous GAAP.

Note 4: Loan:

Para B8C of Ind AS 101 states that if it is impracticable (as defined in Ind AS 8) for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind ASs shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to Ind AS.

Accordingly, Rs. 50,000 would be the gross carrying amount of loan and difference of Rs. 10,000 (Rs. 50,000 – Rs. 40,000) would be adjusted to retained earnings.

Note 5: Mutual Funds:

Para 29 of Ind AS 101 states that an entity is permitted to designate a previously recognised financial asset as a financial asset measured at fair value through profit or loss in accordance with paragraph D19A. The entity shall disclose the fair value of financial assets so designated at the date of designation and their classification and carrying amount in the previous financial statements.

D19A states that an entity may designate a financial asset as measured at fair value through profit or loss in accordance with Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind AS.

Note 6: Trade receivables:

Para 14 of Ind AS 101 states that an entity's estimates in accordance with Ind ASs at the date of transition to Ind AS shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

Para 15 of Ind AS 101 further states that an entity may receive information after the date of transition to Ind ASs about estimates that it had made under previous GAAP. In accordance with paragraph 14, an entity shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with Ind AS 10, Events after the Reporting Period. The entity shall not reflect that new information in its opening Ind AS Balance Sheet (unless the



estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in profit or loss (or, if appropriate, other comprehensive income) for the year ended 31 March 2019.

Note 7: Government Grant:

Para 10A of Ind AS 20 states that the benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognised and measured in accordance with Ind AS 109, Financial Instruments. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for in accordance with this Standard.

However, Para B10 of Ind AS 101 states, a first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32, Financial Instruments: Presentation. Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in Ind AS 109, Financial Instruments, and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to Ind ASs and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant. Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with Ind AS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to Ind AS as the carrying amount of the loan in the opening Ind AS Balance Sheet. An entity shall apply Ind AS 109 to the measurement of such loans after the date of transition to Ind AS.

Note 8: Dividend

Dividend should be deducted from retained earnings during the year when it has been declared and approved. Accordingly, the provision declared for preceding year should be reversed (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment.

Question 2

X Ltd. has a subsidiary Y Ltd. On first time adoption of Ind AS by Y Ltd., it availed the optional exemption of not restating its past business combinations. However, X Ltd. in its consolidated financial statements has decided to restate all its past business combinations.

Whether the amounts recorded by subsidiary need to be adjusted while preparing the consolidated financial statements of X Ltd. considering that X Ltd. does not avail the business combination exemption? Will the answer be different if X Ltd. adopts Ind AS after Y Ltd?(MTP 5 Marks April '18)

Answer 2

As per para C1 of Appendix C of Ind AS 101, a first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS). However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date.

Based on the above, if X Ltd. restates past business combinations, it would have to be applied to all business combinations of the group including those by subsidiary Y Ltd. for the purpose of Consolidated Financial Statements.

Para D17 of Appendix D of Ind AS 101 states that if an entity becomes a first-time adopter later than its subsidiary the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary at the same carrying amounts as in the financial statements of the subsidiary, after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Thus, in case where the parent adopts Ind AS later than the subsidiary then it does not change the amounts already recognized by the subsidiary.


Question 3

H Ltd. has the following assets and liabilities as at March 31, 20X1, prepared in accordance with previous GAAP:

Particulars	Notes	Amount (Rs.)
Property, Plant and Equipment	1	1,34,50,000
Investments in S. Ltd.	2	48,00,000
Debtors		2,00,000
Advances for purchase of inventory		50,00,000
Inventory		8,00,000
Cash		49,000
Total assets		2,42,99,000
Deferral loan	3	60,00,000
Creditors		30,00,000
Short term borrowing		8,00,000
Provisions		12,00,000
Total liabilities		1,10,00,000
Share capital		1,30,00,000
Reserves:		2,99,000
Cumulative translation difference	4	1,00,000
ESOP reserve	4	20,000
Retained earnings		1,79,000
Total equity		1,32,99,000
Total equity and liabilities		2,42,99,000

The following GAAP differences were identified by the Company on first-time adoption of Ind AS with effect from April 1, 20X1:

- In relation to property, plant and equipment, the following adjustments were identified:
 - Property, plant and equipment comprise land held for capital appreciation purposes costing Rs. 4,50,000 and was classified as investment property as per Ind AS 40.
 - Exchange differences of Rs. 1,00,000 were capitalised to depreciable property, plant and equipment on which accumulated depreciation of Rs. 40,000 was recognised.
 - There were no asset retirement obligations.
 - The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.
- The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for Rs. 48,00,000 that carried a fair value of Rs. 68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.
- Financial instruments:
 - Deferral loan Rs. 60,00,000:
The deferral loan of Rs. 60,00,000 was obtained on March 31, 20X1, for setting up a business in a backward region with a condition to create certain defined targets for employment of local population of that region. The loan does not carry any interest and is repayable in full at the end of 5 years. In accordance with Ind AS 109, the discount factor on the loan is to be taken as 10%, being the incremental borrowing rate. Accordingly, the fair value of the loan as at March 31, 20X1, is Rs. 37,25,528. The entity chooses to exercise the option given in paragraph B11 of Ind AS 101, i.e., the entity chooses to apply the requirements of Ind AS 109, Financial Instruments and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially



accounting for deferral loan.

4. The retained earnings of the Company contained the following:

• **ESOP reserve of Rs. 20,000:**

The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised Rs. 12,000 towards the vested options and Rs. 8,000 over a period of time as ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been Rs. 15,000 and Rs. 9,000 for the vested and unvested shares respectively. The Company intends to avail the Ind AS 101 exemption for share-based payments for not restating the ESOP charge as per previous GAAP for vested options.

• **Cumulative translation difference :**

Rs. 1,00,000 The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of Rs. 1,00,000 as part of reserves. On first-time adoption of Ind AS, the Company intends to avail Ind AS 101 exemption of resetting the cumulative translation difference to zero. (MTP 15 Marks Oct 19)

Answer 3

1. Property, plant and equipment:

As the land held for capital appreciation purposes qualifies as investment property, such investment property should be reclassified from property, plant and equipment (PPE) to investment property and presented separately. As the Company has adopted the previous GAAP carrying values as deemed cost, all items of PPE and investment property should be carried at its previous GAAP carrying values. As such, the past capitalized exchange differences require no adjustment in this case.

2. Investment in subsidiary: On first time adoption of Ind AS, a parent company has an option to carry its investment in subsidiary at fair value as at the date of transition in its separate financial statements. As such, the company can recognise such investment at a value of Rs. 68,00,000.

3. Financial instruments: As the deferral loan is a financial liability under Ind AS 109, that liability should be recognised at its present value discounted at an appropriate discounting factor. Consequently, the deferral loan should be recognised at Rs. 37,25,528 and the remaining Rs. 22,74,472 would be recognised as deferred government grant.

4. ESOPs: Ind AS 101 provides an exemption of not restating the accounting as per the previous GAAP in accordance with Ind AS 102 for all options that have vested by the transition date. Accordingly, out of 1000 ESOPs granted, the first-time adoption exemption is available on 800 options that have already vested. As such, its accounting need not be restated. However, the 200 options that are not vested as at the transition date, need to be restated in accordance with Ind AS 102. As such, the additional impact of Rs. 1,000 (i.e., 9,000 less 8,000) would be recognised in the opening Ind AS balance sheet.

5. Cumulative translation difference: As per paragraph D12 of Ind AS 101, the first-time adopter can avail an exemption regarding requirements of Ind AS 21 in context of cumulative translation differences. If a first-time adopter uses this exemption the cumulative translation differences for all foreign operation are deemed to be zero as at the transition date. In that case, the balance is transferred to retained earnings. As such, the balance of Rs. 1,00,000 should be transferred to retained earnings.

Retained earnings should be increased by Rs. 20,99,000 on account of the following:

	Rs.
Increase in fair value of investment in subsidiary (note 2)	20,00,000



Additional ESOP charge on unvested options (note 4)	(1,000)
Transfer of cumulative translation difference balance to retained earnings (note 5)	1,00,000

After the above adjustments, the carrying values of assets and liabilities for the purpose of opening Ind AS balance sheet of Company H should be as under:

Particular	Notes	Previous	Adjustments	Ind AS GAAP
Non-Current Assets				
Property, plant and equipment	1	1,34,50,000	(4,50,000)	1,30,00,000
Investment property	1	0	4,50,000	4,50,000
Investment in S Ltd.	2	48,00,000	20,00,000	68,00,000
Advances for purchase of inventory		50,00,000		50,00,000
Current Assets				
Debtors		2,00,000		2,00,000
Inventory		8,00,000		8,00,000
Cash		49,000		49,000
Total assets		2,42,99,000	20,00,000	2,62,99,000
Non-current Liabilities				
Deferral loan	3	60,00,000	(22,74,472)	37,25,528
Deferred government grant	3	0	22,74,472	22,74,472
Current Liabilities				
Creditors		30,00,000		30,00,000
Short term borrowing		8,00,000		8,00,000
Provisions		12,00,000		12,00,000
Total liabilities		1,10,00,000		1,10,00,000
Share capital		1,30,00,000		1,30,00,000
Reserves:				
Cumulative translation difference	5	1,00,000	(1,00,000)	0
ESOP reserve	4	20,000	1,000	21,000
Other reserves	6	1,79,000	20,99,000	22,78,000
Total equity		1,32,99,000	20,00,000	1,52,99,000
Total equity and liabilities		2,42,99,000	20,00,000	2,62,99,000

Question 4

While preparing an opening balance sheet on the date of transition, an entity is required to:

- recognise all assets and liabilities whose recognition is required by Ind AS;
- reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and
- apply Ind AS in measuring all recognised assets and liabilities.

Give 2 examples for each of the above categories. (MTP 5 Marks Sep '22, RTP Nov '21)



Answer 4

The examples of the items that an entity may need to recognise, derecognise, remeasure, reclassify on the date of transition are as under:

- (a) recognise all assets and liabilities whose recognition is required by Ind AS:
 - (i) customer related intangible assets if an entity elects to restate business combinations
 - (ii) share-based payment transactions with non-employees
- (b) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but is a different type of asset, liability or component of equity in accordance with Ind AS:
 - (i) redeemable preference shares that would have earlier been classified as equity;
 - (ii) non-controlling interests which would have been earlier classified outside equity; and
- (c) apply Ind ASs in measuring all recognised assets and liabilities:
 - (i) discounting of long-term provisions
 - (ii) measurement of deferred income taxes for all temporary differences instead of timing differences.

Question 5

XYZ Pvt. Ltd. is a company registered under the Companies Act, 2013 following Accounting Standards notified under Companies (Accounting Standards) Rules, 2006. The Company has decided to voluntarily adopt Ind AS w.e.f 1st April, 2018 with a transition date of 1st April, 2017.

The Company has one Wholly Owned Subsidiary and one Joint Venture which are into manufacturing of automobile spare parts.

The -consolidated financial statements of the Company under Indian GAAP are as under :

Consolidated Financial Statements

(in Lakhs)

Particulars	31.03.2018	31.03.2017
Shareholder's Funds		
Share Capital	7,953	7,953
Reserves & Surplus	16,547	16,597
Non-Current Liabilities Long		
Term Borrowings Long	1,000	1,000
Term Provisions	1,101	691
Other Long-Term Liabilities	5,202	5,904

Additional Information:

The Company has entered into a joint arrangement by acquiring 50% of the equity shares of ABC Pvt. Ltd. Presently, the same has been accounted as per the proportionate consolidated method. The proportionate share of assets and liabilities of ABC Pvt. Ltd. included in the consolidated financial statement of XYZ Pvt. Ltd. is as under:

Particulars	31.03.2018	31.03.2017
Shareholder's Funds Share	7,953	7,953
Capital Reserves & Surplus	16,547	16,597
Non-Current Liabilities Long	1,000	1,000
Term Borrowings Long Term	1,101	691
Provisions Other Long-Term Liabilities	5,202	5,904
Current Liabilities		



Trade Payables	9,905	8,455
Short Term Provisions	500	475
Total	42,208	41,075
Non-Current Assets		
Property Plant & Equipment	21,488	22,288
Goodwill on Consolidation of subsidiary and JV	1,507	1,507
Investment Property	5,245	5,245
Long Term Loans & Advances	6,350	6,350
Current Assets Trade		
Receivables	4,801	1,818
Investments	1,263	3,763
Other Current Assets	1,554	104
Total	42,208	41,075

The Investment is in the nature of Joint Venture as per Ind AS 111. The Company has approached you to advice and suggest the accounting adjustments which are required to be made in the opening Balance Sheet as on 1st April, 2017. (RTP May 2019, Old & New SM)

Answer 5

As per paras D31AA and D31AB of Ind AS 101, when changing from proportionate consolidation to the equity method, an entity shall recognize its investment in the joint venture at transition date to Ind AS. That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition. If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged. The balance of the investment in joint venture at the date of transition to Ind AS, determined in accordance with paragraph D31AA above is regarded as the deemed cost of the investment at initial recognition

MAY, 2019 Accordingly, the deemed cost of the investment will be

Property, Plant & Equipment	1,200
Goodwill (Refer Note below)	119
Long Term Loans & Advances	405
Trade Receivables	280
Other Current Assets	50
Total Assets	2054
Less: Trade Payables	75
Short Term Provisions	35
Deemed cost of the investment in JV	1944

Calculation of proportionate goodwill share of Joint Venture i.e. ABC Pvt. Ltd.

Property, Plant & Equipment	22,288
Goodwill	1,507
Long Term Loans & Advances	6,350
Trade Receivables	1,818
Other Current Assets	104
Total Assets	32,067
Less: Trade Payables	8,455
Short Term Provisions	475
	23,137



Proportionate Goodwill of Joint Venture

= [(Goodwill on consolidation of subsidiary and JV/Total relative net asset) x Net asset of JV]

= (1507 / 23,137) x 1825 = 119 (approx.)

Accordingly, the proportional share of assets and liabilities of Joint Venture will be removed from the respective values assets and liabilities appearing in the balance sheet on 31.3.2017 and Investment in JV will appear under non-current asset in the transition date balance sheet as on 1.4.2017.

Adjustments made in I GAAP balance sheet to arrive at Transition date Ind AS Balance Sheet

Particulars	31.3.2017	Ind AS Adjustment	Transition date Balance Sheet as per Ind AS
Non-Current Assets			
Property Plant & Equipment	22,288	(1,200)	21,088
Intangible assets - Goodwill on Consolidation	1,507	(119)	1,388
Investment Property	5,245	-	5,245
Long Term Loans & Advances	6,350	(405)	5,945
Non- current investment in JV	-	1,944	1,944
Current Assets	-		
Trade Receivables	1,818	(280)	1,538
Investments	3,763	-	3,763
Other Current Assets	104	(50)	54
Total	41,075	(110)	40,965
Shareholder's Funds			
Share Capital	7,953	-	7,953
Reserves & Surplus	16,597	-	16,597
Non-Current Liabilities			
Long Term Borrowings	1,000		1,000
Long Term Provisions	691		691
Other Long-Term Liabilities	5,904		5,904
Current Liabilities			
Trade Payables	8,455	(75)	8,380
Short Term Provisions	475	(35)	440
Total	41,075	(110)	40,965

Question 6

Mathur India Private Limited has to present its first financials under Ind AS for the year ended 31st March, 20X3. The transition date is 1st April, 20X1.

The following adjustments were made upon transition to Ind AS:

- The Company opted to fair value its land as on the date on transition.
The fair value of the land as on 1st April, 20X1 was Rs. 10 crores. The carrying amount as on 1st April, 20X1 under the existing GAAP was Rs. 4.5 crores.
- The Company has recognised a provision for proposed dividend of Rs. 60 lacs and related



dividend distribution tax of Rs. 18 lacs during the year ended 31st March, 20X1. It was written back as on opening balance sheet date.

- (c) The Company fair values its investments in equity shares on the date of transition. The increase on account of fair valuation of shares is Rs. 75 lacs.
- (d) The Company has an Equity Share Capital of Rs. 80 crores and Redeemable Preference Share Capital of Rs. 25 crores.
- (e) The reserves and surplus as on 1st April, 20X1 before transition to Ind AS was Rs. 95 crores representing Rs. 40 crores of general reserve and Rs. 5 crores of capital reserve acquired out of business combination and balance is surplus in the Retained Earnings.
- (f) The company identified that the preference shares were in nature of financial liabilities.

What is the balance of total equity (Equity and other equity) as on 1st April, 20X1 after transition to Ind AS? Show reconciliation between total equity as per AS (Accounting Standards) and as per Ind AS to be presented in the opening balance sheet as on 1st April, 20X1. Ignore deferred tax impact. (RTP Nov '19, Old & New SM) . (MTP 8 Marks Sep '23)

Answer 6

Computation of balance total equity as on 1st April, 20X1 after transition to Ind AS

			Rs. in crore
Share capital- Equity share Capital			80
Other Equity			
General Reserve		40	
Capital Reserve		5	
Retained Earnings (95-5-40)	50		
Add: Increase in value of land (10-4.5)	5.5		
Add: De recognition of proposed dividend (0.6 + 0.18)	0.78		
Add: Increase in value of Investment	0.75	57.03	102.03
Balance total equity as on 1st April, 20X1 after transition to Ind AS			182.03

Reconciliation between Total Equity as per AS and Ind AS to be presented in the opening balance sheet as on 1st April, 20X1

		Rs. in crore
Equity share capital		80
Redeemable Preference share capital		25
		105
Reserves and Surplus		95
Total Equity as per AS		200
Adjustment due to reclassification		
Preference share capital classified as financial liability		(25)
Adjustment due to derecognition		
Proposed Dividend not considered as liability as on 1 st April 20X1		0.78
Adjustment due to remeasurement		
Increase in the value of Land due to remeasurement at fair value	5.5	
Increase in the value of investment due to remeasurement at fair value	0.75	6.25
Equity as on 1st April, 20X1 after transition to Ind AS		182.03



Question 7

On April 1, 20X1, Sigma Ltd. issued 30,000 6% convertible debentures of face value of Rs. 100 per debenture at par. The debentures are redeemable at a premium of 10% on March 31, 20X5 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10%. The date of transition to Ind AS is April 1, 20X3. Suggest how should Sigma Ltd. account for this compound financial instrument on the date of transition.

The present value of Re. 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as: (RTP May '20)

End of year	6%	10%
1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

Answer 7

'Financial Instruments: Presentation', requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of Ind AS 32 would involve separating two portions of equity. The first portion is recognised in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with Ind AS 101, a first- time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind AS.

In the present case, since the liability is outstanding on the date of transition, Sigma Ltd. will need to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, we will first measure the liability component by discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option).

	Rs.
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment on each debenture for years 1 to 4 (6 x 3.17) (Note 1)	19.02
PV of principal repayment on each debenture (including premium) 110 x 0.68 (Note 2)	74.80
Total liability component on each debenture (A)	93.82
Total equity component per debenture (Balancing figure) (B) = (C) – (A)	6.18
Face value per debenture (C)	100.00
Equity component per debenture	6.18
Total equity component for 30,000 debentures	1,85,400
Total debt amount (30,000 x 93.82)	28,14,600

Thus, on the date of transition, the amount of Rs. 30,00,000 being the amount of debentures will be split as under:

Debt	Rs. 28,14,600
Equity	Rs. 1,85,400

Notes:

- 3.17 is annuity factor of present value of Re. 1 at a discount rate of 10% for 4 years.
- On maturity, Rs. 110 will be paid (Rs. 100 as principal payments + Rs. 10 as premium)

**Question 8**

GG Ltd., a listed company, prepares its first Ind AS financial statements for the year ending 31st March, 20X3. The date of transition is 1st April, 20X1. The functional and presentation currency is Rupee. The financial statements as at and for the year ended 31st March, 20X3 contain an explicit and unreserved statement of compliance with Ind AS. Previously it was using Indian GAAP (AS) as base. It has already published its first interim results of quarter 1, quarter 2 and quarter 3 of 20X2-20X3 in accordance with Ind AS 34 and Ind AS 101. The interim financial report included the reconciliations both of total comprehensive income and of equity that are required by Ind AS 101. Since issuing the interim financial report, its management has concluded that one of accounting policy choices applied at the interim should be changed for the full year. How should GG Ltd. deal with the change in accounting policy under Ind AS framework? (RTP May '22)

Answer 8

The first annual Ind AS financial statements are prepared in accordance with the specific requirements of Ind AS 101. Subject to certain specified exemptions and exceptions, paragraph 7 of Ind AS 101 requires the entity to use the same accounting policies in its opening Ind AS balance sheet and throughout all periods presented. This override Ind AS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first Ind AS financial statements.

GG Ltd. should include an explanation of the change in policy that it has made since the interim financial report, in the notes to the annual financial statements, in accordance with paragraph 27A of Ind AS 101. The disclosure note is likely to include information, similar to what Ind AS 8 would otherwise require, to help users of the financial statements to understand the changes that have been made. The entity should also ensure that the reconciliations of total comprehensive income and of equity, presented in the first Ind AS financial statements in accordance with paragraph 24 of Ind AS 101 are updated from those included in the interim financial report to reflect the amended accounting policy.

Question 9

ABC Ltd., a public limited company, is in the business of exploration and production of oil and gas and other hydrocarbon related activities outside India. It operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in associates. The company was following Accounting Standards as notified under the Companies (Accounting Standards) Rules until 31st March, 20X1. However, it has adopted Indian Accounting Standards (Ind AS) with effect from 1st April, 20X1.

The goodwill recognised in accordance with AS 21 and AS 27 was due to corporate structure and the line-by-line consolidation of subsidiaries'/proportionate consolidation of jointly controlled entities' financial statements which was prepared on historical costs convention. ABC Ltd. has not taken into consideration the valuation of underlying oil and gas reserves for which excess amount (i.e. goodwill calculated as per the relevant AS requirements) has been paid by the company at the time of acquisition. The company further considered that in oil and gas companies, the goodwill generated on acquisition of mineral rights either through jointly controlled entities or subsidiaries, inherently derives its value from the underlying mineral rights and, accordingly, value of such goodwill depletes as the underlying mineral resources are extracted.

Therefore, taking a prudent approach and considering the above substance, the company amortised the goodwill in respect of its subsidiaries / jointly controlled assets over the life of the underlying mineral rights using Unit of Production method. This allowed the company to utilise the value of goodwill over the life of mineral rights and completely charging off the goodwill over the life of the reserves.

For financial year 20X0-20X1, the company has availed transition exemption under Ind AS 101 and has not applied the principles of Ind AS 103 .

ABC Ltd. considering the substance over form of the goodwill to be in the nature of 'acquisition costs' intends to continue amortisation of the goodwill recognised under AS in respect of its



subsidiaries / joint ventures (jointly controlled entities under AS) over the life of the underlying mineral rights using Unit of Production method, under Ind AS also post transition date.

Comment on appropriateness of the accounting treatment, under Ind AS, for amortisation of the goodwill by the company and state whether the accounting treatment in respect of amortisation of goodwill is correct or not. (RTP May '23)

Answer 9

Point (g) of para C4 of Ind AS 101 states that the carrying amount of goodwill or capital reserve in the opening Ind AS Balance Sheet shall be its carrying amount in accordance with previous GAAP at the date of transition to Ind AS after the two adjustments. One of the adjustment states that the standard requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill or capital reserve in accordance with previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill or increase the carrying amount of capital reserve accordingly (and, if applicable, adjust deferred tax and non-controlling interests)

As per the facts given, the entity paid excess amount to avail the rights to use the underlying oil and gas reserves. However, since the rights was not recorded in the books at that time, the value of goodwill subsumed the value of that intangible asset which should be separately identified in the books. Hence, value of goodwill will be reduced accordingly and intangible asset for rights for using mine should be recognised.

Further, regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply Ind AS 36 in testing the goodwill for impairment at the date of transition to Ind AS and in recognising any resulting impairment loss in retained earnings (or, if so required by Ind AS 36, in revaluation surplus). The impairment test shall be based on conditions at the date of transition to Ind AS. No other adjustments (eg- previous amortisation of goodwill) shall be made to the carrying amount of goodwill / capital reserve at the date of transition to Ind AS.

However, once goodwill is recognised in the opening transition date balance sheet, the entity has to follow the provisions of Ind AS, which states that goodwill is not amortised but rather tested for impairment annually. Accordingly, the amortization of goodwill based on 'Unit of Production' method is not correct after implementation of Ind AS.

Question 10

Rainy Pvt Ltd. is a company registered under the Companies Act, 2013 following Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006. The company has decided to present its first financials under Ind AS for the year ended 31st March, 2021. The transition date is 1st April, 2019.

The following adjustments were made upon transition to Ind AS:

- (i) The company opted to fair value its land as on the date on transition. The fair value of the land as on 1st April, 2019 was ₹ 95 lakh. The carrying amount as on 1st April, 2019 under the existing GAAP was ₹ 42.75 lakh.**
- (ii) The company has recognised a provision for proposed dividend of ₹ 5.7 lakh and related dividend distribution tax of ₹ 1.65 lakh during the year ended 31st March, 2019. It was written back as on opening balance sheet date.**
- (iii) The company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of ₹ 2 lakh as part of reserves. On first time adoption of Ind AS, the company intends to avail Ind AS exemption of resetting the cumulative translation difference to zero.**
- (iv) The company had made an investment in subsidiary for ₹ 18.62 lakh that carried a fair value of ₹ 25.75 lakh as at the transition date. The company intends to recognise the investment at its fair value as at the date of transition.**
- (v) The company has an Equity Share Capital of ₹ 760 lakh and Redeemable Preference Share Capital of ₹ 180 lakh. The company identified that the preference shares were in nature of financial liabilities.**



- (vi) The Reserves and Surplus as on 1st April, 2019 before transition to Ind AS was ₹ 910 lakh representing ₹ 380 lakh of general reserve and ₹ 40 lakh of Capital Reserve acquired out of business combination and balance is surplus in the Retained Earnings.

What is the balance of total equity (Equity and other equity) as on 1st April, 2019 after transition to Ind AS? Show reconciliation between Total Equity as per AS (Accounting Standards) and as per Ind AS to be presented in the opening balance sheet as on 1st April, 2019. Ignore deferred tax impact. (PYP 8 Marks Dec '21)

Answer 10

Computation of balance total equity as on 1st April, 2019 after transition to Ind AS

			₹ in lakh
Share capital- Equity share Capital			760.00
Other Equity			
General Reserve		380.00	
Capital Reserve		40.00	
Retained Earnings (910.00 – 380.00 – 40.00)	490.00		
Add: Increase in value of land (95.00 – 42.75)	52.25		
Add: Derecognition of proposed dividend (5.70 + 1.65)	7.35		
Add: Transfer of cumulative translation difference balance to retained earnings	2.00		
Add: Increase in value of Investment (25.75 – 18.62)	7.13	558.73	978.73
Balance total equity as on 1st April, 2019 after transition to Ind AS			1,738.73

Reconciliation between Total Equity as per AS and Ind AS to be presented in the opening balance sheet as on 1st April, 2019

		₹ in lakh
Equity share capital		760.00
Redeemable Preference share capital		180.00
		940.00
Reserves and Surplus		910.00
Total Equity as per AS		1,850.00
Adjustment due to reclassification:		
Preference share capital classified as financial liability		(180.00)
Adjustment due to de-recognition:		
Proposed dividend not considered as liability as on 1st April, 2019		7.35
Adjustment due to re-measurement:		
Increase in the value of Land due to re-measurement at fair value	52.25	
Resetting of cumulative translation difference balance to zero in Ind AS Transition date Balance Sheet	2.00	
Increase in the value of investment due to re-measurement at fair value	7.13	61.38
Equity as on 1st April, 2019 after transition to Ind AS		1,738.73



EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This question dealt with first time adoption of Ind AS. Majority of the examinees attempted this question as a theoretical question by explaining the adjustment. However, they did not compute the final equity after transition under Ind AS or the presentation was not in a proper manner. Some of the examinees failed in presenting the reconciliation between total equity as per AS and Ind AS.

Question 11

(Includes concepts of Chp 12 Ind AS 107, 109, 32, Accounting and Reporting of Financial Instruments & Chp 5.1 Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance)

Government of India provides loans to MSMEs at a below-market rate of interest to fund the set-up of a new manufacturing facility. Sukshma Limited's date of transition to Ind AS is 1st April 2020. In financial year 2014-2015, the Company had received a loan of ₹ 2.0 crore at a below - market rate of interest from the government. Under Indian GAAP, the Company had accounted for the loan as equity and the carrying amount was ₹ 2.0 crore at the date of transition. The amount repayable on 31st March 2024 will be ₹ 2.50 crore. The Company has been advised to recognize the difference of ₹ 0.50 crores in equity by correspondingly increasing the value of various assets under property, plant & equipment by an equivalent amount on proportionate basis. Further, on 31st March 2024 when the loan has to be repaid, ₹ 2.50 crore should be presented as a deduction from property, plant & equipment. Discuss the above treatment and share your views as per applicable Ind AS. (PYP 6 Marks July 21, MTP 7 Marks Apr'23)

Answer 11

Requirement as per Ind AS:

A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32. A first-time adopter shall apply the requirements in Ind AS 109 and Ind AS 20, prospectively to government loans existing at the date of transition to Ind AS and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant.

Treatment to be done:

Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with Ind AS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to Ind AS as the carrying amount of the loan in the opening Ind AS Balance Sheet. An entity shall apply Ind AS 109 to the measurement of such loans after the date of transition to Ind AS.

In the instant case, the loan meets the definition of a financial liability in accordance with Ind AS 32. Company therefore reclassifies it from equity to liability. It also uses the previous GAAP carrying amount of the loan at the date of transition as the carrying amount of the loan in the opening Ind AS balance sheet.

It calculates the annual effective interest rate (EIR) starting 1st April 2020 as below: $EIR = \text{Amount} / \text{Principal}(1/t)$ i.e. $2.50/2(1/4)$ i.e. 5.74%. approx.

At this rate, ₹ 2 crore will accrete to ₹ 2.50 crore as at 31st March 2024. During the next 4 years, the interest expense charged to statement of profit and loss shall be:

Year ended	Opening amortised cost (₹)	Interest expense for the year (₹) @ 5.74% p.a. approx.	Closing amortised cost (₹)
31 st March 2021	2,00,00,000	11,48,000	2,11,48,000
31 st March 2022	2,11,48,000	12,13,895	2,23,61,895
31 st March 2023	2,23,61,895	12,83,573	2,36,45,468
31 st March 2024	2,36,45,468	13,54,532	2,50,00,000

An entity may apply the requirements in Ind AS 109 and Ind AS 20 retrospectively to any government



loan originated before the date of transition to Ind AS, provided that the information needed to do so had been obtained at the time of initially accounting for that loan. The accounting treatment is to be done as per above guidance and the advice which the company has been provided is not in line with the requirements of Ind AS 101 .

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

A very few examinees opted this part of the question. Out of those who attempted this question, many examinees failed to provide the answer in the light of Ind AS 20, Ind AS 32 and Ind AS 109.



Chapter 15

Analysis of Financial Statements

Question 1

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

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

In 20X3-X4, Cheery Limited reported:

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

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

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

State how the above will be treated /accounted in Cheery Limited's Statement of profit and loss, statement of changes in equity and in notes wherever required for current period and earlier period(s) as per relevant Ind AS.(MTP 8 Marks March '21)

Answer 1

Cheery Limited Extract from the Statement of profit and loss

	(Restated)	
	20X4-X5	20X3-X4
	Rs.	Rs.
Sales	1,04,000	73,500
Cost of goods sold	(80,000)	(60,000)
Profit before income taxes	24,000	13,500
Income taxes	(7,200)	(4,050)
Profit	16,800	9,450
Basic and diluted EPS	3.36	1.89

Cheery Limited Statement of Changes in Equity

	Share capital	Retained earnings	Total
Balance at 31 st March, 20X3	50,000	20,000	70,000
Profit for the year ended 31 st March, 20X4 as restated		9,450	9,450
Balance at 31st March, 20X4	50,000	29,450	79,450
Profit for the year ended 31 st March, 20X5		16,800	16,800
Balance at 31st March, 20X5	50,000	46,250	96,250

Extract from the Notes

at 31st March, 20X4 at Rs. 6,500. The financial statements of 20X3-X4 have been restated to correct this error. The effect of the restatement on those financial statements is summarized below:

	Effect on 20X3-X4
(Increase) in cost of goods sold	(6,500)
Decrease in income tax expenses	1,950
(Decrease) in profit	(4,550)
(Decrease) in basic and diluted EPS	(0.91)
(Decrease) in inventory	(6,500)
Decrease in income tax payable	1,950
(Decrease) in equity	(4,550)

There is no effect on the balance sheet at the beginning of the preceding period i.e. 1st April, 20X3.

Question 2

Master Creator Private Limited (a subsidiary of listed company) is an Indian company to whom Ind AS are applicable. Following draft balance sheet is prepared by the accountant for year ending 31st March 20X2.

Balance Sheet of Master Creator Private Limited as at 31st March, 20X2

Particulars	Rs.
ASSETS	
Non-current assets	
Property, plant and equipment	85,37,500
Financial assets	
Other financial assets (Security deposits)	4,62,500
Other non-current assets (capital advances)	17,33,480
Deferred tax assets	2,54,150
Current assets	
Trade receivables	7,25,000
Inventories	5,98,050
Financial assets	
Investments	55,000
Other financial assets	2,17,370
Cash and cash equivalents	1,16,950
TOTAL ASSETS	1,27,00,000
EQUITY AND LIABILITIES	
Equity share capital	10,00,000
Non-current liabilities	
Other Equity	25,00,150
Deferred tax liability	4,74,850
Borrowings	64,00,000
Long term provisions	5,24,436
Current liabilities	
Financial liabilities	
Other financial liabilities	2,00,564
Trade payables	6,69,180
Current tax liabilities	9,30,820
TOTAL EQUITY AND LIABILITIES	1,27,00,000

Additional Information:

- On 1st April 20X1, 8% convertible loan with a nominal value of Rs. 64,00,000 was issued by the entity. It is redeemable on 31st March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each Rs. 200 worth of loan.

An equivalent loan without the conversion option would have carried interest at 10%. Interest of Rs. 5,12,000 has already been paid and included as a finance cost.

Present Value (PV) rates are as follows:

Year End	@ 8%	@ 10%
1	0.93	0.91
2	0.86	0.83
3	0.79	0.75
4	0.73	0.68

- After the reporting period, the board of directors have recommended dividend of Rs. 50,000 for the year ending 31st March, 20X1. However, the same has not been yet accounted by the company in its financials.
- 'Other current financial liabilities' consists of the following:

Particulars	Amount (Rs.)
Wages payable	21,890
Salary payable	61,845
TDS payable	81,265
Interest accrued on trade payables	35,564

- Property, Plant and Equipment consists following items:

Particulars	Amount (Rs.)	Remarks
Building	37,50,250	It is held for administration purposes
Land	15,48,150	It is held for capital appreciation
Vehicles	12,37,500	These are used as the conveyance for employees
Factory premises	20,01,600	The construction was started on 31st March 20X2 and consequently no depreciation has been charged on it. The construction activities will continue to happen, and it will take 2 years to complete and be available for use.

- The composition of 'other current financial assets' is as follows:

Particulars	Amount (Rs.)
Interest accrued on bank deposits	57,720
Prepaid expenses	90,000
Royalty receivable from dealers	69,650

- Current Investments consist of securities held for trading which are carried at fair value through profit & loss. Investments were purchased on 1st January, 20X2 at Rs. 55,000 and accordingly are shown at cost as at 31st March 20X2. The fair value of said investments as on 31st March 20X2 is Rs. 60,000.
- Trade payables and Trade receivables are due within 12 months.

8. There has been no changes in equity share capital during the year.
9. Entity has the intention to set off a deferred tax asset against a deferred tax liability as they relate to income taxes levied by the same taxation authority and the entity has a legally enforceable right to set off taxes.
10. Other Equity consists retained earnings only. The opening balance of retained earnings was Rs.21,25,975 as at 1st April 20X1.
11. No dividend has been actually paid by company during the year.
12. Assume that the deferred tax impact, if any on account of above adjustments is correctly calculated in financials.

Being Finance & Accounts manager, you are required to identify the errors and misstatements if any in the balance sheet of Master Creator Private Limited and prepare corrected balance sheet with details on the face of the balance sheet i.e. no need to prepare notes to accounts, after considering the additional information. Provide necessary explanations/workings for the treated items, wherever necessary. (MTP 16 Marks April '21, MTP 14 Marks Apr'23 Old & New SM)

Answer 2

Balance Sheet of Master Creator Private Limited as at 31st March, 20X2

Particulars	Working / Note reference	(Rs.)
ASSETS		
Non-current assets		
Property, plant and equipment	1	49,87,750
Capital work-in-progress	2	20,01,600
investment Property	3	15,48,150
Financial assets		4,62,500
Other financial assets (Security deposits)		17,33,480
Other non-current assets (capital advances)	4	5,98,050
Current assets		60,000
Inventories		7,25,000
Financial assets		1,16,950
Investments (55,000 + 5,000)	5	1,27,370
Trade receivables	6	90,000
Cash and cash equivalents	7	49,87,750
Other financial assets	8	20,01,600
Other current assets (Prepaid expenses)	8	15,48,150
TOTAL ASSETS		1,24,50,850
EQUITY AND LIABILITIES		
Equity		
Equity share capital	A	10,00,000
Other equity	B	28,44,606
Non-current liabilities		
Financial liabilities		
8% Convertible loan	11	60,60,544

Long term provisions		5,24,436
Deferred tax liability	12	2,20,700
Current liabilities		
Financial liabilities		
Trade payables	13	6,69,180
Other financial liabilities	14	1,19,299
Other current liabilities (TDS payable)	15	81,265
Current tax liabilities		9,30,820
TOTAL EQUITY AND LIABILITIES		1,24,50,850

Statement of changes in equity For the year ended 31st March, 20X2

A. Equity Share Capital

	Balance (Rs.)
As at 31st March, 20X1	10,00,000
Changes in equity share capital during the year	-
As at 31st March, 20X2	10,00,000

B. Other Equity

	Retained Earnings (Rs.)	Equity component of Compound Financial Instrument (Rs.)	Total (Rs.)
As at 31st March, 20X1	21,25,975	-	21,25,975
Total comprehensive income for the year (25,00,150 + 5,000 - 85,504 - 21,25,975)	2,93,671	-	2,93,671
Issue of compound financial instrument during the year	-	4,24,960	4,24,960
As at 31st March, 20X2	24,19,646	4,24,960	28,44,606

Disclosure forming part of Financial Statements:

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance Sheet date. (Note 9)

Notes/ Workings: (for adjustments/ explanations)

- Property, plant and equipment are tangible items that: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period. Therefore, the items of PPE are Buildings (Rs. 37,50,250) and Vehicles (Rs. 12,37,500), since those assets are held for administrative purposes.
- Property, plant and equipment which are not ready for intended use as on the date of Balance Sheet are disclosed as "Capital work-in-progress". It would be classified from PPE to Capital work-in-progress.
- Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital



appreciation or both, rather than for:

- (a) use in the production or supply of goods or services or for administrative purposes; or
- (b) sale in the ordinary course of business.

Therefore, Land held for capital appreciation should be classified as Investment property rather than PPE.

4. Assets for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.
5. Current investments here are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, Rs. 5,000 (60,000 – 55,000) increase in fair value of financial asset will be recognized in profit and loss.
6. A contractual right to receive cash or another financial asset from another entity is a financial asset. Trade receivables is a financial asset in this case and hence should be reclassified.
7. Cash is a financial asset. Hence it should be reclassified.
8. Other current financial assets:

Particulars	Amount (Rs.)
Interest accrued on bank deposits	57,720
Royalty receivable from dealers	69,650
Total	1,27,370

Prepaid expenses does not result into receipt of any cash or financial asset. However, it results into future goods or services. Hence, it is not a financial asset.

9. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.
10. 'Other Equity' cannot be shown under 'Non-current liabilities'. Accordingly, it is reclassified under 'Equity'.
11. There are both 'equity' and 'debt' features in the instrument. An obligation to pay cash i.e. interest at 8% per annum and a redemption amount will be treated as 'financial liability' while option to convert the loan into equity shares is the equity element in the instrument. Therefore, convertible loan is a compound financial instrument.

Calculation of debt and equity component and amount to be recognised in the books:

S. No	Year	Interest amount @ 8%	Discounting factor @ 10%	Amount
Year 1	20X2	5,12,000	0.91	4,65,920
Year 2	20X3	5,12,000	0.83	4,24,960
Year 3	20X4	5,12,000	0.75	3,84,000
Year 4	20X5	69,12,000	0.68	47,00,160
Amount to be recognized as a liability				59,75,040
Initial proceeds				(64,00,000)
Amount to be recognized as equity				4,24,960

* In year 4, the loan note will be redeemed; therefore, the cash outflow would be Rs. 69,12,000 (Rs. 64,00,000 + Rs. 5,12,000).



Presentation in the Financial Statements:

In Statement of Profit and Loss for the year ended on 31 March 20 X2

Finance cost to be recognized in the Statement of Profit and Loss (59,75,040 x 10%)	Rs. 5,97,504
Less: Already charged to the Statement of Profit and Loss	(Rs.5,12,000)
Additional finance charge required to be recognised in the Statement of Profit and Loss	Rs. 85,504

In Balance Sheet as at 31 March 20X2

Equity and Liabilities	
Equity	
Other Equity (8% convertible loan)	4,24,960
Non-current liability	
Financial liability [8% convertible loan – [(59,75,040+ 5,97,504– 5,12,000)]]	60,60,544

12. Since entity has the intention to set off deferred tax asset against deferred tax liability and the entity has a legally enforceable right to set off taxes, hence their balance on net basis should be shown as:

Particulars	Amount (Rs.)
Deferred tax liability	4,74,850
Deferred tax asset	(2,54,150)
Deferred tax liability (net)	2,20,700

13. A liability that is a contractual obligation to deliver cash or another financial asset to another entity is a financial liability. Trade payables is a financial liability in this case.
14. 'Other current financial liabilities':

Particulars	Amount (Rs.)
Wages payable	21,890
Salary payable	61,845
Interest accrued on trade payables	35,564
Total	1,19,299

15. Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities. Hence, TDS payable should be reclassified from 'Other current financial liabilities' to 'Other current liabilities' since it is not a contractual obligation.

Question 3

Deepak started a new company Softbharti Pvt. Ltd. with Iktara Ltd. wherein investment of 55% is done by Iktara Ltd. and rest by Deepak. Voting powers are to be given as per the proportionate share of capital contribution. The new company formed was the subsidiary of Iktara Ltd. with two directors, and Deepak eventually becomes one of the directors of company. A consultant was hired and he charged ` 30,000 for the incorporation of company and to do other necessary statutory registrations. ` 30,000 is to be charged as an expense in the books after incorporation of company. The company, Softbharti Pvt. Ltd. was incorporated on 1st April 20X1.

The financials of Iktara Ltd. are prepared as per Ind AS.

An accountant who was hired at the time of company's incorporation, has prepared the draft financials of Softbharti Pvt. Ltd. for the year ending 31st March, 20X2 as follows:

Statement of Profit and Loss

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income	1,00,000
Total Revenue (a)	11,00,000
Expenses:	
Purchase of stock in trade	5,00,000
(Increase)/Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses (b)	7,45,000
Profit before tax (c) = (a)-(b)	3,55,000
Current tax	1,06,500
Deferred tax	6,000
Total tax expense (d)	1,12,500
Profit for the year (e) = (c) – (d)	2,42,500

Balance Sheet

Particulars	Amount (₹)
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	1,00,000
(b) Reserves & Surplus	2,27,500
(2) Non-Current Liabilities	
(a) Long Term Provisions	25,000
(b) Deferred tax liabilities	6,000
(3) Current Liabilities	
(a) Trade Payables	11,000
(b) Other Current Liabilities	45,000
(c) Short Term Provisions	1,06,500
TOTAL	5,21,000
ASSETS	
(1) Non Current Assets	
(a) Property, plant and equipment (net)	1,00,000
(b) Long-term Loans and Advances	40,000
(c) Other Non Current Assets	50,000
(2) Current Assets	
(a) Current Investment	30,000
(b) Inventories	80,000

(c) Trade Receivables	55,000
(d) Cash and Bank Balances	1,15,000
(e) Other Current Assets	51,000
TOTAL	5,21,000

Additional information of Softbharti Pvt Ltd.:

- i. Deferred tax liability of ` 6,000 is created due to following temporary difference:

Difference in depreciation amount as per Income tax and Accounting profit

- ii. There is only one property, plant and equipment in the company, whose closing balance as at 31st March, 20X2 is as follows:

Asset description	As per Books	As per Income tax
Property, plant and equipment	` 1,00,000	` 80,000

- iii. Pre incorporation expenses are deductible on straight line basis over the period of five years as per Income tax. However, the same are immediately expensed off in the books.
- iv. Current tax is calculated at 30% on PBT - ` 3,55,000 without doing any adjustments related to Income tax. The correct current tax after doing necessary adjustments of allowances / disallowances related to Income tax comes to ` 1,25,700.
- v. After the reporting period, the directors have recommended dividend of ` 15,000 for the year ending 31<sup>st</sup> March, 20X2 which has been deducted from reserves and surplus. Dividend payable of ` 15,000 has been grouped under 'other current liabilities' alongwith other financial liabilities.
- vi. There are 'Government statutory dues' amounting to ` 15,000 which are grouped under 'other current liabilities'.
- vii. The capital advances amounting to ` 50,000 are grouped under 'Other non-current assets'.
- viii. Other current assets of ` 51,000 comprise Interest receivable from trade receivables.
- ix. Current investment of ` 30,000 is in shares of a company which was done with the purpose of trading; current investment has been carried at cost in the financial statements. The fair value of current investment in this case is ` 50,000 as at 31st March, 20X2.
- x. Actuarial gain on employee benefit measurements of ` 1,000 has been omitted in the financials of Softbharti private limited for the year ending 31st March, 20X2.

The financial statements for financial year 20X1-20X2 have not been yet approved.

You are required to ascertain that whether the financial statements of Softbharti Pvt. Ltd. are correctly presented as per the applicable financial reporting framework. If not, prepare the revised financial statements of Softbharti Pvt. Ltd. after the careful analysis of mentioned facts and information. (MTP 16 Marks Nov 21, Old & New SM, RTP Nov 20)(MTP 15 Marks Sep '23)

Answer 3

If Ind AS is applicable to any company, then Ind AS shall automatically be made applicable to all the subsidiaries, holding companies, associated companies, and joint ventures of that company, irrespective of individual qualification of set of standards on such companies.

In the given case it has been mentioned that the financials of Iktara Ltd. are prepared as per Ind AS. Accordingly, the results of its subsidiary Softbharti Pvt. Ltd. should also have been prepared as per Ind AS. However, the financials of Softbharti Pvt. Ltd. have been presented as per accounting



standards (AS).

Hence, it is necessary to revise the financial statements of Softbharti Pvt. Ltd. as per Ind AS after the incorporation of necessary adjustments mentioned in the question.

The revised financial statements of Softbharti Pvt. Ltd. as per Ind AS and Division II to Schedule III of the Companies Act, 2013 are as follows:

STATEMENT OF PROFIT AND LOSS

for the year ended 31st March, 20X2

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income (1,00,000 + 20,000) (refer note -1)	1,20,000
Total Revenue	11,20,000
Expenses:	
Purchase of stock in trade	5,00,000
(Increase) / Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses	7,45,000
Profit before tax	3,75,000
Current tax	1,25,700
Deferred tax (W.N.1)	4,800
Total tax expense	1,30,500
Profit for the year (A)	2,44,500
OTHER COMPREHENSIVE INCOME	
Items that will not be reclassified to Profit or Loss:	
Remeasurements of net defined benefit plans	1,000
Tax liabilities relating to items that will not be reclassified to Profit or Loss	
Remeasurements of net defined benefit plans (tax) [1000 x 30%]	(300)
Other Comprehensive Income for the period (B)	700
Total Comprehensive Income for the period (A+B)	2,45,200

BALANCE SHEET

as at 31st March, 20X2

Particulars	(₹)
ASSETS	
Non-current assets	
Property, plant and equipment	1,00,000
Financial assets	
Other financial assets (Long-term loans and advances)	40,000
Other non-current assets (capital advances) (refer note-2)	50,000



Current assets	
Inventories	80,000
Financial assets	
Investments (30,000 + 20,000) (refer note -1)	50,000
Trade receivables	55,000
Cash and cash equivalents/Bank	1,15,000
Other financial assets (Interest receivable from trade receivables)	51,000
TOTAL ASSETS	5,41,000
EQUITY AND LIABILITIES	
Equity	
Equity share capital	1,00,000
Other equity	2,45,200
Non-current liabilities	
Provision (25,000 – 1,000)	24,000
Deferred tax liabilities (4,800 + 300)	5,100
Current liabilities	
Financial liabilities	
Trade payables	11,000
Other financial liabilities (Refer note 5)	15,000
Other current liabilities (Govt. statutory dues) (Refer note 3)	15,000
Current tax liabilities	1,25,700
TOTAL EQUITY AND LIABILITIES	5,41,000

STATEMENT OF CHANGES IN EQUITY For the year ended 31st March, 20X2

A. EQUITY SHARE CAPITAL

	Balance (₹)
As at 31 st March, 20X1	-
Changes in equity share capital during the year	1,00,000
As at 31 st March, 20X2	1,00,000

B. OTHER EQUITY

	Reserves & Surplus
	Retained Earnings (₹)
As at 31 st March, 20X1	-
Profit for the year	2,44,500
Other comprehensive income for the year	700
Total comprehensive income for the year	2,45,200
Less: Dividend on equity shares (refer note – 4)	-
As at 31 st March, 20X2	2,45,200

DISCLOSURE FORMING PART OF FINANCIAL STATEMENTS:

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance

Sheet date. (refer note 4)

Notes:

1. Current investment are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, ₹ 20,000 (₹ 50,000 – ₹ 30,000) increase in fair value of financial asset will be recognised in profit and loss. However, it will attract deferred tax liability on increased value (Refer W.N).
2. Assets for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.
3. Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities.
4. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.
5. Other current financial liabilities:

	(₹)
Balance of other current liabilities as per financial statements	45,000
Less: Dividend declared for FY 20X1 – 20X2 (Note – 4)	(15,000)
Reclassification of government statutory dues payable to 'other current liabilities'	(15,000)
Closing balance	15,000

Working Note:

Calculation of deferred tax on temporary differences as per Ind AS 12 for financial year 20X1 – 20X2

Item	Carrying amount (₹)	Tax base (₹)	Difference (₹)	DTA / DTL @ 30% (₹)
Property, Plant and Equipment	1,00,000	80,000	20,000	6,000-DTL
Pre-incorporation expenses	Nil	24,000	24,000	7,200-DTA
Current Investment	50,000	30,000	20,000	6,000-DTL
Net DTL				4,800-DTL

Question 4

H Limited having net worth of ₹ 250 crores is required to adopt Ind AS from 1st April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.

Mr. R, the senior manager, of H Ltd. has identified following issues which need specific attention of CFO so that opening Ind AS balance sheet as on the date of transition can be prepared:

Issue 1: As part of Property, Plant and Equipment, Company has elected to measure land at its fair value and want to use this fair value as deemed cost on the date of transition. The carrying value of land as on the date of transition was ₹ 5,00,000. The land was acquired for a consideration of ₹ 5,00,000. However, the fair value of land as on the date of transition was ₹ 8,00,000.

Issue 2: Under Ind AS, the Company has designated mutual funds as investments at fair value through

profit or loss. The value of mutual funds as per previous GAAP was ₹ 4,00,000 (at cost). However, the fair value of mutual funds as on the date of transition was ₹ 5,00,000.

Issue 3: Company had taken a loan from another entity. The loan carries an interest rate of 7% and it had incurred certain transaction costs while obtaining the same. It was carried at cost on its initial recognition. The principal amount is to be repaid in equal instalments over the period of loan. Interest is also payable at each year end. The fair value of loan as on the date of transition is ₹ 1,80,000 as against the carrying amount of loan which at present equals ₹ 2,00,000.

Issue 4: The company has declared dividend of ₹ 30,000 for last financial year. On the date of transition, the declared dividend has already been deducted by the accountant from the company's 'Reserves & Surplus' and the dividend payable has been grouped under 'Provisions'. The dividend was only declared by board of directors at that time, and it was not approved in the annual general meeting of shareholders. However, subsequently when the meeting was held it was ratified by the shareholders.

Issue 5: The company had acquired intangible assets as trademarks amounting to ₹ 2,50,000. The company assumes to have indefinite life of these assets. The fair value of the intangible assets as on the date of transition was ₹ 3,00,000. However, the company wants to carry the intangible assets at ₹ 2,50,000 only.

Issue 6: After consideration of possible effects as per Ind AS, the deferred tax impact is computed as ₹ 25,000. This amount will further increase the portion of deferred tax liability. There is no requirement to carry out the separate calculation of deferred tax on account of Ind AS adjustments.

Management wants to know the impact of Ind AS in the financial statements of company for its general understanding. Prepare Ind AS Impact Analysis Report (Extract) for H Limited for presentation to the management wherein you are required to discuss the corresponding differences between Earlier IGAAP (AS) and Ind AS against each identified issue and its impact there upon for preparation of transition date balance sheet. Also pass journal entry for each of the issues mentioned above. (MTP 12 Marks March '22, 14 Marks Sep'22, RTP May'21, Old & New SM)

Answer 4

Assessment of Preliminary Impact Assessment of Transition to Ind AS on H Limited's Financial Statements

Issue 1: Fair value as deemed cost for property plant and equipment:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS 10, Property, Plant and Equipment is recognised at cost less depreciation.	Ind AS 101 allows entity to elect to measure Property, Plant and Equipment on the transition date at its fair value or previous GAAP carrying value (book value) as deemed cost.	The company has decided to adopt fair value as deemed cost in this case. Since fair value exceeds book value, so the book value should be brought up to fair value. The resulting impact of fair valuation of land ₹ 3,00,000 should be adjusted in other equity (revaluation reserve).

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Property Plant and Equipment (Land) Dr.	3,00,000	
To Revaluation Surplus (OCI- Other Equity)		3,00,000

Issue 2: Fair valuation of Financial Assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per Accounting Standard, investments are measured at lower of cost and fair value.	On transition, financial assets including investments are measured at fair values except for investments in subsidiaries, associates and JVs' which are recorded at cost.	All financial assets (other than Investment in subsidiaries, associates and JVs' which are recorded at cost) are initially recognized at fair value. The subsequent measurement of such assets are based on its categorization either Fair Value through Profit & Loss (FVTPL) or Fair Value through Other Comprehensive Income (FVTOCI) or at Amortised Cost based on business model assessment and contractual cash flow characteristics. Since investment in mutual fund are designated at FVTPL, increase of ₹ 1,00,000 in mutual funds fair value would increase the value of investments with corresponding increase to Retained Earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Investment in mutual funds Dr.	1,00,000	
To Retained earnings		1,00,000

Issue 3: Borrowings - Processing fees/transaction cost:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, such expenditure is charged to Profit and loss account or capitalised as the case may be	As per Ind AS, such expenditure is amortised over the period of the loan. Ind AS 101 states that if it is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability.	Fair value as on the date of transition is ₹ 1,80,000 as against its book value of ₹ 2,00,000. Accordingly, the difference of ₹ 20,000 is adjusted through Retained Earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Borrowings / Loan payable Dr.	20,000	
To Retained earnings		20,000



Issue 4: Proposed dividend:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, provision for proposed dividend is made in the year when it has been declared and approved.	As per Ind AS, liability for proposed dividend is recognized in the year in which it has been declared and approved.	Since dividend should be deducted from retained earnings during the year when it has been declared and approved. Therefore, the provision declared for preceding year should be reversed (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Provisions Dr.	30,000	
To Retained earnings		30,000

Issue 5 : Intangible assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
The useful life of an intangible asset cannot be indefinite under IGAAP principles. The Company amortised brand/trademark on a straight line basis over maximum of 10 years as per AS 26.	The useful life of an intangible asset like brand/trademark can be indefinite. Not required to be amortised and only tested for impairment. Company can avail the exemption given in Ind AS 101 as on the date of transition to use the carrying value as per previous GAAP.	Consequently, there would be no impact as on the date of transition since company intends to use the carrying amount instead of book value at the date of transition.

Issue 6: Deferred tax

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, deferred taxes are accounted as per income statement approach.	As per Ind AS, deferred taxes are accounted as per balance sheet approach.	On date of transition to Ind AS, deferred tax liability would be increased by ₹ 25,000.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Retained earnings Dr.	25,000	
To Deferred tax liability		25,000

Question 5

A Ltd. is an entity who prepares its financial statements based on Accounting Standards. Following is the draft financial statement for the year ended on 31st March, 20X1:

(Note all figures are Rs. in million)

Balance Sheet

Particulars	Note	As at March 31, 20X1
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital (shares of Rs. 10 each)		2,000
Reserves and surplus	1	4,000
Non-current liabilities		
Long-term borrowings	2	11,110
Deferred tax liabilities	3	400
Current liabilities		
Trade payables		600
Short-term provisions		500
Other current liabilities	4	300
TOTAL		18,910
ASSETS		
Non - current assets		
Fixed Assets		11,310
Deferred Tax Assets	3	1,000
Current assets		
Inventories		2,000
Trade receivables	5	2,200
Cash and bank balances		2,400
TOTAL		18,910

Note 1: The Company has achieved a major breakthrough in its consultancy services in South Asia following which it has entered into a contract of rendering services with Floral Inc. for Rs. 12 Billion during the year. The termination clause of the contract is equivalent to Rs. 14 Million and is payable in case transition time schedule is missed from 15th December 20X5. The management however is of the view that the liability cannot be treated as onerous.

Note 2: The Company is not able to assess the final liability for a particular tax assessment pertaining to the assessment year 20X1-20X2 wherein it has received a demand notice of Rs. 12 Million. However, the company is contesting the same with CIT (Appeals) as on the reporting date.

Statement of Profit & Loss

Particulars	Note	Year ended March 31, 20X1
Revenue from operations		11,000
Expenses		
Employee Benefit Expense		2,400
Operating Costs		4,400
Depreciation		1,998
Total Expenses		8,798
Profit before tax		2,202

Tax Expense		(300)
Profit after tax		1,902

Notes to Accounts:
Note 1: Reserves and Surplus

(INR in millions)

Capital Reserve		1,000
Surplus from P & L		
Opening Balance	98	
Additions	1,902	2,000
Reserve for foreseeable loss		1,000
Total		4,000

Note 2: Long Term Borrowings

Term Loan from Bank	11,110
Total	11,110

Note 3: Deferred Tax

Deferred Tax Asset	1,000
Deferred Tax Liability	(400)
Total	600

Note 4: Other Current Liabilities

Unclaimed dividends	6
Billing in Advance	294
Total	300

Note 5: Trade Receivables

Considered good (outstanding within 6 months)	2,130
Considered doubtful (due from past 1 year)	80
Provision for doubtful debts	(10)
Total	2,200

Additional Information:

- (a) Share capital comprises of 200 million shares of Rs. 10 each
- (b) Term Loan from bank for Rs. 11,110 million also includes interest accrued and due of Rs. 11,110 million as on the reporting date.
- (c) Reserve for foreseeable loss is created against a service contract due within 6 months.

Required:

- (i) Evaluate and report the errors and misstatements in the above extracts; and,
- (ii) Prepare the corrected Balance Sheet & Statement of Profit and Loss. (RTP May'18)

Answer 5

- (a) On evaluation of the financial statements, following was observed:

1. For foreseeable loss provision is made and not reserves. Hence, reserve for foreseeable loss for INR 1000 million, (due within 6 months), should be a part of provision. Therefore, it needs to be regrouped. If it was also a part of previous year's comparatives, then a note should be added in the notes to account for regrouping done this year.

2. Interest accrued and due of INR 1,110 million on term loan will be a part of current liabilities

since it is supposed to be paid within 12 months from the reporting date. Hence, it should be shown under the heading "Other Current Liabilities".

3. It can be inferred from Note 3, that the deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws. Hence, these shall be set off, in accordance with AS 22. The net DTA of INR 600 million shall be shown in the balance sheet.
4. The note to trade receivables was incorrectly presented. The rectified note would be as follows:

Trade receivables (Unsecured)	INR in million
Over six months from the date they were due for payment	
i. Considered good	0
ii. Considered doubtful	80
Less: Provision for doubtful debts	(10)
(A)	70
(b) Others	
i. Considered good	2,130
ii. Considered doubtful	0
Less: Provision for doubtful debts	0
(B)	2,130
Total (A + B)	2,200

It is common to have a termination clause in service contracts. Just by having a termination clause, a company cannot create a liability. Para 14 of AS 29 inter alia states that a provision will be recognized when an enterprise has a present obligation as a result of a past event.

Since there is nothing to show that there is a present obligation, no provision will be made.

As per para 27 of AS 29, a contingent liability is recognized only where the possibility of an outflow of resources embodying economic benefits is not remote. Since there is no onerous liability as on the reporting date, the possibility of an outflow becomes remote. Therefore, no contingent liability will arise. In fact, the management has wrongly worded it as 'onerous liability' in its notes to accounts. Onerous liability arises only when the unavoidable costs of meeting the obligation under the contract exceeds the economic benefits expected to be received from it. This note should be eliminated.

The demand notice from the tax department (that is under litigation) is a clear instance of a 'contingent liability'. Accordingly, the notes should be revised as – 'Contingent Liability':

There is a demand notice INR 12 Million, which is under CIT (Appeals) as on the reporting date.

The Statement to Profit and Loss needs to represent earnings per share, as per AS 20.

- (b) Revised extracts of the financial statements

Balance Sheet

(INR in Million)

	Note No.	As at March 31, 20X1
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital		2,000
Reserves and surplus	1	3,000
Non-current liabilities		
Long-term borrowings	2	10,000
Current liabilities		
Trade payables		600



Short-term provisions		1,500
Other current liabilities	4	1,410
TOTAL		18,510
ASSETS		
Non - current assets		
Property Plant & Equipment		11,310
Deferred Tax Assets	3	600
Current assets		
Inventories		2,000
Trade receivables	5	2,200
Cash and Cash Equivalents		2,400
TOTAL		18,510

Statement of Profit and Loss (INR in Million)

Particular	Note No.	Year ended March 31, 20X1
Revenue from operations		11,000
Expenses		
Operating Costs		4,400
Employee Benefit Expense		2,400
Depreciation		1,998
Total Expenses		8,798
Profit Before Tax		2,202
Tax Expense		300
Profit for the period		1,902
Earnings Per Equity Share		
Basic		9.51
Diluted		9.51
Number of equity shares (face value of Rs. 10 each)		200 million

Revised Notes (wherever applicable):
Note on Reserves and Surplus

(INR in Million)

Capital Reserve		1,000
Surplus from P & L		
Opening Bal	98	
Additions	1,902	2,000
Total		3,000

Note on Long Term Borrowings

Term Loan from Bank	10,000
Total	10,000

Note on Other Current Liabilities

Unclaimed dividends	6
Interest on Term Loan	1,110
Billing in Advance	294

Total	1,410

Question 6

Following are the Financial Statements of Abraham Ltd.: Balance Sheet

Particulars	Note No.	As at 31 st March, 2019 (Rs. in lakh)
EQUITY AND LIABILITIES:		
Shareholders' funds		
Share capital (shares of Rs. 10 each)		1,000
Reserves and surplus	1	2,400
Non-current liabilities		
Long term borrowings	2	5,700
Deferred tax liabilities	3	400
Current liabilities		
Trade payables		300
Short-term provisions		300
Other current liabilities	4	200
Total		10,300
ASSETS		
Non-current assets		
Fixed assets		5,000
Deferred tax assets	3	700
Current assets		
Inventories		1,500
Trade receivables	5	1,100
Cash and bank balances		2,000
Total		10,300

Statement of Profit & Loss

Particular	Note No.	Year ended 31 st March, 2019 (Rs. in lakh)
Revenue from operations		6,000
Expenses:		
Employee benefit expense		1,200
Operating costs		3,199
Depreciation		450
Total expenses		4,849
Profit before tax		1,151
Tax expense		201
Profit after tax		950



Notes to Accounts:

Note 1: Reserves and surplus (Rs. in lakh)

Capital reserve		500
Surplus from P & L		
Opening balance	550	
Additions	950	1,500
Reserve for foreseeable loss		400
Total		2,400

Note 2: Long-term borrowings

Term loan from bank	5,700
Total	5,700

Note 3: Deferred tax

Deferred tax asset	700
Deferred tax liability	400
Total	300

Note 4: Other current liabilities

Unclaimed dividends	10
Billing in advance	150
Other current liabilities	40
Total	200

Note 5: Trade Receivables

Considered good (outstanding within 6 months)	1,065
Considered doubtful (due from past 1 year)	40
Provision for doubtful debts	(5)
Total	1,100

Additional information:

- Share capital comprises of 100 lakh shares of Rs. 10 each.
- Term Loan from bank for Rs. 5,700 lakh also includes interest accrued and due of Rs. 700 lakh as on the reporting date.
- Reserve for foreseeable loss is created against a service contract due within 6 months.
- Inventory should be valued at cost Rs. 1,500 lakh, NRV as on date is Rs. 1,200 lakh.
- A dividend of 10 % was declared by the Board of directors of the company.
- Accrued Interest income of Rs. 300 lakh is not booked in the books of the company.
- Deferred taxes related to taxes on income are levied by the same governing tax laws.

Identify and report the errors and misstatements in the above extracts and prepare corrected Balance Sheet and Statement of Profit & Loss and where required the relevant notes to the accounts with explanations thereof. (PYP 12 Marks , Nov'19, MTP 14 Marks Oct '20)(Same concept different figures- PYP 16 Marks May'19)

Answer 6

Following adjustments / rectifications are required to be done

1. Reserve for foreseeable loss for Rs. 400 lakh, due within 6 months, should be a part of provisions. Hence it needs to be regrouped. If it was also part of previous year's comparatives, a note should be added in the notes to account on the regrouping done this year.
2. Interest accrued and due of Rs. 700 lakh on term loan will be a part of current liabilities. Thus, it should be shown under the heading "Other Current Liabilities".
3. As per Ind AS 2, inventories are measured at the lower of cost and net realisable value. The amount of any write down of inventories to net realisable value is recognised as an expense in the period the write-down occurs. Hence, the inventories should be valued at Rs. 1,200 lakh and write down of Rs. 300 lakh (Rs. 1,500 lakh – Rs. 1,200 lakh) will be added to the operating cost of the entity.
4. In the absence of the declaration date of dividend in the question, it is presumed that the dividend is declared after the reporting date. Hence, no adjustment for the same is made in the financial year 2018-2019. However, a note will be given separately in this regard (not forming part of item of financial statements).
5. Accrued income will be shown in the Statement of Profit and Loss as 'Other Income' and as 'Other Current Asset' in the Balance Sheet.
6. Since the deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws, these shall be set off, in accordance with Ind AS 12. The net DTA of Rs. 300 lakh will be shown in the balance sheet.
7. As per Division II of Schedule III to the Companies Act, 2013, the Statement of Profit and Loss should present the Earnings per Equity Share.
8. In Ind AS, Assets are not presented in the Balance sheet as 'Fixed Asset', rather they are classified under various categories of Non-current assets. Here, it is assumed as 'Property, Plant and Equipment'.
9. The presentation of the notes to 'Trade Receivables' will be modified as per the requirements of Division II of Schedule III.

Balance Sheet of Abraham Ltd. For the year ended 31st March, 2019

	Note No.	(Rs. in lakh)
ASSETS		
Non-current assets		
Property, plant and equipment		5,000
Deferred tax assets	1	300
Current assets		
Inventories		1,200
Financial assets		
Trade receivables	2	1,100
Cash and cash equivalents		2,000
Others financial asset (accrued interest)		300
TOTAL		9,900
EQUITY AND LIABILITIES		
Equity		
Equity share capital	3	1,000
Other equity	4	2,000
Non-current liabilities		
Financial liabilities		
Long-term borrowings	5	5,000
Current liabilities		
Financial liabilities		



Trade payables		300
Others	6	710
Short-term provisions (300 + 400)	7	700
Other current liabilities	8	190
TOTAL		9,900

Statement of Profit and Loss of Abraham Ltd. For the year ended 31st March, 2019

	Note No.	(Rs. in lakh)
Revenue from operations		6,000
Other income		300
Total income		6,300
Expenses		
Operating costs	9	3,199
Change in inventories cost		300
Employee benefits expense		1,200
Depreciation		450
Total expenses		5,149
Profit before tax		1,151
Tax expense		(201)
Profit for the period		950
Earnings per equity share		
Basic		9.5
Diluted		9.5
Number of equity shares (face value of Rs. 10 each)		100 lakh

Statement of Changes in Equity of Abraham Ltd. For the year ended 31st March, 2019

3. Equity Share Capital

(Rs. in lakh)

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
1,000	0	1,000

4. Other Equity

(Rs. in lakh)

Particulars	Reserves & Surplus		Total
	Capital reserve	Retained Earnings	
Balance at the beginning of the year	500*	550	1,050
Total comprehensive income for the year		950	950
Balance at the end of the year	500	1,500	2,000

***Note:** Capital reserve given in the Note 1 of the question is assumed to be brought forward from the previous year. However, alternatively, if it may be assumed as created during the year.

1. Deferred Tax

(Rs. in lakh)

Deferred Tax Asset	700
Deferred Tax Liability	400
	300

2. Trade Receivables (Rs. in lakh)

Trade receivables considered good		1,065
Trade receivables which have significant increase in credit risk	40	
Less: Provision for doubtful debts	(5)	35
Total		1,100

3. Long Term Borrowings (Rs. in lakh)

Term Loan from Bank (5,700 - 700)	5,000
Total	5,000

4. Other Financial Liabilities (Rs. in lakh)

Unclaimed dividends	10
Interest on term loan	700
Total	710

5. Short-term provisions (Rs. in lakh)

Provisions	300
Foreseeable loss against a service contract	400
Total	700

6. Other Current Liabilities (Rs. in lakh)

Billing in Advance	150
Other	40
Total	190

7. Dividends not recognised at the end of the reporting period

At year end, the directors have recommended the payment of dividend of 10% i.e. Rs. 1 per equity share. This proposed dividend is subject to the approval of shareholders in the ensuing annual general meeting.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This part of the question is related with the presentation of corrected financial statements. Most of the examinees presented the financial statements as per AS. However, now the syllabus of this paper covers only Ind AS. Therefore, the corrected financial statements were required to be presented as per Ind AS only. Examinees lost marks mainly in the presentation of financial statements as per AS.

Question 7

(Includes concepts of Chp 7.2 Property Plant & Equipment, Ind AS 40 Investment Property)

A Ltd. owns three properties which are shown in its financial statements as 'Property, Plant and Equipment'. All three properties were purchased on April 1, 20X1. The details of purchase price and market values of the properties are given as follows:

Rs. in lakhs

Particulars	Property 1	Property 2	Property 3
	Factory Building	Factory Building	Let-out Building
Purchase price	500	200	300
Market value as on 31.03.20X2	550	220	330
Useful Life	10 Years	10 Years	10 Years
Subsequent Measurement	Cost Model	Revaluation Model	Revaluation Model

Property 1 and 2 are used by A Ltd. as factory building whilst property 3 is let-out to a non-related party at a market rent.

A Ltd. does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognize the difference between purchase price and fair value in Statement of Profit and Loss.

Evaluate whether the accounting policies adopted by A Ltd. in relation to these properties, on various accounting aspects, are in accordance with Ind AS or not. If not, advise the correct treatment along with the workings for the same in all the cases. (MTP 16 Marks March '18)(PYP 10 Marks May '18)(Same concept different figures MTP 10 Marks Mar'23, Old & New SM)

Answer 7

(i) For classification of assets

Para 6 of Ind AS 16 'Property, Plant and Equipment' inter alia, states that Property, plant and equipment are tangible items are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

As per para 6 of Ind AS 40 'Investment property', Investment property is property held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes; or sale in the ordinary course of business.

According, to the facts given in the questions, since Property 1 and 2 are used as factory buildings, their classification as PPE is correct. However, Property 3 is held to earn rentals; hence, it should be classified as Investment Property. Thus, its classification as PPE is not correct. Property '3' shall be presented as separate line item as Investment Property as per Ind AS 1.

(ii) For valuation of assets

Paragraph 29 of Ind AS 16 states that an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. Also, paragraph 36 of Ind AS 16 states that If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

However, for investment property, paragraph 30 of Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property".

Also, paragraph 79 (e) of Ind AS 40 inter alia requires that an entity shall disclose the fair value of investment property. Since property 1 and 2 is used as factory building, they should be classified under same category or class i.e. 'factory building'. Therefore, both the properties should be valued either at cost model or revaluation model. Hence, the valuation model adopted by A Ltd. is not consistent and correct as per Ind AS 16.

In respect to property '3' being classified as Investment Property, there is no alternative of revaluation model i.e. only cost model is permitted for subsequent measurement. However, A Ltd. is required to disclose the fair value of the investment property in the Notes to Accounts.

(iii) For changes in value on account of revaluation and treatment thereof

Paragraph 39 of Ind AS 16 states that if an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognized in other comprehensive income and accumulated in equity under the heading 'revaluation surplus'. However, the increase shall be recognized in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss. Accordingly, the revaluation gain

shall be recognized in other comprehensive income and accumulated in equity under the heading of revaluation surplus.

(iv) For treatment of depreciation

Paragraph 52 of Ind AS 16 states that Depreciation is recognized even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Accordingly, A Ltd. is required to depreciate these properties irrespective of that their fair value exceeds the carrying amount.

(v) Rectified presentation in the balance sheet

As per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet should be as follows:

Case 1: If A Ltd. has applied the Cost Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 20X2		INR in lakhs
Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	450	
Property '2'	180	630
Investment Property		
Property '3' (Fair value being 330 lakhs) (Cost = 300-30)		270

Case 2: If A Ltd. has applied the Revaluation Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 20X2		INR in lakhs
Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	550	
Property '2'	220	770
Investment Properties		
Property '3' (Fair value being 330 lakhs) (Cost = 300-30)		270
Equity and Liabilities		
Other Equity		
Revaluation Reserve*		
Property '1' (550-450)	100	
Property '2' (220-180)	40	140

*The revaluation reserve should be routed through Other Comprehensive Income (OCI) (subsequently not reclassified to Profit and Loss) in the Statement of Profit and Loss and shown as a separate column in Statement of Changes in Equity.

Question 8

On 1st April, 2021, Mohan Ltd. has sold goods to Hari Ltd. at a consideration of ₹ 7,50,000. The receipt of this is receivable in three equal instalments of ₹ 2,50,000 each over a two-year period (receipts on 1st April, 2021; 31st March 2022 and 31st March 2023).

The company is offering a discount of 5% (i.e. ₹ 37,500), if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.358% p.a.

The total consideration to be received from such sale is at ₹ 7,50,000 and hence, the management has recognized the revenue from sale of goods for ₹ 7,50,000.

You are required to analyse whether the above accounting treatment made by the accountant is in compliance of Ind AS. If not, advise the correct treatment along with journal entries and extracts of Statement of Profit & Loss and Balance Sheet. (PYP 6 Marks Nov 22)(Same concept different figures Old & New SM)

Answer 8

The revenue from sale of goods shall be recognised at the fair value of the consideration received or receivable. The fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest where the receipt is deferred beyond normal credit terms. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue. Hence, the accounting treatment of recognizing revenue of ₹ 7,50,000 by the accountant is not correct.

The fair value of consideration (cash price equivalent) of the sale of goods to be recognised on the date of sale should be calculated as follows:

Period	Consideration (Installment)	Present value factor	Present value of consideration
	₹		₹
Time of sale	2,50,000	-	2,50,000
End of 1st year	2,50,000	0.949	2,37,250
End of 2nd year	2,50,000	0.901	2,25,250
	7,50,000		7,12,500

Mohan Ltd. will recognise the revenue from sale of goods and finance income as follows:

Particulars		₹	₹
Initial recognition of sale of goods			
Cash / Bank A/c	Dr.	2,50,000	
Trade Receivable A/c	Dr.	4,62,500	
To Sale A/c			7,12,500
Recognition of interest expense and receipt of second installment			
Cash / Bank A/c	Dr.	2,50,000	
To Interest Income A/c (4,62,500 x 5.358%)			24,781
To Trade Receivable A/c			2,25,219
Recognition of interest expense and payment of final installment			
Cash / Bank A/c	Dr.	2,50,000	
To Interest Income A/c (Balancing figure)			12,719
To Trade Receivable A/c (4,62,500 – 2,25,319)			2,37,281

Statement of Profit and Loss (Extracts) for the year ended 31st March, 2022 and 31st March, 2023

	As at 31st March, 2022	As at 31st March, 2023
	₹	₹
Income		
Sale of Goods	7,12,500	-
Other Income (Finance income)	24,781	12,719



Balance Sheet (extracts) as at 31st March, 2022 and 31st March, 2023

	As at 31st March, 2022	As at 31st March, 2023
	₹	₹
Assets		
Current Assets		
Financial Assets		
Trade Receivables	2,37,281	XXX

Question 9

PB Limited purchased a plastic bottle manufacturing plant for Rs. 24 lakh on 1st April, 2015. The useful life of the plant is 8 years. On 30th September, 2017, PB Limited temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of PB Limited decided to treat the plant as held for sale until the demand picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell. The accountant has also stopped charging depreciation for rest of the period considering the plant as held for sale. The fair value less cost to sell on 30th September, 2017 and 31st March, 2018 was Rs. 13.5 lakh and Rs. 12 lakh respectively.

The accountant has made the following working:

Carrying amount on initial classification as held for sale	Rs.	Rs.
Purchase price of Plant	24,00,000	
Less: Accumulated Depreciation [(Rs. 24,00,000/8)x2.5 years]	7,50,000	16,50,000
Fair value less cost to sell as on 31st March, 2017		12,00,000
The value lower of the above two		12,00,000

Balance Sheet extracts as on 31st March, 2018

Particulars	Rs.
Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	12,00,000

Required:

Analyze whether the above accounting treatment is in compliance with the Ind AS. If not, advise the correct treatment showing necessary workings. (PYP 8 Marks, Nov'18)(Same concept different figures Old & New SM)

Answer 9

As per Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations', an entity shall classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

For asset to be classified as held for sale, it must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable. In such a situation, an asset cannot be classified as a non-current asset held for sale, if the entity intends to sell it in a distant future.

For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one



year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Further Ind AS 105 also states that an entity shall not classify as held for sale a non-current asset that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use. An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned. In addition to Ind AS 105, Ind AS 16 states that depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

The Accountant of PB Ltd. has treated the plant as held for sale and measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.

Accordingly, the manufacturing plant should neither be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use. PB Ltd. shall not stop charging depreciation or treat the plant as held for sale because its carrying amount will be recovered principally through continuing use to the end of their economic life.

The working of the same for presenting in the balance sheet will be as follows:

Calculation of carrying amount as on 31st March, 2018	Rs.
Purchase Price of Plant	24,00,000
Less: Accumulated depreciation (24,00,000/ 8 years) x 3 years	(9,00,000)
Carrying amount before impairment	15,00,000
Less: Impairment loss (Refer Working Note)	(3,00,000)
Revised carrying amount after impairment	12,00,000

Balance Sheet extracts as on 31st March 2018

Assets	Rs.
Non-Current Assets	
Property, Plant and Equipment	12,00,000

Working Note:

Fair value less cost to sell of the Plant = Rs. 12,00,000

Value in Use (not given) or = Nil (since plant has temporarily not been used for manufacturing due to decline in demand)

Recoverable amount = higher of above i.e. Rs. 12,00,000

Impairment loss = Carrying amount – Recoverable amount
Impairment loss = Rs. 15,00,000 - Rs. 12,00,000 = Rs. 3,00,000.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Majority of the examinees faulted in analysing the provisions of Ind AS 105 and applying the same in the given scenario. They also did not calculate the impairment loss on the Plant.

Question 10

Arun Ltd. is an entity engaged in plantation and farming on a large scale and diversified across India. On 1st April, 2018, the company has received a government grant for Rs. 20 lakh subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years. The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus trees for specified period of five years and accordingly it recognizes proportionate grant for Rs. 4 lakh in Statement of Profit and Loss as income following the principles laid down under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

**Required:**

Evaluate whether the above accounting treatment made by the management is in compliance with the applicable Ind AS. If not, advise the correct treatment. (PYP 4 Marks, Nov 19)(Same concept different figures Old & New SM)

Answer 10

Arun Ltd. is engaged in plantation and farming on a large scale. This implies that it has agriculture business. Hence, Ind AS 41 will be applicable.

Further, the government grant has been given subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years. This implies that it is a conditional grant.

In the absence of the measurement base of biological asset, it is assumed that "Arun Ltd measures its Biological Asset at fair value less cost to sell":

- (i) As per Ind AS 41, the government grant should be recognised in profit or loss when, and only when, the conditions attaching to the government grant are met ie continuous plantation of eucalyptus tree for coming period of 5 years. In this case, the grant shall not be recognised in profit or loss until the five years have passed. The entity has recognised the grant in profit and loss on proportionate basis, which is incorrect.
- (ii) However, if the terms of the grant allow part of it to be retained according to the time elapsed, the entity recognises that part in profit or loss as time passes. Accordingly, the entity can recognise the proportionate grant for Rs. 4 lakh in the statement of Profit and Loss based on the terms of the grant.

Alternatively, it may be assumed that Arun Ltd. measures its Biological Asset at its cost less any accumulated depreciation and any accumulated impairment losses (as per para 30 of Ind AS 41):

In such a situation, principles of Ind AS 20 (with respect to conditional grant will apply). According to Ind AS 20, the conditional grant should be recognised in the Statement of Profit and Loss over the periods and in the proportions in which depreciation expense on those assets is recognised. Hence the proportionate recognition of grant Rs. 4 lakh (20 lakh / 5) as income is correct since the entity has reasonable assurance that the entity will comply with the conditions attached to the grant.

Note: In case eucalyptus tree is considered as bearer plant by Arun Ltd., then Ind AS 20 will be applicable and not Ind AS 41.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

This part of the question was related to accounting treatment of Government Grants received for farming and plantation and is governed by Ind AS 41. However, most of the examinees answered the question based on Ind AS 20 only without referring the relevant applicable provisions of Ind AS 41.

Question 11

On 1st April, 20X1, Star Limited has advanced a housing loan of ` 15 lakh to one of its employees at an interest rate of 6% per annum which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit. The market rate of similar loan for housing finance by banks is 10% per annum. The accountant of the company has recognized the staff loan in the balance sheet equivalent to the amount of housing loan disbursed i.e. ` 15 lakh. The interest income for the year is recognized at the contracted rate in the Statement of Profit and Loss by the company i.e. ` 90,000 (6% of ` 15 lakh). Analyze whether the above accounting treatment made by the accountant is in compliance with the relevant Ind AS. If not, advise the correct treatment of housing loan, interest and other expenses in the financial statements of Star Limited for the year 20X1 -20X2 along with workings and applicable Ind AS. You are required to explain how the housing loan should be reflected in the Ind AS compliant Balance Sheet of Star Limited on 31st March, 20X2. Ignore defer tax impact (14 Marks April 22, PYP 12 Ma Nov '20, Old & New SM)

Answer 11

The accounting treatment made by the accountant is not in compliance with Ind AS 109 'Financial Instruments'. As per Ind AS 109, at initial recognition, an entity shall measure a financial asset or financial

liability at its fair value. The fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received.

After initial recognition, an entity shall measure a financial asset either at amortised cost or at fair value through profit and loss or fair value through other comprehensive income.

Here, the loan given to employee is not at market rate. Hence, the fair value of the loan will not be equal to its initial loan proceeds. As per Ind AS 109, a financial instrument is initially measured and recorded in the books at its fair value. Further, interest income to be recognised in the Statement of Profit and Loss will be the finance income recognised at effective rate of interest i.e. @ 10% and not the rate of interest charged by the company i.e. @ 6%. The correct accounting treatment as per Ind AS 109 will be as under: For measuring the fair value or present value of the loan at initial recognition, market rate of interest of similar loan is considered (level 1 observable input) ie @ 10%, to discount the cash outflows.

The fair value of the loan shall be as follows:

Date	Outstanding loan	Principal	Interest income @ 6%	Total inflow	Discount factor @ 10%	PV
31st March 20X2	15,00,000	3,00,000	90,000	3,90,000	0.909	3,54,510
31st March 20X3	12,00,000	3,00,000	72,000	3,72,000	0.826	3,07,272
31st March 20X4	9,00,000	3,00,000	54,000	3,54,000	0.751	2,65,854
31st March 20X5	6,00,000	3,00,000	36,000	3,36,000	0.683	2,29,488
31st March 20X6	3,00,000	3,00,000	18,000	3,18,000	0.621	1,97,478
Fair value of the loan						13,54,602

As per Ind AS 19, employee benefits are all forms of consideration given by an entity in exchange for services rendered by employees or for termination of employment. Difference of loan proceeds and present value of the loan (fair value) will be treated as prepaid employee cost irrespective of the fact that employee is not required to give any specific performance against this benefit. This is because employee is required to be in service of the company to continue availing the benefits of concessional rate of interest on housing loan. Practically, once the employee leaves the organisation, they have to repay the outstanding loan because the company provides the loan at concessional rate of interest only to its employees. Hence, it is an employee benefit given by the company to its employees. This deemed employee cost of ` 1,45,398 (15,00,000 – 13,54,602) will be deferred and amortised over the period of loan on straight line basis.

Calculation of amortised cost of loan to employees

Financial year ending 31st March	Amortised cost (opening balance)	Interest to be recognised @ 10%	Repayment (including interest)	Amortised cost (closing balance)
20X2	13,54,602	1,35,460	3,90,000	11,00,062
20X3	11,00,062	1,10,006	3,72,000	8,38,068
20X4	8,38,068	83,807	3,54,000	5,67,875
20X5	5,67,875	56,788	3,36,000	2,88,663
20X6	2,88,663	29,337*	3,18,000	-

* 2,88,663 x 10% = ` 28,866. Difference of ` 471 (29,337 – 28,866) is due to approximation in computation.

Journal Entries to be recorded at every period end

- On 1st April, 20X1

Particulars	Dr. Amount (')	Cr. Amount (')
Loan to employee A/c Dr.	13,54,602	

Prepaid employee cost A/c	Dr.	1,45,398	
To Bank A/c			15,00,000
(Being loan asset recorded at initial fair value)			

2. On 31st March, 20X2

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c	Dr.	3,90,000	
To Finance income A/c (profit and loss) @10%			1,35,460
To Loan to employee A/c			2,54,540
(Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate @ 10%)			
Employee benefit cost (profit and loss) A/c	Dr.	29,080	
To Prepaid employee cost A/c (1,45,398/5)			29,080
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)			

The following housing loan balances should appear in the financial statements:

Extracts of Balance Sheet of Star Ltd. as at 31st March, 20X2

Non-current asset	
Financial asset	
Loan to employee (11,00,062 – 3,72,000 + 1,10,006)	8,38,068
Other non-current asset	
Prepaid employee cost	87,238
Current asset	
Financial asset	
Loan to employee (3,72,000-1,10,006)	2,61,994
Other current asset	
Prepaid employee cost	29,080

Question 12

On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March 20X2 costing Rs. 8 lakhs. The net realizable value of the inventory prior to the damage was estimated at Rs. 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of Rs. 2 lakhs on repairing and re- packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of Rs. 9 lakhs.

The accountant of Jupiter Ltd. treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows: Rs. lakhs

Cos	8.00
Net realizable value (9.6 -2)	7.60
Inventories (lower of cost and net realizable clue)	7.60

Analyse whether the above accounting treatment made by the accountant in regard to financial par ending on 31.0.20X2 is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same. (MTP 8 Marks April '19, Old & New SM)

Answer 12

The above treatment needs to be examined in the light of the provisions given in Ind AS 10 'Events after the Reporting Period' and Ind AS 2 'Inventories'.

Para 3 of Ind AS 10 'Events after the Reporting Period' defines "Events after the reporting period are those events, favorable and unfavorable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
- (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 10 of Ind AS 10 states that:

"An entity shall not adjust the amounts recognized in its financial statements to reflect non-adjusting events after the reporting period".

Further, paragraph 6 of Ind AS 2 defines:

"Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale".

Further, paragraph 9 of Ind AS 2 states that:

'Inventories shall be measured at the lower of cost and net realizable value'.

Accountant of Jupiter Ltd. has re-measured its inventories after adjusting the event in its financial statement which is not correct and nor in accordance with provision of Ind AS 2 and Ind AS 10. Accordingly, the event causing the damage to the inventory occurred after the reporting date and as per the principles laid down under Ind AS 10 'Events After the Reporting Date' is a non-adjusting event as it does not affect conditions at the reporting date. Non-adjusting events are not recognized in the financial statements, but are disclosed where their effect is material. Therefore, as per the provisions of Ind AS 2 and Ind AS 10, the consignment of inventories shall be recorded in the Balance Sheet at a value of Rs. 8 lakhs calculated below:

Rs. ' lakhs	
Cost	8.00
Net realizable value	9.60
Inventories (lower of cost and net realizable value)	8.00

Question 13

On 1st April, 20X1, Sun Ltd. has acquired 100% shares of Earth Ltd. for ₹ 30 lakh. Sun Ltd. has 3 cash-generating units A, B and C with fair value of ₹ 12 lakh, ₹ 8 lakh and ₹ 4 lakh respectively. The company recognizes goodwill of ₹ 6 lakh that relates to CGU 'C' only. During the financial year 20X2-20X3, the CFO of the company has a view that there is no requirement of any impairment testing for any CGU since their recoverable amount is comparatively higher than the carrying amount and believes there is no indicator of impairment. Analyse whether the view adopted by the CFO of Sun Ltd. is in compliance with the Ind AS. If not, advise the correct treatment in accordance with relevant Ind AS. (MTP 6 Marks April 22, Old & New SM)

Answer 13

Para 9 of Ind AS 36 'Impairment of Assets' states that an entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

Further, paragraph 10(b) of Ind AS 36 states that irrespective of whether there is any indication of



impairment, an entity shall also test goodwill acquired in a business combination for impairment annually.

Sun Ltd. has not tested any CGU on account of not having any indication of impairment is partially correct i.e. in respect of CGU A and B but not for CGU C. Hence, the treatment made by the Company is not in accordance with Ind AS 36.

Impairment testing in respect of CGU A and B are not required since there are no indications of impairment. However, Sun Ltd shall test CGU C irrespective of any indication of impairment annually as the goodwill acquired on business combination is fully allocated to CGU 'C'.

Question 14

On April 1, 20X1, Pluto Ltd. has advance a loan for Rs. 10 lakhs to one of its employees for an interest rate at 4% per annum (market rate 10%) which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit.

The accountant of the company has recognised the staff loan in the balance sheet equivalent to the amount disbursed i.e. Rs. 10 lakhs. The interest income for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs. 40,000 (Rs. 10 lakhs x 4%).

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment alongwith working for the same. (MTP 8 Marks Mar '19)

Answer 14

The above treatment needs to be examined in the light of the provisions given in Ind AS 32 and Ind AS 109 on *Financial Instruments* and Ind AS 19 *Employee Benefits*.

Para 11 (c) (i) of Ind AS 32 'Financial Instruments: Presentation' states that:

"A financial asset is any asset that is:

(c) a contractual right:

(i) to receive cash or....."

Further, paragraph 5.1.1 of Ind AS 109 states that:

"at initial recognition, an entity shall measure a financial asset or financial liability at its fair value".

Further, paragraph 5.1.1 of Appendix B to Ind AS 109 states that:

"The fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received. However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market(s) of interest rate of similar instrument with a similar credit rating. Any additional amount lent is an expense or reduction of income unless it qualifies for recognition as some other type of asset".

Further, paragraph 5.2.1 of Ind AS 109 states that:

"After initial recognition, an entity shall measure a financial asset at:

- (a) amortised cost;
- (b) fair value through other comprehensive income; or
- (c) fair value through profit or loss.

Further, paragraph 5.4.1 of Ind AS 109 states that:

"Interest revenue shall be calculated by using the effective interest method. This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset"

Paragraph 8 of Ind AS 19 states that:

“Employee Benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment”.

The Accountant of Pluto Ltd. has recognised the staff loan in the balance sheet at Rs. 10 lakhs being the amount disbursed and Rs. 40,000 as interest income for the period is recognised at the contracted rate in the statement of profit and loss which is not correct and not in accordance with Ind AS 19, Ind AS 32 and Ind AS 109.

Accordingly, the staff advance being a financial asset shall be initially measured at the fair value and subsequently at the amortised cost. The interest income is calculated by using the effective interest method. The difference between the amount lent and fair value is charged as Employee benefit expense in statement of profit and loss.

a) Calculation of Fair Value of the Loan

Year	Cash Inflow	Discounting Factor (10%)	Present Value
1	2,40,000	0.909	2,18,160
2	2,32,000	0.826	1,91,632
3	2,24,000	0.751	1,68,224
4	2,16,000	0.683	1,47,528
5	2,08,000	0.621	1,29,168
Total			8,54,712

Staff loan should be initially recorded at Rs. 8,54,712.

b) Employee Benefit Expense

Loan Amount – Fair Value of the loan = Rs. 10,00,000 – Rs. 8,54,712 = Rs. 1,45,288

Rs. 1,45,288 shall be charged as Employee Benefit expense in Statement of Profit and Loss for the year ended 31.03.20X2.

Amortisation table:

Year	Opening balance of Staff Advance (a)	Interest (10%) (b)= (a x 10%)	Repayment (c)	Closing balance of Staff Advance (d) = a + b -c
1	8,54,712	85,471	2,40,000	7,00,183
2	7,00,183	70,018	2,32,000	5,38,201
3	5,38,201	53,820	2,24,000	3,68,021
4	3,68,021	36,802	2,16,000	1,88,823
5	1,88,823	19,177 (b.f.)	2,08,000	Nil

Balance Sheet extracts showing the presentation of staff loan as at 31st March 20X2

Ind AS compliant Division II of Sch III needs to be referred for presentation requirement in Balance Sheet on Ind AS.

Assets	
Non-Current Assets	
Financial Assets	
(i) Loan	5,38,201
Current Assets	
Financial Assets	
(i) Loans (7,00,183 - 5,38,201)	1,61,982