AIR1CA CAREER INSTITUTE

CA FINAL

FR

[Volume I]

QUESTION BANK

With

Solutions as per ICAI

By CA AJAY AGARWAL (AIR-1)

For MAY 2022 Exams

Coverage of All ICAI Questions

air1ca.com

Best Wishes... Radhe Radhe!!

ACI

AIR1CA CAREER INSTITUTE

CA FINAL

PAPER 1 : FINANCIAL REPORTING

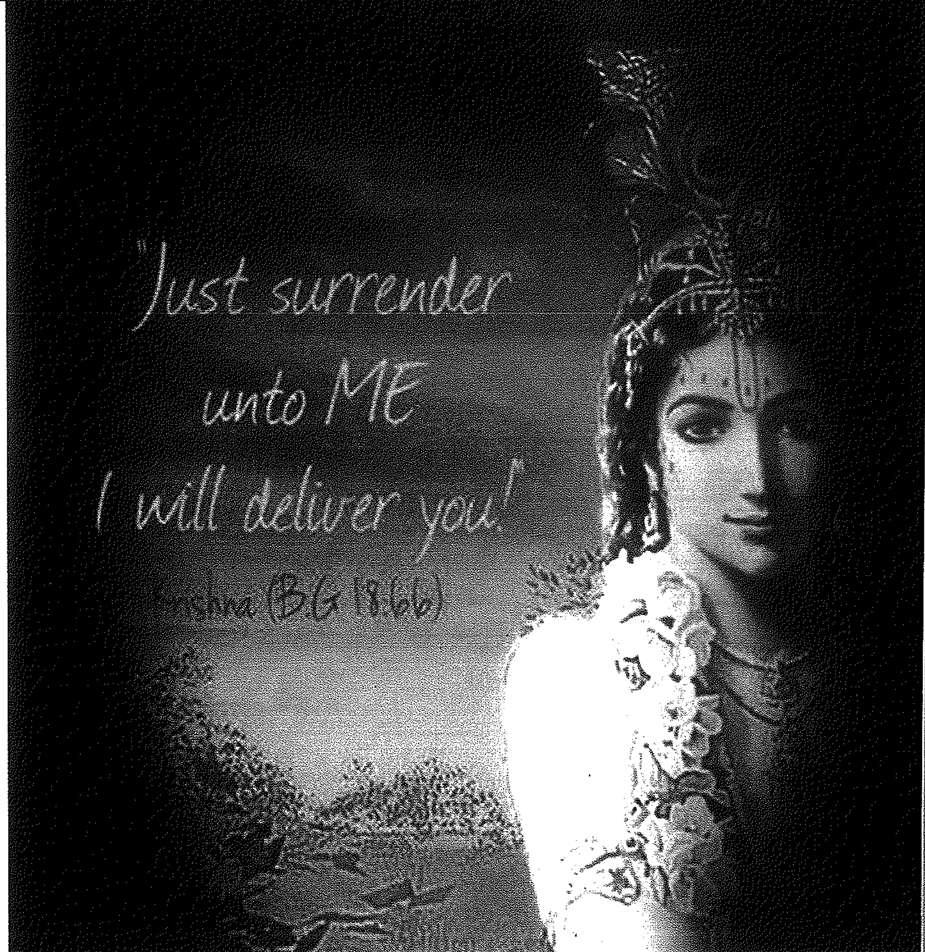
QUESTION BANK

[Volume I]

(Relevant for
MAY 2022 Exams)

It covers:

- ✓ All ICAI Study Material Illustration & Test Your Knowledge Questions
- ✓ All RTP Questions
- ✓ All MTP Questions
- ✓ All Past Exam Questions



This Question Bank is prepared by **CA AJAY AGARWAL (AIR-1)**. It contains **1100+ Questions** which are divided in 2 Volumes. **VOLUME I** contains **600+ Practical and Relevant Theory Questions** and **VOLUME II** contains **500+ Irrelevant Theory Questions** (Weightage 5 Marks).

Reach out to us at following for Classes, Mock Tests, Notes and Guidance:-

- **Telegram Channel** – AIR1CA Guidance & Notes
- **Android App** – AIR1CA Career Institute
- **Call/Whatsapp** – 7742554277
- **Youtube** – Atul Agarwal
- **Website** – air1ca.com
- **Email** – air1icai@gmail.com

Best Wishes... Radhe Radhe!!

CONTENTS

FINANCIAL REPORTING (VOLUME I)

VOLUME - I

Practical Questions
And
Relevant Theory Questions

Scan this QR code to watch Free Revision Lectures on Youtube for CA Final FR May 22 Exams

CHAPTER - 1
Framework for Preparation and Presentation of Financial Statements

Question 1

Balance sheet of a trader on 31st March, 20X1 is given below:

Particulars	₹
Assets	
Non-current assets	
Property, Plant and Equipment	65,000
Current assets	
Inventories	30,000
Financial assets	
Trade receivables	20,000
Other asset	10,000
Cash and cash equivalents	5,000
	1,30,000
Equity and Liabilities	
Equity	
Share capital	60,000
Other Equity - Profit and Loss Account	25,000
Non-current liabilities	
10% Loan	35,000
Current liabilities	
Financial liabilities	
Trade payables	10,000
	1,30,000

Additional information:

(i) The remaining life of Property, Plant and Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant and Equipment on 31.03.20X2 was ₹ 60,000.

(ii) The trader's purchases and sales in 20X1-20X2 amounted to ₹ 4 lakh and ₹ 4.5 lakh respectively.

(iii) The cost and net realisable value of inventories on 31.03.20X2 were ₹ 32,000 and ₹ 40,000 respectively.

(iv) Employee benefit expenses for the year amounted to ₹ 14,900.

(v) Other asset is written off equally over 4 years.

(vi) Trade receivables on 31.03.20X2 is ₹ 25,000, of which ₹ 2,000 is doubtful. Collection of another ₹ 4,000 depends on successful re-installation of certain product supplied to the customer.

(vii) Cash balance on 31.03.20X2 is ₹ 37,100 before deduction of interest paid on loan.

(viii) There is an early repayment penalty for the loan ₹ 2,500.

Prepare Profit and Loss Accounts and Balance Sheets of the trader for the year ended 31st March, 20X2 in following two cases

(i) assuming going concern

(ii) not assuming going concern

Answer

Profit and Loss Account for the year ended 31st March, 20X2

		Case (i) ₹	Case (ii) ₹
Revenue from operations – Sales	(A)	4,50,000	4,50,000
Expenses			
Purchases		4,00,000	4,00,000
Changes in inventories		(2,000)	(10,000)
Employee benefit expenses		14,900	14,900
Finance cost		3,500	6,000
Depreciation and amortisation expenses		15,500	15,000
Other expenses - Provision for doubtful debts		2,000	6,000
Total Expenses	(B)	4,33,900	4,31,900
Profit for the period (A-B)		16,100	18,100

Balance Sheet as at 31st March, 20X2

	Case (i) ₹	Case (ii) ₹
Assets		
Non-current assets		
Property, Plant and Equipment	52,000	60,000
Current Asset		
Inventories	32,000	40,000
Financial assets		
Trade receivables (less provision)	23,000	19,000
Other asset	7,500	Nil
Cash and cash equivalents (after interest paid on loan)	33,600	33,600
	1,48,100	1,52,600
Equity and Liabilities		
Equity		

Share Capital	60,000	60,000
Other Equity - Profit & Loss A/c	41,100	43,100
Non-current liabilities		
10% Loan	35,000	37,500
Current liabilities		
Trade payables (Balancing Figure)	12,000	12,000
	1,48,100	1,52,600

Question 2

Entity A is having inventory amounting ₹ 1,00,000 in total with the details as below:

Spare parts	₹ 30,000
Finished goods	₹ 25,000
Work in progress	₹ 40,000
Tools	₹ 5,000
TOTAL	₹ 1,00,000

Materiality limit has been assessed ₹ 30,000 based on the management estimation pertaining to annual profit basis. What should be the presentation requirement under the "Materiality" criteria?

Answer

Entity A has estimated its materiality limit of ₹ 30,000 which suggests that everything which is more than this amount will be required to present separately, subject to its nature (nature means the components of inventory in this question). Hence, Entity needs to show Inventory as below by way of notes to account

Work in progress	₹ 40,000
Spare parts	₹ 30,000
Finished goods & tools	₹ 30,000
TOTAL	₹ 1,00,000

Since, Work in progress and Spare parts are more than materiality limits, hence, they have been shown separately based on its defined separate nature whereas finished goods & tools have amount lower than materiality limits and same has been clubbed together.

Question 3

Mr. Unique commenced business on 1/04/17 with ₹ 20,000 represented by 5,000 units of the product @ ₹ 4 per unit. During the year 2017-18, he sold 5,000 units @ ₹ 5 per unit. During 2017-18, he withdraw ₹ 4.000.

- 31/03/18: Price of the product @ ₹ 4.60 per unit

- Average price indices: 1/4/17: 100 & 31/3/18: 120 Find out:

(i) Financial capital maintenance at Historical Cost

(ii) Financial capital maintenance at Current Purchasing Power

(iii) Physical Capital Maintenance

Answer

(i) Financial Capital Maintenance at historical costs

	₹	₹
Closing capital (₹ 25,000 – ₹ 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

(ii) Financial Capital Maintenance at current purchasing power

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

(iii) Physical Capital Maintenance

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

CHAPTER - 2
Unit 1 – Ind AS 1: Presentation of Financial Statements

Question 1

X Ltd. provides you the following information:

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

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

Answer

The operating cycle of X Ltd. will be computed as under:
Raw material stock holding period + Work-in-progress holding period + Finished goods holding period + Debtors collection period = 3 + 1 + 5 + 5 = 14 months.

Question 2

X Ltd. provides you the following information:

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

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

Answer

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

Question 3

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:

(i) 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?

(ii) The Company has some trade receivables that are due after 14 months from the date of the balance sheet; the management of the Company expects to receive the amount within the period of the operating cycle. Despite the fact that these are receivables in 14 months, the management would like to present these as current. Is the management's decision correct?

(iii) In the normal course of business, the Company has given 2 contracts and received a total security deposit of ₹ 4 crore. ₹ 3 crore is received from X Limited and ₹ 1 crore is received from Y Limited on 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?

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

Answer

Operating cycle of Charm Limited = 15 months

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

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

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

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

Although it is expected that X Limited will fulfil the contract and the deposit will not be refunded, but in case of cancellation within the contract term, refund of security deposit is a condition that is not within 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 realised in less than twelve months from the end of the reporting period.

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

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

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

Question 4

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?

Answer

(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.

Question 5

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?

Answer

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

However, an entity classifies the liability as non-current, if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which 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 w ill 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 6

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

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

Answer

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

Current service cost	1,75,000
Gains and losses arising from translating the monetary assets in foreign 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 (₹)

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 7

A Limited has prepared the following draft balance sheet as on 31st March 20X1: **(₹ in crores)**

Particulars	**March 31, 20X1**	**March 31, 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	2,300	1,800

Inventory at cost	1,500	1,650
Inventory at fair value less cost to complete and sell	180	130
Investment property	3,100	3,100
Property, plant and equipment (PPE) at cost	5,200	4,700
Total	**12,850**	**11,800**
CLAIMS AGAINST ASSETS		
Long term debt (₹ 500 crores 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 balance sheet using current and non-current classification in accordance with Ind AS 1. Assume operating cycle is 12 months.

Answer

A Limited

Balance Sheet as at 31st March 20X1

(₹ in crores)

Particulars	**Note**	**March 31, 20X1**	**March 31, 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			
(i) Trade and other payables (Other than micro enterprises and small enterprises)	7	895	820
(ii) Current portion of long-term debt	8	500	500
(iii) Interest accrued on long-term debt		260	290
(iv) Dividends payable		150	230
(b) Provisions			
(i) Warranty provision		600	445
(ii) Other short-term provisions		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 ₹ crores	Amount ₹ crores

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 and paid 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 comparative year.

CHAPTER - 2
Unit 2 – Ind AS 34: Interim Financial Reporting

Question 1

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

Following adjustments are made while computing the net profit:

(i) Bad debts of ₹ 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

(ii) Additional depreciation of ₹ 4,50,000 resulting from the change in the method of depreciation.

(iii) Exceptional loss of ₹ 28,000 incurred during the third quarter. 50% of exceptional loss have been deferred to next quarter.

(iv) ₹ 5,00,000 expenditure on account of administrative expenses pertaining to the third quarter is deferred on the argument that the fourth quarter will have more sales; therefore fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.

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

Answer

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

(i) The treatment of bad debts is not correct as the expenses incurred during an interim reporting period should be recognised in the same period. Accordingly, ₹ 50,000 should be deducted from ₹ 20,00,000.

(ii) Recognising additional depreciation of ₹ 4,50,000 in the same quarter is correct and is in tune with Ind AS 34.

(iii) Treatment of exceptional loss is not as per the principles of Ind AS 34, as the entire amount of ₹ 28,000 incurred during the third quarter should be recognized in the same quarter. Hence ₹ 14,000 which was deferred should be deducted from the profits of third quarter only.

(iv) As per Ind AS 34 the income and expense should be recognised when they are earned and incurred respectively. As per para 39 of Ind AS 34, the costs should be anticipated or deferred only when:

  (i) it is appropriate to anticipate or defer that type of cost at the end of the financial year, and

  (ii) costs are incurred unevenly during the financial year of an enterprise.

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

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

Question 2

Navya Limited manufacturer of ceramic tiles has shown a net profit of ₹ 15,00,000 for the first quarter of 2018-2019. Following adjustments were made while computing the net profit:

(i) Bad debts of ₹ 1,64,000 incurred during the quarter. 75% of the bad debts have been deferred for the next three quarters (25% for each quarter).

(ii) Sales promotion expenses of ₹ 5,00,000 incurred in the first quarter and 90% expenses deferred to the next three quarters (30% for each quarter) on the basis that the sales in these quarters will be high in comparison to first quarter.

(iii) Additional depreciation of ₹ 3,50,000 resulting from the change in the method of depreciation has been taken into consideration.

(iv) Extra-ordinary loss of ₹ 1,36,000 incurred during the quarter has been fully recognized in this quarter.

Discuss the treatment required under Ind AS 34 and ascertain the correct net profit to be shown in the Interim Financial report of first quarter to be presented to the Board of Directors.

Answer

As per Ind AS 34, Interim Financial Reporting, the quarterly net profit should be adjusted and restated as follows:

(i) Bad debts of ₹ 1,64,000 have been incurred during current quarter. Out of this, the company has deferred 75% i.e. ₹ 1,23,000 to the next 3 quarters. This treatment is not correct as the expenses incurred during an interim reporting period should be recognised in the same period unless conditions mentioned in Ind AS 34 are fulfilled. Accordingly, ₹ 1,23,000 should be deducted from the net profit of the current quarter ₹ 15,00,000.

(ii) Deferment of sales promotion expenses of ₹ 4,50,000 is not correct. It should be charged in the quarter in which the expenses have been incurred. Hence, it should be charged in the first quarter only.

(iii) Recognising additional depreciation of ₹ 3,50,000 in the same quarter is correct and is in tune with Ind AS 34.

(iv) The treatment of extra-ordinary loss of ₹ 1,36,000 being recognised in the same quarter is correct.

Thus considering the above, the correct net profits to be shown in Interim Financial Report of the third quarter shall be ₹ 15,00,000 – ₹ 1,23,000 – ₹ 4,50,000 = ₹ 9,27,000

Question 3

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

Qtr. I	Qtr. II	Qtr. III	Qtr. IV
ending 30 June	ending 30 September	ending 31 December	ending 31 March
10%	10%	60%	20%

For the first quarter ending on 30 June, 20X1, ICPL has provided the following information:

Particulars	**Amounts (in crore)**

Sales	70
Employees benefits expenses	25
Administrative and other expenses	12
Finance cost	4

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

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

Answer

Result of the first quarter ending 30 June

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

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

Question 4

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.

Answer

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%

Amt (₹)

	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 5

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

Answer

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

Expected total Income = ₹ 15,000 [60,000 – (15,000 x 3)]

Expected tax as per slabs = 15,000 x 20% = ₹ 3,000

Average Annual Income tax rate = 3,000/15,000 = 20%

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

Question 6

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 or not? If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

Answer

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

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

Period	Pre-tax earnings (in ₹)	Effective tax rate	Tax expense (in ₹)
First Quarter	1,50,000	30%	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 7

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

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

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

Answer

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

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.

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

Tax expense to be recognised in each of the quarterly reports

		₹
Quarter I – ₹ 7,00,000 x 38%		2,66,000
Quarter II – ₹ 8,00,000 x 38%		3,04,000
Quarter III – ₹ (12,00,000 – 8,00,000) x 38%	1,52,000	
₹ 8,00,000 x 12%	96,000	2,48,000
Quarter IV – ₹ 6,00,000 x 38%		2,28,000
		10,46,000

Question 8

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

Answer

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

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

₹ 3,000* x 40/100 = ₹ 1,200 lakhs.

*(3,600 lakhs – ₹ 600 lakhs) = ₹ 3,000 lakhs

Average annual effective tax rate = (1,200/3,600) x 100 = 33.33%

Tax expense to be shown in each quarter = 900 x 33.33% = ₹ 300 lakhs

Question 9

An entity's accounting year end 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, 2022. The entity's profit before tax is steady at ₹ 10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31st March, 2022 and 30% for the year ended 31st March, 2023.

How the related tax charge would be calculated for the year 2022 and its quarters.

Answer

Table showing computation of tax charge:

	Quarter ending 31st March, 2022	Quarter ending 30th June, 2022	Quarter ending 30th September, 2022	Quarter ending 31st December, 2022	Year ending 31st December, 2022
	₹	₹	₹	₹	₹
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 10

Fixed production overheads for the financial year is ₹ 10,000. Normal expected production for the year, after considering planned maintenance and normal breakdown, also considering the future demand of the product is 2,000 MT. It is considered that there are no quarterly/seasonal variations. Therefore, the normal expected production for each quarter is 500 MT and the fixed production overheads for the quarter are ₹ 2,500.

Actual production achieved	Quantity (In MT)
First quarter	400
Second quarter	600
Third quarter	500
Fourth quarter	400
Total	**1,900**

Presuming that there are no quarterly/seasonal variation, calculate the allocation of fixed production overheads for all the four quarters as per Ind AS 34 read with Ind AS 2.

Answer

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

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

Quarters	Allocations
First Quarter	➢ Actual fixed production overheads = ₹ 2,500 ➢ Fixed production overheads based on the allocation rate of ₹ 5 per unit allocated to actual production = ₹ 5 x 400 = ₹ 2,000 ➢ Unallocated fixed production overheads to be charged as expense as per Ind AS 2 and consequently as per Ind AS 34 = ₹ 500
Second Quarter	➢ Actual fixed production overheads on year-to-date basis = ₹ 5,000 ➢ Fixed production overheads to be absorbed on year-to-date basis = 1,000 x ₹ 5 = ₹ 5,000 ➢ Earlier, ₹ 500 was not allocated to production in the 1st quarter. To give effect to the entire ₹ 5,000 to be allocated in the second quarter, as per Ind AS 34, ₹ 500 are reversed by way of a credit to the statement of profit and loss of the 2nd quarter.
Third Quarter	➢ Actual production overheads on year-to-date basis = ₹ 7,500 ➢ Fixed production overheads to be allocated on year-to-date basis = 1,500 x 5 = ₹ 7,500 ➢ There is no under or over recovery of allocated overheads. Hence, no further action is required.
Fourth Quarter	➢ Actual fixed production overheads on year-to-date basis = ₹ 10,000 ➢ Fixed production overheads to be allocated on year-to-date basis 1,900 x 5 = ₹ 9,500 ➢ ₹ 500, i.e., [₹ 2,500 – (₹ 5 x 400)] unallocated fixed production overheads in the 4th quarter, are to 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. ➢ Unallocated productions overheads for the year ₹ 500 (i.e. ₹ 10,000 – ₹ 9,500) are expensed in the Statement of profit and loss as per Ind AS 2.

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

CHAPTER - 2
Unit 3 – Ind AS 7: Statement of Cash Flows

Question 1

Company has provided the following information regarding the various assets held by company on 31st March 20X1. Find out, which of the following items will be part of cash and cash equivalents for the purpose of preparation of cash flow statement as per the guidance provided in Ind AS 7.

S.N.	Name of the Security	Additional Information
1.	Fixed deposit with SBI	12%, 3 years maturity on 1st Jan 20X4
2.	Fixed deposit with HDFC	10%, original term was for 2 years, but due for maturity on 30.06.20X1
3.	Redeemable Preference shares in ABC ltd	Acquired on 31st January 20X1 and the redemption is due on 30th April 20X1
4.	Cash balances at various banks	All branches of all banks in India
5.	Cash balances at various banks	All international branches of Indian banks
6.	Cash balances at various banks	Branches of foreign banks outside India
7.	Bank overdraft of SBI Fort branch	Temporary overdraft, which is payable on demand
8.	Treasury Bills	90 days maturity

Answer

S.N.	Name of the Security	Decision
1.	Fixed deposit with SBI	Not to be considered – long term
2.	Fixed deposit with HDFC	Exclude as original maturity is not less than 90 days from the date of acquisition
3.	Redeemable Preference shares in ABC Ltd.	Include as due within 90 days from the date of acquisition
4.	Cash balances at various banks	Include
5.	Cash balances at various banks	Include
6.	Cash balances at various banks	Include
7.	Bank overdraft of SBI Fort branch	Include
8.	Treasury Bills	Include

Question 2

From the following transactions, identify which transactions will be qualified for the calculation of operating cash flows, if company is into the business of trading of mobile phones.

Sr. No.	Nature of Transaction
1	Receipt from sale of mobile phones
2	Purchases of mobile phones from various companies

3	Employees expenses paid
4	Advertisement expenses paid
5	Credit sales of mobile
6	Miscellaneous charges received from customers for repairs of mobiles
7	Loss due to decrease in market value of the closing stock of old mobile phones
8	Payment to suppliers of mobile phones
9	Depreciation on furniture of sales showrooms
10	Interest paid on cash credit facility of the bank
11	Profit on sale of old computers and printers, in exchange of new laptop and printer
12	Advance received from customers
13	Sales Tax and excise duty paid

Answer

Sr. No.	Nature of Transaction	Included/Excluded with reason
1	Receipt from sale of mobile phones	Include – main revenue generating activity
2	Purchases of mobile phones from various companies	Include – expenses related to main operations of business
3	Employees expenses paid	Include – expenses related to main operations of business
4	Advertisement expenses paid	Include – expenses related to main operations of business
5	Credit sales of mobile	Do not include – Credit transaction will not be included in cash flow (receipts from customers will be included)
6	Misc. charges received from customers for repairs of mobiles	Include – supplementary revenue generating activity
7	Loss due to decrease in market value of the closing stock of old mobile phones	Do not include - Non cash transaction
8	Payment to suppliers of mobile phones	Include – cash outflow related to main operations of business
9	Depreciation on furniture of sales showrooms	Do not include – non cash item
10	Interest paid on cash credit facility of the bank	Do not include – cost of finance
11	Profit on sale of old computers and printers, in exchange of new laptop and printer	Do not include – non cash item
12	Advance received from customers	Include – Related to operations of business
13	Sales tax and excise duty paid	Include – related to operations of business

Question 3

From the following transactions taken from a private sector bank operating in India, identify which transactions will be classified as operating and which would be classified as Investing activity.

S. No.	Nature of transaction paid
1	Interest received on loans
2	Interest paid on Deposits
3	Deposits accepted
4	Loans given to customers
5	Loans repaid by the customers
6	Deposits repaid
7	Commission received
8	Lease rentals paid for various branches
9	Service tax paid
10	Furniture purchased for new branches
11	Implementation of upgraded banking software
12	Purchase of shares in 100% subsidiary for opening a branch in Abu Dhabi
13	New cars purchased from Honda dealer, in exchange of old cars and remaining amount paid in cash
14	Provident fund paid for the employees
15	Issued employee stock options

Answer

Sr. No.	Nature of transaction paid	Operating/Investing/Not to be considered
1	Interest received on loans	Operating – Main revenue generating activity
2	Interest paid on Deposits	Operating – Main expenses of operations
3	Deposits accepted	Operating – in case of financial institutes
4	Loans given to customers	Operating – in case of financial institutes
5	Loans repaid by the customers	Operating – in case of financial institutes
6	Deposits repaid	Operating – in case of financial institutes
7	Commission received	Operating – Main revenue generating activity
8	Lease rentals paid for various branches	Operating – Main expenses of operations
9	Service tax paid	Operating – Main expenses of operations
10	Furniture for new branches	Investing – Assets purchased
11	Implementation of upgraded banking software	Investing – Purchased for long term purpose
12	Purchase of shares in 100% subsidiary for	Investing – strategic investment

	opening a branch in Abu Dhabi	
13	New cars purchased from Honda dealer, in exchange of old cars and cash payment	Investing – for cash payment
14	Provident fund paid for the employees	Operating
15	Issued employee stock options	Not to be considered. No cash flow

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

Answer

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 has bank balance in foreign currency aggregating to USD 100 (equivalent to ₹ 4,500) at the beginning of the year. Presuming no other transaction taking place, the entity reported a profit before tax of ₹ 100 on account of exchange gain on the bank balance in foreign currency at the end of the year. What would be the closing cash and cash equivalents as per the balance sheet?

Answer

For the purpose of statement of cash flows, the entity shall present the following:

	Amount (₹)
Profit before tax	100
Less: Unrealised exchange gain	(100)
Cash flow from operating activities	Nil
Cash flow from investing activities	Nil
Cash flow from financing activities	Nil
Net increase in cash and cash equivalents during the year	Nil
Add: Opening balance of cash and cash equivalents	4,500
Cash and cash equivalents as at the year-end	4,500

Reconciliation of cash and cash equivalents

Cash and cash equivalents as per statement of cash flows	4,500
Add: Unrealised gain on cash and cash equivalents	100
Cash and cash equivalents as per the balance sheet	4,600

If any changes in the policies take place, that will be dealt with as per the provisions of Ind AS 8.

Question 6

Z Ltd. has no foreign currency cash flow for the year 2021. It holds some deposit in a bank in the USA. The balances as on 31.12.2021 and 31.12.2022 were US$ 1,00,000 and US$ 1,02,000 respectively. The exchange rate on December 31, 2021 was US$ 1 = ₹ 45. The same on 31.12.2022 was US$ 1 = ₹ 50. The increase in the balance was on account of interest credited on 31.12.2022. Thus, the deposit was reported at ₹ 45,00,000 in the balance sheet as on December 31, 2021. It was reported at ₹ 51,00,000 in the balance sheet as on 31.12.2022. How these transactions should be presented in cash flow for the year ended 31.12.2022 as per Ind AS 7?

Answer

The profit and loss account was credited by ₹ 1,00,000 (US$ 2,000 x ₹ 50) towards interest income. It was credited by the exchange difference of US$ 1,00,000 x (₹ 50 – ₹ 45) that is, ₹ 500,000. In preparing the cash flow statement, ₹ 5,00,000, the exchange difference, should be deducted from the 'net profit before taxes, and extraordinary item'. However, in order to reconcile the opening balance of the cash and cash equivalents with its closing balance, the exchange difference ₹ 5,00,000, 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 7

From the following summary cash account of XYZ Ltd, prepare cash flow statement for the year ended March 31, 20X1 in accordance with Ind AS 7 using direct method.

Summary of Bank Account for the year ended March 31, 20X1

	₹ '000		₹ '000
Balance on 1.4.20X0	50	Payment to creditors	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from customers	2,800	Overhead Expenses	200
Sale of Fixed Assets	100	Payroll	100
		Tax Payment	250
		Dividend	50
		Repayment of Bank loan	300
		Balance on 31.3.20X1	150
	3,250		3,250

Answer

XYZ Ltd.

Cash Flow Statement for the year ended March 31, 20X1 (Using the Direct Method)

Cash flows from operating activities	₹ '000	₹ '000

Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash from operating activities		250
Cash flow from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		**100**
Cash at the beginning of the period		**50**
Cash at end of the period		**150**

Question 8

Use the following data of ABC Ltd. to construct a statement of cash flows using the direct and indirect methods:

(Amount in ₹)

	20X2	**20X1**
Cash	4,000	14,000
Accounts Receivable	25,000	32,500
Prepaid Insurance	5,000	7,000
Inventory	37,000	34,000
Fixed Assets	3,16,000	2,70,000
Accumulated Depreciation	(45,000)	(30,000)
Total Assets	3,42,000	3,27,500
Accounts Payable	18,000	16,000
Wages Payable	4,000	7,000
Debentures	1,73,000	1,60,000

Equity Shares	88,000	84,000
Retained Earnings	59,000	60,500
Total Liabilities & Equity	3,42,000	3,27,500
	20X2	
Sales	2,00,000	
Cost of Goods Sold	(1,23,000)	
Depreciation	(15,000)	
Insurance Expense	(11,000)	
Wages	(50,000)	
Net Profit	1,000	

During the financial year 20X2 company ABC Ltd. declared and paid dividends of ₹ 2,500.

During 20X2, ABC Ltd. paid ₹ 46,000 in cash to acquire new fixed assets. The accounts payable was used only for inventory. No debt was retired during 20X2.

Answer

A. DIRECT METHOD

Cash flows from operating activities		**20X2**
Cash received from customers	2,07,500	
Cash paid for inventory	(1,24,000)	
Cash paid for insurance	(9,000)	
Cash paid for wages	(53,000)	
Net cash flow from operating activities		21,500
Cash flows from investing activities		
Purchase of fixed assets		(46,000)
Cash flows from financing activities		
Dividend paid	(2,500)	
Proceeds from issuance of debentures	13,000	
Proceeds from issue of equity	4,000	
Net cash flows from financing activities		14,500
Net decrease in cash and cash equivalents		**(10,000)**
Opening Cash Balance		**14,000**
Closing Cash Balance		**4,000**

B. INDIRECT METHOD

Cash flows from operating activities		**20X2**
Net Profit	1,000	

Adjustments for Depreciation	15,000	
	16,000	
Decrease in accounts receivable	7,500	
Decrease in prepaid insurance	2,000	
Increase in inventory	(3,000)	
Increase in accounts payable	2,000	
Decrease in wages payable	(3,000)	
Net cash flow from operating activities		21,500
Cash flows from investing activities		
Purchase of fixed assets		(46,000)
Cash flows from financing activities		
Dividend paid	(2,500)	
Proceeds from issue of debentures	13,000	
Proceeds from issue of equity	4,000	
Net cash flows from financing activities		14,500
Net decrease in cash and cash equivalents		**(10,000)**
Opening Cash Balance		**14,000**
Closing Cash Balance		**4,000**

Working notes:

Fixed Assets Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	2,70,000	By Balance c/d	3,16,000
To Cash (Purchase of Fixed Assets)	46,000		
	3,16,000		**3,16,000**

Inventory Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	34,000	By Cost of goods sold	1,23,000
To Creditors account (credit purchase)	2,000	By Balance c/d	37,000
To Purchase (Bal. Figure)	1,24,000		
	1,60,000		**1,60,000**

Accounts Payable Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	18,000	By Balance b/d	16,000
		By Inventory Account (credit purchase) (Bal. Fig.)	2,000

	18,000		**18,000**

Equity Share Capital Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	88,000	By Balance b/d	84,000
		By Bank account (Proceeds from equity share issued)	4,000
	88,000		**88,000**

Question 9

Find out the cash from operations by direct method and indirect method from the following information:

Operating statement of ABC Ltd. for the year ended 31.3.20X2

Particulars	₹
Sales	5,00,000.00
Less: Cost of goods sold	3,50,000.00
Administration & Selling Overheads	55,000.00
Depreciation	7,000.00
Interest Paid	3,000.00
Loss on sale of asset	2,000.00
Profit before tax	83,000.00
Less: Tax	(30,000.00)
Profit After tax	**53,000.00**

Balance Sheet as on 31st March

	20X2	20X1
Assets		
Non-current Assets		
Property, Plant and Equipment	75,000.00	65,000.00
Investment	12,000.00	10,000.00
Current Assets		
Inventories	12,000.00	13,000.00
Trade receivables	10,000.00	7,000.00
Cash and cash equivalents	6,000.00	5,000.00
Total	**1,15,000.00**	**1,00,000.00**
Equity and Liabilities		

Shareholders' Funds	60,000.00	50,000.00
Non-current Liabilities	33,000.00	35,000.00
Current Liabilities		
Trade Payables	12,000.00	8,000.00
Payables for Expenses	10,000.00	7,000.00
Total	**1,15,000.00**	**1,00,000.00**

Answer

1. **Cash flow from Operations by Direct Method**

Particulars	₹	**See Note**
Cash Sales	4,97,000.00	1
Less: Cash Purchases	3,45,000.00	2
Overheads	52,000.00	3
Interest	–	Financing
Depreciation	–	Non cash item
Loss on sale of asset	–	Non cash item
Cash profit	**1,00,000.00**	
Less: Tax	(30,000.00)	
Cash profit after tax	**70,000.00**	

Note No 1 - Cash Receipts from Sales and Trade receivables	
Particulars	₹
Sales	5,00,000.00
Add: Opening Trade receivables	7,000.00
Less: Closing Trade receivables	(10,000.00)
Cash Receipts	**4,97,000.00**

Note No 2 - Payment to Trade Payables for Purchases	
Particulars	₹
Cost of goods sold	3,50,000.00
Closing inventories	12,000.00
Less: Opening inventories	(13,000.00)
Purchases	3,49,000.00
Add: Opening Trade Payables	8,000.00
Less: Closing Trade Payables	(12,000.00)
Payment to creditors	**3,45,000.00**

Note No 3 - Payment to payables for Expenses	
Particulars	₹
Overheads	55,000.00
Add: Opening payables	7,000.00
Less: Closing payables	(10,000.00)
Payment for Overheads	**52,000.00**

2. **Cash flow from Operations by Indirect Method**

Indirect Method	₹
Profit After Tax	53,000.00
Add/(Less): Depreciation	7,000.00
Loss on sale of Asset	2,000.00
Interest paid	3,000.00
Decrease in Inventory	1,000.00
Increase in Trade Receivables	(3,000.00)
Increase in Trade Payables	4,000.00
Increase in Payables for expenses	3,000.00
Total	**70,000.00**

Note: Cash flow derived from operations ₹ 70,000 is same both from Direct Method and Indirect Method.

Question 10

Following is the balance sheet of Kuber Limited for the year ended March 31, 20X2 (₹ 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 March 31, 20X2 = ₹ 4,450 lacs

(2) Interim Dividend paid during the year = ₹ 450 lacs

(3) Depreciation and amortisation charged in the statement of profit and loss during the current year are as under

(a) Property, Plant and Equipment = ₹ 500 lacs

(b) Intangible Assets = ₹ 20 lacs

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

(5) Income taxes paid during the year ₹ 105 lacs

(6) Other non-current/current assets and liabilities are related to operations of Kuber Ltd. and do not contain any element of financing and investing activities.

Using the above information of Kuber Limited, construct a statement of cash flows under indirect method.

Answer

Statement of Cash Flows

		₹ in lacs
Cash flows from Operating Activities		
Net Profit after Tax	4,450	
Add: Tax Paid	105	
	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)	(105)	
	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)	60	
	4,130	
Less: Income Tax	(105)	
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 i.e. Investment (2,500 – 2,300)	200	
Cash outflow from Investing Activities		**(830)**
Cash flows from Financing Activities		
Dividend Paid	(450)	
Long term borrowings paid (5,000 – 2,000)	(3,000)	
Cash outflow from Financing Activities		**(3,450)**
Net Cash outflow from all the activities		**(255)**
Opening cash and cash equivalents (460 – 60)		**400**
Closing cash and cash equivalents (220 – 75)		**145**

Question 11

Entity A acquired a subsidiary, Entity B, during the year. Summarised information from the Consolidated Statement of Profit and Loss and Balance Sheet is provided, together with some supplementary information.

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

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

Other information

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

Particulars	Amount (₹)
Inventories	4,000
Trade receivables	8,000

Cash	2,000
Property, plant and equipment	1,10,000
Trade payables	(32,000)
Long term debt	(36,000)
Goodwill	18,000
Cash consideration paid	**74,000**

Prepare the Consolidated Statement of Cash Flows for the year 20X2, as per Ind AS 7.

Answer

This information will be incorporated into the Consolidated Statement of Cash Flows as follows:

Statement of Cash Flows for the year ended 20X2 (extract)

	Amount (₹)	Amount (₹)
Cash flows from operating activities		
Profit before taxation	70,000	
Adjustments for non-cash items:		
Depreciation	30,000	
Decrease in inventories (W.N. 1)	9,000	
Decrease in trade receivables (W.N. 2)	4,000	
Decrease in trade payables (W.N. 3)	(24,000)	
Interest paid to be included in financing activities	4,000	
Taxation (11,000 + 15,000 – 12,000)	(14,000)	
Net cash generated from operating activities		79,000
Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000 – 2,000)	(72,000)	
Net cash outflow from investing activities		(72,000)
Cash flows from financing activities		
Interest paid	(4,000)	
Net cash outflow from financing activities		(4,000)
Increase in cash and cash equivalents during the year		**3,000**
Cash and cash equivalents at the beginning of the year		**5,000**
Cash and cash equivalents at the end of the year		**8,000**

Working Notes:

1. **Calculation of change in inventory during the year** ₹

Total inventories of the Group at the end of the year	30,000
Inventories acquired during the year from subsidiary	(4,000)

	26,000
Opening inventories	35,000
Decrease in inventories	9,000

2. **Calculation of change in Trade Receivables during the year** ₹

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

3. **Calculation of change in Trade Payables during the year** ₹

Trade payables at the end of the year	68,000
Trade payables of the subsidiary assumed during the year	(32,000)
	36,000
Opening trade payables	60,000
Decrease in trade payables	24,000

Question 12

The relevant extracts of consolidated financial statements of A Ltd. are provided below:

Consolidated Balance Sheet **(₹ in Lac)**

	For the year ended	
	31st March 20X2	**31st March 20X1**
Assets		
Non-Current Assets		
Property, Plant and Equipment	4,750	4,650
Investment in Associate	800	–
Financial Assets	2,150	1,800
Current Assets		
Inventories	1,550	1,900
Trade Receivables	1,250	1,800
Cash and Cash Equivalents	4,650	3,550
Liabilities		
Current Liabilities		

Trade Payables	1,550	3,610

Extracts from Consolidated Statement of Profit and Loss for the year ended 31st March 20X2

Particulars	**Amount (₹ in Lac)**
Revenue	12,380
Cost of Goods Sold	(9,860)
Gross Profit	2,520
Other Income	300
Operating Expenses	(450)
Other expenses	(540)
Interest expenses	(110)
Share of Profit of Associate	120
Profit before Tax	1,840

The below information is relevant for A Ltd Group.

1. A Ltd had spent ₹ 30 Lac on renovation of a building. A Ltd charged the entire renovation cost to profit and loss account.
2. On 1st April 20X1, A Ltd acquired 100% shares in S Ltd, for cash of ₹ 300 Lac. Fair value of the assets acquired and liabilities assumed under the acquisition are as under:

Property, Plant and Equipment	140 Lac
Inventories	60 Lac
Trade Receivables	30 Lac
Cash and Cash Equivalents	20 Lac
Total Assets	250 Lac
Less: Trade Payables	(50 Lac)
Net Assets on acquisition	200 Lac

3. A Ltd.'s property, plant and equipment comprise the following:

Carrying amount on 1st April 20X1	4,650 Lac
Addition (at cost) including assets in S Ltd.	800 Lac
Revaluation Surplus	80 Lac
Disposal (Sale) of Assets	(490 Lac)
Depreciation for the year	(290 Lac)
Carrying Amount on 31st March 20X2	4,750 Lac

A Ltd constructed a machine that is a qualifying asset and incurred construction costs of ₹ 40 Lac that has been charged to other expenses. Of the interest cost of ₹ 110 Lac charged to profit or loss statement, ₹ 10 Lac includes interest cost on specific borrowings that need to be capitalized.

Property, plant and equipment was sold at 630 Lac. Gain on disposal is adjusted against operating expenses.

4. A Ltd. purchased 30% interest in an Associate (G Ltd) for cash on 1st April 20X1. The associate reported profit after tax of ₹ 400 Lac and paid a dividend of ₹ 100 Lac for the year.

5. Impairment test was conducted on 31st March 20X2. The following were impaired as under:

   Goodwill impairment loss: ₹ 265 Lac

   Intangible Assets impairment loss ₹ 900 Lac

   The goodwill impairment relates to 100% subsidiaries.

Assume that interest cost is all paid in cash.

You are required to determine cash generated from operations for group reporting purposes for the year ended 31st March 20X2.

Answer

Extracts of Statement of Cash Flows for the year ended 31st March 20X2

Cash Flows from Operating Activities	**Amount in ₹ Lacs**
Profit before tax (W.N.1)	1,920
Less: Profit on Sale of PPE (630 - 490)	(140)
Add back: Depreciation	290
Impairment of Goodwill	265
Impairment of Intangible Assets	900
Less: Share of Profits of Associate (400 x 30%)	(120)
Add: Interest expense [110 – 10]	100
Working Capital Changes (W.N.2):	
Add: Decrease in Trade Receivables	580
Add: Decrease in Inventories	410
Less: Decrease in Trade Payables	(2,110)
Cash generated from operations	**2,095**

Working Notes:

1. Profit before tax

	Amount in ₹ Lacs
Reported profit as per Profit or Loss Statement	1,840
Add back: Renovation costs charged as expense	30
Construction costs charged as expense	40
Borrowing costs to be capitalized	10
Revised Profit before tax	1,920

2. Changes in Trade Receivables

	Amount in ₹ Lacs
Opening Balance	1,800
Add: Receivables of S Ltd.	30
	1,830

Less: Closing Balance	(1,250)
	580

3. **Changes in Inventories**

Amount in ₹ Lacs

Opening Balance	1,900
Add: Receivables of S Ltd.	60
	1,960
Less: Closing Balance	(1,550)
	410

4. **Changes in Trade Payables**

Amount in ₹ Lacs

Opening Balance	3,610
Add: Receivables of S Ltd.	50
	3,660
Less: Closing Balance	(1,550)
	2,110

Question 13

During the financial year 2021-2022, Akola Limited have paid various taxes & reproduced the below mentioned records for your perusal:

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

You need to determine the net cash flow from operating activities, investing activities and financing activities of Akola Limited as per relevant Ind AS.

Answer

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 analysed as follows:

Particulars	Amount (in crore)	Activity
Sale Consideration	100	Investing Activity
Capital Gain Tax	(20)	Investing Activity

Business profits	30	Operating Activity
Tax on Business profits	(3)	Operating Activity
Dividend Payment	(20)	Financing Activity
Dividend Distribution Tax	(2)	Financing Activity
Income Tax Refund	1.5	Operating Activity
Total Cash flow	**86.5**	

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

Question 14

Entity A (Indian Company) purchased goods for resale from France during January for EUR 10,000 (Exchange rate: 1 EUR = ₹ 70) on a credit period of 4 months. It accounted for the purchase of inventory at ₹ 7,00,000 (10,000 x 70). On 31st March, the exchange rate has changed to 1 EUR = ₹ 65. How will the effect of this transaction be reported in Statement of Cash Flows?

Answer

There is an unrealised gain due to exchange fluctuation of ₹ 50,000 on Payables (since the payables will be recorded at ₹ 6,50,000 (at closing exchange rate).

Assuming that the inventory is unsold at that date, the movement is reported as under:

Profit	₹ 50,000
Less: Increase in Inventory	₹ (7,00,000)
Add: Increase in Payables	₹ 6,50,000
Net Cash flows from operating activities	₹ 0

Question 15

A Ltd., whose functional currency is Indian Rupee, had a balance of cash and cash equivalents of ₹ 2,00,000, but there are no trade receivables or trade payables balances as on 1st April, 2021. During the year 2021-2022, 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 = ₹ 50. This balance is still unpaid at 31st March, 2022 when the exchange rate is € 1 = ₹ 45. An exchange gain on retranslation of the trade payable of ₹ 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 = ₹ 40. This amount was settled when the exchange rate was $ 1 = ₹ 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 = ₹ 50 and immediately converted it to ₹ 50,00,000. The loan was retranslated at 31st March, 2022 @ ₹ 45, with a further exchange gain recorded in the statement of profit or loss.
- A Ltd. therefore records a cumulative exchange gain of ₹ 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 ₹ 10,00,000 (₹ 60,00,000 – ₹ 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?

Answer

Statement of cash flows

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

Question 16

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

Additional information:

(i) Trade receivables and Trade payables include amounts relating to credit sale and credit purchase only.

(ii) Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date.

Answer

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

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 17

Z Ltd. (India) has an overseas branch in USA. It has a bank account having balance of USD 7,000 as on 1st April 2021. During the financial year 2021-2022, 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 2021-2022 were:

Date	**USD 1 to INR**
1st April 2021	70.00
30th November 2021	71.00 (Date of purchase of computer)
31st March 2022	71.50
Average for 2021-2022	70.50

Please prepare the extract of Cash Flow Statement for the year ended 31st March 2022 as per the relevant Ind AS and also show the foreign exchange profitability from these transactions for the financial year 2021-2022?

Answer

In the books of Z Ltd.

Statement of Cash Flows for the year ended 31st March 2022

	₹	₹
Cash flows from operating activities		
Net Profit (Refer Working Note)	10,360	
Adjustments for non-cash items:		
Foreign Exchange Gain	(10,360)	
Net cash outflow from operating activities		0
Cash flows from investing activities		
Acquisition of Property, Plant and Equipment	(19,880)	
Net cash outflow from Investing activities		(19,880)
Cash flows from financing activities		0
Net change in cash and cash equivalents		(19,880)
Cash and cash equivalents at the beginning of the year i.e. 1st April 2021		4,90,000
Foreign Exchange difference		10,360
Cash and cash equivalents at the end of the year i.e. 31st March 2022		4,80,480

Working Note:

Computation of Foreign Exchange Gain

Bank Account USD	Date	USD	Exchange Rate	₹
Opening balance	1.4.2021	7,000	70.00	4,90,000
Less: Purchase of Computer	30.11.2021	280	71.00	19,880
Closing balance calculated		6,720		4,70,120
Closing balance (at year end spot rate)	31.3.2022	6,720	71.50	4,80,480
Foreign Exchange Gain credited to Profit and Loss account				10,360

CHAPTER - 3
Ind AS 115: Revenue from Contracts with Customers

Question 1

An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for ₹ 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 ₹ 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 ₹ 12,00,000. P Ltd. obtains control of the machinery at contract inception.

When should G Ltd. recognise revenue from sale of machinery to P Ltd. in accordance with Ind AS 115?

Answer

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:

(a) 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;

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

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

(d) the contract has commercial substance (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

(e) 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 recognised, 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 recognise 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 recognise 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 recognised 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 ₹ 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 2

AST Limited enters into a contract with a customer to build a manufacturing facility. The entity determines that the contract contains one performance obligation satisfied over time.

Construction is scheduled to be completed by the end of the 36th month for an agreed-upon price of ₹ 25 crore.

The entity has the opportunity to earn a performance bonus for early completion as follows:

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

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

Analyze and determine the amount of variable consideration AST Limited should recognize in its contract with customer to build a manufacturing facility.

Answer

In determining the transaction price, AST Limited separately estimates variable consideration for each element of variability i.e. the early completion bonus and the quality bonus.

AST 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. AST's best estimate of the early completion bonus is ₹ 2.125 crore, calculated as shown in the following table:

Bonus %	Amount of bonus (₹ in crore)	Probability	Probability-weighted amount (₹ in crore)
15%	3.75	25%	0.9375
10%	2.50	40%	1.00
5%	1.25	15%	0.1875
0%	-	20%	-
			2.125

AST 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 (₹ 2 crore or ₹ Nil) and this method would best predict the amount of consideration associated with the quality bonus. AST Limited believes the most likely amount of the quality bonus is ₹ 2 crore.

Total variable consideration = 4.125 crore (2.125 crore + 2 crore).

Question 3

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.

Answer

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**

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

Question 4

Electronics Manufacturer M sells 1,000 televisions to Retailer R for ₹ 50,00,000 (₹ 5,000 per television). M provides price protection to R by agreeing to reimburse R for the difference between this price and the lowest price that it offers for that television during the following six months. Based on M's extensive experience with similar arrangements, it estimates the following outcomes.

Price reduction in next six months (₹)	Probability
0	70%
₹ 500	20%
₹ 1,000	10%

Determine the transaction price.

Answer

After considering all relevant facts and circumstances, M determines that the expected value method provides the best prediction of the amount of consideration to which it will be entitled. As a result, it estimates the transaction price to be ₹ 4,800 per television – i.e. (₹ 5,000 x 70%) + (₹ 4,500 x 20%) + (₹ 4,000 x 10%).

Question 5

Construction Company C enters into a contract with Customer E to build an asset. Depending on when the asset is completed, C will receive either ₹ 1,10,000 or ₹ 1,30,000.

Outcome	Consideration (₹)	Probability
Project completes on time	1,30,000	90%
Project is delayed	1,10,000	10%

Determine the transaction price.

Answer

Because there are only two possible outcomes under the contract, C determines that using the most likely amount provides the best prediction of the amount of consideration to which it will be entitled. C estimates the transaction price to be ₹ 1,30,000, which is the single most likely amount.

Question 6

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 retrospectively once the customer reaches certain sales volume, defined, as follows:

Price per container	Cumulative sales volume
₹ 100	1 – 1,000,000 containers
₹ 90	1,000,001 – 3,000,000 containers
₹ 85	3,000,001 containers and above

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

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

How should Entity J determine the transaction price? And Suggest how revenue is to be recognised in the books of Entity J for the quarter ended 31 March 20X8.

Note: All calculations to be done in ₹ million

Answer

The transaction price is ₹ 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 ₹ 90. Entity J concludes that based on a transaction price of ₹ 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 ₹ 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 ₹ 100 per container (that is, ₹ 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 ₹ 63 million (7,00,000 containers x ₹ 90) and a liability of ₹ 7 million [7,00,000 containers x (₹ 100 – ₹ 90)].

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

Question 7

ABC Limited supplies plastic buckets to wholesaler customers. As per the contract entered into between ABC Limited and a customer for the financial year 2021-2022, 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.

(i) Suggest how revenue is to be recognised 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 2021-2022.

(ii) 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 2021-2022.

(iii) 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 2021-2022.

Answer

(i) Determination of how revenue is to be recognised 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 recognised 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 2021-2022). 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

Under most likely method, Sales volume with highest probability is 28,000 units.

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 2021-2022).

(iii) Journal Entries in the books of ABC Ltd.

(when revenue is accounted for as per expected value method for financial year 2021-2022)

			₹	₹
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 (15,950 x ₹ 80)	Dr.	12,76,000	
	To Revenue A/c (15,950 x ₹ 79.13)			12,62,124
	To Liability (15,950 x ₹ 0.87)			13,876
	[Revenue recognised on sale of remaining 15,950 units (25,950 – 10,000)]			
3.	Liability (1,08,700 + 13,876)	Dr.	1,22,576	
	To Revenue A/c [25,950 x (80 – 79.13)]			22,576
	To Bank (10,000 x ₹ 10)			1,00,000
	(On reversal of liability at the end of the financial year 2021-2022 i.e. after completion of stipulated time and excess amount refunded)			

Question 8

On 1st April, 20X1, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a two per cent quarterly management fee based on the client's assets under management at the end of each quarter. At 31st March, 20X2, the client's assets under management are ₹ 100 crore. In addition, the entity receives a performance-based incentive fee of 20 per cent of the fund's return in excess of the return of an observable market index over the five-year period. Consequently, both the management fee and the performance fee in the contract are variable consideration.

Analyse the revenue to be recognised on 31st March, 20X2.

Answer

The entity accounts for the services as a single performance obligation because it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress – that is, a time-based measure of progress).

The entity observes that the promised consideration is dependent on the market and thus is highly susceptible to factors outside the entity's influence. In addition, the incentive fee has a large number and a broad range of possible consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception – the variability of the fee based on the market index indicates that the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the incentive fee in the transaction price.

At 31st March, 20X2, the client's assets under management are ₹ 100 crore. Therefore, the resulting quarterly management fee and the transaction price is ₹ 2 crore.

At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter. This is because the fee relates specifically to the entity's efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters.

Consequently, the entity recognises ₹ 2 crore as revenue for the quarter ended 31st March, 20X2.

Question 9

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

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

What is the transaction price in this arrangement?

Answer

Entity I is likely to provide a price concession and accept an amount less than ₹ 2 million in exchange for the machinery. The consideration is therefore variable. The transaction price in this arrangement is ₹ 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 ₹ 1.75 million and therefore contract exists.

Question 10

HT Limited enters into a contract with a customer on 1st April, 20X1 to sell Product A for ₹ 1,000 per unit. If the customer purchases more than 100 units of Product A in a financial year, the contract specifies that the price per unit is retrospectively reduced to ₹ 900 per unit. Consequently, the consideration in the contract is variable.

For the first quarter ended 30th June, 20X1, the entity sells 10 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 100 unit threshold required for the volume discount in the financial year. HT Limited determines that it has significant experience with this product and with the purchasing pattern of the customer. Thus, HT Limited concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ₹ 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known).

Further, in May, 20X1, the customer acquires another company and in the second quarter ended 30th September, 20X1 the entity sells an additional 50 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 100 unit threshold for the financial year and therefore it will be required to retrospectively reduce the price per unit to ₹ 900.

Determine the amount of revenue to be recognise by HT Ltd. for the quarter ended 30th June, 20X1 and 30th September, 20X1.

Answer

The entity recognises revenue of ₹ 10,000 (10 units x ₹ 1,000 per unit) for the quarter ended 30th June, 20X1.

HT Limited recognises revenue of ₹ 44,000 for the quarter ended 30th September, 20X1. That amount is calculated from ₹ 45,000 for the sale of 50 units (50 units x ₹ 900 per unit) less the change in transaction price of ₹ 1,000 (10 units x ₹ 100 price reduction) for the reduction of revenue relating to units sold for the quarter ended 30th June, 20X1.

Question 11

RT Limited enters into a contract to build an office building for AT Limited over an 18-month period. AT Limited agrees to pay the construction entity ₹ 350 crore for the project. RT Limited will receive a bonus of 10 lakh equity shares of AT Limited if it completes construction of the office building within one year. Assume a fair value of ₹ 100 per share at contract inception.

Determine the transaction price if the entity earns the bonus.

Note: Calculations to be done in ₹ crore

Answer

The ultimate value of any shares the entity might receive could change for two reasons:

1) the entity earns or does not earn the shares and

2) the fair value per share may change during the contract term.

When determining the transaction price, the entity would reflect changes in the number of shares to be earned. However, the entity would not reflect changes in the fair value per share. Said another way, the share price of ₹ 100 is used to value the potential bonus throughout the life of the contract.

As a result, if the entity earns the bonus, its revenue would be ₹ 350 crore plus 10 lakh equity shares at ₹ 100 per share for total consideration of ₹ 360 crore.

Question 12

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?

Answer

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 noncash 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 talktime 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 13

Production Company Y sells a television show to Television Company X. The consideration under the arrangement is a fixed amount of ₹ 1,000 and 100 advertising slots.

Determine the transaction price:

(i) If Based on market rates, Y determines that the fair value of the advertising slots is ₹ 600.

(ii) If the fair value of the advertising slots could not be reasonably estimated but Y determines that the stand-alone selling price of the show would be ₹ 1,500.

Answer

(i) Y determines that the transaction price is ₹ 1,600, comprising of ₹ 1,000 fixed amount plus the fair value of the advertising slots i.e. ₹ 600.

(ii) If the fair value of the advertising slots could not be reasonably estimated, then the transaction price would be ₹ 1,500 i.e. Y would use the stand-alone selling price of the goods or services promised for the non-cash consideration.

Question 14

MS Limited is a manufacturer of cars. It has a supplier of steering systems – SK Limited. MS Limited places an order of 10,000 steering systems on SK Limited. It also agrees to pay ₹ 25,000 per steering system and contributes tooling to be used in SK's production process.

The tooling has a fair value of ₹ 2 crore at contract inception. SK Limited determines that each steering system represents a single performance obligation and that control of the steering system transfers to MS Limited upon delivery.

SK Limited may use the tooling for other projects and determines that it obtains control of the tooling.

Determine the transaction price?

Note: Calculations to be done in ₹ crore

Answer

As a result, at contract inception, SK Limited includes the fair value of the tooling in the transaction price at contract inception, which it determines to be ₹ 27 crore (₹ 25 crore for the steering systems and ₹ 2 crore for the tooling).

Question 15

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least ₹ 15 crore of products during the year. The contract also requires the entity to make a non-refundable payment of ₹ 1.5 crore to the customer at the inception of the contract. The ₹ 1.5 crore payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products. The entity does not obtain control of any rights to the customer's shelves.

Determine the transaction price. And Suggest how much revenue is to be recognised in the books of Entity in the first month.

Note: All calculations to be done in ₹ crore

Answer

The entity considers the requirements in paragraphs 70 – 72 of Ind AS 115 and concludes that the payment to the customer is not in exchange for a distinct good or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer's shelves. Consequently, the entity determines that, in accordance with paragraph 70 of Ind AS 115, the ₹ 1.5 crore payment is a reduction of the transaction price.

The entity applies the requirements in paragraph 72 of Ind AS 115 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognises revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by 10 per cent [(₹ 1.5 crore ÷ ₹ 15 crore) x 100]. Therefore, in the first month in which the entity transfers goods to the customer, the entity recognises revenue of ₹ 1.125 crore (₹ 1.25 crore invoiced amount less ₹ 0.125 crore of consideration payable to the customer).

Question 16

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

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

How should entity K determine the transaction price?

Answer

Entity K records sales to the retailer at a transaction price of ₹ 47.50 (₹ 50 less 25% of ₹ 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.

Question 17

A manufacturer enters into a contract to sell goods to a retailer for ₹ 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?

Answer

The transaction price is ₹ 950, because the expected reimbursement is ₹ 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 18

Customer C is in the middle of a two-year contract with Telco B Ltd., its current wireless service provider, and would be required to pay an early termination penalty if it terminated the contract today. If C cancels the existing contract with B Ltd. and signs a two-year contract with Telco D Ltd. for ₹ 800 per month, then D Ltd. promises at contract inception to give C a one-time credit of ₹ 2,000 (referred to as a 'port-in credit'). The amount of the port-in credit does not depend on the volume of service subsequently purchased by C during the two-year contract.

Determine the transaction price.

Answer

D Ltd. determines that it should account for the port-in credit as consideration payable to a customer. This is because the credit will be applied against amounts owing to D Ltd. Since, D Ltd. does not receive any distinct goods or services in exchange for this credit, it will account for it as a reduction in the transaction price ₹ 17,200 [(₹ 800 x 24 month) – ₹ 2,000]. D Ltd. will recognise the reduction in the transaction price as the promised goods or services are transferred.

Question 19

NKT Limited sells a product to a customer for ₹ 1,21,000 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence.

The cash selling price of the product is ₹ 1,00,000 which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is ₹ 80,000. The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 1,21,000 to the cash selling price of ₹ 1,00,000).

Analyse the above transaction with respect to its financing component and compute the amount to be charged in each year as financing component.

Answer

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 20

VT Limited enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed. The price stated in the contract is ₹ 1 crore plus a 10% contractual rate of interest, payable in 60 monthly instalments of ₹ 212,470.

Determine the discounting rate and the transaction price when

Case A – Contractual discount rate reflects the rate in a separate financing transaction

Case B – Contractual discount rate does not reflect the rate in a separate financing transaction i.e. 14%.

Note: PVFA @0.8333% for 60 months is 47.06547 and PVFA @1.1666% for 60 Months is 42.97711

Answer

Case A – Contractual discount rate reflects the rate in a separate financing transaction

In evaluating the discount rate in the contract that contains a significant financing component, VT Limited observes that the 10% contractual rate of interest reflects the rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% reflects the credit characteristics of the customer).

The market terms of the financing mean that the cash selling price of the equipment is ₹ 1 crore. This amount is recognised as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with Ind AS 109.

Case B – Contractual discount rate does not reflect the rate in a separate financing transaction

In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 10% contractual rate of interest is significantly lower than the 14% interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than ₹ 1 crore.

VT Limited determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 14% interest rate that reflects the credit characteristics of the customer. Consequently, the entity determines that the transaction price is ₹ 9,131,346 (60 monthly payments of ₹ 212,470 discounted at 14%). The entity recognises revenue and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with Ind AS 109.

Question 21

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 2020 and to service this machine on 30th September 2020 and 1st April 2021. 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, 2021.

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 1st April, 2020, 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:

(i) Segregate the components of the transaction that A Ltd. shall apply to the revenue recognition criteria separately as per Ind AS 115;

(ii) Calculate the amount of revenue which A Ltd. must allocate to each component of the transaction;

(iii) Prepare journal entries to record the information set out above in the books of accounts of A Ltd. for the years ended 31st March 2021 and 31st March 2022; and

(iv) Draft an extract showing how revenue could be presented and disclosed in the financial statements of A Ltd. for the year ended 31st March 2021 and 31st March 2022.

Answer

(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:

(a) 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

(b) 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:

(a) 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)

(b) the goods or services does not significantly modify or customize other promised goods or services in the contract.

(c) 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, 2020, entity A entered into a single transaction with three identifiable separate components:

1. Sale of a good (i.e. engineering machine);
2. Rendering of services (i.e. engineering machine maintenance services on 30th September, 2020 and 1st April, 2021); and
3. 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, 2020	–	–	2,51,927	–	–	2,51,927
30th September, 2020	2,51,927	12,596 (Note 1)	–	45,000	–	3,09,523
31st March 2021	3,09,523	15,477 (Note 2)	–	–	–	3,25,000
1st April, 2021	3,25,000	–	–	75,000	(4,00,000)	

Notes:

1. Calculation of finance income as on 30th September, 2020 = 5% x 2,51,927 = ₹ 12,596
2. Calculation of finance income as on 31st March, 2021 = 5% x 3,09,523 = ₹ 15,477

(iii) **Journal Entries**

Date	Particulars	Dr. (₹)	Cr. (₹)
1st April, 2020	Mr. Anik Dr. To Revenue – sale of goods (Profit or loss A/c) (Being revenue recognised from the sale of the machine on credit)	2,51,927	2,51,927
	Cost of goods sold (Profit or loss A/c) Dr. To Inventories (Being cost of goods sold recognised)	1,60,000	1,60,000
30th September 2020	Mr. Anik Dr. To Finance Income (Profit or loss A/c) (Being finance income recognised)	12,596	12,596
	Mr. Anik Dr. To Revenue – rendering of services (Profit or	45,000	45,000

	loss A/c) (Being revenue from the rendering of maintenance services recognised)		
	Cost of services (Profit or loss A/c) Dr. To Cash/Bank or payables (Being the cost of performing maintenance services recognised)	30,000	30,000
31st March 2021	Mr. Anik Dr. To Finance Income (Profit or loss A/c) (Being finance income recognised)	15,477	15,477
1st April, 2021	Mr. Anik Dr. To Revenue – rendering of services (Profit or loss A/c) (Being revenue from the rendering of maintenance services recognised)	75,000	75,000
	Cost of services (Profit or loss A/c) Dr. To Cash/Bank or payables (Being the cost of performing maintenance services recognised)	50,000	50,000
	Cash/Bank Dr. To Mr. Anik (Being the receipt of cash from the customer recognised)	4,00,000	4,00,000

(iv) Extract of Notes to the financial statements for the year ended 31st March, 2021 and 31st March, 2022

Note on Revenue

	2021-2022	2020-2021
	₹	₹
Sale of goods	–	2,51,927
Rendering of machine maintenance services	75,000	45,000
Finance income (12,596 + 15,477)	–	28,073
	75,000	3,25,000

Question 22

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

1) Payment of ₹ 5,000 in two years when the customer obtains control of the asset or

2) Payment of ₹ 4,000 when the contract is signed. The customer elects to pay ₹ 4,000 when the

contract is signed.

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

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

Pass journal entries showing how the entity would account for the significant financing component.

Answer

Journal Entries showing accounting for the significant financing component:

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

Cash	Dr.	₹ 4,000	
To Contract liability			₹ 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 recognising interest on ₹ 4,000 at 6% for two years:

Interest for 1st Year			
Interest expense	Dr.	₹ 240	
To Contract liability			₹ 240
(₹ 4,000 contract liability x 6%)			
Interest for 2nd Year			
Interest expense	Dr.	₹ 254	
To Contract liability			₹ 254
[(₹ 4,000 + ₹ 240) x 6%]			

(c) Recognise revenue for the transfer of the asset:

Contract liability	Dr.	₹ 4,494	
To Revenue			₹ 4,494

Question 23

An entity enters into a contract with a customer to sell Products A, B and C in exchange for ₹ 10,000. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.

Because the stand-alone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximises the use of observable inputs.

The entity estimates the stand-alone selling prices as follows:

Product	Stand-alone selling price	Method
	₹	
Product A	5,000	Directly observable
Product B	2,500	Adjusted market assessment approach
Product C	7,500	Expected cost plus a margin approach
Total	15,000	

Determine the transaction price allocated to each product.

Answer

The customer receives a discount for purchasing the bundle of goods because the sum of the stand-alone selling prices (₹ 15,000) exceeds the promised consideration (₹ 10,000). The entity considers that there is no observable evidence about the performance obligation to which the entire discount belongs. The discount is allocated proportionately across Products A, B and C. The discount, and therefore the transaction price, is allocated as follows:

Product	Allocated transaction price (to nearest ₹ 100)	
	₹	
Product A	3,333	[(₹ 5,000 ÷ ₹ 15,000) x ₹ 10,000]
Product B	1,667	[(₹ 2,500 ÷ ₹ 15,000) x ₹ 10,000]
Product C	5,000	[(₹ 7,500 ÷ ₹ 15,000) x ₹ 10,000]
Total	10,000	

Question 24

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.

Answer

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) x ₹ 1,90,000]
Product T	41,800	[₹ 44,000 ÷ ₹ 2,00,000) x ₹ 1,90,000]
Product M	62,700	[₹ 66,000 ÷ ₹ 2,00,000) x ₹ 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) x ₹ 1,00,000]
Product M	60,000	[₹ 66,000 ÷ ₹ 1,10,000 total stand-alone selling price) x ₹ 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.

Question 25

An entity regularly sells Products X, Y and Z individually, thereby establishing the following stand-alone selling prices:

Product	**Stand-alone selling price**
	₹
Product X	50,000
Product Y	25,000
Product Z	45,000
Total	120,000

In addition, the entity regularly sells Products Y and Z together for ₹ 50,000.

Case A

The entity enters into a contract with a customer to sell Products X, Y and Z in exchange for ₹ 100,000. The entity will satisfy the performance obligations for each of the products at different points in time; or Product Y and Z at same point of time. Determine the allocation of transaction price to Product Y and Z.

Case B

The entity enters into a contract with a customer to sell Products X, Y and Z as described in Case A. The contract also includes a promise to transfer Product Alpha. Total consideration in the contract is ₹ 130,000. The stand-alone selling price for Product Alpha is highly variable because the entity sells Product Alpha to different customers for a broad range of amounts (₹ 15,000 – ₹ 45,000). Determine the stand-alone selling price of Products, X, Y, Z and Alpha using the residual approach.

Case C

The same facts as in Case B apply to Case C except the transaction price is ₹ 1,05,000 instead of ₹ 130,000.

Discuss how the transaction price should be allocated.

Answer

Case A – Allocating a discount to one or more performance obligations

The contract includes a discount of ₹ 20,000 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 Y and Z together for ₹ 50,000 and Product X for ₹ 50,000, it has evidence that the entire discount should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.

If the entity transfers control of Products Y and Z 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 ₹ 50,000 of the transaction price to the single performance obligation and recognise revenue of ₹ 50,000 when Products Y and Z simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Products Y and Z at different points in time, then the allocated amount of ₹ 50,000 is individually allocated to the promises to transfer Product Y (stand-alone selling price of ₹ 25,000) and Product Z (stand-alone selling price of ₹ 45,000) as follows:

Product	Allocated transaction price	
	₹	
Product Y	17,857	[(₹ 25,000 ÷ ₹ 70,000 total stand-alone selling price) x ₹ 50,000)]
Product Z	32,143	[(₹ 45,000 ÷ ₹ 70,000 total stand-alone selling price) x ₹ 50,000)]
Total	50,000	

Case B – Residual approach is appropriate

Before estimating the stand-alone selling price of Product Alpha using the residual approach, the entity determines whether any discount should be allocated to the other performance obligations in the contract.

As in Case A, because the entity regularly sells Products Y and Z together for ₹ 50,000 and Product X for ₹ 50,000, it has observable evidence that ₹ 100,000 should be allocated to those three products and a ₹ 20,000 discount should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.

Using the residual approach, the entity estimates the stand-alone selling price of Product Alpha to be ₹ 30,000 as follows:

Product	Stand-alone selling price	Method
	₹	
Product X	50,000	Directly observable

Products Y and Z	50,000	Directly observable with discount
Product Alpha	30,000	Residual approach
Total	130,000	

The entity observes that the resulting ₹ 30,000 allocated to Product Alpha is within the range of its observable selling prices (₹ 15,000 – ₹ 45,000).

Case C – Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is ₹ 105,000 instead of ₹ 130,000. Consequently, the application of the residual approach would result in a stand-alone selling price of ₹ 5,000 for Product Alpha (₹ 105,000 transaction price less ₹ 100,000 allocated to Products X, Y and Z).

The entity concludes that ₹ 5,000 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 Alpha, because ₹ 5,000 does not approximate the stand-alone selling price of Product Alpha, which ranges from ₹ 15,000 – ₹ 45,000.

Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product Alpha using another suitable method. The entity allocates the transaction price of ₹ 105,000 to Products X, Y, Z and Alpha using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of Ind AS 115.

Question 26

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 ₹ 1,00,000. 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.

Answer

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:

(a) 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;

(b) 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

(c) 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 (1,00,000/1,20,000 x 1,00,000)
Accessory A	16,667 (20,000/1,20,000 x 1,00,000)
Total	1,00,000

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 27

On 1st April, 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for ₹ 2 crore. The consultant can earn ₹ 20 lakh bonus if it completes the software implementation by 30th September, 20X0 or ₹ 10 lakh bonus if it completes the software implementation by 31st December, 20X0.

The due diligence, valuation, and software implementation services are distinct and therefore are accounted for as separate performance obligations. The consultant allocates the transaction price, disregarding the potential bonus, on a relative stand-alone selling price basis as follows:

- Due diligence – ₹ 80 lakh
- Valuation – ₹ 20 lakh
- Software implementation – ₹ 1 crore

At contract inception, the consultant believes it will complete the software implementation by 30th January, 20X1. After considering the factors in Ind AS 115, the consultant cannot conclude that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty is resolved since the consultant lacks experience in completing similar projects. As a result, the consultant does not include the amount of the early completion bonus in its estimated transaction price at contract inception.

On 1st July, 20X0, the consultant notes that the project has progressed better than expected and believes that implementation will be completed by 30th September, 20X0 based on a revised forecast. As a result, the consultant updates its estimated transaction price to reflect a bonus of ₹ 20 lakh.

After reviewing its progress as of 1st July, 20X0, the consultant determines that it is 100 percent complete in satisfying its performance obligations for due diligence and valuation and 60 percent complete in satisfying its performance obligation for software implementation.

Determine how the change in consultant's estimate to reflect a bonus of ₹ 20 lakh be included in transaction price. Also on 1st July 20X0, determine the effect of this estimate to cumulative revenue recognised till date.

Answer

On 1st July, 20X0, the consultant allocates the bonus of ₹ 20 lakh to the software implementation performance obligation, for total consideration of ₹ 1.2 crore allocated to that performance obligation, and adjusts the cumulative revenue to date for the software implementation services to ₹ 72 lakh (60 percent of ₹ 1.2 crore).

Question 28

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 ₹ 16,00,000 and ₹ 20,00,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.

Case A

The price stated in the contract for Licence A is a fixed amount of ₹ 16,00,000 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 (i.e. the variable consideration) to be ₹ 20,00,000. Allocate the transaction price.

Case B

The price stated in the contract for Licence A is a fixed amount of ₹ 6,00,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (i.e. the variable consideration) is ₹ 30,00,000. Here, Licence A is transferred 3 months later. The royalty due from the customer's first month of sale is ₹ 4,00,000.

Allocate the transaction price and determine the revenue to be recognised for each licence and the contract liability, if any.

Answer

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:

(a) 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).

(b) allocating the expected royalty amounts of ₹ 20,00,000 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 (₹ 20,00,000) approximates the stand-alone selling price of Licence B and the fixed amount of ₹ 16,00,000 approximates the stand-alone selling price of Licence A. The entity allocates ₹ 16,00,000 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 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 recognise revenue because the consideration allocated to Licence B is in the form of a sales-based royalty. Therefore, the entity recognises revenue for the sales-based royalty when those subsequent sales occur.

When Licence A is transferred, the entity recognises as revenue the ₹ 16,00,000 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 (i.e. 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 (i.e. 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 ₹ 6,00,000 to Licence A and ₹ 30,00,000 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 ₹ 16,00,000 and ₹ 20,00,000, respectively. Consequently, the entity applies the general allocation requirements of Ind AS 115.

The entity allocates the transaction price of ₹ 6,00,000 to Licences A and B on the basis of relative stand-alone selling prices of ₹ 16,00,000 and ₹ 20,00,000, 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 ₹ 3,33,333 [(₹ 20,00,000 ÷ ₹ 36,00,000) x ₹ 6,00,000] allocated to Licence B. When Licence A is transferred, the entity recognises as revenue ₹ 2,66,667 [(₹ 16,00,000 ÷ ₹ 36,00,000) x ₹ 6,00,000] allocated to Licence A.

In the first month, the royalty due from the customer's first month of sales is ₹ 4,00,000. Consequently, the entity recognises as revenue ₹ 2,22,222 [(₹ 20,00,000 ÷ ₹ 36,00,000) x ₹ 4,00,000] 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 ₹ 1,77,778 [(₹ 16,00,000 ÷ ₹ 36,00,000) x ₹ 4,00,000] 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 29

On 1st January, 20X1, an entity contracts to renovate a building including the installation of new elevators. The entity estimates the following with respect to the contract:

Particulars	Amount (₹)
Transaction price	5,000,000
Expected costs:	
(a) Elevators	1,500,000
(b) Other costs	2,500,000
Total	4,000,000

The entity purchases the elevators and they are delivered to the site six months before they will be installed. The entity uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of 500,000 by 31st March, 20X1.

How will the Company recognize revenue, if performance obligation is met over a period of time?

Answer

Costs to be incurred comprise two major components – elevators and cost of construction service.

(a) The elevators are part of the overall construction project and are not a distinct performance obligation

(b) The cost of elevators is substantial to the overall project and are incurred well in advance.

(c) Upon delivery at site, customer acquires control of such elevators.

(d) And 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 made 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 (₹)
Transaction price	5,000,000
Costs incurred:	
(a) Cost of elevators	1,500,000
(b) Other costs	500,000
Measure of progress:	500,000/2,500,000 ≐ 20%
Revenue to be recognised:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 3,500,000

	% of work completed = 20% Revenue to be recognised = 700,000
(b) Revenue for elevators	1,500,000 (equal to costs incurred)
Total revenue to be recognised	1,500,000 + 700,000 = 2,200,000

Therefore, for the year ended 31st March, 20X1, the Company shall recognize revenue of ₹ 2,200,000 on the project.

Question 30

Company X enters into an agreement on 1st January, 20X1 with a customer for renovation of hospital and install new air-conditioners for total consideration of ₹ 50,00,000. The promised renovation service, including the installation of new air-conditioners is a single performance obligation satisfied over time. Total expected costs are ₹ 40,00,000 including ₹ 10,00,000 for the air conditioners.

Company X determines that it acts as a principal in accordance with paragraphs B34-B38 of Ind AS 115 because it obtains control of the air conditioners before they are transferred to the customer. The customer obtains control of the air conditioners when they are delivered to the hospital premises.

Company X uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation.

As at 31st March, 20X1, other costs incurred excluding the air conditioners are ₹ 6,00,000.

Whether Company X should include cost of the air conditioners in measure of its progress of performance obligation? How should revenue be recognised for the year ended March 20X1?

Answer

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 (₹ 10,00,000) are significant relative to the total costs to completely satisfy the performance obligation (₹ 40,00,000). Also, Company X is not involved in manufacturing or designing the 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).

Company X assesses that as at March, 20X1, the performance is 20 per cent complete (i.e., ₹ 6,00,000/₹ 30,00,000). Consequently, Company X recognises the following

As at 31st March, 20X1

	Amount in ₹

Revenue	18,00,000
Cost of goods sold	16,00,000
Profit	2,00,000

Revenue recognised is calculated as (20 per cent x ₹ 40,00,000) + ₹ 10,00,000

* (₹ 40,00,000 = ₹ 50,00,000 transaction price – ₹ 10,00,000 costs of air conditioners)

Cost of goods sold is ₹ 6,00,000 of costs incurred + ₹ 10,00,000 costs of air conditioners

Question 31

An entity has a fixed fee contract for ₹ 1 million to develop a product that meets specified performance criteria. Estimated cost to complete the contract is ₹ 950,000. The entity will transfer control of the product over five years, and the entity uses the cost-to-cost input method to measure progress on the contract. An incentive award is available if the product meets the following weight criteria:

Weight (kg)	Award % of fixed fee	Incentive fee
951 or greater	0%	–
701–950	10%	₹ 100,000
700 or less	25%	₹ 250,000

The entity has extensive experience creating products that meet the specific performance criteria. Based on its experience, the entity has identified five engineering alternatives that will achieve the 10% incentive and two that will achieve the 25% incentive. In this case, the entity determined that it has 95% confidence that it will achieve the 10% incentive and 5% confidence that it will achieve the 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 95% 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 criterion. 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.

Analyse the impact of changes in variable consideration when cost incurred is as follows:

Year	₹
1	50,000
2	175,000
3	400,000
4	275,000

5	50,000

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.

Answer

Calculation of yearly Revenue, Operating Profit and Margin (%):

Fixed consideration	A	1,000,000				
Estimated costs to complete	B	950,000				
		Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Total estimated variable consideration	C	100,000	100,000	100,000	250,000	250,000
Fixed revenue	D = A x H/B	52,632	184,211	421,053	289,474	52,632
Variable revenue	E = C x H/B	5,263	18,421	42,105	72,368	13,158
Cumulative revenue adjustment	F (see below)	-	-	-	98,693	-
Total revenue	G = D + E + F	57,895	202,632	463,158	460,535	65,790
Costs	H	50,000	175,000	400,000	275,000	50,000
Operating profit	I = G – H	7,895	27,632	63,158	185,535	15,790
Margin	J = I/G	13.64%	13.64%	13.64%	40.29%	24%

Calculation of cumulative catch-up adjustment:

Updated variable consideration	L		250,000
Percent complete in Year 4:	M = N/O		94.74%
Cumulative costs through Year 4	N	900,000	
Estimated costs to complete	O	950,000	
Cumulative variable revenue through Year 4:	P		138,157
Cumulative catch-up adjustment	F = L x M – P		98,693

Question 32

Nivaan Limited commenced work on two long-term contracts during the financial year ended on 31st March, 2022.

The first contract with A & Co. commences on 1st June, 2021 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, 2022, Nivaan Limited revised its estimate of the total expected cost to ₹ 34 lakh on the basis of the additional rectification cost (treat it as normal cost) of ₹ 2 lakh incurred on the contract during the current financial year. An independent surveyor has estimated at 31st March, 2022 that the contract is 30% complete. Nivaan Limited has incurred costs up to 31st March, 2022 of ₹ 16 lakh and has received payments on account of ₹ 13 lakh.

The second contract with B & Co. commenced on 1st September, 2021 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, 2022 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, 2022. In absence of any financial data 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, 2022.

Prepare financial statement extracts for Nivaan Limited in respect of the two construction contracts for the year ending 31st March, 2022.

Note: Present all calculations in ₹ lakh

Answer

(a) Extracts of Balance Sheet of Nivaan Ltd. as on 31st March, 2022

	₹ 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

(b) Extracts of Statement of Profit and Loss of Nivaan Ltd. as on 31st March, 2022

	₹ 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:

1. 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 x 30%) = 12	(30 x 20%) = 6	18
Expenses due for the year	(34 x 30%) = 10.2	(24 x 20%) = 4.8	15
Profit or loss on contract	1.8	1.2	3

2. **Calculation of amount due from/(to) customers**

₹ in lakh

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

3. **Work in Progress recognised as part of contract asset at the end of the year**

₹ in lakh

	A & Co.	B & Co.	Total
Total actual cost incurred during the year	16	8	24
Less: Cost recognised in books for the year 31.3.2022	(10.2)	(4.8)	(15)
Work-in-progress recognised at the end of the year	5.8	3.2	9.0

Question 33

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

The entity applies the requirements in Ind AS 115 to the portfolio of 1,000 contracts because it reasonably expects that, in accordance with paragraph 4, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of Ind AS 115) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 970 products will not be returned.

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

Determine the amount of revenue, refund liability and the asset to be recognised by the entity for the said contracts.

Answer

The entity also 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 ₹ 48,500 (₹ 50 x 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 recognised (i.e. ₹ 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 ₹ 48,500 (₹ 50 x 970 products not expected to be returned);

(b) a refund liability of ₹ 1,500 (₹ 50 refund x 30 products expected to be returned); and

(c) an asset of ₹ 900 (₹ 30 x 30 products for its right to recover products from customers on settling the refund liability).

Question 34

An entity enters into a contract with a customer to sell 10 units of a product for ₹ 100 per unit. The customer has the right to return the product, but if it does so, it will be charged a 3% restocking fee (or ₹ 3 per returned unit). The entity estimates that 10% of the sold units will be returned.

Determine the amount of revenue and refund liability to be recognised by the entity for the said contract.

Answer

Upon transfer of control of the 10 units, the entity will recognise revenue of ₹ 903 [(9 units not expected to be returned x ₹ 100 selling price) + (1 unit expected to be returned x ₹ 3 restocking fee per unit)].

A refund liability of ₹ 97 will also be recorded [1 unit expected to be returned x (₹ 100 selling price – ₹ 3 restocking fee)].

Question 35

Entity sells 100 ultra-life batteries for ₹ 2,000 each and provides the customer with a five-year guarantee that the batteries will withstand the elements and continue to perform to specifications. The entity, which normally provides a one-year guarantee to customer purchasing ultra-life batteries, determines that years two through five represent a separate performance obligation. The entity determines that ₹ 1,70,000 of the ₹ 2,00,000 transaction price should be allocated to the batteries and ₹ 30,000 to the service warranty (based on estimated stand-alone selling prices and a relative selling price allocation). The entity's normal one-year warranty cost is ₹ 100 per battery.

Pass required journal entries.

Answer

The entity will record the following journal entries:

Upon delivery of the batteries, the entity records the following entry:

Cash/Receivables	Dr.	2,00,000	
To Revenue			1,70,000
To Contract liability (service warranty)			30,000

Warranty expense	Dr.	10,000	
To Accrued warranty costs (assurance warranty)			10,000

The contract liability is recognised as revenue over the service warranty period (years 2-5). The costs of providing the service warranty are recognised as incurred. The assurance warranty obligation is used/derecognised as defective units are replaced/repaired during the initial year of the warranty. Upon expiration of the assurance warranty period, any remaining assurance warranty obligation is reversed.

Question 36

An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional 'extended coverage' plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty. Since the optional 'extended coverage' plan is sold separately, the entity determines that the three years of extended coverage represent a separate performance obligation (i.e. a service-type warranty). The total transaction price for the sale of a computer and the extended warranty is ₹ 36,000. The entity determines that the stand-alone selling prices of the computer and the extended warranty are ₹ 32,000 and ₹ 4,000, respectively. The inventory value of the computer is ₹ 14,400. Furthermore, the entity estimates that, based on its experience, it will incur ₹ 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty.

Pass required journal entries.

Answer

The entity will record the following journal entries:

		₹	₹
Cash/Trade receivables	Dr.	36,000	
Warranty expense	Dr.	2,000	
To Accrued warranty costs (assurance-type warranty)			2,000
To Contract liability (service-type warranty)			4,000
To Revenue			32,000
(To record revenue and contract liabilities related to warranties)			
Cost of goods sold	Dr.	14,400	
To Inventory			14,400
(To derecognise inventory and recognise cost of goods sold)			

The entity derecognises the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer. The entity recognises the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognises the costs associated with providing the service-type warranty as they are incurred. The entity had to determine whether the repair costs incurred are applied against the warranty reserve already established for claims that occur during the first 90 days or recognised as an expense as incurred.

Question 37

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 recognised in the first year and the amount of contract liability against the option given to the customer for renewing the membership at discount.

Answer

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 recognised 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 38

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

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

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

Answer

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 ₹ 500 of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is ₹ 120 (₹ 500 average purchase price of additional products x 30% incremental discount x 80% likelihood of exercising the option). The stand-alone selling prices of Product A and discount voucher and resulting allocation of the ₹ 1,000 transaction price are as follows:

Performance obligations	Stand-alone selling price
Product A	₹ 1,000
Discount voucher	₹ 120
Total	₹ 1,120

Performance obligations		Allocated transaction price
Product A	[(₹ 1,000 ÷ ₹ 1,120) x ₹ 1,000]	₹ 893
Discount voucher	[(₹ 120 ÷ ₹ 1,120) x ₹ 1,000]	₹ 107
Total		₹ 1,000

The entity allocates ₹ 893 to Product A and recognises revenue for Product A when control transfers. The entity allocates ₹ 107 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

Question 39

KK Ltd. runs a departmental store which awards 10 points for every purchase of ₹ 500 which can be discounted by the customers for further shopping with the same merchant. Each point is redeemable on any future purchases of KK Ltd.'s products within 3 years. Value of each point is ₹ 0.50. During the accounting period 2019-2020, the entity awarded 1,00,00,000 points to various customers of which 18,00,000 points remained undiscounted (to be redeemed till 31st March, 2022). The management expects only 80% of the remaining will be discounted in future.

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 ₹ 10,00,000 on a particular day?

(b) How should the redemption transaction be recorded in the year 2019-2020? The Company has requested you to present the sale of goods and redemption as independent transaction. Total sales of the entity is ₹ 5,000 lakhs.

(c) How much of the deferred revenue should be recognised at the year-end (2019-2020) because of the estimation that only 80% of the outstanding points will be redeemed?

(d) In the next year 2020-2021, 60% of the outstanding points were discounted. Balance 40% of the outstanding points of 2019-2020 still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 2020-2021 and what will be the amount of balance deferred revenue?

(e) How much revenue will the merchant recognized in the year 2021-2022, if 3,00,000 points are redeemed in the year 2021-2022?

Answer

(a) Points earned on ₹ 10,00,000 @ 10 points on every ₹ 500

= [(10,00,000/500) x 10]

= 20,000 points

Value of points = 20,000 points x ₹ 0.5 each point

= ₹ 10,000

Revenue recognized for sale of goods	₹ 9,90,099	[10,00,000 x (10,00,000/10,10,000)]
Revenue for points deferred	₹ 9,901	[10,00,000 x (10,000/10,10,000)]

Journal Entry

		₹	₹
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 ₹ 50,00,00,000 @ 10 points on every ₹ 500 = [(50,00,00,000/500) x 10] = 1,00,00,000 points

Value of points = 1,00,00,000 points x ₹ 0.5 each point = ₹ 50,00,000

Revenue recognized for sale of goods

= ₹ 49,50,49,505 [50,00,00,000 x (50,00,00,000/50,50,00,000)]

Revenue for points = ₹ 49,50,495 [50,00,00,000 x (50,00,000/50,50,00,000)]

Journal Entries in the year 2019-20

		₹	₹
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 x 80% = 14,40,000 points

Total expected points to be redeemed in 2019-20, 2020-2021 and 2021-2022 = [(1,00,00,000 – 18,00,000) + 14,40,000] = 96,40,000

Revenue to be recognised with respect to discounted point = 49,50,495 x (82,00,000/96,40,000) = 42,11,002

(c) Revenue to be deferred with respect to undiscounted point in 2019-2020 = 49,50,495 – 42,11,002 = 7,39,493

(d) In 2020-2021, KK Ltd. would recognize revenue for discounting of 60% of outstanding points as follows:

Outstanding points = 18,00,000 x 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 2020-2021 = [{49,50,495 x (92,80,000/96,40,000)} – 42,11,002] = ₹ 5,54,620

Journal Entry in the year 2020-2021

		₹	₹
Liability under Customer Loyalty programme	Dr.	5,54,620	

To Sales A/c (On redemption of further 10,80,000 points)			5,54,620

The Liability under Customer Loyalty programme at the end of the year 2018-2019 will be ₹ 7,39,493 – 5,54,620 = 1,84,873

(e) In the year 2021-2022, the merchant will recognized the balance revenue of ₹ 1,84,873 irrespective of the points redeemed as this is the last year for redeeming the points. Journal entry will be as follows:

Journal Entry in the year 2021-2022

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

Question 40

An entity promises to sell 120 products to a customer for ₹ 120,000 (₹ 1,000 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer at a price of ₹ 950 per product which is the standalone selling price for such additional products at the time of placing this additional order. The additional 30 products were not included in the initial contract.

It is assumed that additional products are contracted for a price that reflects the stand-alone selling price.

Determine the accounting for the modified contract?

Answer

When the contract is modified, the price of the contract modification for the additional 30 products is an additional ₹ 28,500 or ₹ 950 per product. The pricing for the additional products reflects the stand-alone selling price of the products at the time of the contract modification and the additional products are distinct from the original products.

Accordingly, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract and ₹ 950 per product for the 30 products in the new contract.

Question 41

On 1st April, 20X1, KLC Ltd. enters into a contract with Mr. K to provide

- A machine for ₹ 2.5 million
- One year of maintenance services for ₹ 55,000 per month

On 1st October, 20X1, KLC Ltd. and Mr. K agree to modify the contract to reduce the amount of services from ₹ 55,000 per month to ₹ 45,000 per month.

Determine the effect of change in the contract?

Answer

The next six months of services are distinct from the services provided in the first six months before modification in contract,

Therefore, KLC Ltd. will account for the contract modification as if it were a termination of the existing contract and the creation of a new contract.

The consideration allocated to remaining performance obligation is ₹ 270,000, which is the sum of

- The consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and had not yet been recognized as revenue. This amount is zero.
- The consideration promised as part of the contract modification i.e. ₹ 270,000.

Question 42

Entity AB Ltd. enters into a three-year service contract with a customer CD Ltd. for ₹ 4,50,000 (₹ 1,50,000 per year). The standalone selling price for one year of service at inception of the contract is ₹ 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 ₹ 1,20,000; and

(ii) CD Ltd. agrees to extend the contract for another three years for ₹ 3,00,000 (₹ 1,00,000 per year).

The standalone selling price for one year of service at the time of modification is ₹ 1,20,000. How should AB Ltd. account for the modification? Analyze.

Answer

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 recognise a total of ₹ 4,20,000 (₹ 1,20,000 + ₹ 3,00,000) over the remaining four-year service period (one year remaining under the original contract plus three additional years) or ₹ 1,05,000 per year.

Question 43

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?

Answer

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	5,000
Contract amount after modification	250	140*	35,000
Revenue to be recognised	100	140	14,000
Revenue already booked	100	150	15,000
Adjustment in revenue			(1,000)

*35,000/250 = 140

Question 44

A Ltd. is in the business of the infrastructure and has two divisions under the same; (I) Toll Roads and (II) Wind Power. The brief details of these business and underlying project details are as follows:

I. Bhilwara-Jabalpur Toll Project – The Company has commenced the construction of the project in the current year and has incurred total expenses aggregating to ₹ 50 crore as on 31st December, 20X1. Under IGAAP, the Company has 'recorded such expenses as Intangible Assets in the books of account. The brief details of the Concession Agreement are as follows:

- Total Expenses estimated to be incurred on the project ₹ 100 crore;
- Fair Value of the construction services is ₹ 110 crore;
- Total Cash Flow guaranteed by the Government under the concession agreement is ₹ 200 crore;
- Finance revenue over the period of operation phase is ₹ 15 crore:
- Other income relates to the services provided during the operation phase.

II. Kolhapur-Nagpur Expressway – The Company has also entered into another concession agreement with Government of Maharashtra in the current year. The construction cost for the said project will be ₹ 110 crore. The fair value of such construction cost is approximately ₹ 200 crore. The said concession agreement is Toll based project and the Company needs to collect the toll from the users of the expressway. Under IGAAP, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Asset.

Required

(i) What would be the classification of Bhilwara-Jabalpur Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

(ii) What would be the classification of Kolhapur-Nagpur Expressway Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

(iii) Also, suggest suitable accounting treatment for preparation of financial statements as per Ind AS for the above 2 projects.

Note: Present all calculations in ₹ crore

Answer

(i) Here the operator has a contractual right to receive cash from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, operator recognizes a financial asset to the extent it has a contractual right to receive cash.

(ii) Here the operator has a contractual right to charge users of the public services. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service. Therefore, the operator shall recognise an intangible asset to the extent it receives a right (a licence) to charge users of the public service.

(iii) Accounting treatment for preparation of financial statements

Bhilwara-Jabalpur Toll Project

Journal Entries

	Particulars		Dr. (₹ in crore)	Cr. (₹ in crore)
	During construction:			
1	Financial asset A/c	Dr.	110	
	To Construction revenue			110
	[To recognise revenue relating to construction services, to be settled in case]			
2	Cost of construction (profit or loss)	Dr.	100	
	To Bank A/c (As and when incurred)			100
	[To recognise costs relating to construction services]			
	During the operation phase:			
3	Financial asset	Dr.	15	
	To Finance revenue (As and when received or due to receive)			15

	[To recognise interest income under the financial asset model]		
4	Financial asset Dr. To Revenue [(200 – 110) – 15] [To recognise revenue relating to the operation phase]	75	75
5	Bank A/c Dr. To Financial asset [To recognise cash received from the grantor]	200	200

Kolhapur-Nagpur Expressway – Intangible asset

Journal Entries

	Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
1	**During construction:** Cost of construction (profit or loss) Dr. To Bank A/c (As and when incurred) [To recognise costs relating to construction services]	110	110
2	Intangible asset Dr. To Revenue [To recognise revenue relating to construction services provided for non-cash consideration]	200	200
3	**During the operation phase:** Amortisation expense Dr. To Intangible asset (accumulated amortisation) [To recognise amortisation expense relating to the operation phase over the period of operation]	200	200
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.

Question 45

An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ₹ 1 million. The contract includes a call option that gives the entity the right to repurchase the asset for ₹ 1.1 million on or before 31st December, 20X1.

How would the entity account for this transaction?

Answer

In the above case, where the entity has a right to call back the goods upto a certain date –

- The customer cannot be said to have acquired control, owing to the repurchase right with the seller entity

- Since the original selling price (₹ 1 million) is lower than the repurchase price (₹ 1.1 million), this is construed to be a financing arrangement and accounted as follows:
  (a) Amount received shall be recognized as 'liability'.
  (b) Difference between sale price and repurchase price to be recognised as 'finance cost' and recognised over the repurchase term.

Question 46

An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ₹ 1,000,000. The contract includes a put option that gives the customer the right to sell the asset for ₹ 900,000 on or before 31st December, 20X1. The market price for such goods is expected to be ₹ 750,000.

How would the entity account for this transaction?

Answer

In the above case, where the entity has an obligation to buy back the goods upto a certain date–

- The entity shall evaluate if the customer has a significant economic incentive to return the goods. Since the repurchase price is significantly higher than market price, therefore, customer has a significant economic incentive to return the goods. There are no other factors which entity may affect this assessment.
- Therefore, company determines that 'control' of goods is not transferred to the customer till 31st December, 20X1, i.e., till the put option expires.
- Against payment of ₹ 1,000,000; the customer only has a right to use the asset and put it back to the entity for ₹ 900,000. Therefore, this will be accounted as a lease transaction in which difference between original selling price (i.e., ₹ 1,000,000) and repurchase price (i.e., ₹ 900,000) shall be recognized as lease income over the period of lease.
- At the end of repurchase term, i.e., 31st December, 20X1, if the customer does not exercise such right, then the control of goods would be passed to the customer at that time and revenue shall be recognized for sale of goods for repurchase price (i.e., ₹ 900,000).

Question 47

Customer outsources its information technology data centre

Term = 5 years plus two 1-yr renewal options

Average customer relationship is 7 years

Entity spends ₹ 400,000 designing and building the technology platform needed to accommodate out-sourcing contract:

Design services	₹ 50,000
Hardware	₹ 140,000
Software	₹ 100,000
Migration and testing of data centre	₹ 110,000

TOTAL	**₹ 400,000**

How should such costs be treated?

Answer

Design services	₹ 50,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
Hardware	₹ 140,000	Account for asset under Ind AS 16
Software	₹ 100,000	Account for asset under Ind AS 38
Migration and testing of data centre	₹ 110,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
TOTAL	**₹ 400,000**	

CHAPTER - 4

Unit 1 – Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors

Question 1

During 20X2, Delta Ltd., changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.

In years before 20X2, Delta Ltd.'s asset records were not sufficiently detailed to apply a components approach fully. At the end of 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 20X2. 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.

Delta Ltd.'s management 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 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 Delta Ltd.'s new policy prospectively from the start of 20X2.

Additional information:

(i) Delta Ltd.'s tax rate is 30%

(ii) Property, plant and equipment at the end of 20X1:

Cost	₹ 25,000
Depreciation	₹ 14,000
Net book value	₹ 11,000
Prospective depreciation expense for 20X2 (old basis)	₹ 1,500

(iii) Some results of the engineering survey:

Valuation	₹ 17,000
Estimated residual value	₹ 3,000
Average remaining asset life	7 years
Depreciation expense on existing property, plant and equipment for 20X2 (new basis)	₹ 2,000

You are required to prepare relevant note for disclosure in accordance with Ind AS 8.

Answer

Extract from the notes

From the start of 20X2, Delta Ltd., changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a 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 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 effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by ₹ 6,000 (17,000 – 11,000); increase the opening deferred tax provision by ₹ 1,800 (6,000 x 30%); create a revaluation surplus at the start of the year of ₹ 4,200 (6,000 – 1,800); increase depreciation expense by ₹ 500 (2,000 – 1,500); and reduce tax expense by ₹ 150 (500 x 30%).

Question 2

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.

In years 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

	₹
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.

Answer

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:

	₹
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	₹
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 (₹ 2,000 – ₹ 1,500)	500
Reduce tax expense on depreciation (30%)	150

Question 3

ABC Ltd. changed its method adopted for inventory valuation in the year 2021-2022. 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, 2020 – Increase of ₹ 10 million

- 31st March, 2021 – Increase of ₹ 15 million
- 31st March, 2022 – Increase of ₹ 20 million

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

	2021-2022	2020-2021
Revenue	324	296
Cost of goods sold	(173)	(164)
Gross profit	**151**	**132**
Expenses	(83)	(74)
Profit	**68**	**58**

Retained earnings at 31st March, 2020 were ₹ 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.

Answer

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

	2021-2022	2020-2021 (Restated)
Revenue	324	296
Cost of goods sold	(168)	(159)
Gross profit	**156**	**137**
Expenses	(83)	(74)
Profit	**73**	**63**

Statement of changes in Equity (extract)

	Retained earnings	Retained earnings (Original)
At 1st April, 2020	423	423
Change in inventory valuation policy	10	-
At 1st April, 2020 (Restated)	**433**	-
Profit for the year 2020-2021	63	58
At 31st March, 2021	**496**	**481**
Profit for the 2021-2022	73	68
At 31st March, 2022	**569**	**549**

Question 4

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 ₹ 6,500.

Cheery Limited's accounting records for 20X4-X5 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-X4, 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-X4 opening retained earnings was ₹ 20,000 and closing retained earnings was ₹ 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 ₹ 50,000 (5,000 shares of ₹ 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.

Answer

Cheery Limited

Extract from the Statement of profit and loss

		(Restated)
	20X4-X5	**20X3-X4**
	₹	₹
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 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-X4 were incorrectly included in inventory at 31st March, 20X4 at ₹ 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 5

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?

Answer

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 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 6

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 ₹ 100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 March 20X3. An additional ₹ 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, ₹ 5,000 of which relates to items of inventory at 31 March 20X3. The defective inventory was reported at cost ₹ 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at ₹ 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.

Answer

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 recognised 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 ₹ 1,00,000 and overstatement of inventory ₹ 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 (i.e. ₹ 15,000) and fair value less costs to complete and sell (i.e. ₹ 18,000 originally estimated minus ₹ 5,000 costs to rectify latent defect) = ₹ 13,000

Question 7

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?

Answer

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.

CHAPTER - 4
Unit 2 – Ind AS 10: Events after the Reporting Period

Question 1

While preparing its financial statements for the year ended 31st March, 20X1, XYZ Ltd. made a general provision for bad debts @ 5% of its debtors. In the last week of February, 20X1 a debtor for Rs. 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. Considering the event of earthquake, XYZ Ltd. made a provision @ 50% of the amount receivable from that debtor apart from the general provision of 5% on remaining debtors. In April, 20X1 the debtor became bankrupt. Can XYZ Ltd. provide for the full loss arising out of insolvency of the debtor in the financial statements for the year ended 31st March, 20X1?

Would the answer be different if earthquake had taken place after 31st March, 20X1, and therefore, XYZ Ltd. did not make any specific provision in context that debtor and made only general provision for bad debts @ 5% on total debtors?

Answer

As per the definition of 'Events after the Reporting Period' and paragraph 8 of Ind AS 10, Events after the Reporting Period, financial statements should be adjusted for events occurring after the reporting period that provide evidence of conditions that existed at the end of the reporting period. In the instant case, the earthquake took place in February 20X1 (i.e. before the end of the reporting period). Therefore, the condition exists 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 ₹ 2 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, 20X1. In this case, assuming that the financial statements are approved by the approving authority after April, 20X1, XYZ Ltd should provide for the remaining amount as a consequence of declaration of this debtor as bankrupt.

In case, the earthquake had taken place after the end of the reporting period, i.e., after 31st March, 20X1, and XYZ Ltd. had not made any specific provision for the debtor who was declared bankrupt later on, since the earthquake occurred after the end of the reporting period no condition existed at the end of the reporting period. The company had made only general provision for bad debts in the ordinary business course – without taking cognizance of the catastrophic situation of an earthquake. Accordingly, bankruptcy of the debtor in this case is a non-adjusting event.

As per para 21 of Ind AS 10, if non-adjusting events after the reporting period are material, their non-disclosure could influence the economic decisions that users make based on the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:

(a) the nature of the event; and

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made."

If the amount of bad debt is considered to be material, the nature of this non-adjusting event, i.e., event of bankruptcy of the debtor should be disclosed along with the estimated financial effect of the same in the financial statements.

Question 2

ABC Ltd. received a demand notice on 15th June, 20X2 for an additional amount of ₹ 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 in respect of transactions related to financial year 20X1-20X2. The financial statements for the year 20X1-20X2 are approved on 10th August, 20X2. In July, 20X2, the company has appealed against the demand of ₹ 28,00,000 and the company has expected that the demand would be settled at ₹ 15,00,000 only. Show how the above event will have a bearing on the financial statements for the year 20X1-20X2. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly.

Answer

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

Events after the reporting period are those events, favourable and unfavourable, 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, 20X2, 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, 20X2, 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 20X1-20X2, at best estimate of the expenditure to be incurred, i.e., ₹ 15,00,000.

Question 3

A company has inventory of 100 finished cars on 31st March, 20X2, which are having a cost of ₹ 4,00,000 each. On 30th April, 20X2, as per the new government rules, higher road tax and penalties are to be paid by the buyers for such cars (which were already expected to come) and hence the selling price of a car has come down and the demand for such cars has dropped drastically. The selling price has come down to ₹ 3,00,000 each. The financial statements of the company for the year 20X1-20X2 are not yet approved. Should the company value its stock at ₹ 4,00,000 each or should it value at ₹ 3,00,000 each? Ignore estimated costs necessary to make the sale.

Answer

Events after the reporting period provide the evidence about the net realisable value of the cars at the end of the reporting period and, therefore, the amount of ₹ 3,00,000 should be considered for the valuation of stock.

Question 4

ABC Ltd., is trading in laptops. On 31st March, 20X2, the company has 50 laptops which were purchased at ₹ 45,000 each. The company has considered the same price for calculation of closing inventory valuation. On 15th April, 20X2, advanced version of same series of laptops is introduced in the market. Therefore, the price of the current laptops crashes to ₹ 35,000 each. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The company does not want to value the stock at ₹ 35,000 less estimated costs necessary to make the sale as the event of reduction in selling price took place after 31st March, 20X2 and the reduced prices were not applicable as on 31st March, 20X2. Comment on the company's views.

Answer

As per Ind AS 10, the decrease in the net realisable value of the stock after reporting period should normally be considered as an adjusting event.

Question 5

XY Ltd had taken a large-sized civil construction contract, for a public sector undertaking, valued at ₹ 200 Crores. Execution of the project started during 20X1-20X2, and continued in the next financial year also. During the course of execution of the work on 29th May, 20X2, the company found while raising the foundation work that it had met a rocky surface and cost of contract would go up by an extra ₹ 50 crore, which would not be recoverable from the Contractee as per the terms of the contract. The Company's financial year ended on 31st March, 20X2, and the financial statements were considered and approved by the Board of Directors on 15th June, 20X2. How will you treat the above in the financial statements for the year ended 31st March, 20X2?

Answer

In the instant case, the execution of work started during the F.Y. 20X1-X2 and the rocky surface was there at the end of the reporting period, though the existence of rocky surface is confirmed after the end of the reporting period as a result of which it became evident that the cost may escalate by ₹ 50 Crores. In accordance with the definition of 'Events after the Reporting Period', since the rocky surface was there, the condition was existing at the end of the reporting period, therefore, it is an adjusting event. The cost of the project and profit should be accounted for accordingly.

Question 6

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 17th March, 20X2 and 31st March, 20X2. ABC Ltd. paid the dues by 15th April, 20X2 with respect to sales made between 17th March, 20X2 and 31st March, 20X2. Financial statements were approved for issue by Board of Directors on 31st May, 20X2.

State whether discount will be adjusted from the sales at the end of the reporting period.

Answer

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 with 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 7

Mac Ltd. purchased goods on credit from Toy Ltd. for ₹ 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 ₹ 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 15th 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.

Answer

Toy Ltd. had sold goods to Mac Ltd on credit worth for ₹ 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 8

A Ltd. was required to pay penalty for a breach in the performance of a contract. A Ltd. believed that the penalty was payable at a lower amount than the amount demanded by the other party. A Ltd. created provision for the penalty but also approached the arbitrator with a submission that the case may be dismissed with costs. A Ltd. prepared the financial statements for the year 20X1-X2, which were approved in July 20X2. The arbitrator, in June 20X2, awarded the case in favour of A Ltd. As a result of the award of the arbitrator, the provision earlier made by A Ltd. was required to be reduced. The arbitrator also decided that cost of the case should be borne by the other party. Now, whether A Ltd. is required to remeasure its provision and what would be the accounting treatment of the cost that will be recovered by A Ltd., which has already been charged to the Statement of Profit and Loss as an expense for the year 20X1-X2?

Answer

In the instant case, A Ltd. approached the arbitrator before the end of the reporting period, who decided the award after the end of the reporting period but before approval of the financial statements for issue. Accordingly, the conditions were existing at the end of the reporting date because A Ltd. had approached the arbitrator before the end of the reporting period whose outcome has been confirmed by the award of the arbitrator. Therefore, it is an adjusting event.

Accordingly, the measurement of the provision is required to be adjusted for the event occurring after the reporting period. As far as the recovery of the cost by A Ltd. from the other party is concerned, this right to recover was a contingent asset as at the end of the reporting period.

As per para 35 of Ind AS 37, 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.

On the basis of the above, a contingent asset should be recognised in the financial statements of the period in which the realisation of asset and the related income becomes virtually certain. In the instant case, the recovery of cost became certain when the arbitrator decided the award during F.Y. 20X2-X3.

Accordingly, the recovery of cost should be recognised in the financial year 20X2-X3.

Question 9

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?

Answer

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 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, since 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 F.Y.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 10

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-X5 have been approved by the Board of Directors on 10th July, 20X5. Whether it is appropriate to prepare financial statements on going concern basis?

Answer

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 contact 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 11

In one of the plant of PQR Ltd., fire broke out on 10.05.2022 in which the entire plant was damaged. PQR Ltd. estimated the loss of ₹ 40,00,000 due to fire. The company filed a claim with the insurance company and expects recovery of ₹ 27,00,000 from the claim. The financial statements for the year ending 31.03.2022 were approved by the Board of Directors on 12th June, 2022. Discuss the accounting treatment of the above situation.

Answer

Events after the reporting period are those events, favourable and unfavourable, 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).

An entity shall adjust the amounts recognised in its financial statements to reflect 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 para 21 of Ind AS 10, disclosures regarding 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, since 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 2021-2022 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 31.03.2022.

Question 12

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, 2022 for ₹ 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 31.03.2022 on 1st May, 2022. The management did not consider the effect of the above transaction in Financial Year 2021-2022, 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 ₹ 5,000 each on 15th March, 2022. The manufacturers of phone had announced the release of the new version on 1st March, 2022 but had not announced the price. Zoom Ltd. has valued inventory at cost of ₹ 5,000 each at the year ending 31st March, 2022.

Due to arrival of new advance version of Mobile Phone on 8th April, 2022, the selling prices of the mobile stocks remaining with Company was dropped at ₹ 4,000 each.

The financial statements of the company valued mobile phones @ ₹ 5,000 each and not at the value @ ₹ 4,000 less expenses on sales, as the price reduction in selling price was effected after 31.03.2022.

(iii) There as an old due from a debtor amounting to ₹ 15 lakh against whom insolvency proceedings was instituted prior to the financial year ending 31st March, 2022. The debtor was declared insolvent on 15th April, 2022.

(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?

Answer

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 ₹ 40,00,000.

(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 recognised 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. Hence, appropriate provision must be made for ₹ 15 lakh.

(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.

CHAPTER - 4
Unit 3 – Ind AS 113: Fair Value Measurement

Question 1

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 ₹ 26, transaction costs in that market are ₹ 3 and the costs to transport the asset to that market are ₹ 2.

In Market B:

The price that would be received is ₹ 25, transaction costs in that market are ₹ 1 and the costs to transport the asset to that market are ₹ 2.

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.

Answer

(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 will be

	₹
Price receivable	26
Less: Transportation cost	(2)
Fair value of the asset	24

(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 maximises 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).

	₹	₹
	Market A	**Market B**
Price receivable	26	25
Less: Transaction cost	(3)	(1)
Less: Transportation cost	(2)	(2)
Net Proceeds of the asset	21	22

Since the entity would maximise the net amount that would be received for the asset in Market B i.e. ₹ 22, the fair value of the asset would be measured using the price in Market B.

Fair value

	₹
Price receivable	25
Less: Transportation cost	(2)
Fair value of the asset	23

Question 2

UK Ltd. is in the process of acquisition of shares of PT Ltd. as part of business reorganization plan. The projected free cash flow of PT Ltd. for the next 5 years are as follows:

(₹ in crore)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965

The weightage average cost of capital of PT Ltd. is 11%. The total debt as on measurement date is ₹ 1,465 crore and the surplus cash & cash equivalent is ₹ 106.14 crore.

The total numbers of shares of PT Ltd. as on the measurement date is 8,52,84,223 shares. Determine value per share of PT Ltd. as per Income Approach.

Answer

Determination of equity value of PT Ltd. **(₹ in crore)**

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965
Discount rate	0.9009	0.8116	0.7312	0.6587	0.5935
Free Cash Flow available to the firm	168.56	152.26	89.06	177.19	2,518.69
Total of all years					3,105.76
Less: Debt					(1,465)
Add: Cash & Cash equivalent					106.14
Equity Value of PT Ltd.					1,746.90
No. of Shares					8,52,84,223
Per Share Value					204.83

Question 3

You are a senior consultant of your firm and are in process of determining the valuation of KK Ltd. You have determined the valuation of the company by two approaches i.e. Market Approach and Income approach and selected the highest as the final value. However, based upon the discussion with your partner you have been requested to assign equal weights to both the approaches and determine a fair value of shares of KK Ltd. The details of the KK Ltd. are as follows:

Particulars	**₹ in crore**
Valuation as per Market Approach	5,268.2
Valuation as per Income Approach	3,235.2
Debt obligation as on Measurement date	1,465.9
Surplus cash & cash equivalent	106.14
Fair value of surplus assets and Liabilities	312.4
Number of shares of KK Ltd.	8,52,84,223 shares

Determine the Equity value of KK Ltd. as on the measurement date on the basis of above details.

Answer

Equity Valuation of KK Ltd.

Particulars	**Weights**	**(₹ in crore)**
As per Market Approach	50	5,268.2
As per Income Approach	50	3,235.2
Enterprise Valuation based on weights (5,268.2 x 50%) + (3,235.2 x 50%)		4,251.7
Less: Debt obligation as on measurement date		(1,465.9)
Add: Surplus cash & cash equivalent		106.14
Add: Fair value of surplus assets and liabilities		312.40
Enterprise value of KK Ltd.		3,204.33
No. of shares		8,52,84,223
Value per share		375.72

Question 4

ABC Ltd. acquired 5% equity shares of XYZ Ltd. for ₹ 10 crore in the year 20X1-X2. The company is in process of preparing the financial statements for the year 20X2-X3 and is assessing the fair value at subsequent measurement of the investment made in XYZ Ltd. Based on the observable input, the ABC Ltd. identified a similar nature of transaction in which PQR Ltd. acquired 20% equity shares in XYZ Ltd. for ₹ 60 crore. The price of such transaction was determined on the basis of Comparable Companies Method (CCM) - Enterprise Value (EV)/EBITDA which was 8. For the current year, the EBITDA of XYZ Ltd. is ₹ 40 crore. At the time of acquisition, the valuation was determined after considering 5% of liquidity discount and 5% of non-controlling stake discount. What will be the fair value of ABC Ltd.'s investment in XYZ Ltd. as on the balance sheet date?

Answer

Determination of Enterprise Value of XYZ Ltd.

Particulars	₹ in crore
EBITDA as on the measurement date	40
EV/EBITDA multiple as on the date of valuation	8
Enterprise value of XYZ Ltd.	320

Determination of subsequent measurement of XYZ Ltd.

Particulars	₹ in crore
Enterprise Value of XYZ Ltd.	320
ABC Ltd.'s share based on percentage of holding (5% of 320)	16
Less: Liquidity discount & Non-controlling stake discount (5% + 5% = 10%)	(1.6)
Fair value of ABC Ltd.'s investment in XYZ Ltd.	14.4

Question 5

Investment 1 is a contractual right to receive ₹ 800 in 1 year. There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

a. Investment 2 is a contractual right to receive ₹ 1,200 in 1 year and has a market price of ₹ 1,083.

b. Investment 3 is a contractual right to receive ₹ 700 in 2 years and has a market price of ₹ 566.

All three assets are comparable with respect to risk (that is, dispersion of possible payoffs and credit).

You are required to measure the fair value of Asset 1 basis above information.

Answer

On the basis of the timing of the contractual payments to be received for Investment 1 relative to the timing for Investment 2 and Investment 3 (that is, one year for Investment 2 versus two years for Investment 3), Investment 2 is deemed more comparable to Investment 1. Using the contractual payment to be received for Investment 1 (₹ 800) and the 1-year market rate derived from Investment 2, the fair value of Investment 1 is calculated as under:

Investment 2 Fair Value = ₹ 1,083

Contractual Cash flows in 1 year = ₹ 1,200

IRR = ₹ 1,083 x (1 + r) = ₹ 1,200

= (1 + r) = (₹ 1,200/₹ 1,083) = 1.108

r = 1.108 – 1 = 0.108 or 10.8%

Value of Investment 1 = ₹ 800/1.108 = ₹ 722

Alternatively, in the absence of available market information for Investment 2, the one-year market rate could be derived from Investment 3 using the build-up approach. In that case, the 2-year market rate indicated by Investment 3 would be adjusted to a 1-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

Question 6

A Ltd., a large biotech company with shares traded publicly, has developed a new drug that is in the final phase of clinical trials. B Ltd. has an equity investment in A Ltd.'s shares. B Ltd. determines that the shares have a readily determinable fair value and accounts for the investment at fair value through profit and loss. B Ltd. assesses the fair value as of the measurement date of 31 March 2022. Consider the following:

(i) On 31 March 2022, the Drug Approval authority notifies A Ltd.'s management that the drug was not approved. A Ltd.'s shares closed at ₹ 36.00 on 31 March 2022.

(ii) A Ltd. issued a press release after markets closed on 31 March 2022 announcing the failed clinical trial.

(iii) A Ltd.'s shares opened on next working day at ₹ 22.50.

Answer

The drug failure is a condition (or a characteristic of the asset being measured) that existed as of the measurement date. B Ltd. concludes the ₹ 36.00 closing price on the measurement date does not represent fair value of the A Ltd. 's shares at 31 March 2022 because the price does not reflect the effect of the Authority's non-approval.

The subsequent transactions that take place when the market opens are relevant to the fair value measurement recorded as of the measurement date. The opening price of ₹ 22.50 indicates how market participants have incorporated the effect of the non-approval on A Ltd.'s stock price.

B Ltd. adjusts the 31 March 2022 quoted price for the new information, records the shares at ₹ 22.50 per share at 31 March 2022 and discloses the investment as a Level 2 measurement.

Question 7

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 ₹ 290, transaction costs in that market are ₹ 40 and the costs to transport the asset to that market are ₹ 30. Thus, the net amount that would be received is ₹ 220.

In Kolkata market the price that would be received is ₹ 280, transaction costs in that market are ₹ 20 and the costs to transport the asset to that market are ₹ 30. Thus, the net amount that would be received in Kolkata market is ₹ 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 principal market?

(ii) If the net realization after expenses is more in export market, say ₹ 280, but Government allows only 15% of the production to be exported out of India. Discuss what would be fair value in such case.

Answer

(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

	₹
Price receivable	290
Less: Transportation cost	(30)
Fair value of the asset	260

(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).

	₹	₹
	Mumbai Market	**Kolkata Market**
Fair value of the asset as per the question	220	230

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

Fair value in such a case would be

	₹
Price receivable	280
Less: Transportation cost	(30)
Fair value of the asset	250

(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.

Question 8

(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 recognised in its balance sheet and those that are not recognised is ₹ 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares.

Answer

(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 x ₹ 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 x ₹ 170 per share).

Question 9

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.

Answer

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 x 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/(1.08510)]**	**194.88**

Working Note:

Expected labour cost:

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**

CHAPTER - 5

Unit 1 – Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance

Question 1

A Limited establishes solar panels to supply solar electricity to its manufacturing plant. The cost of solar panels is ₹ 1,00,00,000 with a useful life of 10 years. The depreciation is provided on straight line method basis. The government gives ₹ 50,00,000 as a subsidy. Examine how the Government grant be realized.

Also state how the same will be disclosed in the Statement of cash flows.

Answer

A Limited will set up ₹ 50,00,000 as deferred income and will credit ₹ 5,00,000 equally to its statement of profit and loss over next 10 years.

Alternatively, A Ltd. may deduct ₹ 50,00,000 from the cost of solar panel of ₹ 1,00,00,000.

A Limited will show ₹ 1,00,00,000 being acquisition of solar panels as outflow in investing activities. The receipt of ₹ 50,00,000 from government will be shown as inflow under financing activities.

Question 2

A Limited wants to establish a manufacturing unit in a backward area and requires 5 acres of land. The government provides the land on a leasehold basis at a nominal value of ₹ 10,000 per acre. The fair value of the land is ₹ 100,000 per acre. Calculate the amount of the Government grant to be recognized by an entity.

Answer

A limited will recognise the land at fair value of ₹ 5,00,000 and ₹ 450,000 [(₹ 100,000 – ₹ 10,000) x 5)] as government grant. This government grant should be presented in the balance sheet by setting up the grant as deferred income.

Alternatively, the land may be recognised by A Ltd. at nominal value of ₹ 50,000 (₹ 10,000 x 5).

Question 3

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

Answer

A Limited will recognise ₹ 10,00,000 as government grant and set it up as a deferred income and will recognise it in profit or loss over the period of three years as per the principles enunciated in Ind AS 20.

Once a government grant is recognised, any related contingent liability or contingent asset is treated in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

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

Question 4

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

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

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

Answer

ABC Ltd. should recognise the grants in the following manner:

- ₹ 20 lakhs have been received for immediate start-up of business. This should be recognised in Statement of Profit and Loss immediately as there are no conditions attached to the grant.
- ₹ 50 lakhs should be recognised in profit or loss on a systematic basis over the periods which the entity recognises as expense the related costs for which the grants are intended to compensate provided that there is reasonable assurance that ABC Ltd. will comply with the conditions attached to the grant.
- Land should be recognised at fair value of ₹ 10 lakhs and government grants should be presented in the balance sheet by setting up the grant as deferred income. Alternatively, deduct the amount of grant from the cost of the asset. In the given case, the land is granted at no cost. It will be presented in the books at nominal value.
- ₹ 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, ₹ 40,000 [₹ 2 lakhs/5] should be credited to profit and loss each year over period of 5 years. Alternatively, ₹ 2,00,000 will be deducted from the cost of the asset and depreciation will be charged at ₹ 8,00,000 (₹ 10,00,000 – ₹ 2,00,000).

Question 5

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 ₹ 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.

Answer

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 year 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 ₹ 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 ₹ 100,000 against the cost of the equipment as on 1st 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 6

A Limited received from the government a loan of ₹ 50,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be recognised. Also state how the grant will be recognized in the statement of profit or loss assuming:

(a) the loan is an immediate relief measure to rescue the enterprise

(b) the loan is a subsidy for staff training expenses, incurred equally, for a period of 4 years

(c) the loan is to finance a depreciable asset.

Year	1	2	3	4	5
PVF	0.892856	0.797193	0.711779	0.635517	0.567427

Answer

The fair value of the loan is calculated at ₹ 37,38,328 [(3.604772 x 2,50,000) + (0.567427 x 50,00,000)]

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on ₹ 50,00,000 + principal paid	Closing Balance
(a)	(b)	(c) = (b) x 12%	(d)	(e) = (b) + (c) - (d)
1	37,38,328	4,48,600	2,50,000	39,36,928
2	39,36,928	4,72,431	2,50,000	41,59,359
3	41,59,359	4,99,123	2,50,000	44,08,482
4	44,08,482	5,29,018	2,50,000	46,87,500
5	46,87,500	5,62,500	52,50,000	Nil

A Limited will recognise ₹ 12,61,672 (₹ 50,00,000 – ₹ 37,38,328) as the government grant and will make the following entry on receipt of loan:

Bank Account	Dr.	50,00,000	
To Deferred Income			12,61,672
To Loan Account			37,38,328

₹ 12,61,672 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognised as expenses the related costs for which the grant is intended to compensate.

Assuming (a), the loan is an immediate relief measure to rescue the enterprise. ₹ 12,61,672 will be recognised in profit or loss immediately.

Assuming (b), the loan is a subsidy for staff training expenses, incurred equally, for a period of 4 years. ₹ 12,61,672 will be recognised in profit or loss over a period of 4 years.

Assuming (c), the loan is to finance a depreciable asset. ₹ 12,61,672 will be recognised in profit or loss on the same basis as depreciation.

Question 7

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?

Answer

As per paragraph 29 of Ind AS 20, 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 are 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".

The supporters of this method consider it inappropriate to present income and expense items on a net basis and that "separation of the grant from the expense facilitates 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).

The supporters of this method are of the view 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 may 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 8

A Ltd. has received a grant of ₹ 10,00,00,000 in the year 20X1-20X2 from local government in the form of subsidy for selling goods at lower price to lower income group population in a particular area for two years. A Ltd. had accounted for the grant as income in the year 20X1-20X2. While accounting for the grant in the year 20X1-20X2, A Ltd. was reasonably assured that all the conditions attached to the grant will be complied with. However, in the year 20X5-20X6, it was found that A Ltd. has not complied with the above condition and therefore notice of refund of grant has been served to it. A Ltd. has contested but lost in court in 20X5-20X6 and now grant is fully repayable. How should A Ltd. reflect repayable grant in its financial statements ending 20X5-20X6?

Answer

It is being assumed that the accounting done in previous years was not incorrect and was not in error as per Ind AS 8.

Paragraph 32 of Ind AS 20, states that a Government grant that becomes repayable shall be accounted for as a change in accounting estimate (see Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors).

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.

Repayment of a grant related to an asset shall be recognised by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognised in profit or loss to date in the absence of the grant shall be recognised immediately in profit or loss.

The following journal entries should be passed:

S.N.	Particulars	Nature of Account	Dr./Cr.	Amount (₹ in crores)
(i)	Repayment of Government Grant	Expense (P/L)	Dr.	10
	To Grant repayable	Balance sheet (Liability)		10
	(Being recognition of repayment of grant in statement of profit or loss)			
(ii)	Grant repayable	Balance sheet (Liability)	Dr.	10
	To Bank	Balance sheet (Asset)		10
	(Being grant refunded)			

Assuming that no deferred credit balance exists in the year 20 X5-20X6, therefore repayment recognised in P&L.

It may also be noted that the standard also provides that 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.

Question 9

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.

Answer

(a) 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 Less: Accumulated depreciation	1,00,000 (1,00,000 x 20%) (20,000)	 80,000
		????
Non-current liabilities		
Government grant	[12,000 – 3,000 (current liability)]	9,000
Current liabilities		
Government grant	(15,000 x 20%)	3,000
		????

Working Note:

Government grant deferred income account

	₹		₹
To Profit or loss (15,000 x 20%) To Balance c/f	3,000 12,000	By Grant cash received	15,000
	15,000		15,000

(b) 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) Less: Accumulated depreciation	85,000 (17,000)	 68,000

Question 10

A company receives a cash grant of ₹ 30,000 on 31 March 20X1. The grant is towards the cost of training young apprentices. Training programme is expected to last for 18 months starting from 1 April 20X1. Actual costs of the training incurred in 20X1-20X2 was ₹ 50,000 and in 20X2-20X3 ₹ 25,000. State, how this grant should be accounted for?

Answer

At 31st March 20X1 the grant would be recognised as a liability and presented in the balance sheet as a split between current and non-current amounts.

₹ 20,000 [(12 months/18 months) x 30,000] is current and would be recognised in profit and loss for the year ended 31st March, 20X1. The balance amount of ₹ 10,000 will be shown as non-current.

At the end of year 20X1-20X2, there would be a current balance of 10,000 (being the non- current balance at the end of year 20X1-20X1 reclassified as current) in the balance sheet. This would be recognised in profit in the year 20X2-20X3.

Extracts from the financial statements are as follows:

Balance Sheet (extracts)

	31 March 20X1	31 March 20X2	31 March 20X3
Current liabilities			
Deferred income	20,000	10,000	–
Non-current liabilities			
Deferred income	10,000	–	–

Statement of profit and loss (extracts)

	31 March 20X2	31 March 20X3
Method 1		
Other Income (Government grant received)	20,000	10,000
Training costs	(50,000)	(25,000)
Method 2		
Training costs (50,000 – 20,000)	30,000	
Training costs (25,000 – 10,000)		15,000

Question 11

Entity A is awarded a government grant of ₹ 60,000 receivable over three years (₹ 40,000 in year 1 and ₹ 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 ₹ 30,000, and the wage bill for the first year is ₹ 1,00,000, rising by ₹ 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.

Answer

The income of ₹ 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	
	₹	₹		₹	
1	1,30,000	21,667	60,000 x (130/360)	18,333	(40,000 – 21,667)
2	1,10,000	18,333	60,000 x (110/360)	10,000	(50,000 – 21,667 – 18,333)
3	1,20,000	20,000	60,000 x (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 ₹ 21,667, ₹ 18,333 and ₹ 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 ₹ 18,333, ₹ 10,000 and Nil respectively.

Question 12

How will you recognize and present the grants received from the Government in the following cases as per Ind AS 20?

(i) A Ltd. received one acre of land to setup a plant in backward area (fair value of land ₹ 12 lakh and acquired value by Government is ₹ 8 lakhs).

(ii) B Ltd. received an amount of loan for setting up a plant at concessional rate of interest from the Government.

(iii) D Ltd. received an amount of ₹ 25 lakh for immediate start-up of a business without any condition.

(iv) S Ltd. received ₹ 10 lakh for purchase of machinery costing ₹ 80 lakh. Useful life of machinery is 10 years. Depreciation on this machinery is to be charged on straight line basis.

(v) Government gives a grant of ₹ 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%.

Answer

(i) The land and government grant should be recognized by A Ltd. at fair value of ₹ 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 ₹ 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) ₹ 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) ₹ 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, ₹ 1,00,000 [₹ 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 ₹ 70 lakh (₹ 80 lakh – ₹ 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 ₹ 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 13

A Limited received from the government a loan of ₹ 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 gran t 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.

Answer

The fair value of the loan is calculated at ₹ 74,76,656.

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on ₹ 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 ₹ 25,23,344 (₹ 1,00,00,000 – ₹ 74,76,656) as the government grant and will make the following entry on receipt of loan:

Bank Account	Dr.	1,00,00,000	
To Deferred Income			25,23,344
To Loan Account			74,76,656

₹ 25,23,344 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognised as expenses the related costs for which the grant is intended to compensate.

If the loan is to finance a depreciable asset. ₹ 25,23,344 will be recognised in profit or loss on the same basis as depreciation.

Unit 2 – Ind AS 102: Share Based Payment

Question 1

An entity issued 100 shares each to its 1,000 employees subject to service condition of next 2 years. Grant date fair value of the share is ₹ 195 each. There is an expectation 97% of the employees will remain in service at the end of 1st year. However, at the end of 2nd year the expected employees to remain in service would be 91% of the total employees. Calculate expense for the year 1 & 2?

Answer

Year end	% Vest	Expense (current period)
First	97%	100 x 1,000 x 195 x 97% x 1/2 = 94,57,500
Second	91%	[100 x 1,000 x 195 x 91% x 2/2] – 94,57,500 = 82,87,500

Question 2

Entity X grants 10 shares each to its 1,000 employees on the conditions as mentioned below-

- To remain in service & entity's profit after tax (PAT) shall reach to ₹ 100 million.
- It is expected that PAT should reach to ₹ 100 million by the end of 3 years.
- Fair value at grant date is ₹ 100.
- Employees expected for vesting right by 1st year 97%, then it revises to 95% by 2nd year and finally to 93% by 3rd year.

Calculate expenses for next 3 years in respect of share-based payment?

Answer

Entity's PAT is one of the non-market related condition and hence would be included while making an expectation of vesting shares and there is no requirement to make any changes in the non-market condition whether this is fulfilled or not because it has already been considered in the expectation of vesting rights at the end of each year.

Year-1	1,000 x 10 x 100 x 97% x 1/3 = 3,23,333
Year-2	[1,000 x 10 x 100 x 95% x 2/3] – 3,23,333 = 3,10,000
Year-3	[1,000 x 10 x 100 x 93% x 3/3] – 6,33,333 = 2,96,667

Question 3

ACC limited granted 10,000 share options to one of its managers. In order to get the options, the manager has to work for next 3 years in the organization and reduce the cost of production by 10% over the next 3 years.

Fair value of the option at grant date was ₹ 95

Cost reduction achieved:

Year 1	12%	Achieved

Year 2	8%	Not expected to vest in future
Year 3	10%	Achieved

How the expenses would be recorded?

Answer

It is a non-market related condition. Hence the target to achieve cost reduction would be taken while estimating the number of options to be vested.

Year	Options	Fair value		FV of the options vested
Year 1	10,000	95	1/3	3,16,667
Year 2	10,000	95	0	(3,16,667)
Year 3	10,000	95	3/3	9,50,000

The condition to achieve 10% cost reduction each was not fulfilled in the year 2 and there was no expectation to vest this non-market condition in future as well and hence earlier expense amount was reversed in year 2. Since in the year 3 the non-market condition was again met, hence all such expense will be charged to Profit and Loss.

Question 4

Apple Limited has granted 10,000 share options to one of its directors for which he must work for next 3 years and the price of the share should increase by 20% over next 3 years.

The share price has moved as per below details:

Year 1	22%
Year 2	19%
Year 3	25%

At the grant date, the fair value of the option was ₹ 120.

How should we recognize the transaction?

Answer

The share price movement is a market based vesting condition hence its expectations are taken into consideration while calculating the fair value of the option.

Even if the required market condition as required is not fulfilled, there is no requirement to reverse the expense previously booked.

Irrespective of the outcome of the market prices (as it is already taken care of in the fair value of the option), each period an amount of (120 x 10,000)/3 = ₹ 4,00,000 will be charged to profit and loss.

Question 5

An entity P issues share-based payment plan to its employees based on the below details:

Number of employees	100

Fair value at grant date	₹ 25
Market condition	Share price to reach at ₹ 30
Service condition	To remain in service until market condition is fulfilled
Expected completion of market condition	4 years

Define expenses related to such share-based payment plan in each year subject to the below scenarios:

a) Market condition if fulfilled in year 3, or

b) Market condition is fulfilled in year 5.

Answer

Market conditions are required to be considered while calculating fair value at grant date. However, service conditions will be considered as per the expected vesting right to be exercised by the employees and would be re-estimated during vesting period. However, if the market related condition is fulfilled before it is expected then all remaining expenses would immediately be charged off. If market related condition takes longer than the expected period then original expected period will be followed.

a) Market condition is fulfilled in year 3:

Year 1	2,500/4 = 625
Year 2	2,500/4 = 625
Year 3	2,500 – 625 – 625 = 1,250
Year 4	NIL

b) Market condition is fulfilled in year 5:

Year 1	2,500/4 = 625
Year 2	2,500/4 = 625
Year 3	2,500/4 = 625
Year 4	2,500/4 = 625
Year 5	NIL

Question 6

ABC Limited granted to its employees, share options with a fair value of ₹ 5,00,000 on 1st April, 20X0, if they remain in the organization upto 31st March, 20X3. On 31st March, 20X1, ABC limited expects only 91% of the employees to remain in the employment. On 31st March, 20X2, company expects only 89% of the employees to remain in the employment. However, only 82% of the employees remained in the organisation at the end of March, 20X3 and all of them exercised their options. Pass the Journal entries?

Answer

Period	Proportion a	Fair value b	To be vested c	Cumulative expenses d = b x c x a	Expenses e = d – previous period d

Period 1	1/3	5,00,000	91%	1,51,667	1,51,667
Period 2	2/3	5,00,000	89%	2,96,667	1,45,000
Period 3	3/3	5,00,000	82%	4,10,000	1,13,333
					4,10,000

Journal Entries

Particulars		₹	₹
31st March, 20X1			
Employee benefits expenses	Dr.	1,51,667	
To Share based payment reserve (equity)			1,51,667
(1/3 of expected vested equity instruments value)			
31st March, 20X2			
Employee benefits expenses	Dr.	1,45,000	
To Share based payment reserve (equity)			1,45,000
(2/3 of expected vested equity instruments value)			
31st March, 20X3			
Employee benefits expenses	Dr.	1,13,333	
To Share based payment reserve (equity)			1,13,333
(Final vested equity instruments value)			
Share based payment reserve (equity)	Dr.	4,10,000	
To Share Capital			4,10,000
(re-allocated and issued shares)			

Question 7

Ankita Holding Inc. 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 ₹ 122. In 20X1, earnings increased by 10%, and 29 employees left the organisation. The company expects that the shares will vest at the end of the year 20X2. The company also expects that additional 31 employees will leave the organisation 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%. Therefore, the shares did not vest. 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. Assume that 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?

Answer

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:

Expense for 20X1 = Number of employees x Shares per employee x Fair value of share x Proportionate vesting period

= 440 x 100 x 122 x ½ = 26,84,000

Note 2:

Expense for 20X2 = (Number of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expense recognized in year 20X1

= (419 x 100 x 122 x 2/3) – 26,84,000

= 7,23,867

Note 3:

Expense for 20X3 = (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expense recognized in year 20X1 and 20X2

= (421 x 100 x 122 x 3/3) – (26,84,000 + 7,23,867)

= 17,28,333

Journal Entries

31st December, 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)			
31st December, 20X2			
Employee benefits expenses	Dr.	7,23,867	

To Share based payment reserve (equity) (Equity settled shared based payment expected vesting amount)		7,23,867
31st December, 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)		

Question 8

On 1st April 2022, 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. Fair value of each option on the grant date was ₹ 129.

Towards the end of 31st March 2023, Kara Ltd.'s share price dropped; so on 1st April 2023 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 2023-2024, 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 2025, awards to 930 employees actually vested.

Determine the expense for each year and pass appropriate journal entries as per the relevant Ind AS.

Answer

Calculation of expenses:

<u>For the year ended 31st March 2023</u>

= [₹ 129 x 150 awards x 900 employees x (1 year/3 years of service)]

= ₹ 58,05,000

<u>For the year ended 31st March 2024</u>

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 standard requires the entity to include the incremental fair value granted (i.e. 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, 2023	[₹ 129 x 150 awards x 900 employees x (1 year/3 years of service)]	58,05,000	58,05,000
31 March, 2024	[₹ 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, 2025	[(₹ 129 + 30) x 150 awards x 930 employees] – 1,43,92,500	77,88,000	2,21,80,500

Journal Entries

31st March, 2023		
Employee benefits expenses Dr. To Share based payment reserve (equity) (Equity settled shared based payment expected vesting amount)	58,05,000	58,05,000
31st March, 2024		
Employee benefits expenses Dr. To Share based payment reserve (equity) (Equity settled shared based payment expected vesting amount)	85,87,500	85,87,500
31st March, 2025		
Employee benefits expenses Dr. To Share based payment reserve (equity) (Equity settled shared based payment expected vesting amount)	77,88,000	77,88,000
Share based payment reserve (equity) Dr. To Equity share capital (Share capital Issued)	2,21,80,500	2,21,80,500

Question 9

Marathon Inc. issued 150 share options to each of its 1,000 employees subject to the service condition of 3 years. Fair value of the option given was calculated at ₹ 129. Below are the details and activities related to the SBP plan-

Year 1: 35 employees left and further 60 employees are expected to leave

Share options re-priced (as MV of shares has fallen) as the FV fell to ₹ 50.

After the re-pricing they are now worth ₹ 80, hence expense is expected to increase by ₹ 30.

Year 2: 30 employees left and further 36 employees are expected to leave

Year 3: 39 employees left

How the modification/re-pricing will be accounted?

Answer

The re-pricing has been done at the end of year 1, and hence the increased expense would be spread over next 2 years equally.

Total increased value due to modification is ₹ 30 (1/2 weight each years)

	Year 1	Year 2	Year 3
Number of employees	1,000	1,000	1,000
Employee left	(35)	(65)	104
Expected to leave	(60)	(36)	–
Net employees	905	899	896
Options per employee	150	150	150
Fair value of the option	129	129	129
Period weight	1/3	2/3	3/3
Modification		30	30
Expense (original)	58,37,250	57,59,850	57,40,500
Modification	Nil	20,22,750	20,09,250
		(899 x 150 x 30 x 1/2)	(896 x 150 x 30 x 2/2) – 20,22,750)

Question 10

QA Ltd. had on 1st April, 20X1 granted 1,000 share options each to 2,000 employees. The options are due to vest on 31st March, 20X4 provided the employee remains in employment till 31st March, 20X4.

On 1st April, 20X1, the Directors of Company estimated that 1,800 employees would qualify for the option on 31st March, 20X4. This estimate was amended to 1,850 employees on 31st March, 20X2 and further amended to 1,840 employees on 31st March, 20X3.

On 1st April, 20X1, the fair value of an option was ₹ 1.20. The fair value increased to ₹ 1.30 as on 31st March, 20X2 but due to challenging business conditions, the fair value declined thereafter. In September, 20X2, when the fair value of an option was ₹ 0.90, the Directors repriced the option and this caused the fair value to increase to ₹ 1.05. Trading conditions improved in the second half of the year and by 31st March, 20X3 the fair value of an option was ₹ 1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30th September, 20X2 should be spread over the remaining vesting period from 30th September, 20X2 to 31st March, 20X4.

The Company has requested you to suggest the suitable accounting treatment for these transaction as on 31st March, 20X3.

Answer

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 (i.e. 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 in years 1 and 2 are as follows:

Year	Calculation	Compensation expense for period	Cumulative compensation expense
		₹	₹
1	[1,850 employees x 1,000 options x ₹ 1.20] x 1/3	7,40,000	7,40,000
2	(1,840 employees x 1,000 options x [(₹ 1.20 x 2/3) + {(₹ 1.05 – ₹ 0.90) x 0.5/1.5}] – 7,40,000	8,24,000	15,64,000

Note: Year 3 calculations have not been provided as it was not required in the question.

Question 11

Anara Fertilisers Limited issued 2,000 share options to its 10 directors for an exercise price of ₹ 100. The directors are required to stay with the company for next 3 years.

Fair value of the option estimated	₹ 130
Expected number of directors to vest the option	8

During the year 2, there was a crisis in the company and Management decided to cancel the scheme immediately. It was estimated further as below-

Fair value of option at the time of cancellation was ₹ 90

Market price of the share at the cancellation date was ₹ 99

There was a compensation which was paid to directors and only 9 directors were currently in employment. At the time of cancellation of such scheme, it was agreed to pay an amount of ₹ 95 per option to each of 9 directors.

How the cancellation would be recorded?

Answer

	Year 1	Year 2	
A) Employee compensation expense			

Expected directors to vest	8	9	
Fair value of option	130	130	
Number of options	2,000	2,000	
Total	20,80,000	23,40,000	
Expense weightage	1/3		Full, as it is cancelled
Expense for the year	6,93,333	16,46,667	Remaining amount since cancelled

B)	**Cancellation compensation**	
	Number of directors	9
	Amount agreed to pay	95
	Number of options per director	2,000
	Compensation amount (9 x 95 x 2,000) [Refer working notes 1 and 2]	17,10,000

Working Notes:

1. **Amount to be deducted from Equity**

Number of directors	9
Fair value of option (at the date of cancellation)	90
Number of options per director	2,000
Total	16,20,000

2. **Amount transferred to Profit and Loss**

Total cancellation compensation	17,10,000
Less: To deduct from Equity	(16,20,000)
Balance transferred to Profit and Loss	90,000

Question 12

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 per option. 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.

Answer

(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 2/3rd 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 per 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 per 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

Question 13

An entity issued 50 Share Appreciation Rights (SARs) each to its 170 employees subject to service condition of next 2 years. The settlement is to be made in cash. Grant date fair value of the share is ₹ 85 each, however, the fair value as at end of 1st year, 2nd year were ₹ 80 & ₹ 90 respectively. Calculate expense for years 1 and 2?

Answer

Year end	Vest	Expense (current period)
First	1/2	50 x 170 x 80 x 1/2 = 3,40,000
Second	2/2	[50 x 170 x 90 x 2/2] – 3,40,000 = 4,25,000

- Liability will be re-measured at each reporting date.

- Fair value at the end of the year will be used.

Question 14

XYZ issued 10,000 Share Appreciation Rights (SARs) that vest immediately to its employees on 1st April, 20X0. The SARs will be settled in cash. Using an option pricing model, at that date it is estimated that the fair value of a SAR is ₹ 95. SAR can be exercised any time upto 31st March, 20X3. At the end of period on 31st March, 20X1 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 exercised only at the end of the 3rd year. Fair Values at the end of each period have been given below:

Fair value of SAR	₹
31st March, 20X1	112
31st March, 20X2	109
31st March, 20X3	114

Pass the Journal entries?

Answer

Period	Fair value a	To be vested b	Cumulative c = a x b x 10,000	Expense d = c – prev. period c
Start	95	100%	9,50,000	9,50,000
Period 1	112	95%	10,64,000	1,14,000
Period 2	109	92%	10,02,800	(61,200)
Period 3	114	89%	10,14,600	11,800
				10,14,600

Journal Entries

1st April, 20X0			
Employee benefits expenses	Dr.	9,50,000	
To Share based payment liability			9,50,000
(Fair value of the SAR recognized)			
31st March, 20X1			
Employee benefits expenses	Dr.	1,14,000	
To Share based payment liability			1,14,000
(Fair value of the SAR re-measured)			
31st March, 20X2			
Share based payment liability	Dr.	61,200	
To Employee benefits expenses			61,200
(Fair value of the SAR re-measured & reversed)			
31st March, 20X3			

Employee benefits expenses To Share based payment liability (Fair value of the SAR recognized)	Dr.	11,800	11,800
Share based payment liability To Cash (Settlement of SAR)	Dr.	10,14,600	10,14,600

Question 15

MINDA issued 11,000 share appreciation rights (SARs) that vest immediately to its employees on 1st April, 20X0. The SARs will be settled in cash. Using an option pricing model, at that date it is estimated that the fair value of a SAR is ₹ 100. SAR can be exercised any time until 31st March, 20X3. It is expected that out of the total employees, 94% at the end of period on 31st March, 20X1, 91% at the end of next year will exercise the option. Finally, when these were exercised i.e. at the end of the 3rd year, only 85% of the total employees exercised the option.

Fair value of SAR	₹
31st March, 20X1	132
31st March, 20X2	139
31st March, 20X3	141

Pass the Journal entries?

Answer

Period	Fair value	To be vested	Cumulative	Expense
Start	100	100%	11,00,000	11,00,000
Period 1	132	94%	13,64,880	2,64,880
Period 2	139	91%	13,91,390	26,510
Period 3	141	85%	13,18,350	(73,040)
				13,18,350

Journal Entries

1st April, 20X0			
Employee benefits expenses To Share based payment liability (Fair value of the SAR recognised)	Dr.	11,00,000	11,00,000
31st March, 20X1			
Employee benefits expenses To Share based payment liability (Fair value of the SAR re-measured)	Dr.	2,64,880	2,64,880
31st March, 20X2			

Employee benefits expenses To Share based payment liability (Fair value of the SAR re-measured)	Dr.	26,510	26,510
31st March, 20X3			
Share based payment liability To Employee benefits expenses (Fair value of the SAR reversed)	Dr.	73,040	73,040
Share based payment liability To Cash (Settlement of SAR)	Dr.	13,18,350	13,18,350

Question 16

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 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
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 ₹ 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.

Answer

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
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
31 December 20X8	(30,000)**	0	Liability extinguished

*Expense comprises an increase in the liability of ₹ 102,000 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 i.e. ₹ 30,000.

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)			

Note: Last two entries can be combined.

Question 17

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 SAR's 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 SAR's 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 SAR's as at 31st March, 20X3 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.

Note: Do all calculations in ₹ million

Answer

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 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 18

P Ltd. granted 400 stock appreciation rights (SAR) each to 75 employees on 1st April 20X1 with a fair value ₹ 200. The terms of the award require the employee to provide service for four years in order to earn the award. The fair value of each SAR at each reporting date is as follows:

31st March 20X2	₹ 210
31st March 20X3	₹ 220
31st March 20X4	₹ 215
31st March 20X5	₹ 218

What would be the difference if at the end of the second year of service (i.e. at 31st March 20X3), P Ltd. modifies the terms of the award to require only three years of service.

Answer

Journal entries in the books of P Ltd (without modification of service period of stock appreciation rights)

(₹ in lakhs)

Date	Particulars	Debit	Credit
31.03.20X2	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	15.75	 15.75

31.03.20X3	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	17.25	17.25
31.03.20X4	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	15.38	15.38
31.03.20X5	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	17.02	17.02

Journal entries in the books of P Ltd (with modification of service period of stock appreciation rights)

(₹ in lakhs)

Date	Particulars	Debit	Credit
31.03.20X2	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	15.75	15.75
31.03.20X3	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	28.25	28.25
31.03.20X4	Profit and Loss account Dr. To Liability against SARs (Being expenses liability for stock appreciation rights recognised)	20.50	20.50

Working Notes:

Calculation of expenses for issue of stock appreciation rights without modification of service period

For the year ended 31st March 20X2

= ₹ 210 x 400 awards x 75 employees x 1 year/4 years of service

= ₹ 15,75,000

For the year ended 31st March 20X3

= ₹ 220 x 400 awards x 75 employees x 2 years/4 years of service – ₹ 15,75,000 previous recognised

= ₹ 33,00,000 – ₹ 15,75,000 = ₹ 17,25,000

For the year ended 31st March 20X4

= ₹ 215 x 400 awards x 75 employees x 3 years/4 years of service – ₹ 33,00,000 previously recognised

= ₹ 48,37,500 – ₹ 33,00,000 = ₹ 15,37,500

For the year ended 31st March, 20X5

= ₹ 218 x 400 awards x 75 employees x 4 years/4 years of service – ₹ 48,37,500 previously recognised

= ₹ 65,40,000 – ₹ 48,37,500 = ₹ 17,02,500

Calculation of expenses for issue of stock appreciation rights with modification of service period

For the year ended 31st March 20X2

= ₹ 210 x 400 awards x 75 employees x 1 year/4 years of service = ₹ 15,75,000

For the year ended 31st March 20X3

= ₹ 220 x 400 awards x 75 employees x 2 years/3 years of service – ₹ 15,75,000 previous recognised

= ₹ 44,00,000 – ₹ 15,75,000 = ₹ 28,25,000

For the year ended 31st March 20X4

= ₹ 215 x 400 awards x 75 employees x 3 years/3 years of service – ₹ 44,00,000 previous recognised

= ₹ 64,50,000 – ₹ 44,00,000 = ₹ 20,50,000

Question 19

On 1st January, 20X1, ABC limited gives options to its key management personnel (employees) to take either 1,500 equity shares or cash amount equivalent to 1,000 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 January, 20X1	113
Fair value on 31st December, 20X1	120
Fair Value on 31st December, 20X2	132

The employees exercise their cash option at the end of 20X2. Pass the journal entries.

Answer

	1st January, 20X1 ₹	**31st December, 20X1** ₹	**31st December, 20X2** ₹
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

31st December, 20X1			
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 December, 20X2			
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 20

At 1st January, 20X0, Ambani Limited grants its CEO an option to take either cash amount equivalent to 800 shares or 990 shares. The minimum service requirement is 2 years. There is a condition to keep the shares for 3 years if shares are opted.

Fair values of the shares	₹
Share alternative fair value (with restrictions)	212
Grant date fair value on 1st January, 20X0	213
Fair value on 31st December, 20X0	220
Fair value on 31st December, 20X1	232

The key management exercises his cash option at the end of 20X2. Pass journal entries.

Answer

	1st January, 20X0	31st December, 20X0	31st December, 20X1

Equity alternative (990 x 212)	2,09,880		
Cash alternative (800 x 213)	1,70,400		
Equity option (2,09,880 – 1,70,400)	39,480		
Cash Option (cumulative) (using period end fair value)		88,000	1,85,600
Equity Option (cumulative)		19,740	39,480
Expense for the period			
Equity option		19,740	19,740
Cash Option		88,000	97,600
Total		1,07,740	1,17,340

Journal Entries

31st December, 20X0		
Employee benefits expenses Dr.	1,07,740	
To Share based payment reserve (equity)*		19,740
To Share based payment liability		88,000
(Recognition of Equity option and cash settlement option)		
31st December, 20X1		
Employee benefits expenses Dr.	1,17,340	
To Share based payment reserve (equity)*		19,740
To Share based payment liability		97,600
(Recognition of Equity option and cash settlement option)		
Share based payment liability Dr.	1,85,600	
To Bank/Cash		1,85,600
(Settlement in cash)		

*The equity component recognized (₹ 39,480) 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 21

Tata Industries issued share-based option to one of its key management personnel which can be exercised either in cash or equity and it has following features:

Option I	**Period**	
No of cash settled shares		74,000
Service condition	3 years	
Option II		
No of equity settled shares (Face Value ₹ 100)		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 20X0		138
20X1		140
20X2		147

Pass the Journal entries?

Answer

Fair value of Equity option components:		
Fair value of a share with restrictive clause		₹ 115
Number of shares		90,000
Fair value (90,000 x 115)	(A)	₹ 1,03,50,000
Fair value of a share at the date of grant		₹ 135
Number of cash settled shares		74,000
Fair value (74,000 x 135)	(B)	₹ 99,90,000
Fair value of equity component in compound instrument (A – B)		₹ 3,60,000

Journal Entries

31/12/20X0			
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)			
31/12/20X1			
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) x 2/3] – 34,04,000			35,02,667
(Recognition of equity option and cash settlement option)			
31/12/20X2			
Employee benefits expenses	Dr.	40,91,333	
To Share based payment reserve (equity) (3,60,000/3)			1,20,000
To Share based payment liability (147 x 74,000) x 3/3 – (34,04,000 + 35,02,667)			39,71,333

(Recognition of equity option and cash settlement option)		
Upon cash alternative chosen		
Share based payment liability (147 x 74,000) Dr. To Bank/Cash (Being settlement made in cash)	1,08,78,000	1,08,78,000
Share based payment reserve (equity) Dr. To Retained Earnings (Being transfer of equity from one account to another one)	3,60,000	3,60,000
Upon equity alternative chosen		
Share based payment liability Dr. To Share Capital To Share Premium (Being settlement made in equity)	1,08,78,000	90,00,000 18,78,000
Share based payment reserve (equity) Dr. To Retained Earnings (Being transfer of equity from one account to another one)	3,60,000	3,60,000

Question 22

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	₹ 87
Number of shares granted to each employee	25
Vesting conditions	Immediately
Face value per share	₹ 10

Pass the journal entries in the books of company P & company B.

Answer

Journal Entries

Books of Company P

Particulars	Debit (₹)	Credit (₹)
Investment in Company B Dr. To Equity Share Capital A/c (2,500 shares x ₹ 10) To Securities Premium A/c (2,500 shares x ₹ 77) (Being allotment of 25 shares each to 100 employees of B at fair value of ₹ 87 per share)	2,17,500	25,000 1,92,500

Books of Company B

Particulars		Debit (₹)	Credit (₹)
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 23

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 for the employees of company B. The details are as below:

Number of employees of company B	100
Grant date fair value of share	₹ 87
Number of shares to each employee granted	25
Vesting conditions	Immediately

Pass the journal entry in the books of company P & company B.

Answer

Books of Company P

Investment in Company B	Dr.	₹ 2,17,500	
To Equity (Issue of Shares)			₹ 2,17,500

Books of Company B

Expense	Dr.	₹ 2,17,500	
To Capital contribution from Parent P			₹ 2,17,500

Question 24

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 ₹ 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 in the books of subsidiary for giving effect to the above arrangement.

Answer

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 recognised 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		₹	₹
Remuneration expense (200 x 100 employees x ₹ 30 x 80% x ½) To Equity (Contribution from the parent)	Dr.	2,40,000	 2,40,000
Year 2			
Remuneration expense [(200 x 81 employees x ₹ 30) – 2,40,000] To Equity (Contribution from the parent)	Dr.	2,46,000	 2,46,000

Question 25

A parent, Company P, grants 30 shares to 100 employees each of its subsidiary, Company S, on condition that the employees remain employed by Company S for three years. Assume that at the outset, and at the end of Years 1 and 2, it is expected that all the employees will remain employed for all the three years. At the end of Year 3, none of the employees has left. The fair value of the shares on grant date is ₹ 5 per share.

Company S agrees to reimburse Company P over the term of the arrangement for 75 percent of the final expense recognised by Company S. What would be the accounting treatment in the books of Company P and Company S?

Answer

Company S expects to recognise an expense totalling ₹ 15,000 (30 shares x 100 employees x ₹ 5 per share) and, therefore, expects the total reimbursement to be ₹ 11,250 (₹ 15,000 x 75%). Company S therefore reimburses Company P ₹ 3,750 (₹ 11,250 x 1/3) each year.

Accounting by Company S

In each of Years 1 to 3, Company S recognises an expense in profit or loss, the cash paid to Company P, and the balance of the capital contribution it has received from Company P.

Journal Entry			
Employee benefits expenses	Dr.	5,000	
To Cash/Bank			3,750
To Equity (Contribution from the parent)			1,250
(To recognise the share-based payment expense and partial reimbursement to parent)			

Accounting by Company P

In each of Years 1 to 3, Company P recognises an increase in equity for the instruments being granted, the cash reimbursed by Company S, and the balance as investment for the capital contribution it has made to Company S.

Journal Entry			
Investment in Company S	Dr.	1,250	

Cash/Bank Dr.	3,750	
To Equity		5,000
(To recognise the grant of equity instruments to employees of subsidiary less partial reimbursement from subsidiary)		

Question 26

Indian Inc. issued 995 shares in exchange for purchase of an office building. The title was transferred in the name of Indian Inc. on 1st February, 20X1 and shares were issued. Fair value of the office building was ₹ 2,00,000 and face value of each share of Indian Inc was ₹ 100.

Pass the journal entries?

Answer

1st February, 20X1		
Office Building Dr.	2,00,000	
To Share capital (995 x 100)		99,500
To Securities premium (balance)		1,00,500
(Recognition of equity option)		

Question 27

Reliance limited hired a maintenance company for its oil fields. The services will be settled by issuing 1,000 shares of Reliance. Period for which the service is to be provided is 1st April, 20X1 to 1st July, 20X1 and fair value of the service was estimated using market value of similar contracts for ₹ 1,00,000. Nominal value per share is ₹ 10.

Record the transactions?

Answer

Fair value of services	1,00,000
Number of months	3
Monthly expense	33,333.33

Journal Entries

30th April, 20X1		
Repair & Maintenance Dr.	33,333.33	
To Share based payment reserve (equity)		33,333.33
(Recognition of Equity settled SBP using fair value of services rendered)		
31st May, 20X1		
Repair & Maintenance Dr.	33,333.33	
To Share based payment reserve (equity)		33,333.33

(Recognition of Equity settled SBP using fair value of services rendered)		
30th June, 20X1		
Repair & Maintenance Dr.	33,333.33	
To Share based payment reserve (equity)		33,333.33
(Recognition of Equity settled SBP using fair value of services rendered)		
1st July, 20X1		
Share based payment reserve (equity) Dr.	1,00,000	
To Equity Shares (1,000 x 10)		10,000
To Securities premium (balancing figure)		90,000
(Recognition of Equity settled SBP using fair value of services rendered)		

Question 28

Entity X acquired entity Y in a business combination as per Ind AS 103. There is an existing share-based plan in entity Y with a vesting condition for 3 years in which 2 years have already lapsed at the date of such business acquisition. Entity X agrees to replace the existing award for the employees of combined entity. The details are as below-

Acquisition date fair value of share-based payment plan	₹ 300
Number of years to vest after acquisition	1 year
Fair Value of award which replaces existing plan	₹ 400

Calculate the share-based payment values as per Ind AS 102?

Answer

Pre-acquisition period = 2

Post-acquisition period = 1

Total fair value at acquisition date = ₹ 300

Value to be recorded as per business combination under Ind AS 103 = (₹ 300/3) x 2 = ₹ 200

Value to be recorded as per Ind AS 102 (A) = (₹ 300/3) x 1 = ₹ 100

Fair value of the replacement of such award = ₹ 400

Difference from acquisition date fair value (B) = ₹ 400 – ₹ 300 = ₹ 100

Total value to be accounted over vesting period as per Ind AS 102 = (A) + (B) = ₹ 100 + ₹ 100 = ₹ 200

CHAPTER - 6
Ind AS 101: First-Time Adoption of Ind AS

Question 1

H Ltd. has the following assets and liabilities as at March 31, 20X1, prepared in accordance with previous GAAP:

Particulars	Notes	Amount (₹)
Property, Plant & Equipment	1	1,34,50,000
Investments in S. Ltd.	2	48,00,000
Trade Receivables		2,00,000
Advances for purchase of inventory		50,00,000
Inventory		8,00,000
Cash		49,000
Total assets		2,42,99,000
VAT 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:

1. In relation to property, plant and equipment, the following adjustments were identified:
   - Property, plant and equipment comprise land held for capital appreciation purposes costing ₹ 4,50,000 and was classified as investment property as per Ind AS 40.
   - Exchange differences of ₹ 1,00,000 were capitalised to depreciable property, plant and equipment on which accumulated depreciation of ₹ 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.
2. The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for ₹ 48,00,000 that carried

a fair value of ₹ 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.

3. Financial instruments:

   - **VAT deferral loan of ₹ 60,00,000:**

     The VAT deferral loan of ₹ 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 ₹ 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 VAT deferral loan

4. The retained earnings of the Company contained the following:

   - **ESOP reserve of ₹ 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 ₹ 12,000 towards the vested options and ₹ 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 ₹ 15,000 and ₹ 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 of ₹ 1,00,000:**

     The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of ₹ 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.

Prepare transition date Ind AS balance sheet of Company H showing adjustments to the values of assets and liabilities.

Answer

Adjustments for opening balance sheet as per Ind AS 101

1. **Property, Plant & 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 capitalised 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 ₹ 68,00,000.

3. **Financial instruments:** As the VAT 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 VAT deferral loan should be recognised at ₹ 37,25,528 and the remaining ₹ 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 ₹ 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 ₹ 1,00,000 should be transferred to retained earnings.

6. **Retained earnings should be increased by ₹ 20,99,000 on account of the following:**

	₹
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
Increase in Retained Earnings	20,99,000

The transition date Ind AS Balance Sheet after the above adjustments in the carrying values of assets and liabilities is as under:

Transition date Ind AS Balance Sheet of H Ltd. as at 1st April, 20X1

Particular	Notes	Previous GAAP	Adjustments	Ind AS GAAP
Non-Current Assets				
Property, Plant & Equipment	1	1,34,50,000	(4,50,000)	1,30,00,000
Investment property	1	0	4,50,000	4,50,000
Current Assets				
Inventory		8,00,000		8,00,000
Financial Assets				
Investment in S Ltd.	2	48,00,000	20,00,000	68,00,000
Trade Receivables		2,00,000		2,00,000
Cash		49,000		49,000
Other current asset (Advances for purchase of inventory)		50,00,000		50,00,000

Total assets		2,42,99,000	20,00,000	2,62,99,000
Share capital		1,30,00,000		1,30,00,000
Other Equity:				
Cumulative translation difference	5	1,00,000	(1,00,000)	0
ESOP reserve	4	20,000	1,000	21,000
Retained earnings	6	1,79,000	20,99,000	22,78,000
Total equity		1,32,99,000	20,00,000	1,52,99,000
Non-current Liabilities				
Financial Liability				
VAT 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				
Financial Liability				
Trade Payables		30,00,000		30,00,000
Short term borrowings		8,00,000		8,00,000
Provisions		12,00,000		12,00,000
Total liabilities		1,10,00,000		1,10,00,000
Total equity and liabilities		2,42,99,000	20,00,000	2,62,99,000

Question 2

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:

(a) 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 ₹ 10 crores. The carrying amount as on 1st April, 20X1 under the existing GAAP was ₹ 4.5 crores.

(b) The Company has recognised a provision for proposed dividend of ₹ 60 lacs and related dividend distribution tax of ₹ 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 ₹ 75 lacs.

(d) The Company has an Equity Share Capital of ₹ 80 crores and Redeemable Preference Share Capital of ₹ 25 crores.

(e) The reserves and surplus as on 1st April, 20X1 before transition to Ind AS was ₹ 95 crores representing ₹ 40 crores of general reserve and ₹ 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.

Answer

Computation of balance total equity as on 1st April, 20X1 after transition to Ind AS

			₹ 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

		₹ 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 1st 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 3

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 voluntary 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	1,000	1,000
Long Term Provisions	1,101	691
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**

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	₹ in Lakhs
Property, Plant & Equipment	1,200

Long Term Loans & Advances	405
Trade Receivables	280
Other Current Assets	50
Trade Payables	75
Short Term Provisions	35

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.

Answer

As per paras D31AA and D31AB of Ind AS 101, when changing from proportionate consolidation to the equity method, an entity shall recognise 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.

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	2,054
Less: Trade Payables	75
Short Term Provisions	35
Deemed cost of the investment in JV	1,944

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

Note: Only those assets and liabilities have been taken into account for calculation of "proportionate goodwill share of Joint Venture", which were given in the question as "proportionate share of assts and liabilities of ABC Ltd. added to XYZ Ltd."

Proportionate Goodwill of Joint Venture

= [(Goodwill on consolidation of subsidiary and JV/Total relative net asset) x Net asset of JV]

= (1,507/23,137) x 1,825 = 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 IGAAP balance sheet to arrive at Transition date Ind AS Balance Sheet

Transition Date Ind AS Balance Sheet of XYZ Pvt. Ltd. as at 1st April, 2017

Particulars	**Previous GAAP**	**Ind AS Adjustment**	**Ind AS GAAP**
Non-Current Assets			
Property Plant & Equipment	22,288	(1,200)	21,088
Investment Property	5,245	–	5,245
Intangible assets - Goodwill on Consolidation	1,507	(119)	1,388
Financial Assets			
Long Term Loans & Advances	6,350	(405)	5,945
Non-current investment in JV	–	1,944	1,944
Current Assets			
Financial Assets			
Investments	3,763	–	3,763
Trade Receivables	1,818	(280)	1,538
Other Current Assets	104	(50)	54
Total	**41,075**	**(110)**	**40,965**
Equity and liabilities			
Equity			
Share Capital	7,953	–	7,953
Other equity	16,597	–	16,597
Non-Current Liabilities			
Financial Liabilities			
Borrowings	1,000		1,000

Long Term Provisions	691		691
Other Long-Term Liabilities	5,904		5,904
Current Liabilities			
Financial Liabilities			
Trade Payables	8,455	(75)	8,380
Short Term Provisions	475	(35)	440
Total	**41,075**	**(110)**	**40,965**

Question 4

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.

Answer

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 = $(\text{Amount/Principal})^{(1/t)}$ 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 (₹)
31st March 2021	2,00,00,000	11,48,000	2,11,48,000
31st March 2022	2,11,48,000	12,13,895	2,23,61,895
31st March 2023	2,23,61,895	12,83,573	2,36,45,468
31st 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.

Question 5

Shaurya Limited is the company having its registered and corporate office at New Delhi. 60% of 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):

1. Other current liabilities include ₹ 3,90,000 liabilities to be paid in cash such as expense payable, salary payable etc. and ₹ 60,000 are statutory government dues.
2. Long term loans and advances include ₹ 40,000 loan and the remaining amount consists Advance to staff of ₹ 1,10,000. Other non-current assets of ₹ 2,00,000 consists Capital advances to suppliers.
3. Other current assets include ₹ 3,50,000 current assets receivable in cash and Prepaid expenses of ₹ 50,000.
4. Short term provisions include Dividend payable of ₹ 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 ₹ 10,00,000. However, the fair value of said office building as on the date of transition is estimated to be ₹ 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 ₹ 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 ₹ 20,000 as provision for doubtful debts measured in accordance with previous GAAP. Now as per latest estimates using hindsights, the provision needs to be revised to ₹ 25,000.

e) Company had given a loan of ₹ 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 ₹ 50,000 as against the carrying amount of loan which at present amounts to ₹ 40,000. However, Ind AS 109 mandates to recognise the interest income 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, ₹ 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 ₹ 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 ₹ 2,00,000 as included in 'current investment'. However, the fair value of mutual funds as on the date of transition is ₹ 2,30,000.

h) Ignore separate calculation of deferred tax on above adjustments. Assume the net deferred tax income to be ₹ 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.

Answer

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 (₹)	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 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.

Para D7AA has to be applied for all items of property, plant and equipment. So, if D5 exemption is taken for buildings, Ind AS will have to be applied retrospectively for other assets as well. Since, an entity 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, it is assumed that the carrying amount of other assets based on retrospective application of Ind AS is equal to their fair value of ₹ 10 lakhs.

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, f or 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, ₹ 50,000 would be the gross carrying amount of loan and difference of ₹ 10,000 (₹ 50,000 – ₹ 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 AS 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 AS 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 6

On April 1, 20X1, Sigma 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 31 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 1 April 20X3. Suggest how should Sigma 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

Answer

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 x 100) + (30,000 x 100 x 10/100 x 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, 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).

	(₹)
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment for years 1 to 4 (6 x 3.17) (Note 1)	19.02
PV of principal repayment (including premium) 110 x 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 x 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, Sigma Ltd. shall

a. recognise the carrying amount of convertible debentures at ₹ 30,27,666;

b. recognise equity component of compound financial instrument of ₹ 1,85,400;

c. 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

d. derecognise the debenture liability in previous GAAP of ₹ 31,50,000.

Notes:

1. 3.17 is present value of annuity factor of ₹ 1 at a discount rate of 10% for 4 years.
2. On maturity, ₹ 110 will be paid (₹ 100 as principal payment + ₹ 10 as premium)

Question 7

HIM Limited having net worth of ₹ 250 crores is required to adopt Ind AS from 1 April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.

Rahul, the senior manager, of HIM 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 HIM 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 for preparation of transition date balance sheet. Also pass journal entry for each issue.

Answer

Preliminary Impact Assessment on Transition to Ind AS in HIM 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.

Journal Entry on the date of transition

Particulars		Debit (₹)	Credit (₹)
Property Plant and Equipment	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	All financial assets (other than Investment in' subsidiaries, associates and JVs' which are recorded at cost) are initially recognized at fair value.

	recorded at cost.	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 divided is made in the year when it has been declared and approved.	As per Ind AS, liability for proposed dividend is recognised 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

CHAPTER - 7
Unit 1 – Ind AS 2: Inventories

Question 1

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

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

Solar power panel (WIP)	₹ 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.

Answer

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.

Question 2

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

Answer

As per Ind AS 2 "Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, UA Ltd. will value the inventory of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Question 3

Sun Pharma Limited, a renowned company in the field of pharmaceuticals has the following four items in inventory: The Cost and Net realizable value is given as follows:

Item	Cost	Net Realisable Value
A	2,000	1,900
B	5,000	5,100
C	4,400	4,550
D	3,200	2,990
Total	**14,600**	**14,540**

Determine the value of Inventories:

(a) On an item by item basis

(b) On a group basis

Answer

Inventories shall be measured at the lower of cost and net realisable value.

(a) Item by item basis:

Item A	1,900
Item B	5,000
Item C	4,400
Item D	2,990
	14,290

(b) Group basis:

Value of Inventories = 14,540

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.

Answer

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

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 ₹ 30,00,000, Fixed overhead, therefore based on normal capacity is ₹ 3 per unit.

Determine Fixed overhead as per Ind AS 2 'Inventories' if

(i) Actual production is 7,50,000 units.

(ii) Actual production is 15,00,000 units.

Answer

(i) Actual production is 7,50,000 units: Fixed overhead is not going to change with the change in output and will remain constant at ₹ 30,00,000, therefore, overheads on actual basis is ₹ 4 per unit (30,00,000/7,50,000).

Hence, by valuing inventory at ₹ 4 each for fixed overhead purpose, it will be overvalued and the losses of ₹ 7,50,000 will also be included in closing inventory leading to a higher gross profit then actually earned.

Therefore, it is advisable to include fixed overhead per unit on normal capacity to actual production (7,50,000 x 3) ₹ 22,50,000 and balance ₹ 7,50,000 shall be transferred to Profit & Loss Account.

(ii) Actual production is 15,00,000 units: Fixed overhead is not going to change with the change in output and will remain constant at ₹ 30,00,000, therefore, overheads on actual basis is ₹ 2 (30,00,000/15,00,000).

Hence by valuing inventory at ₹ 3 each for fixed overhead purpose, we will be adding the element of cost to inventory which actually has not been incurred. At ₹ 3 per unit, total fixed overhead comes to ₹ 45,00,000 whereas, actual fixed overhead expense is only ₹ 30,00,000. Therefore, it is advisable to include fixed overhead on actual basis (15,00,000 x 2) ₹ 30,00,000.

Question 6

A business plans for production overheads of ₹ 10,00,000 per annum.

The normal level of production is 1,00,000 units per annum.

Due to supply difficulties the business was only able to make 75,000 units in the current year. Other costs per unit were ₹ 126.

Calculate the per unit cost and amount of overhead to be expensed during the year.

Answer

Calculation of cost per unit:	₹
Other costs	126
Production overhead (10,00,000/1,00,000 units)	10
Unit cost	136

Overhead to be expensed:	₹
Total production overhead	10,00,000
The amount absorbed into inventory is (75,000 x 10)	(7,50,000)
The amount not absorbed into inventory	2,50,000

₹ 2,50,000 that has not been included in inventory is expensed during the year i.e. recognised in the statement of profit and loss.

Question 7

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

The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this.

Import duties (basic custom duties) of ₹ 60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost of ₹ 5,000 to have the components taken to its warehouse.

Calculate the cost of inventory.

Answer

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

Note: The intention to take settlement discount is irrelevant.

Question 8

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

(a)	Cost of purchases (based on vendors' invoices)	5,00,000
(b)	Trade discounts on purchases	10,000
(c)	Import duties	200
(d)	Freight and insurance on purchases	250
(e)	Other handling costs relating to imports	100
(f)	Salaries of accounting department	15,000
(g)	Brokerage commission payable to indenting agents for arranging imports	300
(h)	Sales commission payable to sales agents	150
(i)	After-sales warranty costs	600

Sharp Trading Inc. is seeking your advice as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per Ind AS 2.

Answer

Items (a), (b), (c), (d), (e), and (g) are permitted to be included in the cost of inventory since these elements contribute to cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition, as per Ind AS 2

Statement showing cost of inventory

	₹
Cost of purchases (based on vendors' invoices)	5,00,000
Trade discounts on purchases	(10,000)
Import duties	200
Freight and insurance on purchases	250
Other handling costs relating to imports	100
Brokerage commission payable to indenting agents for arranging imports	300
Cost of inventory under Ind AS 2	4,90,850

Note: Salaries of accounting department, sales commission, and after-sales warranty costs are not considered as part of cost of inventory under Ind AS 2.

Question 9

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 = ₹ 200 per unit;

Labour = ₹ 100 per unit;

Variable manufacturing overhead = ₹ 100 per unit;

Fixed factory production overhead = ₹ 1,00,00,000;

Fixed factory selling overhead = ₹ 50,00,000;

Variable factory selling overhead = ₹ 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?

Answer

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

Particulars	Value per unit (₹)
Raw material	200
Labour	100
Variable manufacturing overhead	100
Fixed production overhead (1,00,00,000/1,00,000)	100
	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 ₹ 50,00,000 (1,00,00,000 – 50,00,000) will be charged to P&L.

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

Question 10

ABC Ltd. manufactures control units for air conditioning systems.

Each control unit requires the following:

1 component X at a cost of ₹ 1,205 each

1 component Y at a cost of ₹ 800 each

Sundry raw materials at a cost of ₹ 150 each

The company faces the following monthly expenses:

Factory rent ₹ 16,500

Energy cost ₹ 7,500

Selling and administrative costs ₹ 10,000

Each unit takes two hours to assemble. Production workers are paid ₹ 300 per hour.

Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours.

Determine the cost of inventory.

Answer

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

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

Question 11

On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts.

On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for ₹ 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 1 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.

Answer

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 (i.e. net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation

Question 12

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

	Finished Goods	1,200	

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

Answer

Calculation of cost for closing inventory

Particulars	₹
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead (75,000 x 10,200/15,000)	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

Since net realisable value is less than cost, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ₹ 9.50.

Therefore, value of closing inventory:

Finished Goods (1,200 x 20)	₹ 24,000
Raw Materials (900 x 9.50)	₹ 8,550
	₹ 32,550

Question 13

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

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

Answer

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

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

Finance cost	1,000 cars x 20,000	2,00,00,000
Cost of goods sold	980 cars x 2,80,000	27,44,00,000

Question 14

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

Item	Unit	Amount	Output	Closing Stock 31.3.20X1
Raw material	14,500	1,50,000	MP 1 – 5,000 units	250
Wages	–	90,000	MP II – 4,000 units	100
Fixed overhead	–	65,000	BP – 2,000 units	
Variable overhead	–	50,000		

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

Calculate the value of closing stock of MP1 and MP2 as on 31.3.20X1.

Answer

As per Ind AS 2 'Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.

1) Calculation of NRV of By-product BP

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

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

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

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

	MP I	MP 2

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

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

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

Question 15

ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of ₹ 50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was ₹ 40 per pack. Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of ₹ 15 per pack for repairing and reapplying glue to the envelopes.

Calculate the net realizable value and inventory write-down (loss) amount.

Answer

The net realisable value is the expected sale price ₹ 40, less cost incurred to bring the goods to its saleable condition i.e. ₹ 15.

Thus, NRV of envelopes pack = ₹ 40 – ₹ 15 = ₹ 25 per pack.

The loss (inventory write-down) per pack is the difference between cost and net realizable value = ₹ 50 – ₹ 25 = ₹ 25 per pack.

Question 16

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 ₹ 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is ₹ 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to ₹ 8 million. The estimated selling expense required to make the sales would ₹ 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 ₹ 11 million and estimated selling expenses are same ₹ 0.5 million.

What will be the value inventory at the following dates:

(a) 31st March 20X1

(b) 31st March 20X2

Answer

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

(a) In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be ₹ 10 million and net realisable value would be ₹ 7.5 million (i.e. Expected selling price ₹ 8 million – estimated selling expenses ₹ 0.5 million). Accordingly, inventory shall be measured at ₹ 7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of ₹ 2.5 million would be recorded in income statement of that year.

(b) 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 ₹ 10 million and net realisable value would be ₹ 10.5 million (i.e. expected selling price ₹ 11 million – estimated selling expense ₹ 0.5 million). Accordingly, inventory would be recorded at ₹ 10 million and inventory write down carried out in previous year for ₹ 2.5 million shall be reversed.

Question 17

At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of ₹ 10 per unit. The current market price is ₹ 8 per unit at which these units can be sold. Company P has a firm sales contract with Company Q to sell 60 units at ₹ 11 per unit, which cannot be settled net. Estimated incremental selling cost is ₹ 1 per unit.

Determine Net Realisable Value (NRV) of the inventory of Company P.

Answer

While performing NRV test, NRV of 60 units that will be sold to Company Q is ₹ 10 per unit (i.e. 11 – 1).

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

Therefore, Company P will write down those remaining 40 units by ₹ 120 (i.e. 40 x 3).

Total cost of inventory would be

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

Question 18

Mercury Ltd. uses a periodic inventory system. The following information relates to 20X1-20X2.

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

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

(a) FIFO

(b) Weighted Average

Answer

(a) **FIFO Method:**

FIFO inventory 31.03.20X2	350 @ 14 =	4,900
	50 @ 12 =	600
		5,500
Cost of Sales	12,250 – 5,500 =	6,750

(b) **Weighted Average Cost Method:**

Weighted average cost per item	12,250/1,000 =	12.25
Weighted average inventory at 31.03.20X2	400 x 12.25 =	4,900
Cost of sales 20X1-20X2	12,250 – 4,900 =	7,350

Question 19

Particulars	Units available	Units sold	Actual Cost/unit (₹)	Actual Total Cost (₹)
Opening inventory	100	–	2.10	210
Sale	–	75	–	–
Purchases	150	–	2.80	420
Sale	–	100	–	–
Purchase	50	–	3.00	150
Total	300	175	–	780

Calculate Closing Inventory Value and Cost of Goods Sold using FIFO Method and Weighted Average Method.

Answer

FIFO Method:

Closing Inventory: 50 units x ₹ 3.00 + 75 units x ₹ 2.80 = ₹ 360

Cost of Goods Sold: 100 units x ₹ 2.10 + 75 units x ₹ 2.80 = ₹ 420

Weighted Average Method:

Weighted average cost = Total Cost/Total units: ₹ 780/300 units = ₹ 2.60

Closing Inventory: 125 units x ₹ 2.60 = ₹ 325

Cost of Goods Sold: 175 units x ₹ 2.60 = ₹ 455

Question 20

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 ₹ 1,500.
- Total variable production overhead is ₹ 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?

Answer

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

= ₹ 1,500/7,500 = ₹ 0.2 per hour

Management should allocate fixed overhead costs to units produced at a rate of ₹ 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 ₹ 0.2 = ₹ 1,300.

The remaining fixed overhead incurred during the year of ₹ 200 (₹ 1,500 − ₹ 1,300) that remains unallocated is recognised 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

= ₹ 2,600/6,500 hours = ₹ 0.4 per hour

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

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 recognised 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 (₹ 0.2 + ₹ 0.4) = ₹ 1,380

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

	₹
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

CHAPTER - 7
Unit 2 – Ind AS 16: Property, Plant & Equipment

Question 1

Moon Ltd incurs the following costs in relation to the construction of a new factory and the introduction of its products to the local market.

Particulars	**₹ '000 (cost incurred)**
Site preparation costs	150
Direct Material	2,000
Direct Labour cost, including ₹ 10,000 incurred during an industrial strike	1,160
Testing of various processes in factory	200
Consultancy fees for installation of equipment	300
Relocation of staff to new factory	450
General overheads	550
Estimated Costs to dismantle (at present value)	200

Calculate Cost to be capitalised as per Ind AS 16.

Answer

Particulars	**₹ '000 (As per Ind AS 16)**
Site preparation costs	150
Direct Material	2,000
Direct Labour cost, including ₹ 10,000 incurred during an industrial strike	1,150
Testing of various processes in factory	200
Consultancy fees for installation of equipment	300
Relocation of staff to new factory	-
General overheads	-
Estimated Costs to dismantle (at present value)	200
Total Cost to be Capitalised as per Ind AS 16	**4,000**

Question 2

On 1st April, 20X1, XYZ Ltd. acquired a machine under the following terms:

Particulars	₹
List price of machine	80,00,000
Import duty	5,00,000

Delivery fees	1,00,000
Electrical installation costs	10,00,000
Pre-production testing	4,00,000
Purchase of a five-year maintenance contract with vendor	7,00,000

In addition to the above information XYZ Ltd. was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5%, if payment for the machine was received within one month of purchase. XYZ Ltd. paid for the plant on 20th April, 20X1. At what cost the asset will be recognised?

Answer

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 asset should be:

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

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

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

Question 3

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

	₹
Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Materials	10,00,000
Direct labour cost	4,00,000

General overheads	1,00,000

Other relevant information: Material costing ₹ 1,00,000 had been spoiled and therefore wasted and a further ₹ 1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November, 20X0 and it is estimated that ₹ 22,000 of the labour cost relate to that period. The building was completed on 1st January, 20X1 and brought in use 1st April, 20X1 (Assume that Period for Construction of building is not a substantial period). X Limited had taken a loan of ₹ 40,00,000 on 1st April, 20X0 for construction of the building. The loan carried an interest rate of 8% per annum and is repayable on 1st April, 20X2.

Calculate the cost of the building that will be included in tangible non-current asset as an addition?

Answer

Only those costs which are directly attributable to bringing the asset into working condition for its intended use should be included. Administration and general costs cannot be included. Cost of abnormal amount of wasted material/labor or other resources is not included as per para 22 of Ind AS 16. Here, the cost of spoilt materials and faulty designs are assumed to be abnormal costs. Also it is assumed that the wastages and labor charges incurred are abnormal in nature. Hence, same are also not included in the cost of PPE.

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

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

*Since Period for Construction of building is not a substantial period (i.e. 9 months), borrowing cost are not eligible for capitalisation.

Question 4

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants used for advice on the acquisition of the plant	₹ 7,00,000

5.	Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
6.	Net present value of estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
7.	Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the costs that can be capitalized in accordance with Ind AS 16.

Answer

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

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

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 5

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

- Preparation and levelling of the land – ₹ 3,00,000.
- Purchase of materials for the construction – ₹ 6.08 million in total.
- Employment costs of the construction workers – ₹ 2,00,000 per month.
- Overhead costs incurred directly on the construction of the factory – ₹ 1,00,000 per month.
- Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – ₹ 50,000 per month.
- Income received during the temporary use of the factory premises as a car park during the construction period – ₹ 50,000.
- Costs of relocating employees to work at the new factory – ₹ 3,00,000.
- Costs of the opening ceremony on 31st January, 20X1 – ₹ 1,50,000.

Available for use

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 ₹ 1,00,000 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.

Note: Present all calculations in ₹ '000

Answer

Computation of the cost of the factory

Description	Included in PPE ₹ '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 1st 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. Also acceptable to reduce by allocating a portion to the non-depreciable land element principle.
Depreciation must be in two parts:		
Depreciation of roof component	49.56	9,912.50 x 30% x 1/20 x 4/12
Depreciation of remainder	57.82	9,912.50 x 70% x 1/40 x 4/12
Total depreciation	107.38	
Computation of carrying amount	19,805.12	19,912.50 – 107.38

Question 6 Good

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 ₹ '000
Costs of the basic materials (list price ₹ 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. Available for use

The other overheads were incurred in the two months period ended on 31 May 20X1. They included an abnormal cost of ₹ 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 ₹ 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 ₹ 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 ₹ 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.

Note: Present all calculations in ₹ '000

Answer

Statement showing Cost of production line:

Particulars	Amount ₹'000
Purchase cost	10,000
Goods and services tax – recoverable goods and services tax not included	–
Employment costs during the period of getting the production line ready for use (1,200 x 2 months/3 months)	800
Other overheads – excluding 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 ₹ '000
Cost of Production line	13,260
Less: Depreciation (W.N.1)	(1,694)
Net carrying value carried to Balance Sheet	11,566

Provision for dismantling cost:

Particulars	Amount ₹ '000
Non-current liabilities	1,360
Add: Finance cost (W.N.3)	57
Net book value carried to Balance Sheet	1,417

Extract of Statement of Profit & Loss

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

Extract of Balance Sheet

Particulars	Amount ₹ '000
Assets	
Non-current assets	
Property, plant and equipment	11,566
Equity and liabilities	
Non-current liabilities	
Other liabilities	
Provision for dismantling cost	1,417

Working Notes:

1. **Calculation of depreciation charge**

Particulars	Amount ₹ '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 (3,000x ¼ x 10/12)	625
This is related to a major overhaul to ensure that it generates economic benefits for the second half of its useful life	
For balance amount, depreciation for 10,260 with an useful economic life (UEL) of eight years will be: 10,260 x 1/8 x 10/12	1,069
Total (To Statement of Profit & Loss for the year ended 31st March 20X2)	1,694

2. **Finance costs**

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

Question 7 2.4

On 1st October, 2021, A Ltd. completed the construction of a power generating facility. The total construction cost was ₹ 200,00,000. The facility was capable of being used from 1st October, 2021 but A Ltd. did not bring the facility into use until 1st January, 2022. The estimated useful life of the facility at 1st October, 2021 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 ₹ 100,00,000. A relevant annual discount rate to use in any discounting calculations is 5%. When the annual discount rate is 5%, the present value of ₹ 1 receivable in 40 years' time is approximately 0.142.

Analyse and present how the above events would be reported in the financial statements of A Ltd. for the year ended 31st March, 2022 as per Ind AS.

Note: Present all calculations in ₹ '000

Answer

All figures are ₹ 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, 2021.

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 x 0.142).

This will be recognised as a provision under non-current liabilities in the Balance Sheet of A Ltd. at 31st March, 2022.

As time passes the discounted amount unwinds. The unwinding of the discount for the year ended 31st March, 2022 will be 35.5 (1,420 x 5% x 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, 2022 is 267.75 (21,420 x 1/40 x 6/12).

The closing balance included in non-current assets will be 21,152.25 (21,420 – 267.75).

Question 8

On 1st April, 20X1, an item of property is offered for sale at ₹ 10 million, with payment terms being three equal installments of ₹ 33,33,333 over a two-year period (payments are made on 1st April, 20X1, 31st March, 20X2 and 31st March, 20X3). Implicit interest rate of 5.36 percent p.a.

Show how the property will be recorded in accordance with Ind AS 16 and also pass necessary journal entries.

Answer

Ind AS 16 requires that the cost of an item of PPE is the cash price equivalent at the recognition date. Hence, the purchaser that takes up the deferred payment terms will recognise the acquisition of the asset as follows:

On 1st April, 20X1		**(₹)**	**(₹)**
Property, Plant and Equipment (W.N. 1)	Dr.	95,00,000	
To Bank A/c			33,33,333
To Accounts Payable (W.N. 2)			61,66,667

(Initial recognition of property)		
On 31st March, 20X2		
Interest Expense (W.N. 2) Dr.	3,30,533	
Accounts payable (W.N. 2) Dr.	30,02,800	
To Bank A/c		33,33,333
(Recognition of interest expense and payment of second installment)		
On 31st March, 20X3		
Interest Expense (W.N. 2) Dr.	1,69,467	
Accounts payable (W.N. 2) Dr.	31,63,867	
To Bank A/c		33,33,334
(Recognition of interest expense and payment of final installment)		

Working Notes:

1. **Calculation of cash price equivalent at initial recognition**

Year	Payment	Discounting factor	Present value
1.4.20X1	33,33,333	1.000	33,33,333
31.3.20X2	33,33,333	0.949	31,63,333
31.3.20X3	33,33,334	0.901	30,03,333
Initial date cash price equivalent	1,00,00,000		95,00,000

2. **Calculation of interest expenses**

Year	Opening balance (a)	Interest @ 5.36% (b) = (a) x 5.36%	Total payment at year beginning (c)	Principal amount in instalment (d) = (c) – (b)	Closing balance (e) = (a) – (d)
1.4.20X1	95,00,000	–	33,33,333	33,33,333	61,66,667
31.3.20X2	61,66,667	3,30,533	33,33,333	30,02,800	31,63,867
31.3.20X3	31,63,867	1,69,467*	33,33,334	31,63,867	Nil

*Difference of ₹ 116 [(31,63,867 x 5.36%) – (33,33,334 – 31,63,867)] is due to approximation.

Pluto (L&B) C.A = 10 m
F.V = 15m

Question 9

Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of ₹ 10 million. The fair value of such asset is ₹ 15 million. It exchanges the land and building for a private jet, which has a fair value of ₹ 20 million, and pays additional ₹ 3 million in cash.

Show the necessary treatment as per Ind AS 16 and pass journal entry for the transaction.

Note: Present all calculations in ₹ '000

PPE Acquired (Pvt. Jet)
F.V 20 m
Cash = 3m

Answer

Provided that the transaction has commercial substance, the entity should recognise the private jet at a cost of ₹ 18 million (being ₹ 15 million plus 3 million cash) and should recognise a profit on disposal of the land and building of ₹ 5 million, calculated as follow:

	(₹' 000)
Recognition of fair value of asset acquired (15,000 + 3,000)	18,000
Less: Carrying amount of land and building disposed	(10,000)
Cash Paid	(3,000)
Profit on exchange of assets	5,000

The required journal entry is therefore as follow:

Property, Plant and Equipment (Private Jet)	Dr.	18,000	
To Property, Plant and Equipment (Land and Building)			10,000
To Cash			3,000
To Profit on exchange of assets			5,000

Question 10

Entity X has a warehouse which is closer to factory of Entity Y and vice versa. The factories are located in the same vicinity (Area). Entity X and Entity Y agree to exchange their warehouses. The carrying value of warehouse of Entity X is ₹ 1,00,000 and its fair value is ₹ 1,25,000. It exchanges its warehouse with that of Entity Y, the fair value of which is ₹ 1,20,000. It also receives cash amounting to ₹ 5,000. How should Entity X account for the exchange of warehouses?

Lack of Comm. Sub. ∴ Carrying Amt

Entity X C.A = 100000
F.V = 125000
Cash Rec. 5000
Y F.V = 120500

Answer

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 recognise the assets received at the carrying amount of asset given up, i.e., ₹ 1,00,000 being carrying amount of existing warehouse of Entity X and ₹ 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 ₹ 95,000 in the books of Entity X.

Question 11

An asset which cost ₹ 10,000 was estimated to have a useful life of 10 years and residual value ₹ 2,000. After two years, useful life was revised to 4 remaining years.

Calculate the depreciation charge for the years 1,2,3.

Answer

	Year-1	Year-2	Year-3
Cost	10,000	10,000	10,000
Less: Accumulated Depreciation	(800)	(1,600)	(3,200)
Carrying Amount	9,200	8,400	6,800
Charges for year	(10,000 – 2,000)/10 = 800	(10,000 – 2,000)/10 = 800	(8,400 – 2,000)/4 = 1,600

Question 12

B Ltd. owns an asset with an original cost of ₹ 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be ₹ 20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.

At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to ₹ 10,000.

How would the above changes in estimates be accounted by B Ltd.?

Answer

Calculation of accumulated depreciation till 8th year

Depreciable amount {Cost less residual value} = ₹ 2,00,000 – ₹ 20,000 = ₹ 1,80,000.

Annual depreciation = Depreciable amount/Useful life = 1,80,000/10 = ₹ 18,000.

Accumulated depreciation = 18,000 x No. of years (8) = ₹ 1,44,000.

Calculation of carrying amount at the end of the 8th year

The asset has a carrying amount of ₹ 56,000 at the end of year 8 [i.e. ₹ 2,00,000 – ₹ 1,44,000]

Accounting of the changes in estimates

Revision of the useful life to 12 years results in a remaining useful life of 4 years (i.e. 12 years – 8 years).

The revised depreciable amount is ₹ 46,000 (₹ 56,000 – ₹ 10,000)

Thus, depreciation should be charged in future i.e. from 9th year onwards at ₹ 11,500 per annum (₹ 46,000/4 years).

Question 13

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	₹ 1,50,00,000	15 years
Plant and machinery	₹ 1,00,00,000	10 years
Furniture and fixtures	₹ 35,00,000	7 years

A Ltd. uses the straight-line method of depreciation. On 1st April, 20X4, the entity reviewed the following remaining useful lives of the property, plant, and equipment through an external valuation expert:

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

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised.

Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X5.

Answer

The annual depreciation charges prior to the change in useful life were

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

The revised annual depreciation for the year ending 31st March, 20X5, would be

Buildings	[₹ 1,50,00,000 – (₹ 10,00,000 x 3)]/10	₹ 12,00,000
Plant and machinery	[₹ 1,00,00,000 – (₹ 10,00,000 x 3)]/7	₹ 10,00,000
Furniture and fixtures	[₹ 35,00,000 – (₹ 5,00,000 x 3)]/5	₹ 4,00,000
Total		₹ 26,00,000 (B)

The impact on Statement of Profit and Loss for the year ending 31st March, 20X5 = ₹ 26,00,000 – ₹

25,00,000 = ₹ 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 ₹ 1,00,000 will be charged in the Statement of Profit and Loss every year till the time there is any further revision.

Question 14 Same Q 13

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.

Answer

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

Buildings:	₹ 1,50,00,000/15 = ₹ 10,00,000
Plant and machinery:	₹ 1,00,00,000/10 = ₹ 10,00,000
Furniture and fixtures:	₹ 35,00,000/7 = ₹ 5,00,000

   Total = ₹ 25,00,000 (A)

2. The revised annual depreciation for the year ending 31st December, 20X5, would be

Buildings:	[₹ 1,50,00,000 – (₹ 10,00,000 x 3)]/10 = ₹ 12,00,000
Plant and machinery:	[₹ 1,00,00,000 – (₹ 10,00,000 x 3)]/7 = ₹ 10,00,000

Furniture and fixtures: [₹ 35,00,000 – (₹ 5,00,000 x 3)]/5 = ₹ 4,00,000

Total = ₹ 26,00,000 (B)

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

= (B) – (A)

= ₹ 26,00,000 – ₹ 25,00,000

= ₹ 1,00,000

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 15 Good

An entity acquired an asset 3 years ago at a cost of ₹ 5 million. The depreciation method adopted for the asset was 10 percent reducing balance method.

At the end of Year 3, the entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight-line method from that date so as to reflect the revised estimated pattern of recovery of economic benefits.

Show the necessary treatment in accordance of Ind AS 16. Calculate the depreciation charge for respective years.

Answer

Change in Depreciation Method shall be accounted for as a change in an accounting estimate in accordance of Ind AS 8 and hence will have a prospective effect.

Depreciation Charges for year 1 to 11 will be as follows:

Year 1	₹ 5,00,000
Year 2	₹ 4,50,000
Year 3	₹ 4,05,000
Year 4 to Year 11 (refer W.N.)	₹ 4,55,625 p.a.

Working Note:

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

Year 3 onwards method of depreciation has been changed from reducing balance method to straight line method for which it is assessed that the remaining useful life is 8 years. Hence revised depreciation would be calculated as follows:

Revised depreciation as per straight line method = (Carrying amount as at the end of the 3rd year – Residual value)/Remaining useful life

= 36,45,000/8 years

= ₹ 4,55,625 per annum (for year 4 to year 11)

Question 16

A shipping company is required by law to bring all ships into dry dock every five years for a major inspection and overhaul. Overhaul expenditure might at first sight seem to be a repair to the ships but it is actually a cost incurred in getting the ship back into a seaworthy condition. As such the costs must be capitalised.

A ship which cost ₹ 20 million with a 20 year life must have major overhaul every five years. The estimated cost at current prices of the overhaul at the five-year point is ₹ 5 million. The actual overhaul costs incurred at the end of year 5 are ₹ 6 million.

Calculate Revised Carrying Amount at the end of 5th year and Depreciation thereon.

Answer

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

	Overhaul component(million)	**Ship (other than overhaul component) (million)**
Cost	5	15
Years	5	20
Depreciation per year	1	0.75

Total accumulated depreciation for the first five years will be ₹ 8.75 [₹ (1 + 0.75) x 5], and the carrying amount of the ship at the end of year 5 will be ₹ 11.25 million (₹ 20 less 8.75).

Actual overhaul costs incurred at the end of year 5 are ₹ 6 million. This amount will now be capitalised into the costs of the ship, to give a carrying amount of ₹ 17.25 million (being ₹ 11.25 million plus 6 million).

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

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

Annual depreciation for years 6 to 10 will now be ₹ 1.95 million [₹ (1.2 + 0.75)]. This process will be continued for years 11 to 15 and years 16 to 20. By the end of year 20, the capital cost of ₹ 20 million will have been depreciated plus the actual overhaul costs incurred at years 5, 10 and 15.

Question 17

MS Ltd. has acquired a heavy machinery at a cost of ₹ 1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 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 ₹ 45,00,000. The discount rate assumed is 5%.

Can the cost of the new turbine be recognised as an asset, and, if so, what treatment should be used?

Note: Consider 4 decimals in PV Factor

Answer

The new turbine will produce economic benefits to MS Ltd., and the cost is measurable. Hence, the item should be recognised as an asset. The original invoice for the machine did not specify the cost of the turbine; however, the cost of the replacement ₹ 45,00,000 can be used as an indication (usually by discounting) of the likely cost, six years previously.

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

The current carrying amount of the turbine which is required to be replaced of ₹ 13,43,160 would be derecognised from the books of account, (i.e., Original Cost ₹ 33,57,900 as reduced by accumulated depreciation for past 6 years ₹ 20,14,740, assuming depreciation is charged on straight-line basis.)

The cost of the new turbine, ₹ 45,00,000 would be added to the cost of machine, resulting in a revision of carrying amount of machine to ₹ 71,56,840. (i.e., ₹ 40,00,000* – ₹ 13,43,160 + ₹ 45,00,000).

*Original cost of machine ₹ 1,00,00,000 reduced by accumulated depreciation (till the end of 6 years) ₹ 60,00,000.

Question 18

Jupiter Ltd. has an item of property, plant and equipment with an initial cost of ₹ 100,000. At the date of revaluation accumulated depreciation amounted to ₹ 55,000. The fair value of asset, by reference to transactions in similar assets, is assessed to be ₹ 65,000.

Find out the entries to be passed?

Answer

Method – I: Depreciation Elimination Approach

Accumulated depreciation	Dr.	55,000	
To Asset Cost			55,000
Asset Cost	Dr.	20,000	
To Revaluation reserve			20,000

The net result is that the asset has a carrying amount of ₹ 65,000 (100,000 – 55,000 + 20,000).

Method – II: Restatement Approach

Carrying amount (100,000 – 55,000) = 45,000

Fair value (revalued amount) = 65,000

Surplus = 65,000 – 45,000 = 20,000

% of surplus = (20,000/45,000) x 100 = 44.44%

Journal Entry to be Made:

Asset (1,00,000 x 44.44%)	Dr.	44,444	
To Accumulated Depreciation (55,000 x 44.44%)			24,444
To Surplus on Revaluation			20,000

(Being the entry to increase both the original cost and the accumulated depreciation by 44.44%)

Question 19

A Ltd. has an item of property, plant and equipment with an initial cost of ₹ 1,00,000. At the date of revaluation, accumulated depreciation amounted to ₹ 55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be ₹ 65,000.

Pass Journal Entries with regard to Revaluation using Accumulated Depreciation Elimination Approach?

Answer

The entries to be passed would be:

		₹	₹
Accumulated depreciation To Asset A/c (Being elimination of accumulated depreciation against the cost of the asset)	Dr.	55,000	 55,000
Asset A/c To Revaluation Surplus (Being increase of net asset value to Fair value)	Dr	20,000	 20,000

Note: The net result is that the asset has a carrying amount of ₹ 65,000 [1,00,000 – 55,000 + 20,000]

Question 20

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

	Amount ('000)
Gross carrying amount	₹ 200
Accumulated depreciation (straight-line method)	(₹ 80)
Net carrying amount	₹ 120
Fair value	₹ 150

The useful life of the machinery is 10 years and the company uses Straight line method of depreciation. The revaluation was performed at the end of the 4th year.

How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? Support your answer with journal entries.

Note: Present all calculations in ₹ '000

Answer

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	₹ 250	[(200/120) x 150]
Net carrying amount	₹ 150	
Accumulated depreciation	₹ 100	(₹ 250 – ₹ 150)

Journal entry

Plant and Machinery A/c (Gross Block)	Dr.	₹ 50	
To Accumulated Depreciation			₹ 20
To Revaluation Reserve			₹ 30

Depreciation subsequent to revaluation

Since the Gross Block has been restated, the depreciation charge will be ₹ 25 per annum (₹ 150/6 years).

Journal entry

Depreciation A/c	Dr.	₹ 25 p.a.	
To Accumulated Depreciation			₹ 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 paragraphs 39 and 40 of Ind AS 16.

In this case, the gross carrying amount is restated to ₹ 150 to reflect the fair value and Accumulated depreciation is set at zero.

Journal entry

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

Depreciation subsequent to revaluation

Since the Revalued amount is the revised Gross Block, the useful life to be considered is the remaining useful life of the asset which results in the same depreciation charge of ₹ 25 per annum as per Option A (₹ 150/6 years).

Journal entry

Depreciation A/c	Dr.	₹ 25 p.a.	
To Accumulated Depreciation			₹ 25 p.a.

Question 21

An item of PPE was purchased for ₹ 9,00,000 on 1st April, 20X1. It is estimated to have a useful life of 10 years and is depreciated on a straight line basis. On 1st April, 20X3, the asset is revalued to ₹ 9,60,000. The useful life remains unchanged as ten years. Ignore impact of deferred taxes.

Show the necessary treatment as per Ind AS 16 to calculate depreciation and revaluation surplus for 20X3-20X4 if entity has availed the option given by Ind AS of transferring some of the surplus as the asset is used by an enterprise.

Answer

Calculation of Additional Depreciation:	**(₹)**
Actual depreciation for 20X3-20X4 based on revalued amount (9,60,000/8)	1,20,000
Depreciation for 20X3-20X4 based on historical cost (9,00,000/10)	(90,000)
Additional Depreciation	30,000

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

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

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

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

Question 22

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.

Answer

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 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 x 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 23

X Ltd. has a machine which got damaged due to fire as on 31st January, 20X1. The carrying amount of machine was ₹ 1,00,000 on that date. X Ltd. sold the damaged asset as scrap for ₹ 10,000. X Ltd. has insured the same asset against damage. As on 31st March, 20X1, the compensation proceeds was still in process but the insurance company has confirmed the claim. Compensation of ₹ 50,000 is receivable from the insurance company. How X Ltd. will account for the above transaction?

Answer

As per para 66 of Ind AS 16, impairment or losses of items of property, plant and equipment and related claims for or payments of compensation from third parties are separate economic events and should be accounted for separately.

X Ltd. should account for the above transaction as given below:

At the time of sale of scrap machine, X Ltd. should write off the carrying amount of asset from books of account and provide a loss of ₹ 90,000. (i.e., carrying amount of ₹ 1,00,000 – realised amount of ₹ 10,000).

As on 31st March, 20X1, X Ltd. should recognise income of ₹ 50,000 against the compensation receivable in its profit or loss.

Question 24

An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1st April, 2XX1. The plant has a useful life of 40 years. Its initial cost was ₹ 1,20,000 which included an amount for decommissioning costs of ₹ 10,000, which represented ₹ 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5%. The entity's financial year ends on 31st March. On March, 2X11, the net present value of the decommissioning liability has decreased by ₹ 8,000. The discount rate has not yet changed.

How the entity will account for the above changes in decommissioning liability in the year 2X11, if it adopts cost model?

Answer

On 31st March, 2X11, the plant is 10 years old. Accumulated depreciation is ₹ 30,000 (₹ 120,000 x 10/40 years). Due to unwinding of discount @ 5% over the 10 years, the amount of decommissioning liability has increased from ₹ 10,000 to ₹ 16,300 (approx.).

On 31st March, 2X11, the discount rate has not changed. However, the entity estimates that, as a result of technological advances, the net present value of the decommissioning liability has decreased by ₹ 8,000. Accordingly, the entity adjusts the decommissioning liability from ₹ 16,300 to ₹ 8,300. On this date, the entity passes the following journal entry to reflect the change:

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

Following this adjustment, the carrying amount of the asset is ₹ 82,000 (₹ 1,20,000 – ₹ 8,000 – ₹ 30,000), which will be depreciated over the remaining 30 years of the asset's life giving a depreciation expense for the next year of ₹ 2,733 (₹ 82,000/30). The next year's finance cost for unwinding of discount will be ₹ 415 (₹ 8,300 x 5%).

Question 25

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

The company follows SLM method of depreciation. H Limited follows the Cost Model for accounting of PPE.

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

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

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

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

Note: Take PV Factor in 3 decimals and All other calculations should be done in 2 decimals in million.

Answer

The present value of such decommissioning and site restoration obligation at the end of 10th year is ₹ 2.32 million [being $5/(1.08)^{10}$]. H Limited will recognise the present value of decommissioning liability of ₹ 2.32 million as an addition to cost of PPE and will also recognize a corresponding decommissioning liability. Further, the entity will recognise the unwinding of discount as finance charge.

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

(₹ in million)

Year	Opening Amount of PPE	Depreciation Charge (on SLM) for 10 Years	Carrying Amount of PPE at end of the year	Opening Decommissioning Liability	Unwinding of Interest @ 8%	Closing Decommissioning Liability
1	102.32	10.23	92.08	2.32	0.19	2.50
2	92.08	10.23	81.85	2.50	0.20	2.70
3	81.85	10.23	71.62	2.70	0.22	2.92
4	71.62	10.23	61.39	2.92	0.23	3.15
5	61.39	10.23	51.16	3.15	0.25	3.40
6	51.16	10.23	40.93	3.40	0.27	3.68
7	40.93	10.23	30.69	3.68	0.29	3.97
8	30.69	10.23	20.46	3.97	0.32	4.29
9	20.46	10.23	10.23	4.29	0.34	4.63
10	10.23	10.23	–	4.63	0.37	5.00
Total		**102.32**			**2.68**	

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

- The present value of the decommissioning liability at the end of Year 4 works out to be ₹ 5.04 million [being $8/(1.08)^6$].
- As against this, the carrying amount of decommissioning liability at the end of Year 4 is ₹ 3.15 million (as computed above).
- The changes in the decommissioning liability of ₹ 1.89 million (being ₹ 5.04 million less ₹ 3.15 million) shall be added to the cost of the asset in the current period and the related provision for decommissioning liability is also adjusted.

  The journal entry will be:

PPE	Dr.	₹ 1.89 million	
To Provision for decommissioning liability			₹ 1.89 million

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

Year	Opening Amount of PPE	Depreciation Charge on SLM for 10 Years	Carrying Amount of PPE at end of the year	Opening Decommissioning Liability	Unwinding of Interest @8%	Closing Decommissioning Liability
5	63.28	10.55	52.73	5.04	0.40	5.44
6	52.73	10.55	42.19	5.44	0.44	5.88
7	42.19	10.55	31.64	5.88	0.47	6.35
8	31.64	10.55	21.09	6.35	0.51	6.86
9	21.09	10.55	10.55	6.86	0.55	7.41
10	10.55	10.55	-	7.41	0.59	8.00
Total		**63.28**			**2.96**	

Note that in the above table:

- Opening amount of PPE at the beginning of Year 5 is computed as ₹ 63.28 million (being carrying amount of ₹ 61.39 million at the end of Year 4 plus increase of ₹ 1.89 million arising due to increase in the present value of the decommissioning liability at the end of Year 4).
- The revised carrying amount of PPE (at ₹ 63.28 million) at the beginning of Year 5 will be depreciated over the balance 6 years of the useful life).
- Opening decommissioning liability at the beginning of Year 5 is computed as ₹ 5.04 million (being carrying amount of ₹ 3.15 million at the end of Year 4 plus increase of ₹ 1.89 million).

  Since the entity has adjusted the increase in the decommissioning liability against the carrying amount of PPE, it needs to evaluate whether the new carrying amount (in this case, ₹ 63.28 million) is recoverable. If not, it will give rise to impairment loss, to be accounted for under Ind AS 36.

Question 26

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%. 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?

Note: Round off Finance Cost for unwinding of discount on decommissioning liability to nearest ₹ 100

Answer

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)	15,600

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:

(a) 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.

(b) 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.

(2) Three years' depreciation on original cost ₹ 1,20,000 x 3/40 = ₹ 9,000 plus cumulative discount on ₹ 10,000 at 5% 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 x 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 recognised 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)	Dr.	3,420	
To Asset at valuation			3,420
Revaluation surplus (2)	Dr.	8,980	
To Asset at valuation (3)			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.

CHAPTER - 7
Unit 3 – Ind AS 116: Leases

Question 1

Entity L enters into a lease for 10 years, with a single lease payment payable at the beginning of each year. The initial lease payment is ₹ 1,00,000. Lease payments will increase by the rate of LIBOR each year. At the date of commencement of the lease, LIBOR is 2 per cent.

Assume that the interest rate implicit in the lease is 5 per cent. How lease liability is initially measured?

Answer

In the given case, the lease payments depend on a rate (i.e., LIBOR) and hence is included in measuring lease liability, As per Ind AS 116, the lease payments should initially be measured using the rate (i.e. LIBOR) as at the commencement date. LIBOR at that date is 2 per cent; therefore, in measuring the lease liability, it is assumed that each year the payments will increase by 2 per cent, as follows:

Year	Lease Payment	Discount factor @ 5%	PV of lease payments
1	1,00,000	1	1,00,000
2	1,02,000	0.952	97,102
3	1,04,040	0.907	94,364
4	1,06,121	0.864	91,689
5	1,08,243	0.823	89,084
6	1,10,408	0.784	86,560
7	1,12,616	0.746	84,012
8	1,14,869	0.711	81,672
9	1,17,166	0.677	79,321
10	1,19,509	0.645	77,083
			8,80,887

Therefore, the lease liability is initially measured at ₹ 8,80,887

Question 2

Entity Y and Entity Z execute a 12-year lease of a railcar with the following terms on January 1, 20X1:

- The lease commencement date is February 1, 20X1.
- Entity Y must pay Entity Z the first monthly rental payment of ₹ 10,000 upon execution of the lease.
- Entity Z will pay Entity Y ₹ 50,000 cash incentive to enter into the lease payable upon lease execution.

Entity Y incurred ₹ 1,000 of initial direct costs, which are payable on February 1, 20X1. Entity Y calculated the initial lease liability as the present value of the lease payments discounted using its incremental borrowing rate because the rate implicit in the lease could not be readily determined; the initial lease liability is ₹ 8,50,000.

How would Lessee Company measure and record this lease?

Answer

Entity Y would calculate the right-of-use asset as follows: ₹

Initial measurement of lease liability	8,50,000
Lease payments made to Entity Z before the commencement date	10,000
Lease incentives received from Entity Z	(50,000)
Initial direct cost	1,000
Initial measurement of right-of-use asset	**8,11,000**

Question 3

Entity ABC (lessee) enters into a three-year lease of equipment. Entity ABC agrees to make the following annual payments at the end of each year:

₹ 20,000 in year one

₹ 30,000 in year two

₹ 50,000 in year three

For simplicity purposes, there are no other elements to the lease payments (like purchase options, lease incentives from the lessor or initial direct costs). Assumed a discount rate of 12% (which is Entity ABC's incremental borrowing rate because the interest rate implicit in the lease cannot be readily determined). Entity ABC depreciates the ROU Asset on a straight-line basis over the lease term.

How would Entity ABC would account for the said lease under Ind AS 116 and Pass Journal Entries for the 1st Year?

Note: Take PV Factor in 4 decimals

Answer

At the commencement date, Entity ABC would initially recognise ROU Asset and the corresponding Lease Liability of ₹ 77,364 which is calculated as follows:

Year	Payments (Cash flows)	Discounting Factor @12%	Discounted Cash flows/Present Value
1	20,000	0.8929	17,858
2	30,000	0.7972	23,916
3	50,000	0.7118	35,590
	1,00,000		**77,364**

Then, the next step would be to prepare a schedule for Lease Liability and ROU Asset as follows:

Lease Liability

Year	Opening balance	Interest Expense	Payments	Closing balance
1	77,364	9,284	(20,000)	66,648

2	66,648	7,998	(30,000)	44,646
3	44,646	5,354*	(50,000)	-

*Difference of ₹ 4 is due to approximation.

ROU Asset (assuming no lease incentives, no initial direct costs, etc.):

Year	Opening balance	Depreciation	Closing balance
1	77,364	(25,788)	51,576
2	51,576	(25,788)	25,788
3	25,788	(25,788)	-

At lease commencement, Entity ABC would recognise the Lease Liability and the corresponding ROU Asset as follows:

ROU Asset Dr. To Lease Liability To initially recognise the Lease Liability and the corresponding ROU Asset	77,364	77,364

The following journal entries would be recorded in the first year:

Interest Expense Dr. To Lease Liability To record interest expense and accrete the lease liability using the effective interest method (₹ 77,364 x 12%)	9,284	9,284

Depreciation Expense Dr. To ROU Asset To record interest expense and accrete the lease liability using the straight line method (₹ 77,364/3 years)	25,788	25,788

Lease Liability Dr. To Cash/Bank To record lease payment	20,000	20,000

Following is summary of said lease contract's accounting (assuming no changes due to reassessment):

Particulars	**Initially**	**Year 1**	**Year 2**	**Year 3**
Cash lease payments		20,000	30,000	50,000
Lease Expense Recognised:				
Interest Expense		9,284	7,998	5,354
Depreciation Expense		25,788	25,788	25,788
Total Periodic Expense		35,072	33,786	31,142

Balance Sheet:				
ROU Asset	77,364	51,576	25,788	-
Lease Liability	(77,364)	(66,648)	(44,646)	-

Question 4

Company EFG enters into a property lease with Entity H. The initial term of the lease is 10 years with a 5-year renewal option. The economic life of the property is 40 years and the fair value of the leased property is ₹ 50 Lacs. Company EFG has an option to purchase the property at the end of the lease term for ₹ 30 lacs. The first annual payment is ₹ 5 lacs with an increase of 3% every year thereafter. The implicit rate of interest is 9.04%. Entity H gives Company EFG an incentive of ₹ 2 lacs (payable at the beginning of year 2), which is to be used for normal tenant improvement.

Company EFG is reasonably certain to exercise that purchase option. How would EFG measure the right-of-use asset and lease liability over the lease term?

Note: Take PV Factor in 2 decimals

Answer

As per Ind AS 116, Company EFG would first calculate the lease liability as the present value of the annual lease payments, less the lease incentive paid in year 2, plus the exercise price of the purchase option using the rate implicit in the lease of approximately 9.04%.

PV of lease payments, less lease incentive (W.N. 1)	₹ 37,39,648
PV of purchase option at end of lease term (W.N. 2)	₹ 12,60,000
Total lease liability	**₹ 49,99,648 or ₹ 50,00,000 (approx.)**

The right-of-use asset is equal to the lease liability because there is no adjustment required for initial direct costs incurred by Company EFG, lease payments made at or before the lease commencement date, or lease incentives received prior to the lease commencement date.

Entity EFG would record the following journal entry on the lease commencement date.

Right-of-use Asset Dr.	₹ 50,00,000	
To Lease Liability		₹ 50,00,000
To record ROU asset and lease liability at commencement date.		

Since the purchase option is reasonably certain to be exercised, EFG would amortize the right-of- use asset over the economic life of the underlying asset (40 years). Annual amortization expense would be ₹ 1,25,000 (₹ 50,00,000/40 years)

Interest expense on the lease liability would be calculated as shown in the following table. This table includes all expected cash flows during the lease term, including the lease incentive paid by Entity H and Company EFG's purchase option.

Year	Payment	Principal paid at beginning	Interest paid	Interest expense	Lease Liability (end of the year)

		of the year			
	a	b = a – c	c = (d of previous year)	d = [(e of previous year – a) x 9.04%]	e = (e of previous year + d – a)
Commencement					50,00,000
Year 1	5,00,000	5,00,000	-	4,06,800	49,06,800
Year 2	3,15,000*	(91,800)	4,06,800	4,15,099	50,06,899
Year 3	5,30,450	1,15,351	4,15,099	4,04,671	48,81,120
Year 4	5,46,364	1,41,693	4,04,671	3,91,862	47,26,618
Year 5	5,62,754	1,70,892	3,91,862	3,76,413	45,40,277
Year 6	5,79,637	2,03,224	3,76,413	3,58,042	43,18,682
Year 7	5,97,026	2,38,984	3,58,042	3,36,438	40,58,094
Year 8	6,14,937	2,78,499	3,36,438	3,11,261	37,54,418
Year 9	6,33,385	3,22,124	3,11,261	2,82,141	34,03,174
Year 10	6,52,387	3,70,246	2,82,141	2,49,213	30,00,000
Year 10	30,00,000	27,50,787	2,49,213	-	-
Total	**85,31,940**	**50,00,000**	**35,31,940**	**35,31,940**	

*(5,00,000 + increased by 3% – lease incentive paid amounting to 2,00,000)

Although the lease was for 10 years, the asset had an economic life of 40 years. When Company EFG exercises its purchase option at the end of the 10-year lease, it would have fully extinguished its lease liability but continue depreciating the asset over the remaining useful life.

Working Notes

1. Calculating PV of lease payments, less lease incentive:

Year	Lease Payment (A)	Present value factor @ 9.04% (B)	Present value of lease payments (A x B = C)
Year 1	5,00,000	1	5,00,000
Year 2	3,15,000	0.92	2,89,800
Year 3	5,30,450	0.84	4,45,578
Year 4	5,46,364	0.77	4,20,700
Year 5	5,62,754	0.71	3,99,555
Year 6	5,79,637	0.65	3,76,764
Year 7	5,97,026	0.59	3,52,245
Year 8	6,14,937	0.55	3,38,215
Year 9	6,33,385	0.50	3,16,693
Year 10	6,52,387	0.46	3,00,098
Total			**37,39,648**

2. **Calculating PV of purchase option at end of lease term:**

Year	Payment on purchase option (A)	Present value factor @ 9.04% (B)	Present value of purchase option (A x B = C)
Year 10	30,00,000	0.42	12,60,000
Total			**12,60,000**

The discount rate for year 10 is different in the above calculations because in the earlier one it's beginning of year 10 and in the later one its end of the year 10.

Question 5

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 = ₹ 68. The average rate for Year 1 was ₹ 69 and at the end of year 1, the exchange rate was ₹ 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 end of Year 1?

Answer

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 ₹ 69 (i.e., USD 2,165 x 69) = ₹ 1,49,385

Particulars		**Dr. (₹)**	**Cr. (₹)**
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. ₹ 70 at the end of year 1

Particulars		**Dr. (₹)**	**Cr. (₹)**
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., ₹ 70 at the end of Year 1. Accordingly, the lease liability will be measured at ₹ 24,82,550 (35,465 x ₹ 70) with the corresponding impact due to exchange rate movement of ₹ 88,765 [24,82,550 – (29,44,400 + 1,49,385 – 7,00,000)] taken to profit and loss.

At the end of year 1, the ROU asset will be measured as under:

Year	**Opening Balance (₹)**	**Depreciation (₹)**	**Closing Balance (₹)**
1	29,44,400	5,88,880	23,55,520

Question 6

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?

Answer

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on:

(a) An eight-year remaining lease term

(b) Annual payments of ₹ 1,00,000 and

(c) Lessee's incremental borrowing rate of 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.

Working Notes:

1. **Calculation of modified lease liability:**

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
Modified lease liability			**5,97,100**

2. **Calculation of Lease liability as at commencement date:**

Year	Lease Payment (A)	Present value factor @ 6% (B)	Present value 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
Lease liability as at modification date			**7,35,900**

3. **Calculation of Lease liability immediately before 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 7

Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from ₹ 1,00,000 per year to ₹ 95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a. The annual lease payments are payable at the end of each year.

How should the said modification be accounted for?

Answer

In the given case, Lessee calculates the ROU asset and the lease liabilities before modification as follows:

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			

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 ₹ 95,000, and

(c) Lessee's incremental borrowing rate of 7% p.a.

Year	Lease Payments (A)	Present value @ 7% (B)	Present value of lease payments (A x B = C)

1	95,000	0.935	88,825
2	95,000	0.873	82,935
3	95,000	0.816	77,520
4	95,000	0.763	72,485
5	95,000	0.713	67,735
			3,89,500

Lessee recognises the difference between the carrying amount of the modified liability (₹ 3,89,500) and the lease liability immediately before the modification (₹ 4,21,090) of ₹ 31,590 as an adjustment to the ROU Asset.

Working Note:

Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment (A)	Present value factor @ 6% (B)	Present value 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
Lease liability as at modification date			**7,35,900**

Question 8

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are ₹ 50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are ₹ 30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5% p.a.

How should the said modification be accounted for?

Answer

In the given case, Lessee calculates the ROU asset and the lease liabilities before modification as follows:

	Lease Liability				ROU asset		
Year	Initial value	Lease payments	Interest expense @6%	Closing balance	Initial Value	Depreciation	Closing balance
	a	b	c = a x 6%	d = a – b + c	e	f	g
1	3,67,950*	50,000	22,077	3,40,027	3,67,950	36,795	3,31,155
2	3,40,027	50,000	20,402	3,10,429	3,31,155	36,795	2,94,360
3	3,10,429	50,000	18,626	2,79,055	2,94,360	36,795	2,57,565
4	2,79,055	50,000	16,743	2,45,798	2,57,565	36,795	2,20,770
5	2,45,798	50,000	14,748	2,10,546	2,20,770	36,795	1,83,975
6	2,10,546				1,83,975		

*(refer note 1)

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 ₹ 30,000 and

(c) Lessee's incremental borrowing rate of 5% p.a.

Year	Lease Payment(A)	Present value factor @ 5% (B)	Present value of lease payments (A x B = C)
6	30,000	0.952	28,560
7	30,000	0.907	27,210
8	30,000	0.864	25,920
9	30,000	0.823	24,690
10	30,000	0.784	23,520
	Total		**1,29,900**

Lessee determines the proportionate decrease in the carrying amount of the ROU Asset on the basis of the remaining ROU Asset (i.e., 2,500 square metres corresponding to 50% of the original ROU Asset).

50% of the pre-modification ROU Asset (₹ 1,83,975) is ₹ 91,987.50.

50% of the pre-modification lease liability (₹ 2,10,546) is ₹ 1,05,273.

Consequently, Lessee reduces the carrying amount of the ROU Asset by ₹ 91,987.50 and the carrying amount of the lease liability by ₹ 1,05,273. Lessee recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (₹ 1,05,273 – ₹ 91,987.50 = ₹ 13,285.50) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lessee recognises the difference between the remaining lease liability of ₹ 1,05,273 and the modified lease liability of ₹ 1,29,900 (which equals ₹ 24,627) as an adjustment to the ROU Asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Working Note:

Calculation of Initial value of ROU asset and lease liability:

Year	Lease Payment(A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	50,000	0.943	47,150
2	50,000	0.890	44,500
3	50,000	0.840	42,000
4	50,000	0.792	39,600
5	50,000	0.747	37,350
6	50,000	0.705	35,250
7	50,000	0.665	33,250
8	50,000	0.627	31,350
9	50,000	0.592	29,600
10	50,000	0.558	27,900
			3,67,950

Question 9

Lessee enters into a 10-year lease for 2,000 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 6, Lessee and Lessor agree to amend the original lease to:

(a) include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and

(b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is ₹ 1,50,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.

How should the said modification be accounted for?

Answer

The pre-modification ROU Asset and the pre-modification lease liability in relation to the lease are as follows:

	Lease liability				ROU Asset		
Year	Opening balance	Interest expense @ 6%	Lease payment	Closing balance	Opening balance	Depreciation charge	Closing balance
1	7,35,900*	44,154	(1,00,000)	6,80,054	7,35,900	(73,590)	6,62,310
2	6,80,054	40,803	(1,00,000)	6,20,857	6,62,310	(73,590)	5,88,720

3	6,20,857	37,251	(1,00,000)	5,58,108	5,88,720	(73,590)	5,15,130
4	5,58,108	33,486	(1,00,000)	4,91,594	5,15,130	(73,590)	4,41,540
5	4,91,594	29,496	(1,00,000)	4,21,090	4,41,540	(73,590)	3,67,950
6	4,21,090				3,67,950		

*Refer Note 4.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of:

(a) A three-year remaining lease term (i.e. till 8th year),

(b) Annual payments of ₹ 1,50,000 and

(c) Lessee's incremental borrowing rate of 7% p.a.

Year	Lease Payments (A)	Present value @ 7% (B)	Present value of lease payments (A x B = C)
1	1,50,000	0.935	1,40,250
2	1,50,000	0.873	1,30,950
3	1,50,000	0.816	1,22,400
	Modified lease liability		**3,93,600**

The modified liability equals ₹ 3,93,600, of which (a) ₹ 1,31,200 relates to the increase of ₹ 50,000 in the annual lease payments from Year 6 to Year 8 and (refer note 1) (b) ₹ 2,62,400 relates to the remaining three annual lease payments of ₹ 1,00,000 from Year 6 to Year 8 with reduction of lease term (Refer Note 3)

Decrease in the lease term:

At the effective date of the modification (at the beginning of Year 6), the pre-modification ROU Asset is ₹ 3,67,950. Lessee determines the proportionate decrease in the carrying amount of the ROU Asset based on the remaining ROU Asset for the original 2,000 square metres of office space (i.e., a remaining three-year lease term rather than the original five-year lease term). The remaining ROU Asset for the original 2,000 square metres of office space is ₹ 2,20,770 [i.e., ₹ (3,67,950/5) x 3 years].

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is ₹ 4,21,090. The remaining lease liability for the original 2,000 square metres of office space is ₹ 2,67,300 (i.e., present value of three annual lease payments of ₹ 1,00,000, discounted at the original discount rate of 6% p.a.) (Refer note 2).

Consequently, Lessee reduces the carrying amount of the ROU Asset by ₹ 1,47,180 (₹ 3,67,950 – ₹ 2,20,770), and the carrying amount of the lease liability by ₹ 1,53,790 (₹ 4,21,090 – ₹ 2,67,300). Lessee recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (₹ 1,53,790 – ₹ 1,47,180 = ₹ 6,610) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lease Liability	Dr.	1,53,790	
To ROU Asset			1,47,180
To Gain			6,610

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7% p.a., which is ₹ 4,900 (₹ 2,67,300 – ₹ 2,62,400*), as an adjustment to the ROU Asset.

*(Refer note 3)

Lease Liability	Dr.	4,900	
To ROU Asset			4,900

Increase in the leased space:

At the commencement date of the lease for the additional 1,500 square metres of space (at the beginning of Year 6), Lessee recognises the increase in the lease liability related to the increase in leased space of ₹ 1,31,200 (i.e., present value of three annual lease payments of ₹ 50,000, discounted at the revised interest rate of 7% p.a.) as an adjustment to the ROU Asset.

ROU Asset	Dr.	1,31,200	
To Lease Liability			1,31,200

The modified ROU Asset and the modified lease liability in relation to the modified lease are as follows:

Year	Lease liability				ROU Asset		
	Opening balance	Interest expense @ 7%	Lease payment	Closing balance	Opening balance	Depreciation charge	Closing balance
6	3,93,600	27,552	(1,50,000)	2,71,152	3,47,070**	(1,15,690)	2,31,380
7	2,71,152	18,981	(1,50,000)	1,40,133	2,31,380	(1,15,690)	1,15,690
8	1,40,133	9,867*	(1,50,000)	-	1,15,690	(1,15,690)	-

*Difference is due to approximation.

**Refer Note 5

Working Notes:

1. **Calculation of lease liability on increased consideration:**

Year	Lease Payments (A)	Present value @ 7% (B)	Present value of lease payments (A x B = C)
1	50,000	0.935	46,750
2	50,000	0.873	43,650
3	50,000	0.816	40,800
Modified lease liability			**1,31,200**

2. **Calculation of remaining lease liability for the original contract of 2,000 square meters at Original discount rate:**

Year	Lease Payments (A)	Present value factor @ 6% (B)	Present value 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
	Remaining lease liability		**2,67,300**

3. **Calculation of remaining lease liability for the original contract of 2,000 square meters at revised discount rate:**

Year	Lease Payments (A)	Present value factor @ 7% (B)	Present value of lease payments (A x B = C)
1	1,00,000	0.935	93,500
2	1,00,000	0.873	87,300
3	1,00,000	0.816	81,600
	Remaining lease liability		**2,62,400**

4. **Calculation of Initial value of ROU asset and lease liability:**

Year	Lease Payment (A)	Present value factor @ 6% (B)	Present value 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
	Lease liability as at modification date		**7,35,900**

5. **Calculation of opening balance of Modified ROU Asset at the beginning of 6th year:**

The remaining ROU Asset for the original 2,000 square metres of office space after decrease in term	2,20,770
Less: Adjustment for increase in interest rate from 6% to 7%	(4,900)
Add: Adjustment for increase in leased space	1,31,200
	3,47,070

Question 10

The Company has entered into a lease agreement for its retail store as on 1st April, 20X1 for a period of 10 years. A lease rental of ₹ 56,000 per annum is payable in arrears. The Company recognized a lease liability of ₹ 3,51,613 at inception using an incremental borrowing rate of 9.5% p.a. as at 1st April 20X1. As per the terms of lease agreement, the lease rental shall be adjusted every 2 years to give effect of inflation. Inflation cost index as notified by the Income tax department shall be used to derive the lease payments. Inflation cost index was 280 for financial year 20X1-20X2 and 301 for financial year 20X3-20X4. The current incremental borrowing rate is 8% p.a.

Show the Journal entry at the beginning of year 3, to account for change in lease.

Answer

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 lease liability at 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) x 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 11

Entity W entered into a contract for lease of retail store with Entity J on January 01/01/20X1. The initial term of the lease is 5 years with a renewal option of further 3 years. The annual payments for initial term and renewal term is ₹ 1,00,000 and ₹ 1,10,000 respectively. The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year. For example, the payment due on 01/01/20X2 will be based on the CPI available at 31/12/20X1.

Entity W's incremental borrowing rate at the lease inception date and as at 01/01/20X4 is 5% and 6%

respectively and the CPI at lease commencement date and as at 01/01/20X4 is 120 and 125 respectively.

At the lease commencement date, Entity W did not have a significant economic incentive to exercise the renewal option. In the first quarter of 20X4, Entity W installed unique lease improvements into the retail store with an estimated five-year economic life. Entity W determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.

Is Entity W required to remeasure the lease in the first quarter of 20X4?

Answer

Since Entity W is now reasonably certain that it will exercise its renewal option, it is required to remeasure the lease in the first quarter of 20X4.

The following table summarizes information pertinent to the lease remeasurement.

Remeasured lease term	**5 years; 2 years remaining in the initial term plus 3 years in the renewal period**
Entity W's incremental borrowing rate on the remeasurement date	6%
CPI available on the remeasurement date	125
Right-of-use asset immediately before the remeasurement	₹ 1,81,840 (Refer note 1)
Lease liability immediately before the remeasurement	₹ 1,95,244 (Refer note 1)

To remeasure the lease liability, Entity W would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 6%). The following table shows the present value of the future lease payments based on an updated CPI of 125. Since the initial lease payments were based on a CPI of 120, the CPI has increased by 4.167% approx. As a result, Entity W would increase the future lease payments by 4.167%. As shown in the table, the revised lease liability is ₹ 4,91,376.

Year	4	5	6	7	8	**Total**
Lease payment	1,04,167	1,04,167	1,14,583	1,14,583	1,14,583	5,52,083
Discount @ 6%	1	0.943	0.890	0.840	0.792	
Present value	1,04,167	98,230	1,01,979	96,250	90,750	4,91,376

To calculate the adjustment to the lease liability, Entity W would compare the recalculated and original lease liability balances on the remeasurement date.

Revised lease liability	4,91,376
Original lease liability	(1,95,244)
	2,96,132

Entity W would record the following journal entry to adjust the lease liability.

ROU Asset	Dr.	2,96,132	
To Lease liability			2,96,132

(Being lease liability and ROU asset adjusted on account of remeasurement.)		

Working Notes:

1. **Calculation of Lease Liability and ROU asset before the date of remeasurement**

Year beginning	Lease Payment (A)	Present value factor @ 5% (B)	Present value of lease payments (A x B = C)
1	1,00,000	1.000	1,00,000
2	1,00,000	0.952	95,200
3	1,00,000	0.907	90,700
4	1,00,000	0.864	86,400
5	1,00,000	0.823	82,300
Lease liability as at commencement date			**4,54,600**

2. **Calculation of Lease Liability and ROU asset at each year end**

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense	Closing balance	Initial Value	Depreciation	Closing balance
1	4,54,600	1,00,000	17,730	3,72,330	4,54,600	90,920	3,63,680
2	3,72,330	1,00,000	13,617	2,85,947	3,63,680	90,920	2,72,760
3	2,85,947	1,00,000	9,297	1,95,244	2,72,760	90,920	1,81,840
4	1,95,244				1,81,840		

Question 12

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 (Assume it as Fair Value).

- 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.

Answer

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
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 13

A Dealer-Lessor enters into a 10-year lease of equipment with Lessee. The equipment is not specialised in nature and is expected to have alternative use to Lessor at the end of the 10-year lease term. Under the lease:

- Lessor receives annual lease payments of ₹ 15,000, payable at the end of the year
- Lessor expects the residual value of the equipment to be ₹ 50,000 at the end of the 10-year lease term
- Lessee provides a residual value guarantee that protects Lessor from the first ₹ 30,000 of loss for a sale at a price below the estimated residual value at the end of the lease term (i.e., ₹ 50,000)
- The equipment has an estimated remaining economic life of 15 years, a carrying amount of ₹ 1,00,000 and a fair value of ₹ 1,11,000

- The lease does not transfer ownership of the underlying asset to Lessee at the end of the lease term or contain an option to purchase the underlying asset
- The interest rate implicit in the lease is 10.078%.

How should the Lessor account for the same in its books of accounts and Pass Journal Entries for the 1st Year?

Answer

Lessor shall classify the lease as a FINANCE LEASE because the sum of the present value of lease payments amounts to substantially all of the fair value of the underlying asset.

At lease commencement, Lessor accounts for the finance lease, as follows:

Net investment in the lease	Dr.	₹ 1,11,000(a)	
Cost of goods sold	Dr.	₹ 92,340(b)	
To Revenue			₹ 1,03,340(c)
To Property held for lease			₹ 1,00,000(d)

To record the net investment in the finance lease and derecognise the underlying asset.

(a) The net investment in the lease consists of:

(1) the present value of 10 annual payments of ₹ 15,000 plus the guaranteed residual value of ₹ 30,000, both discounted at the interest rate implicit in the lease, which equals ₹ 1,03,340 (i.e., the lease payment) (Refer note 1) AND

(2) the present value of unguaranteed residual asset of ₹ 20,000, which equals ₹ 7,660 (Refer note 2).

Note that the net investment in the lease is subject to the same considerations as other assets in classification as current or non-current assets in a classified balance sheet.

(b) Cost of goods sold is the carrying amount of the equipment of ₹ 1,00,000 (less) the present value of the unguaranteed residual asset of ₹ 7,660.

(c) Revenue equals the lease receivable.

(d) The carrying amount of the underlying asset.

At lease commencement, Lessor recognises selling profit of ₹ 11,000 which is calculated as = lease payment of ₹ 1,03,340 – [carrying amount of the asset (₹ 1,00,000) – net of any unguaranteed residual asset (₹ 7,660) i.e. which equals ₹ 92,340]

Year 1 **Journal entry for a finance lease**

Cash	Dr.	₹ 15,000(e)	
To Net investment in the lease			₹ 3,813(f)
To Interest income			₹ 11,187(g)

Note:

(e) Receipt of annual lease payments at the end of the year.

(f) Reduction of the net investment in the lease for lease payments received of ₹ 15,000, net of interest income of ₹ 11,187

(g) Interest income is the amount that produces a constant periodic discount rate on the remaining balance of the net investment in the lease. Please refer the computation below:

The following table summarises the interest income from this lease and the related amortisation of the net investment over the lease term:

Year	Annual Rental Payment	Annual Interest Income(h)	Net investment at the end of the year
Initial net investment	–	–	1,11,000
1	15,000	11,187	1,07,187
2	15,000	10,802	1,02,989
3	15,000	10,379	98,368
4	15,000	9,914	93,282
5	15,000	9,401	87,683
6	15,000	8,837	81,520
7	15,000	8,216	74,736
8	15,000	7,532	67,268
9	15,000	6,779	59,047
10	15,000	5,953	50,000(i)

Note:

(h) Interest income equals 10.078% of the net investment in the lease at the beginning of each year. For e.g., Year 1 annual interest income is calculated as ₹ 1,11,000 (net investment) x 10.078%.

(i) The estimated residual value of the equipment at the end of the lease term.

Working Notes:

1. Calculation of net investment in lease:

Year	Lease Payment (A)	Present value factor @ 10.078% (B)	Present value of lease payments (A x B = C)
1	15,000	0.908	13,620
2	15,000	0.825	12,375
3	15,000	0.750	11,250
4	15,000	0.681	10,215
5	15,000	0.619	9,285
6	15,000	0.562	8,430
7	15,000	0.511	7,665
8	15,000	0.464	6,960
9	15,000	0.421	6,315
10	15,000	0.383	5,745
10	30,000	0.383	11,480*
			1,03,340

*Figure has been rounded off for equalization of journal entry.

2. **Calculation of present value of unguaranteed residual asset**

Year	Lease Payment (A)	Present value factor @ 10.078% (B)	Present value of lease payments (A x B = C)
10	20,000	0.383	7,660

Question 14

A lessee enters into a lease of an equipment. The contract stipulates the lessor will perform maintenance of the leased equipment and receive consideration for that maintenance service. The contract includes the following fixed prices for the lease and non-lease component:

Lease	₹ 80,000
Maintenance	₹ 10,000
Total	**₹ 90,000**
Assume the stand-alone prices cannot be readily observed, so the lessee makes estimates, maximising the use of observable information, of the lease and non-lease components, as follows:	
Lease	₹ 85,000
Maintenance	₹ 15,000
Total	**₹ 1,00,000**

In the given scenario, assuming lessee has not opted the practical expedient, how will the lessee allocate the consideration to lease and non-lease component?

Answer

The stand-alone price for the lease component represents 85% (i.e., ₹ 85,000/₹ 1,00,000) of total estimated stand-alone prices. The lessee allocates the consideration in the contract (i.e., ₹ 90,000), as follows:

Lease (₹ 90,000 x 85%)	₹ 76,500
Maintenance (₹ 90,000 x 15%)	₹ 13,500
Total	**₹ 90,000**

Question 15

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 ₹ 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 ₹ 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 ₹ 1,20,000 per year and stand-alone price of the 'facilities agreement' is ₹ 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?

Answer

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 ₹ 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
	₹		₹
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	0.909	92,718
Year 2	1,02,000	0.826	84,252
Year 3	1,02,000	0.751	76,602
Year 4	1,02,000	0.683	69,666
Year 5	1,02,000	0.621	63,342
Year 6	1,02,000	0.564	57,528
Year 7	1,02,000	0.513	52,326
Year 8	1,02,000	0.467	47,634
Year 9	1,02,000	0.424	43,248
Lease Liability at commencement date			**5,87,316**

Further, ₹ 68,000 allocated to the non-lease component of facility used will be recognised in profit or loss as and when incurred.

Question 16

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of ₹ 30,00,000.

Immediately before the transaction, the building is carried at a cost of ₹ 15,00,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with annual payments of ₹ 2,00,000 payable at the end of each year.

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in Ind AS 115 'Revenue from Contracts with Customers'.

The fair value of the building at the date of sale is ₹ 27,00,000. Initial direct costs, if any, are to be ignored. The interest rate implicit in the lease is 12% p.a., which is readily determinable by Seller-lessee.

Buyer-lessor classifies the lease of the building as an operating lease.

How should the said transaction be accounted by the Seller-lessee and the Buyer-lessor?

Note: PVFA @12% for 20 years is 7.47

Answer

Considering facts of the case, Seller-lessee and 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 ₹ 3,00,000 (as calculated below) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

Sale Price	30,00,000
Less: Fair Value (at the date of sale)	(27,00,000)
Additional financing provided by Buyer-lessor to Seller-lessee	**3,00,000**

Next step would be to calculate the present value of the annual payments which amounts to ₹ 14,94,000 (calculated considering 20 payments of ₹ 2,00,000 each, discounted at 12% p.a.) of which ₹ 3,00,000 relates to the additional financing (as calculated above) and balance ₹ 11,94,000 relates to the lease – corresponding to 20 annual payments of ₹ 40,164 and ₹ 1,59,836, respectively (refer calculations below).

Proportion of annual lease payments:

Present value of lease payments (as calculated above)	(A)	14,94,000
Additional financing provided (as calculated above)	(B)	3,00,000
Relating to the Additional financing provided	(C) = (E x B/A)	40,160
Relating to the Lease	(D) = (E – C)	1,59,840
Annual payments (at the end of each year)	(E)	2,00,000

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)	15,00,000
Fair Value (at the date of sale)	(B)	27,00,000
Discounted lease payments for the 20-year ROU asset	(C)	11,94,000
ROU Asset	**[(A/B) x C]**	**6,63,333**

Seller-lessee recognises 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)	27,00,000
Carrying Amount	(B)	15,00,000
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]	5,30,667
Relating to the rights transferred to Buyer-lessor	(D – E)	6,69,333

At the commencement date, Seller-lessee accounts for the transaction, as follows:

Cash	Dr.	30,00,000	
ROU Asset	Dr.	6,63,333	
To Building			15,00,000
To Financial Liability			14,94,000
To Gain on rights transferred			6,69,333

Buyer-Lessor:

At the commencement date, Buyer-lessor accounts for the transaction, as follows:

Building	Dr.	27,00,000	
Financial Asset (20 payments of ₹ 40,160 discounted @ 12% p.a.) (approx.)	Dr.	3,00,000	
To Cash			30,00,000

After the commencement date, Buyer-lessor accounts for the lease by treating ₹ 1,59,840 of the annual payments of ₹ 2,00,000 as lease payments. The remaining ₹ 40,160 of annual payments received from Seller-lessee are accounted for as:

(a) payments received to settle the financial asset of ₹ 3,00,000 AND

(b) interest revenue.

Unit 4 – Ind AS 23: Borrowing Costs

Question 1

X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended 31st March, 20X2, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date	Amount (₹)
1st July, 20X1	2,50,000
1st December, 20X1	3,00,000

The details of borrowings and interest thereon are as under:

Particulars	Average Balance (₹)	Interest (₹)
Long term loan @ 10%	10,00,000	1,00,000
Working capital loan	5,00,000	65,000
	15,00,000	1,65,000

Compute the borrowing costs that need to be capitalised.

Answer

The capitalisation rate is:

Total borrowing costs/Weighted average total borrowings: 1,65,000/15,00,000 = 11%

Interest will be capitalised as under:

On ₹ 2,50,000 @ 11% p.a. for 9 months = ₹ 20,625

On ₹ 3,00,000 @ 11% p.a. for 4 months = ₹ 11,000

Total interest capitalised for year ended 31 March 2002 is ₹ 31,625

Question 2

Beta Ltd had the following loans in place at the end of 31st March, 20X2:

(Amounts in ₹' 000s)

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

14% debenture was issued to fund the construction of Office building on 1st July, 20X1 but the development activities has yet to be started.

On 1st April, 20X1, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: ₹ 500,000 on 1st April, 20X1 and ₹ 2,500,000 on 1st January, 20X2.

Calculate the borrowing cost that can be capitalised for the plant.

Answer

$$\text{Capitalisation rate} = \frac{(18\% \times 1{,}000)}{1{,}000 + 3{,}000} + \frac{(16\% \times 3{,}000)}{1{,}000 + 3{,}000} = 16.5\%$$

Borrowing Costs = (500,000 x 16.5%) + (2,500,000 x16.5% x 3/12) = ₹ 1,85,625

Question 3

Alpha Ltd. on 1st April, 20X1 borrowed 9% ₹ 30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April, 20X1. The loan facility was availed on 1st April, 20X1 and was utilized as follows with remaining funds invested temporarily at 7%.

	Factory Building	**Office Building**
1st April, 20X1	5,00,000	10,00,000
1st October, 20X1	5,00,000	10,00,000

Calculate the cost of the asset and the borrowing cost to be capitalized.

Answer

Particulars	**Factory Building**		**Office Building**	
Borrowing Costs	(10,00,000 x 9%)	90,000	(20,00,000 x 9%)	1,80,000
Less: Investment Income	(5,00,000 x 7% x 6/12)	(17,500)	(10,00,000 x 7% x 6/12)	(35,000)
		72,500		1,45,000
Cost of the asset:				
Expenditure incurred		10,00,000		20,00,000
Borrowing Costs		72,500		1,45,000
Total		**10,72,500**		**21,45,000**

Question 4

On 1st April, 20X1, entity A contracted for the construction of a building for ₹ 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor:

Payment date	**Amount (₹ '000)**
1st April, 20X1	200
30th June, 20X1	600
31st December, 20X1	1,200
31st March, 20X2	200
Total	2,200

Entity A's borrowings at its year end of 31st March, 20X2 were as follows:

a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to ₹ 7,00,000. Interest of ₹ 65,000 was incurred on these borrowings during the year, and interest income of ₹ 20,000 was earned on these funds while they were held in anticipation of payments.

b. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ₹ 1,000,000 and remained unchanged during the year; and

c. 10% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ₹ 1,500,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

Answer

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 capitalisation 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 (₹'000)	Amount allocated in general borrowings (₹'000)	Weighted for period outstanding (₹'000)
1st April 20X1	200	0	0
30th June 20X1	600	100*	100 x 9/12 = 75
31st Dec 20X1	1,200	1,200	1,200 x 3/12 = 300
31st March 20X2	200	200	200 x 0/12 = 0
Total	2,200		375

*Specific borrowings of ₹ 7,00,000 fully utilized on 1st April & on 30th June to the extent of ₹ 5,00,000 hence remaining expenditure of ₹ 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.

$$\text{Capitalisation rate} = \frac{(10,00,000 \times 12.5\%) + (15,00,000 \times 10\%)}{10,00,000 + 15,00,000} = 11\%$$

Borrowing cost to be capitalized:	Amount (₹)
On specific loan	65,000
On General borrowing (3,75,000 x 11%)	41,250
Total	1,06,250
Less interest income on specific borrowings	(20,000)
Amount eligible for capitalization	86,250

Therefore, the borrowing costs to be capitalized are ₹ 86,250.

Question 5

K Ltd. began construction of a new building at an estimated cost of ₹ 7 lakh on 1st April, 2017. To finance construction of the building it obtained a specific loan of ₹ 2 lakh from a financial institution at an interest rate of 9% per annum.

The company's other outstanding loans were:

Amount	Rate of Interest per annum
₹ 7,00,000	12%
₹ 9,00,000	11%

The expenditure incurred on the construction was:

April, 2017	₹ 1,50,000
August, 2017	₹ 2,00,000
October, 2017	₹ 3,50,000
January, 2018	₹ 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.

Answer

(i) Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
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 of expenditure	Amount spent	Financed through	Calculation	₹
1st April, 2017	1,50,000	Specific borrowing	1,50,000 x 9% x 10/12	11,250
1st August, 2017	2,00,000	Specific borrowing	50,000 x 9% x 10/12	3,750
		General borrowing	1,50,000 x 11.4375% x 6/12	8,578.125
1st October, 2017	3,50,000	General borrowing	3,50,000 x 11.4375% x 4/12	13,343.75

1st January, 2018	1,00,000	General borrowing	1,00,000 x 11.4375% x 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.

(iii) Total expenses to be capitalized for building

	₹
Cost of building ₹ (1,50,000 + 2,00,000 + 3,50,000 + 1,00,000)	8,00,000
Add: Amount of interest to be capitalized	37,875
	8,37,875

(iv) Journal Entry

Date	**Particulars**		₹	₹
31.1.2018	Building account	Dr.	8,37,875	
	To Bank account			8,00,0000
	To Interest payable (borrowing cost)			37,875
	(Being expenditure incurred on construction of building & 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**		₹	₹
31.1.2018	Building account	Dr.	8,37,875	
	To Bank account			8,37,875
	(Being expenditure incurred on construction of building & borrowing cost thereon capitalized)			

Question 6

An entity constructs a new head 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 ₹ 100,000 in September 20X1 and ₹ 250,000 in each of the months of October to December 20X1.

The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 10% debentures with a face value of ₹ 20 lacs and had an overdraft of ₹ 500,000, which increased to ₹ 750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%.

Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23

'Borrowing Costs'.

Answer

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding balance	Amount of loan (₹)	Rate of interest p.a.	Weighted average amount of interest (₹)
	a	b	c	d = [(b x c) x (a/12)]
10% Debentures	12 months	20,00,000	10%	2,00,000
Bank overdraft	9 months	5,00,000	15%	56,250
	2 months	5,00,000	16%	13,333
	1 month	7,50,000	16%	10,000
		37,50,000		2,79,583

Weighted average cost of borrowings

= {20,00,000 x (12/12)} + {5,00,000 x (11/12)} + {7,50,000 x (1/12)}

= 25,20,833

Capitalisation rate

= (Weighted average amount of interest/Weighted average of general borrowings) x 100

= (2,79,583/25,20,833) x 100 = 11.09% p.a.

ALTERNATIVELY, Capitalisation rate can be calculated for construction period as follows:

Since the entity has only general borrowing hence first step will be to compute the capitalisation rate. The capitalisation rate of the general borrowings of the entity during the period of construction is calculated as follows:

Finance cost on ₹ 20 lacs 10% debentures during September to December 20X1	₹ 66,667
Interest @ 15% on overdraft of ₹ 5,00,000 in September 20X1	₹ 6,250
Interest @ 16% on overdraft of ₹ 5,00,000 in October and November 20X1	₹ 13,333
Interest @ 16% on overdraft of ₹ 750,000 in December 20X1	₹ 10,000
Total finance costs in September to December 20X1	₹ 96,250

Weighted average borrowings during period

= [(20,00,000 x 4) + (500,000 x 3) + (750,000 x 1)]/4 = ₹ 25,62,500

Capitalisation rate = Total finance costs during the construction period/Weighted average borrowings during the construction period

= 96,250/25,62,500 = 3.756%

Question 7

ABC Ltd. has taken a loan of USD 20,000 on 1st April, 20X1 for constructing a plant at an interest rate of 5% per annum payable on annual basis.

On 1st April, 20X1, the exchange rate between the currencies i.e. USD vs Rupees was ₹ 45 per USD. The exchange rate on the reporting date i.e. 31st March, 20X2 is ₹ 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 1st April, 20X1.

Compute the borrowing cost to be capitalized for the construction of plant by ABC Ltd. for the period ending 31st March,20X2.

Answer

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: USD 20,000 x 5% = USD 1,000

Converted in ₹: USD 1,000 x ₹ 48/USD = ₹ 48,000

Increase in liability due to change in exchange difference: USD 20,000 x (48 – 45) = ₹ 60,000

(b) Interest that would have resulted if the loan was taken in Indian Currency:

USD 20,000 x ₹ 45/USD x 11% = ₹ 99,000

(c) Difference between Interest on Foreign Currency borrowing and local Currency borrowing:

₹ 99,000 – 48,000 = ₹ 51,000

Hence, out of Exchange loss of ₹ 60,000 on principal amount of foreign currency loan, only exchange loss to the extent of ₹ 51,000 is considered as borrowing costs.

Total borrowing cost to be capitalized is as under:

(a)	Interest cost on borrowing	₹ 48,000
(b)	Exchange difference to the extent considered to be an adjustment to Interest cost	₹ 51,000
		₹ 99,000

The exchange difference of ₹ 51,000 has been capitalized as borrowing cost and the remaining ₹ 9,000 will be expensed off in the Statement of Profit and loss.

Question 8

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 the amount to be adjusted in the borrowing cost at 31st March, 2013 in each of the following cases:

Case 1: If exchange rate on 31st March, 20X3, is $ 1 = ₹ 48

Case 2: If exchange rate on 31st March, 20X3, is $ 1 = ₹ 44

Case 3: If exchange rate on 31st March, 20X3, is $ 1 = ₹ 44 and part of loan $ 600 is repaid on 31st March, 20X2

Answer

31st March, 20X2:

The exchange loss in this case is ₹ 10,000 [$ 1000 x (₹ 50 – ₹ 40)]. The borrowing cost is ₹ 2,000 ($ 1,000 x 4% x ₹ 50). Had the entity borrowed 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.

31st March, 20X3:

Case 1: the exchange rate on 31st March, 20X2, being $ 1= ₹ 50, the borrowings are still not due for payment. The entity will recognise a borrowing cost of ₹ 1,920 ($ 1,000 x 4% x ₹ 48). There is an exchange gain of ₹ 2,000 ($ 1,000 x (₹ 50 – ₹48). This will be adjusted in the borrowing cost as there is unrealised exchange loss and the adjustment is less than the exchange loss of ₹ 2,800 recognised in earlier year.

Case 2: the exchange rate on 31st March, 20X2, being $ 1 = ₹ 50, the borrowings are still not due for payment. The entity will recognise a borrowing cost of ₹ 1,760 ($ 1,000 x 4% x ₹ 44). There is an exchange gain of ₹ 6,000 [$ 1,000 x (₹ 50 – ₹ 44)]. This will be adjusted in the borrowing cost upto ₹ 2,800 as there is unrealised exchange loss and the adjustment of the exchange loss recognised in earlier years is of ₹ 2,800.

Case 3: the exchange rate on 31st March, 20X2, being $ 1 = ₹ 50; $ 600 of the borrowings was paid on 31st March, 20X2, $ 400 of the borrowings are still not due for payment. The entity will recognise a borrowing cost of ₹ 704 ($ 400 x 4% x ₹ 44). There is an exchange gain of ₹ 2400 [$ 400 x (₹ 50 – ₹ 44)]. The unrealised exchange loss of earlier year is ₹ 4,000 [$ 400 x (₹ 50 – ₹ 40)] out of which ₹ 1,120 [₹ 2,800 x ($ 400/$ 1,000)] was charged in 31st March, 20X1, as borrowing cost. Thus there will be an adjustment in the borrowing cost upto ₹ 1,120 as this is unrealised exchange loss.

Question 9

In a group with Parent Company "P" there are 3 subsidiaries with following business:

"A" – Real Estate Company

"B" – Construction Company

"C" – Finance Company

- Parent Company has no operating activities of its own but performs management functions for its subsidiaries.
- Financing activities and cash management in the group are coordinated centrally.
- Finance Company is a vehicle used by the group solely for raising finance.
- All entities in the group prepare Ind AS financial statements.

The following information is relevant for the current reporting period 20X1-20X2:

Real Estate Company

- Borrowings of ₹ 10,00,000 with an interest rate of 7% p.a.
- Expenditures on qualifying assets during the period amounted to ₹ 15,40,000.
- All construction works were performed by Construction Company. Amounts invoiced to Real Estate Company included 10% profit margin.

Construction Company

- No borrowings during the period.
- Financed ₹ 10,00,000 of expenditures on qualifying assets using its own cash resources.

Finance Company

- Raised ₹ 20,00,000 at 7% p.a. externally and issued a loan to Parent Company for general corporate purposes at the rate of 8%.

Parent Company

- Used loan from Finance Company to acquire a new subsidiary.
- No qualifying assets apart from those in Real Estate Company and Construction Company.
- Parent Company did not issue any loans to other entities during the period.

What is the amount of borrowing costs eligible for capitalisation in the financial statements of each of the four entities for the current reporting period 20X1-20X2?

Answer

Following is the treatment as per Ind AS 23:

Finance Company

No expenditure on qualifying assets have been incurred, so Finance Company cannot capitalise anything.

Real Estate Company

Total interest costs in the financial statements of Real Estate Company is ₹ 70,000. Expenditures on qualifying assets exceed total borrowings, so the total amount of interest can be capitalised.

Construction Company

No interest expense has been incurred, so Construction Company cannot capitalise anything.

Consolidated financial statements of Parent Company:

Total general borrowings of the group: ₹ 10,00,000 + ₹ 20,00,000 = ₹ 30,00,000

Although Parent Company used proceeds from loan to acquire a subsidiary, this loan cannot be excluded from the pool of general borrowings.

Total interest expenditures for the group = ₹ 30,00,000 x 7% = ₹ 2,10,000

Total expenditures on qualifying assets for the group are added up. Profit margin charged by Construction Company to Real Estate Company is eliminated:

Real Estate Company = ₹ 15,40,000/1.1 = ₹ 14,00,000

Construction Co = ₹ 10,00,000

Total consolidated expenditures on qualifying assets: ₹ (14,00,000 + 10,00,000) = ₹ 24,00,000

Capitalisation rate = 7%

Borrowing costs eligible for capitalisation = ₹ 24,00,000 x 7% = ₹ 1,68,000

Total interest expenditures of the group are higher than borrowing costs eligible for capitalisation calculated based on the actual expenditures incurred on the qualifying assets. Therefore, only ₹ 1,68,000 can be capitalised.

Question 10

How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹ 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

Answer

Capitalisation Method

As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation 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 capitalised 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.

Capitalisation of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised 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 i.e. ₹ 1,80,000 (2,00,000 – 20,000) Therefore, Y Ltd will recognize the borrowing at ₹ 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised

Y 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 ₹ 48,753 will be capitalized to the cost of qualifying asset.

Question 11

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?

Answer

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 capitalised	Interest to be charged to profit and loss account
		₹ in lakh	**₹ in lakh**
Modernisation and renovation of plant and machinery	Qualifying asset	[68.20 x (510/620)] = 56.10	
Advance to Suppliers for additional assets	Qualifying asset	[68.20 x (54/620)] = 5.94	
Working Capital	Not a qualifying asset		[68.20 x (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.

Unit 5 – Ind AS 36: Impairment of Assets

Question 1

Mars Ltd. gives the following estimates of cash flows relating to property, plant and equipment on 31st March, 20X4. The discount rate is 15%

Year	Cash Flow (₹ in lakh)
20X4-20X5	2,000
20X5-20X6	3,000
20X6-20X7	3,000
20X7-20X8	4,000
20X8-20X9	2,000
Residual Value at 31st March, 20X9	500

Property, plant & equipment was purchased on 1st April, 20X1 for	₹ 20,000 lakh
Useful Life was	8 Years
Residual Value estimated at the end of 8 years	₹ 500 lakh
Fair value less cost to disposal	₹ 10,000 lakh

Calculate impairment loss, if any on the property, plant and equipment. Also calculate the revised carrying amount and revised depreciation of property, plant and equipment.

Answer

(a) Calculation of Carrying Amount on 31st March, 20X4 **(₹ in lakh)**

Particular	Amount
Original Cost on 1st April, 20X1	20,000
Less: Depreciation [{(20,000 – 500)/8} x 3]	(7,313)
Carrying Amount	12,687

(b) Calculation of Value in Use

Year	Cash Flows	P.V.	Amount
20X4-20X5	2,000	.870	1,740
20X5-20X6	3,000	.756	2,268
20X6-20X7	3,000	.658	1,974
20X7-20X8	4,000	.572	2,288
20X8-20X9 (including residual value)	2,500	.497	1,243
Total			**9,513**

(c) Calculation of Recoverable Amount

Particular	Amount
Value in Use	9,513

Fair value less costs of disposal	10,000
Recoverable Amount	10,000

(d) Calculation of Impairment Loss

Carrying Amount – Recoverable Amount

12,687 – 10,000 = 2,687

(e) Calculation of Revised Carrying Amount

Particular	Amount
Carrying Amount	12,687
Less: Impairment Loss	(2,687)
Revised Carrying Amount	10,000

(f) Calculation of Revised Depreciation

$$\frac{\text{Revised Carrying Amount} - \text{Residual Value}}{\text{Remaining Life}}$$

$$\frac{10{,}000 - 500}{5} = 1{,}900$$

Question 2

Jupiter Ltd, a leading manufacturer of steel is having a furnace, which is carried in the balance sheet on 31st March, 20X1 at ₹ 250 lakh. As at that date the value in use and fair value is ₹ 200 lakh. The cost of disposal is ₹ 13 lakh.

Calculate the Impairment Loss to be recognised in the books of the Company?

Answer

Calculation of Impairment Loss:

Calculation of Impairment Loss	₹ in lakh
Recoverable Amount =	200
Higher of,	
Fair Value less Cost of Disposal (200 – 13)	187
Or	
Value in Use	200
Impairment Loss = Carrying Amount – Recoverable Amount	
= 250 – 200	50

Question 3

Mercury Ltd. has an identifiable asset with a carrying amount of ₹ 1,000. Its recoverable amount is ₹ 650. The tax rate is 30% and the tax base of the asset is ₹ 800. Impairment losses are not deductible for tax purposes. What would be the impact of impairment loss on related deferred tax asset/liability against the revised carrying amount of asset?

Answer

The effect of impairment loss is as follows:

	Identifiable assets before impairment loss	Impairment loss	Identifiable assets after impairment loss
	₹	₹	₹
Carrying amount	1,000	(350)	650
Tax Base	800	–	800
Taxable/(deductible) temporary difference	200	(350)	(150)
Deferred tax liability/(asset) at 30%	60	(105)	(45)

In accordance with Ind AS 12, the entity recognises the deferred tax asset to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

Question 4

Earth Infra Ltd has two cash-generating units, X and Y. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for ₹ 20 million and CGU B for ₹ 30 million. The company has an office building which it is using as an office headquarter and has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of ₹ 10 million. The recoverable amounts are based on value-in-use of ₹ 18 million for CGU A and ₹ 38 million for CGU B.

Determine whether the carrying values of CGU A and B are impaired.

Answer

The office building is a corporate asset which needs to be allocated to CGU A and B on a reasonable and consistent basis:

	A	B	Total
Carrying value of CGUs	20	30	50
Allocation of office building	4	6	10
(office building is allocated in the ratio of Carrying value of CGUs)			
Carrying value of CGU after Allocation of corporate asset	24	36	60
Recoverable Amount	18	38	56
Impairment Loss	6	–	

The impairment loss will be allocated on the basis of 4/24 against the building (₹ 1 million) and 20/24 against the other assets (₹ 5 million).

Question 5

On 1st April 20X1, Venus Ltd acquired 100% of Saturn Ltd for ₹ 4,00,000. The fair value of the net identifiable assets of Saturn Ltd was ₹ 3,20,000 and goodwill was ₹ 80,000. Saturn Ltd is in coal mining business. On 31st March, 20X3, the government has cancelled licenses given to it in few states.

As a result Saturn's Ltd revenue is estimated to get reduce by 30%. The adverse change in market place and regulatory conditions is an indicator of impairment. As a result, Venus Ltd has to estimate the recoverable amount of goodwill and net assets of Saturn Ltd on 31st March, 20X3.

Venus Ltd uses straight line depreciation. The useful life of Saturn's Ltd assets is estimated to be 20 years with no residual value. No independent cash inflows can be identified to any individual assets. So the entire operation of Saturn Ltd is to be treated as a CGU. Due to the regulatory entangle it is not possible to determine the selling price of Saturn Ltd as a CGU. Its value in use is estimated by the management at ₹ 2,12,000.

Suppose by 31st March, 20X5 the government reinstates the licenses of Saturn Ltd. The management expects a favourable change in net cash flows. This is an indicator that an impairment loss may have reversed. The recoverable amount of Saturn's Ltd net asset is re-estimated. The value in use is expected to be ₹ 3,04,000 and fair value less cost to disposal is expected to be ₹ 2,90,000.

Calculate the impairment loss, if any. Also show the accounting treatment for reversal of impairment loss and the subsequent depreciation thereon.

Answer

Since the fair value less costs of disposal is not determinable the recoverable amount of the CGU is its value in use. The carrying amount of the assets of the CGU on 31st March, 20X3 is as follows:

Calculation of Impairment loss

			₹
	Goodwill	**Other assets**	**Total**
Historical Cost	80,000	3,20,000	4,00,000
Accumulated Depreciation [(3,20,000/20) x 2]	–	(32,000)	(32,000)
Carrying Amount	80,000	2,88,000	3,68,000
Impairment Loss	(80,000)	(76,000)	(1,56,000)

Revised Carrying Amount

- Impairment Loss = Carrying Amount – Recoverable Amount (₹ 3,68,000 – ₹ 2,12,000) = ₹ 1,56,000 is charged in statement of profit and loss for the period ending 31st March, 20X3 as impairment loss.
- Impairment loss is allocated first to goodwill ₹ 80,000 and remaining loss of ₹ 76,000 (₹ 1,56,000 – ₹ 80,000) is allocated to the other assets.

Reversal of Impairment loss

Reversal of impairment loss is recognised subject to:

- The impairment loss on goodwill cannot be reversed.
- The increased carrying amount of an asset after reversal of an impairment loss not to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

Calculation of carrying amount of identifiable assets had no impairment loss is recognised

	₹
Historical Cost	3,20,000
Accumulated Depreciation for 4 years [(3,20,000/20) x 4]	(64,000)
Carrying amount had no impairment loss is recognised on 31st March, 20X5	2,56,000

Carrying amount of other assets after recognition of impairment loss

	₹
Carrying amount on 31st March, 20X3	2,12,000
Accumulated Depreciation for 2 years [(2,12,000/18) x 2] (rounded off to nearest thousand for ease of calculation)	(24,000)
Carrying amount on 31st March, 20X5	1,88,000

- The impairment loss recognised previously can be reversed only to the extent of lower of re-estimated recoverable amount is ₹ 2,56,000 (higher of fair value less costs of disposal ₹ 2,90,000 and value in use ₹ 3,04,000)
- Impairment loss reversal will be ₹ 68,000 i.e. (₹ 2,56,000 – ₹ 1,88,000). This amount is recognized as income in the statement of profit and loss for the year ended 31st March, 20X5.
- The carrying amount of other assets at 31st March, 20X5 after reversal of impairment loss will be ₹ 2,56,000.
- From 1st April, 20X5 the depreciation charge will be ₹ 16,000 i.e. (₹ 2,56,000/16)

Question 6

From the following details of an asset, find out:

(a) Impairment loss and its treatment.

(b) Current year depreciation for the year end.

Particulars of assets:

Cost of asset	₹ 56 lakh
Useful life	10 years
Salvage value	Nil
Carrying value at the beginning of the year	₹ 27.30 lakh
Remaining useful life	3 years
Recoverable amount at the beginning of the year	₹ 12 lakh

Upward revaluation done in last year	₹ 14 lakh

Answer

Impairment loss

Impairment loss = Carrying amount of the asset – Recoverable amount

= ₹ 27.30 lakh – ₹ 12 lakh

= ₹ 15.30 lakh

Treatment of impairment loss

As per Ind AS 36, impairment loss (whether of an individual asset of a CGU) is recognised in the following manner:

(a) Impairment loss of a revalued asset: It is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. The balance, if any, is recognised as an expense in the statement of profit and loss.

(b) Impairment loss of other assets: Impairment loss of any other asset should be recognised as an expense in the statement of profit and loss.

Since, the asset in question has been revalued upwards, the impairment loss will be adjusted first against the revaluation surplus of ₹ 14 lakh. The balance amount of ₹ 1.30 lakh will be recognised as an expense in the profit and loss account.

Current year depreciation

Revised carrying amount (after recognising impairment loss)	₹ 12 lakh
Remaining useful life	3 years
Salvage value	Nil
Annual depreciation (12/3)	₹ 4 lakh

Question 7

Venus Ltd. has an asset, which is carried in the Balance Sheet on 31st March, 20X1 at ₹ 500 lakh. As at that date the value in use is ₹ 400 lakh and the fair value less costs to sells is ₹ 375 lakh.

From the above data:

(a) Calculate impairment loss.

(b) Prepare journal entries for adjustment of impairment loss.

Answer

According to Ind AS 36, Impairment of Assets, impairment loss is the excess of 'Carrying amount of the asset' over 'Recoverable Amount'.

In the present case, the impairment loss can be computed in the following manner:

Step 1: Fair value less costs to sell: ₹ 375 lakh

Step 2: Value in use: ₹ 400 lakh

Step 3: Recoverable amount, i.e., higher of 'fair value *less* costs to sell' & 'value in use'. Thus, recoverable amount is ₹ 400 lakh

Step 4: Carrying amount of the asset ₹ 500 lakh

Step 5: Impairment loss, i.e., excess of amount computed in step 4 over amount computed in Step 3.

₹ 100 lakh (being the difference between ₹ 500 lakh and ₹ 400 lakh).

According to Ind AS 36, an impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at revalued amount in accordance with another Accounting Standard. Assuming, that the asset is not carried at revalued amount, the impairment loss of ₹ 100 lakh will be charged to Profit & Loss Account.

Journal Entries

Date	Particulars	Dr. Amt.	Cr. Amt.
		₹ in lakh	
31.3.20X1	Impairment Loss A/c Dr.	100	
	To Assets A/c		100
	(Being impairment loss on an asset recognised)		
31.3.20X1	Statement of Profit & Loss Dr.	100	
	To Impairment Loss A/c		100
	(Being impairment loss transferred to statement of profit and loss)		

Question 8

XYZ Limited has a cash-generating unit 'Plant A' as on 1st April, 20X1 having a carrying amount of ₹ 1,000 crore. Plant A was acquired under a business combination and goodwill of ₹ 200 crore was allocated to it. It is depreciated on straight line basis. Plant A has a useful life of 10 years with no residual value. On 31st March, 20X2, Plant A has a recoverable amount of ₹ 600 crore. Calculate the impairment loss on Plant A. Also, prescribe its allocation as per Ind AS 36.

Answer

Particulars	Goodwill (₹ in crore)	Identifiable assets (₹ in crore)	Total (₹ in crore)
Historical cost	200	1,000	1,200
Depreciation (20X1-20X2)	–	(100)	(100)
Carrying amount	200	900	1,100

Since, the recoverable amount is ₹ 600 crore, there is an impairment loss of ₹ 500 crore. The impairment loss of ₹ 500 crore should be allocated to goodwill first, and then to the other identifiable assets, i.e., ₹ 200 crore to goodwill and ₹ 300 crore to identifiable assets of Plant A.

			(₹ in crore)
Particulars	**Goodwill**	**Identifiable assets**	**Total**
Impairment loss	(200)	(300)	(500)

Carrying amount after impairment loss	–	600	600

Question 9

ABC Ltd. has three cash-generating units: A, B and C, the carrying amounts of which as on 31st March, 20X1 are as follows:

Cash-generating units	Carrying amount (₹ in crore)	Remaining useful life
A	500	10
B	750	20
C	1,100	20

ABC Ltd. also has two corporate assets having a remaining useful life of 20 years.

		(₹ in crore)
Corporate asset	**Carrying amount**	**Remarks**
X	600	The carrying amount of X can be allocated on a reasonable basis (i.e., pro rata basis) to the individual cash-generating units.
Y	200	The carrying amount of Y cannot be allocated on a reasonable basis to the individual cash- generating units.

Recoverable amount as on 31st March, 20X1 is as follows:

Cash-generating units	Recoverable amount (₹ in crore)
A	600
B	900
C	1,400
ABC Ltd.	3,200

Calculate the impairment loss, if any. Ignore decimals.

Answer

Allocation of corporate assets

The carrying amount of X is allocated to the carrying amount of each individual cash- generating unit. A weighted allocation basis is used because the estimated remaining useful life of A's cash-generating unit is 10 years, whereas the estimated remaining useful lives of B and C's cash-generating units are 20 years.

				(₹ in crore)
Particulars	**A**	**B**	**C**	**Total**
Carrying amount	500	750	1,100	2,350
Useful life	10 years	20 years	20 years	–

Weight based on useful life	1	2	2	-
Carrying amount (after assigning weight)	500	1,500	2,200	4,200
Pro-rata allocation of X	12%	36%	52%	100%
	(500/4,200)	(1,500/4,200)	(2,200/4,200)	
Allocation of carrying amount of X	72	216	312	600
Carrying amount (after allocation of X)	572	966	1,412	2,950

Calculation of impairment loss

Step I: Impairment losses for individual cash-generating units and its allocation

(a) Impairment loss of each cash-generating units

			(₹ in crore)
Particulars	**A**	**B**	**C**
Carrying amount (after allocation of X)	572	966	1,412
Recoverable amount	600	900	1400
Impairment loss	-	66	12

(b) Allocation of the impairment loss

				(₹ in crore)
Allocation to	**B**		**C**	
X	15	(66 x 216/966)	3	(12 x 312/1,412)
Other assets in cash-generating units	51	(66 x 750/966)	9	(12 x 1,100/1,412)
Impairment loss	66		12	

Step II: Impairment losses for the larger cash-generating unit, i.e., ABC Ltd. as a whole

						(₹ in crore)
Particulars	**A**	**B**	**C**	**X**	**Y**	**ABC Ltd.**
Carrying amount	500	750	1,100	600	200	3,150
Impairment loss (Step I)	-	(51)	(9)	(18)	-	(78)
Carrying amount (after Step I)	500	699	1,091	582	200	3,072
Recoverable amount						3,200
Impairment loss for the 'larger' cash-generating unit						Nil

Question 10

A Ltd. purchased a machinery of ₹ 100 crore on 1st April, 20X1. The machinery has a useful life of 5 years. It has nil residual value. A Ltd. adopts straight line method of depreciation for depreciating the machinery. Following information has been provided as on 31st March, 20X2:

Financial year	Estimated future cash flows (₹ in crore)
20X2-20X3	15
20X3-20X4	30
20X4-20X5	40
20X5-20X6	10

Discount rate applicable: 10%

Fair value less costs to sell as on 31st March, 20X2: ₹ 70 crore

Calculate the impairment loss, if any.

Answer

Value in use of the machinery as on 31st March, 20X2 can be calculated as follows:

Financial year	Estimated cash flows (₹ in crore)	Present value factor @ 10%	Present value
20X2-20X3	15	0.9091	13.64
20X3-20X4	30	0.8264	24.79
20X4-20X5	40	0.7513	30.05
20X5-20X6	10	0.6830	6.83
			75.31

The recoverable amount of the machinery is ₹ 75.31 crore (higher of value in use of ₹ 75.31 crore and fair value less costs to sell of ₹ 70 crore). Carrying amount of the machinery is ₹ 80 crore (after providing for one year depreciation @ ₹ 20 crore). Therefore, the impairment loss of ₹ 4.69 crore should be provided in the books.

Question 11

Assuming in the above Question 20, as on 31st March, 20X3, there is no change in the estimated future cash flows and discount rate. Fair value less costs to sell as on 31st March, 20X3 is ₹ 40 crore. How should it be dealt with under Ind AS 36?

Answer

Value in use of the machinery as on March 31,20X3 can be calculated as follows:

Financial year	Estimated cash flows (₹ in crore)	Present value factor @ 10%	Present value
20X3-20X4	30	0.9091	27.27
20X4-20X5	40	0.8264	33.06
20X5-20X6	10	0.7513	7.51
			67.84

The recoverable amount of the machinery is ₹ 67.84 crore (higher of value in use of ₹ 67.84 crore and fair value less costs to sell of ₹ 40 crore). Carrying amount of the machinery at the end of the year 20X2 is ₹ 56.48 crore [after providing for two years depreciation (100 – 20 – 4.69) – 18.83].

However, as per paragraph 116 of Ind AS 36, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Therefore, the impairment loss of ₹ 4.69 crore should not be reversed.

Question 12

A Ltd. purchased an asset of ₹ 100 lakh on 1st April, 20X0. It has useful life of 4 years with no residual value. Recoverable amount of the asset is as follows:

As on	Recoverable amount
31st March, 20X1	₹ 60 lakh
31st March, 20X2	₹ 40 lakh
31st March, 20X3	₹ 28 lakh

Calculate the amount of impairment loss or its reversal, if any, on 31st March, 20X1, 31st March, 20X2 and 31st March, 20X3.

Answer

As on 31st March, 20X1

Carrying amount of the asset (opening balance)	₹ 100 lakh
Depreciation (₹ 100 lakh/4 years)	₹ 25 lakh
Carrying amount of the asset (closing balance)	₹ 75 lakh
Recoverable amount (given)	₹ 60 lakh

Therefore, an impairment loss of ₹ 15 lakh should be recognised as on 31st March, 20X1. Depreciation for subsequent years should be charged on the carrying amount of the asset (after providing for impairment loss), i.e., ₹ 60 lakh.

As on 31st March, 20X2

Carrying amount of the asset (opening balance)	₹ 60 lakh
Depreciation (₹ 60 lakh/3 years)	₹ 20 lakh
Carrying amount of the asset (closing balance)	₹ 40 lakh

Therefore, no impairment loss should be recognised as on 31st March, 20X2.

As on 31st March, 20X3

Carrying amount of the asset (opening balance)	₹ 40 lakh
Depreciation (₹ 40 lakh/2 years)	₹ 20 lakh
Carrying amount of the asset (closing balance)	₹ 20 lakh
Recoverable amount (given)	₹ 28 lakh

Since, the recoverable amount of the asset exceeds the carrying amount of the asset by ₹ 8 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 amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

Carrying amount as on 31st March, 20X3 had no impairment loss being recognised would have been ₹ 25 lakh. Therefore, the reversal of an impairment loss of ₹ 5 lakh should be done as on 31st March, 20X3.

Question 13

On 31st March, 20X1, XYZ Ltd. makes following estimate of cash flows for one of its asset located in USA:

Year	Cash flows
20X1-20X2	US$ 80
20X2-20X3	US$ 100
20X3-20X4	US$ 20

Following information has been provided:

Particulars	India	USA
Applicable discount rate	15%	10%

Exchange rates are as follows:

As on	Exchange rate
31st March, 20X1	₹ 45/US $

As on	Expected Exchange rate
31st March, 20X2	₹ 48/US $
31st March, 20X3	₹ 51/US $
31st March, 20X4	₹ 55/US $

Calculate value in use as on 31st March, 20X1.

Answer

Year	Cash flows (US$)	Present value factor @10%	Discounted cash flows (US$)
20X1-20X2	80	0.9091	72.73
20X2-20X3	100	0.8264	82.64
20X3-20X4	20	0.7513	15.03
Total Discounted cash flows in US$			170:40
Exchange rate as on 31st March, 20X1, i.e., date of calculating value in use = ₹ 45/US $			
Value in use as on 31st March, 20X1 = ₹ 7,668			

Question 14

Cash flow is ₹ 100, ₹ 200 or ₹ 300 with probabilities of 10%, 60% and 30%, respectively.

Calculate expected cash flows.

Answer

Cash flow	Probability	Expected cash flow
100	10%	10
200	60%	120
300	30%	90
Total		220

The expected cash flow is ₹ 220.

Question 15

Cash flow of ₹ 1,000 may be received in one year, two years or three years with probabilities of 10%, 60% and 30%, respectively. Calculate expected cash flows assuming applicable discount rate of 5%, 5.25% and 5.5% in year 1, 2 and 3, respectively.

Answer

Years	Cash flow	P.V.F.	Present value	Probability	Expected cash flow
1	1,000	0.95238	952.38	10%	95.24
2	1,000	0.90273	902.73	60%	541.64
3	1,000	0.85161	851.61	30%	255.48
Total					892.36

The expected present value is ₹ 892.36.

Question 16

Calculate expected cash flows in each of the following cases:

(a) the estimated amount falls somewhere between ₹ 50 and ₹ 250, but no amount in the range is more likely than any other amount.

(b) the estimated amount falls somewhere between ₹ 50 and ₹ 250, and the most likely amount is ₹ 100. However, the probabilities attached to each amount are unknown.

(c) the estimated amount will be ₹ 50 (10 per cent probability), ₹ 250 (30 per cent probability), or ₹ 100 (60 per cent probability).

Answer

(a) the estimated expected cash flow is ₹ 150 [(50 + 250)/2].

(b) the estimated expected cash flow is ₹ 133.33 [(50 + 100 + 250)/3].

(c) the estimated expected cash flow is ₹ 140 [(50 x 0.10) + (250 x 0.30) + (100 x 0.60)].

Question 17

Elia limited is a manufacturing company which deals in to manufacturing of cold drinks and beverages. It is having various plants across India. There is a Machinery A in the Baroda plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machine A it cannot produce output as well. The Company considers this group of assets as a Cash Generating Unit and an Inventory amounting to ₹ 2 Lakh and Goodwill amounting to ₹ 1.50 Lakhs is included in such CGU.

Machinery A was purchased on 1st April 2013 for ₹ 10 Lakhs and residual value is ₹ 50 thousands. Machinery B was purchased on 1st April, 2015 for ₹ 5 Lakhs with no residual value. The useful life of both Machine A and B is 10 years. The Company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of the company is 10%.

Year	Cash Flows from Machinery A
1	1,50,000
2	1,00,000
3	1,00,000
4	1,50,000
5	1,00,000 (excluding Residual Value)
Total	**6,00,000**

On 31st March, 2018, the professional valuers have estimated that the current market value of Machinery A is ₹ 7 lakhs. The valuation fee was ₹ 1 lakh. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is ₹ 1.50 lakhs. Specialised packaging cost would be ₹ 25 thousand and legal fees would be ₹ 75 thousand.

The Inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is ₹ 10 Lakh as on 31st March, 2018. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is ₹ 11 Lakhs i.e. on 31st March, 2019. The Recoverable value of Machine A is ₹ 4,50,000 and combined Machine A and B is ₹ 7,60,000 as on 31st March, 2019.

Required:

(a) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2018 by providing all the relevant working notes to arrive at such calculation.

(b) Compute the prospective depreciation for the year 2018-2019 on the above assets.

(c) Compute the carrying value of CGU as at 31st March, 2019.

Answer

(a) Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss

(i) Calculation of carrying value of Machinery A and B before impairment

Machinery A		
Cost	(A)	₹ 10,00,000
Residual Value		₹ 50,000
Useful life		10 years
Useful life already elapsed		5 years
Yearly depreciation	(B)	₹ 95,000
WDV as at 31st March, 2018 [A – (B x 5)]		**₹ 5,25,000**
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, 2018 [C – (D x 3)]		**₹ 3,50,000**

(ii) Calculation of Value-in-use of Machinery A

Period	Cash Flows (₹)	PVF	PV
1	1,50,000	0.909	1,36,350
2	1,00,000	0.826	82,600
3	1,00,000	0.751	75,100
4	1,50,000	0.683	1,02,450
5	1,00,000	0.621	62,100
5	50,000	0.621	31,050
Value in use			**4,89,650**

(iii) Calculation of Fair Value less cost of disposal of Machinery A

	₹
Fair Value	7,00,000
Less: Dismantling cost	(1,50,000)
Packaging cost	(25,000)
Legal Fees	(75,000)
Fair value less cost of disposal	**4,50,000**

(iv) Calculation of Impairment loss on Machinery A

	₹
Carrying Value	5,25,000
Less: Recoverable Value i.e. higher of Value-in-use and Fair value	4,89,650

less cost of disposal	
Impairment Loss	**35,350**

(v) Calculation of Impairment loss of CGU

1. First goodwill will be impaired fully and then the remaining impairment loss of ₹ 75,000 will be allocated to Machinery A and B.
2. If we allocate remaining impairment loss to Machinery A and B on pro- rata basis, it would come to ₹ 45,000 on Machinery A. However, the impairment loss of Machinery A cannot exceed ₹ 35,350. Hence, impairment to CGU will be as follows:

	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	₹	₹	₹
Machinery A	5,25,000	35,350	4,89,650
Machinery B	3,50,000	39,650*	3,10,350
Inventory	2,00,000	-	2,00,000
Goodwill	1,50,000	1,50,000	-
Total	**12,25,000**	**2,25,000**	**10,00,000**

*Balancing figure.

(vi) Carrying value after adjustment of depreciation

	₹
Machinery A [4,89,650 – {(4,89,650 – 50,000)/5}]	4,01,720
Machinery B [3,10,350 – (3,10,350/7)]	2,66,014
Inventory	2,00,000
Goodwill	–
Total	**8,67,734**

(b) Calculation of carrying value of CGU as on 31st March, 2019

The revised value of CGU is ₹ 11 Lakh. However, impaired goodwill cannot be reversed. Further, the individual assets cannot be increased by lower of recoverable value or Carrying Value as if the assets were never impaired.

Accordingly, the carrying value as on 31st March, 2019 assuming that the impairment loss had never incurred, will be:

	Carrying Value	Recoverable Value	Final CV as at 31st Mar 2019
Machinery A	4,30,000	4,50,000	4,30,000
Machinery B	3,00,000	(7,60,000 – 4,50,000) 3,10,000	3,00,000

Inventory	2,00,000	2,00,000	2,00,000
Goodwill	-	-	-
Total	**9,30,000**	**9,60,000**	**9,30,000**

Hence the impairment loss to be reversed will be limited to ₹ 62,266 only (₹ 9,30,000 – ₹ 8,67,734).

Question 18

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 ₹ 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 ₹ 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 ₹ 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% each year until 31st March, 20X8.
- East estimates that each steering wheel costs ₹ 160 to manufacture, which includes ₹ 110 variable costs, ₹ 30 share of fixed overheads and ₹ 20 transport costs.
- Costs are expected to rise by 1 per cent during 20X4-X5, and then by 2% per annum until 31st March, 20X8.
- During 20X5-X6, the machine will be subject to regular maintenance costing ₹ 50,000.
- In 20X3-X4, East expects to invest in new technology costing ₹ 1,00,000. This technology will reduce the variable costs of manufacturing each steering wheel from ₹ 110 to ₹ 100 and the share of fixed overheads from ₹ 30 to ₹ 15 (subject to the availability of technology, which is still under development).
- 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 ₹ 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%, 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?

Answer

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 ₹ 80,000 from the disposal of the asset in March, 20X8. Cash outflows include routing capital expenditures of ₹ 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. ₹ 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
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 estimated cash inflows (E = C + D)	₹ 20,00,000	₹ 21,63,000	₹ 23,37,300	₹ 25,35,144	₹ 28,14,875	
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 19

PQR Ltd. is the company which has performed well in the past but one of its major assets, an item of equipment, suffered a significant and unexpected deterioration in performance. Management expects to use the machine for a further four years after 31st March 20X6, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for PQR Ltd. has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. CFO thought that the projections were too conservative, and he intended to use the highest figures each year. These were as follows:

	₹ '000
Year ended 31st March 20X7	276
Year ended 31st March 20X8	192
Year ended 31st March 20X9	120
Year ended 31st March 20Y0	114

The above cash inflows should be assumed to occur on the last day of each financial year. The pre-tax discount rate is 9%. The machine could have been sold at 31st March 20X6 for ₹ 6,00,000 and related selling expenses in this regard could have been ₹ 96,000. The machine had been re valued previously, and at 31st March 20X6 an amount of ₹ 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 31st March 20X6 was ₹ 6,60,000. The Indian government has indicated that it may compensate the company for any loss in value of the assets up to its recoverable amount.

Calculate impairment loss, if any and revised depreciation of asset. Also suggest how Impairment loss, if any would be set off and how compensation from government be accounted for?

Answer

Carrying amount of asset on 31st March 20X6 = ₹ 6,60,000

Calculation of Value in Use:

Year ended	Cash flow (₹)	Discount factor @ 9%	Amount (₹)
31st March, 20X7	2,76,000	0.9174	2,53,202
31st March, 20X8	1,92,000	0.8417	1,61,606
31st March, 20X9	1,20,000	0.7722	92,664
31st March, 20Y0	1,14,000	0.7084	80,758
Total (Value in Use)			**5,88,230**

Calculation of Recoverable amount:

Particulars	Amount (₹)
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 (₹)
Carrying amount	6,60,000
Less: Recoverable amount	(5,88,230)
Impairment loss	71,770

Calculation of Revised carrying amount:

Particulars	Amount (₹)
Carrying amount	6,60,000
Less: Impairment loss	(71,770)
Revised carrying amount	5,88,230

Calculation of Revised Depreciation:

$$\frac{\text{Revised Carrying Amount} - \text{Residual Value}}{\text{Remaining Life}}$$

$$\frac{5,88,230 - 0}{4} = ₹\ 1,47,058 \text{ per annum}$$

Set off of Impairment loss:

The impairment loss of ₹ 71,770 must first be set off against any revaluation surplus in relation to the same asset. Therefore, the revaluation surplus of ₹ 36,000 is eliminated against impairment loss, and the remainder of the impairment loss ₹ 35,770 (₹ 71,770 – ₹ 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 20

Sun Ltd is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31st March. On 1st July, 20X1, Sun Ltd acquired an 80% interest in Pluto Ltd. Details of the acquisition were as follows:

- Sun ltd acquired 800,000 shares in Pluto Ltd by issuing two equity shares for every five acquired. The fair value of Sun Ltd's share on 1st July, 20X1 was ₹ 4 per share and the fair value of a Pluto's share was ₹ 1.40 per share. The costs of issue were 5% per share.
- Sun Ltd incurred further legal and professional costs of ₹ 100,000 that directly related to the acquisition.
- The fair values of the identifiable net assets of Pluto Ltd at 1st July, 20X1 were measured at ₹ 1.3 million. Sun Ltd initially measured the non-controlling interest in Pluto Ltd at fair value.

  They used the market value of a Pluto Ltd share for this purpose. No impairment of goodwill arising on the acquisition of Pluto Ltd was required at 31st March, 20X2 or 20X3.

Pluto Ltd comprises three cash generating units A, B and C. When Pluto Ltd was acquired the directors of Sun Ltd estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	Carrying value (before goodwill allocation)	Recoverable amount
	₹ '000	₹ '000
A	600	740
B	550	650
C	450	400

Required:

(i) Compute the carrying value of the goodwill arising on acquisition of Pluto Ltd in the consolidated Balance Sheet of Sun ltd at 31st March, 20X4 following the impairment review.

(ii) Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Pluto ltd.

Answer

1. **Computation of goodwill on acquisition**

Particular	Amount (₹ '000)
Cost of investment (8,00,000 x 2/5 x ₹ 4)	1,280
Fair value of non-controlling interest (2,00,000 x ₹ 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

₹ 21.2 (20%) of the above is allocated to the NCI with the balance allocated to the shareholders of Sun ltd.

Question 21

Parent acquires an 80% ownership interest in Subsidiary for ₹ 2,100 on 1st April, 20X1. At that date, Subsidiary's net identifiable assets have a fair value of ₹ 1,500. Parent chooses to measure the non-controlling interests as the proportionate interest of Subsidiary's net identifiable assets. The assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Since other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of ₹ 500 related to those synergies has been allocated to other cash-generating units within Parent. On 31st March, 20X2, Parent determines that the recoverable amount of cash-generating unit Subsidiary is ₹ 1,000. The carrying amount of the net assets of Subsidiary, excluding goodwill, is ₹ 1,350. Allocate the impairment loss on 31st March, 20X2.

Answer

Non-controlling interests is measured as the proportionate interest of Subsidiary's net identifiable assets, i.e., ₹ 300 (20% of ₹ 1,500). Goodwill is the difference between the aggregate of the consideration transferred and the amount of the non-controlling interests (₹ 2,100 + ₹ 300) and the net identifiable assets (₹ 1,500), i.e., ₹ 900.

Since, the assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets, therefore, Subsidiary is a cash-generating unit. Since other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of ₹ 500 related to those synergies has been allocated to other cash-generating units within Parent. Because the cash-generating unit comprising Subsidiary includes goodwill within its carrying amount, it should be tested for impairment annually, or more frequently if there is an indication that it may be impaired.

Testing Subsidiary (cash-generating unit) for impairment

Goodwill attributable to non-controlling interests is included in Subsidiary's recoverable amount of ₹ 1,000 but has not been recognised in Parent's consolidated financial statements. Therefore, the carrying amount of Subsidiary should be grossed up to include goodwill attributable to the non-controlling interests, before being compared with the recoverable amount of ₹ 1,000. Goodwill attributable to Parent's 80% interest in Subsidiary at the acquisition date is ₹ 400 after allocating ₹ 500 to other cash-generating units within Parent. Therefore, goodwill attributable to the 20% non-controlling interests in Subsidiary at the acquisition date is ₹ 100.

Testing subsidiary for impairment on 31st March, 20X2

On 31st March, 20X2	**Goodwill of subsidiary (₹)**	**Net identifiable assets (₹)**	**Total (₹)**
Carrying amount	400	1,350	1,750
Unrecognised non-controlling interests	100	–	100
Adjusted carrying amount	**500**	**1,350**	**1,850**
Recoverable amount			1,000
Impairment loss			**850**

Allocating the impairment loss

The impairment loss of ₹ 850 should be allocated to the assets in the unit by first reducing the carrying amount of goodwill.

Therefore, ₹ 500 of the ₹ 850 impairment loss for the unit is allocated to the goodwill. If the partially-owned subsidiary is itself a cash-generating unit, the goodwill impairment loss should be allocated to the controlling and non-controlling interests on the same basis as that on which profit or loss is allocated. In this case, profit or loss is allocated on the basis of relative ownership interests. Because the goodwill is recognised only to the extent of Parent's 80% ownership interest in Subsidiary, Parent recognises only 80% of that goodwill impairment loss (i.e., ₹ 400).

The remaining impairment loss of ₹ 350 is recognised by reducing the carrying amounts of Subsidiary's identifiable assets.

Allocation of the impairment loss for Subsidiary on 31st March, 20X2

On 31st March, 20X2	**Goodwill of subsidiary (₹)**	**Net identifiable Assets (₹)**	**Total (₹)**
Carrying amount	400	1,350	1,750
Impairment loss	(400)	(350)	(750)
Carrying amount after impairment loss	-	**1,000**	**1,000**

Question 22

Entity A acquires Entity B for ₹ 50 million, of which ₹ 35 million is the fair value of the identifiable assets acquired and liabilities assumed. The acquisition of B Ltd. is to be integrated into two of Entity A's CGUs with the net assets being allocated as follows:

₹ in million

	CGU 1	CGU 2	Total
Fair value of acquired identifiable tangible and intangible assets	25	10	35

In addition to the net assets acquired that are assigned to CGU 2, the acquiring entity expects CGU 2 to benefit from certain synergies related to the acquisition (e.g. CGU 2 is expected to realise higher sales of its products because of access to the acquired entity's distribution channels). There is no synergistic goodwill attributable to other CGUs.

Entity A allocated the purchase consideration of the acquired business to CGU 1 and CGU 2 as ₹ 33 million and ₹ 17 million respectively.

Determine the allocation of goodwill to each CGU?

Answer

If goodwill is allocated to the CGUs based on the difference between the purchase consideration and the fair value of net assets acquired i.e. direct method, the allocation would be as follows:

(All figures are ₹ in million, unless otherwise specified)

	CGU 1	CGU 2	Total
Allocation of Purchase consideration	33	17	50
Less: Acquired identifiable tangible and intangible assets	(25)	(10)	(35)
Goodwill assigned to CGUs	8	7	15

Question 23

A Ltd acquires 80% shares of a subsidiary B Ltd. for ₹ 3,200 thousand. At the date of acquisition, B Ltd.'s identifiable net assets is ₹ 3,000 thousand. A elects to measure NCI at proportionate share of net identifiable assets. It recognizes

	₹ in thousand
Purchase Consideration	3,200
NCI (3,000 x 20%)	600
	3,800
Less: Net Assets	(3,000)
Goodwill	800

At the end of next financial year, B Ltd.'s carrying amount is reduced to ₹ 2,700 thousand (excluding goodwill).

Recoverable amount of B Ltd.'s assets is

Case (i) ₹ 2,000 thousand,

Case (ii) ₹ 2,800 thousand

Calculate impairment loss allocable to Parent and NCI in both the cases.

Answer

Case (i)

₹ in thousand

Particulars	**Goodwill**	**Other Asset**	**Total**
Carrying amount	800	2,700	**3,500**
Unrecognised NCI (notional) [(800/80%) x 20%]	200	–	**200**
Notional Total	**1,000**	**2,700**	**3,700**
Recoverable amount	–	–	**2,000**
Total Impairment loss	–	–	**(1,700)**
Impairment loss recognised in CFS	(800)	(700)	**(1,500)**
Carrying amount after impairment	–	2,000	**2,000**

Impairment loss on:	**Parent**	**NCI**
Goodwill	(800)	–
Other assets	(560)	(140)
Total	**(1,360)**	**(140)**

Case (ii)

Particulars	**Goodwill**	**Other Asset**	**Total**
Carrying amount	800	2,700	**3,500**
Unrecognised NCI (notional) (800/80% x 20%)	200	–	**200**
Notional Total	**1,000**	**2,700**	**3,700**
Recoverable amount	–	–	**2,800**
Total Impairment loss	–	–	**(900)**
Impairment loss recognised in CFS (900 x 80%)	(720)	–	**(720)**
Carrying amount after impairment (800 – 720)	80	2,700	**2,780**

Impairment loss on:	**Parent**	**NCI**
Goodwill	(720)	–
Other assets	–	–
Total	**(720)**	–

It is to be noted that since an entity measures NCI at its proportionate interest in the net identifiable assets of a subsidiary at the acquisition date, rather than at fair value, goodwill attributable to NCI is not recognised in the parent's consolidated financial statements and so the impairment loss on such goodwill not recognised.

Question 24

On 1 January Year 1, Entity Q purchased a machine costing ₹ 2,40,000 with an estimated useful life of 20 years and an estimated zero residual value. Depreciation is computed on straight-line basis. The asset had been re-valued on 1 January Year 3 to ₹ 2,50,000, but with no change in useful life at that date. On 1 January Year 4 an impairment review showed the machine's recoverable amount to be ₹ 1,00,000 and its estimated remaining useful life to be 10 years.

Calculate:

a) The carrying amount of the machine on 31 December Year 2 and the revaluation surplus arising on 1 January Year 3.

b) The carrying amount of the machine on 31 December Year 3 (immediately before the impairment).

c) The impairment loss recognised in the year to 31 December Year 4 and its treatment thereon.

d) The depreciation charge in the year to 31 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.

Answer

(a) **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 x (2,40,000 ÷ 20)]	(24,000)
Carrying amount of the machine at the end of Year 2	2,16,000

(b) **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

(c) **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.

(d) 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 25

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.

Answer

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 [US$ 18,00,000 @ 1.8 – US$ 18,00,000 @ £ 1.6] =	(1,25,000)

*Recoverable amount being less than cost becomes the carrying value.

Question 26

The carrying value of a building in the books of Sun Ltd. as at 31st March, 20X1 is ₹ 300 lakh. As on that date the value in use is ₹ 250 lakh and fair value less cost of disposal is ₹ 238 lakh. Calculate the Recoverable Amount.

Answer

Recoverable Amount: Higher of Fair Value less Costs of disposal and Value in Use

Fair Value less costs of disposal: ₹ 250 lakh

Value in Use: ₹ 238 lakh

Therefore, Recoverable value will be ₹ 250 lakh

Question 27

On 31 March 20X1, Vision Ltd acquired 80% of the equity shares of Mission Ltd for ₹ 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 ₹ 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 ₹ 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 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 ₹ 350 million.

Discuss and compute the accounting treatment of impairment of goodwill as per Ind AS 36?

Answer

The goodwill on consolidation of Mission Ltd that is recognized in the consolidated balance sheet of Vision 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 of Unit B 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 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 ₹ 350 million: **(₹ 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 ₹ 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).

CHAPTER - 7
Unit 6 – Ind AS 38: Intangible Assets

Question 1

Jupiter Ltd acquires new energy efficient technology that will significantly reduce its energy costs for manufacturing. Calculate the cost to be capitalised as per Ind AS 38 on the basis of following details:

	Costs incurred
Cost of new solar technology	10,00,000
Trade discount provided	(1,00,000)
Training course for staff in new technology	50,000
Initial testing of new technology	35,000
Losses incurred while other parts of plant shut down during testing and training	25,000
Total	**10,10,000**

Answer

	Cost to be capitalised
Cost of new solar technology	10,00,000
Trade discount provided	(1,00,000)
Training course for staff in new technology	–
Initial testing of new technology	35,000
Losses incurred while other parts of plant shut down during testing and training	–
Total	**9,35,000**

Question 2

X Ltd. purchased a standardised finance software at a list price of ₹ 30,00,000 and paid ₹ 50,000 towards purchase tax which is non-refundable. In addition to this, the entity was granted a trade discount of 5% on the initial list price. X Ltd. incurred cost of ₹ 7,00,000 towards customisation of the software for its intended use. X Ltd. purchased a 5-year maintenance contract with the vendor company of ₹ 2,00,000. At what cost the intangible asset will be recognised?

Answer

In accordance with Ind AS 38, the cost of a separately acquired intangible asset is its purchases price and non-refundable purchase taxes, after deducting trade discounts and rebates and any directly attributable cost of preparing the asset for its intended use.

Therefore, the initial cost of the asset should be:

	Amount (₹)
List price	30,00,000

Less: Trade discount (5%)	(1,50,000)
	28,50,000
Non-refundable purchase tax	50,000
Customisation cost	7,00,000
Total cost	36,00,000

The maintenance contract of ₹ 2,00,000 is an expense and therefore should be taken as a prepaid expense and charged to profit and loss over a period of 5 years.

Question 3

Venus India Private Ltd acquired a software for its internal use costing ₹ 10,00,000. The amount payable for the software was ₹ 6,00,000 immediately and ₹ 4,00,000 in one year time. The other expenditure incurred were:

Purchase tax: ₹ 1,00,000

Entry Tax: 10% (recoverable later from tax department)

Legal fees: ₹ 87,000

Consultancy fees for implementation: ₹ 1,20,000

Cost of capital of the company is 10%.

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

Answer

Particulars	**Amount**
Cash paid	6,00,000
Deferred consideration (₹ 4,00,000/1.1)	3,63,636
Purchase Tax	1,00,000
Entry tax (not to be considered as it is a refundable tax)	–
Legal fees	87,000
Consultancy fees for implementation	1,20,000
Total cost to be capitalised	**12,70,636**

Question 4

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 ₹ 8,00,000 before 31st March, 2022. ₹ 7,00,000 of this sum relates to advertisements shown before 31st March, 2022 and ₹ 1,00,000 to advertisements shown in April, 2022. Since 31st March, 2022, A Ltd. has paid for further advertisements costing ₹ 4,00,000. The accountant charged all these costs as expenses in the year to 31 March 2022. However, CFO of A Ltd. does not want to charge ₹ 12,00,000 against 2021-2022 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.

Examine and justify the treatment of these costs of ₹ 12,00,000 in the financial statements for the year ended 31st March, 2022 as per Ind AS.

Answer

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 accrual basis.

Therefore, of the advertisements paid for before 31st March, 2022, ₹ 7,00,000 would be recognised as an expense and ₹ 1,00,000 as a pre-payment in the year ended 31st March 2022.

₹ 4,00,000 cost of advertisements paid for since 31st March, 2022 would be charged as expenses in the year ended 31st March, 2023.

Question 5

Pluto Ltd. intends to open a new retail store in a new location in the next few weeks. Pluto Ltd has spent a substantial sum on a series of television advertisements to promote this new store. The Company has paid an amount of ₹ 800,000 for advertisements before 31st March, 20X1. ₹ 700,000 of this sum relates to advertisements shown before 31st March, 20X1 and ₹ 100,000 to advertisements shown in April, 20X1. Since 31st March, 20X1, the Company has paid for further advertisements costing ₹ 400,000.

Pluto Ltd is of view that such costs can be carried forward as intangible assets. Since market research indicates that this new store is likely to be highly successful. Please explain and justify the treatment of the above costs in the financial statements for the year ended 31st March, 20X1.

Answer

Under Ind AS 38 – Intangible Assets – intangible assets can only be recognised if they are identifiable and have a cost which can be reliably measured.

These criteria are very difficult to satisfy for internally developed intangibles.

For these reasons, Ind AS 38 specifically prohibits recognising advertising expenditure as an intangible asset. The issue of how successful the store is likely to be does not affect this prohibition. Therefore, such costs should be recognised as expenses.

However, the costs would be recognised on accrual basis. Therefore, of the advertisements paid for before 31st March, 20X1, ₹ 7,00,000 would be recognised as an expense and ₹ 1,00,000 as a pre-payment in the year ended 31st March, 20X1. The ₹ 4,00,000 cost of advertisements paid for since 31st March, 20X1 would be charged as expenses in the year ended 31st March, 20X2.

Question 6

X Ltd. has started developing a new production process in financial year 20X1-20X2. Total expenditure incurred till 30th September, 20X1, was ₹ 1,00,00,000. The expenditure on the development of the production process meets the recognition criteria on 1st July, 20X1. The records of X Ltd. show that, out of total ₹ 1,00,00,000, ₹ 70,00,000 were incurred during July to September, 20X1. X Ltd. publishes its financial results quarterly. How X Ltd. should account for the development expenditure?

Answer

X Ltd. should recognise the intangible asset at ₹ 70,00,000 and ₹ 30,00,000 which was already recognised as an expense in first quarter should not be capitalised.

Question 7

X Ltd. is engaged in developing computer software. The expenditures incurred by X Ltd. in pursuance of its development of software is given below:

(a) Paid ₹ 2,00,000 towards salaries of the program designers.

(b) Incurred ₹ 5,00,000 towards other cost of completion of program design.

(c) Incurred ₹ 2,00,000 towards cost of coding and establishing technical feasibility.

(d) Paid ₹ 7,00,000 for other direct cost after establishment of technical feasibility.

(e) Incurred ₹ 2,00,000 towards other testing costs.

(f) A focus group of other software developers was invited to a conference for the introduction of this new software. Cost of the conference aggregated to ₹ 70,000.

On 15th March, 20X1, the development phase was completed and a cash flow budget was prepared.

Net profit for the year was estimated to be equal ₹ 40,00,000. How X Ltd. should account for the above mentioned cost?

Answer

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, ₹ 9,00,000 (salary cost of ₹ 2,00,000, program design cost of ₹ 5,00,000 and coding and technical feasibility cost of ₹ 2,00,000) would be recorded as expense in Profit and Loss since it belongs to research phase.

Cost incurred from the point of technical feasibility are capitalised as software costs. But the conference cost of ₹ 70,000 would be expensed off.

In this situation, direct cost after establishment of technical feasibility of ₹ 7,00,000 and testing cost of ₹ 2,00,000 will be capitalised.

The cost of software capitalised is = ₹ (7,00,000 + 2,00,000) = ₹ 9,00,000.

Question 8

X Ltd. acquired Y Ltd. on 30th April, 20X1. The purchase consideration is ₹ 50,00,000. The fair value of the tangible assets is ₹ 45,00,000. The company estimates the fair value of "in-process research projects" at ₹ 10,00,000. No other Intangible asset is acquired by X Ltd. in the transaction. Further, cost incurred by X Ltd. in relation to that research project is as follows:

(a) ₹ 5,00,000 – as research expenses

(b) ₹ 2,00,000 – to establish technological feasibility

(c) ₹ 7,00,000 – for further development cost after technological feasibility is established.

At what amount the intangible asset should be measured under Ind AS 38?

Answer

X Ltd. should initially recognise the acquired "in house research project" at its fair value i.e., ₹ 10,00,000. Research cost of ₹ 5,00,000 and cost of ₹ 2,00,000 for establishing technical feasibility should be charged to profit & loss. Costs incurred from the point of technological feasibility/asset recognition criteria until the time when development costs are incurred are capitalised.

So the intangible asset should be recognised at ₹ 17,00,000 (₹ 10,00,000 + ₹ 7,00,000).

Question 9

X Pharmaceutical Ltd. seeks your opinion in respect of following accounting transactions:

1. Acquired a 4 year license to manufacture a specialised drug at a cost of ₹ 1,00,00,000 at the start of the year. Production commenced immediately.
2. Also purchased another company at the start of year. As part of that acquisition, X Pharmacy Ltd. acquired a brand with a fair value of ₹ 3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.
3. Spent ₹ 1,00,00,000 on an advertising campaign during the first six months. Subsequent sales have shown a significant improvement and it is expected this will continue for 3 years.
4. It has commenced developing a new drug 'Drug-A'. The project cost would be ₹ 10,00,00,000. Clinical trial proved successful and such drug is expected to generate revenue over next 5 years.

   Cost incurred (accumulated) till 31st March, 20X1 is ₹ 5,00,00,000.

   Balance cost incurred during the financial year 20X1-20X2 is ₹ 5,00,00,000.
5. It has also commenced developing another drug 'Drug B'. It has incurred ₹ 50,00,000 towards research expenses till 31st March, 20X2. The technological feasibility has not yet been established.

How the above transactions will be accounted for in the books of account of X Pharmaceutical Ltd?

Answer

X Pharmaceutical Ltd. is advised as under:

1. It should recognise the drug license as an intangible asset, because it is a separate external purchase, separately identifiable asset and considered successful in respect of feasibility and probable future cash inflows.

   The drug license should be recorded at ₹ 1,00,00,000.
2. It should recognise the brand as an intangible asset because it is purchased as part of acquisition and it is separately identifiable. The brand should be amortised over a period of 15 years.

   The brand will be recorded at ₹ 3,00,00,000.

3. The advertisement expenses of ₹ 1,00,00,000 should be expensed off.
4. The development cost incurred during the financial year 20X1-20X2 should be capitalised.

   Cost of intangible asset (Drug A) as on 31st March, 20X2

Opening cost	₹ 5,00,00,000
Development cost	₹ 5,00,00,000
Total cost	₹ 10,00,00,000

5. Research expenses of ₹ 50,00,000 incurred for developing 'Drug B' should be expensed off since technological feasibility has not yet established.

Question 10

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

1. The company completed a grand marketing and advertising campaign costing ₹ 4.8 lakh. The finance director had authorised this campaign on the basis that it would create ₹ 8 lakh of additional profits over the next three years.
2. A new product was developed during the year. The expenditure totalled ₹ 3 lakh of which ₹ 1.5 lakh was incurred prior to 30th September, 20X1, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at ₹ 1.4 lakh.
3. Staff participated in a training programme which cost the company ₹ 5 lakh. The training organisation had made a presentation to the directors of the company outlining that incremental profits to the business over the next twelve months would be ₹ 7 lakh.

What amounts should appear as intangible assets in accordance with Ind AS 38 and Ind AS 36 in Mercury's balance sheet as on 31st March, 20X2?

Answer

The treatment in Mercury's financials as at 31st March, 20X2 will be as follows:

1. **Marketing and advertising campaign:** No intangible asset will be recognised, because it is not possible to identify future economic benefits that are attributable only due to this campaign. All of the expenditure should be expensed in the statement of profit and loss.
2. **New product:** Development expenditure appearing in the balance sheet will be valued at ₹ 1.5 lakh as per Ind AS 38. The expenditure prior to the date on which the product becomes technically feasible is recognised in the statement of profit and loss. However, its recoverable amount is also given in the question. Therefore, applying provisions of Ind AS 36, the revised carrying amount on 31st March, 20X2 after impairment will be ₹ 1.4 lakh.
3. **Training programme:** No asset will be recognised, because there is no control of company over the staff and when staff leaves the benefits of the training, whatever they may be, also departs.

Question 11

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

1. Company has completed a big marketing and advertising campaign costing ₹ 2,40,000. The finance director had authorised this campaign on the basis that it would create ₹ 5,00,000 of additional profits over the next three years.
2. A new product was developed during the year. The expenditure aggregated ₹ 1,50,000 of which ₹ 1,00,000 was incurred prior to 30th September, 20X1, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at ₹ 70,000.
3. Staff participated in a training programme which cost the company ₹ 300,000. The training organisation had made a presentation to the directors of Baxter outlining that incremental profits to the business over the next twelve months would be ₹ 500,000.

What amounts should appear as assets in Venus Ltd. Balance sheet as at 31st March, 20X2?

Answer

The treatment in Venus Ltd's balance sheet as at 31st March, 20X2 will be as follows:

1. Marketing and advertising campaign: No asset will be recognised because it is not possible to identify future economic benefits that are attributable only to this campaign. All of the expenditure should be expensed in the statement of profit and loss account.
2. New product: Development expenditure appearing in the statement of financial position will be valued at ₹ 50,000. The expenditure prior to the date on which the product becomes technically feasible is recognised in the statement of profit and loss account as an expense.
3. Training programme: No intangible asset will be recognised, because staff are not under the control of Venus Ltd. and when staff leave the benefits of the training, whatever they may be, also leave.

Question 12

Sun Ltd acquired a software from Earth Ltd. in exchange for a telecommunication license. The telecommunication license is carried at ₹ 5,00,000 in the books of Sun Ltd. The Software is carried at ₹ 10,000 in the books of the Earth Ltd which is not the fair value.

Advise journal entries in the following situations in the books of Sun Ltd and Earth Ltd:

1) Fair value of software is ₹ 5,20,000 and fair value of telecommunication license is ₹ 5,00,000.
2) Fair Value of Software is not measureable. However similar Telecommunication license is transacted by another company at ₹ 4,90,000.
3) Neither Fair Value of Software nor Telecommunication license could be reliably measured.

Note: Present all amounts in ₹ '000

Answer

					₹ in '000
Situation	**Sun Ltd.**		**Earth Ltd.**		
1	Software	Dr. 500	Telecommunication license	Dr. 520	

	To Telecommunication license 500 To Profit on Exchange Nil	To Software 10 To Profit on Exchange 510
2	Software Dr. 490 Loss on Exchange Dr. 10 To Telecommunication license 500	Telecommunication license Dr. 490 To Software 10 To Profit on Exchange 480
3	Software Dr. 500 To Telecommunication license 500	Telecommunication license Dr. 10 To Software 10

Question 13

X Ltd. acquired a patent right of manufacturing drug from Y Ltd. in exchange X Ltd. gives its intellectual property right to Y Ltd. Current market value of the patent and intellectual property rights are ₹ 20,00,000 and ₹ 18,00,000 respectively. At what value patent right should be initially recognised in the books of X Ltd. in following two situations?

(a) X Ltd. did not pay any cash to Y Ltd.

(b) X Ltd. pays ₹ 2,00,000 to Y Ltd.

Answer

If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

The transaction at the fair value of the asset received adjusted for any cash received or paid. Therefore, in case (a) patent is measured at ₹ 18,00,000, in case (b) it is measured at ₹ 20,00,000 (18,00,000 + 2,00,000).

Question 14

X Limited engaged in the business of manufacturing fertilisers entered into a technical collaboration agreement with a foreign company Y Limited. As a result, Y Limited would provide the technical know-how enabling X Limited to manufacture fertiliser in a more efficient way. X Limited paid ₹ 10,00,00,000 for the use of know-how for a period of 5 years. X Limited estimates the production of fertiliser as follows:

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

At the end of the 1st year, it achieved its targeted production. At the end of 2nd year, 65,000 metric tons of fertiliser was being manufactured, and X Limited considered to revise the estimates for the next 3 years. The revised figures are 85,000, 1,05,000 and 1,15,000 metric tons for year 3, 4 & 5 respectively.

How will X Limited amortise the technical know-how fees as per Ind AS 38?

Answer

Based on the above data, it may be suitable for X Ltd. to use unit of production method for amortisation of technical know-how.

The total estimated unit to be produced 4,50,000 MT. The technical know-how will be amortised on the basis of the ratio of yearly production to total production.

The first year charge should be a proportion of 50,000/4,50,000 on ₹ 10,00,00,000 = ₹ 1,11,11,111

At the end of 2nd year, as per revised estimate the total number of units to be produced in future are 3,70,000 MT (i.e. 65,000 + 85,000 + 1,05,000 + 1,15,000).

Amortisation for second year will be 65,000/3,70,000 on (10,00,00,000 – 1,11,11,111) i.e. 1,56,15,615.

Amortisation for remaining years (unless the estimates are again revised):

Year 3 = 85,000/3,70,000 on (10,00,00,000 – 1,11,11,111) i.e. ₹ 2,04,20,420

Year 4 = 1,05,000/3,70,000 on (10,00,00,000 – 1,11,11,111) i.e. ₹ 2,52,25,225

Year 5 = 1,15,000/3,70,000 on (10,00,00,000 – 1,11,11,111) i.e. ₹ 2,76,27,629

Question 15

Expenditure on a new production process in 20X1-20X2:

	₹
1st April to 31st December	2,700
1st January to 31st March	900
	3,600

The production process met the intangible asset recognition criteria for development on 1st January, 20X2. The amount estimated to be recoverable from the process is ₹ 1,000.

Expenditure incurred for development of the process in FY 20X2-20X3 is ₹ 6,000. Asset was brought into use on 31st March, 20X3 and is expected to be useful for 6 years.

What is the carrying amount of the intangible asset at 31st March, 20X2 and 31st March, 20X3. Also determine the charge to profit or loss for 20X1-20X2?

At 31st March, 20X4, the amount estimated to be recoverable from the process is ₹ 5,000.

What is the carrying amount of the intangible asset at 31st March, 20X4 and the charge to profit or loss for 20X3-20X4 on account of impairment loss?

Answer

1) Expenditure to be transferred to profit or loss in 20X1-20X2

	₹
Total Expenditure	3,600
Less: Expenditure during development phase	(900)
Expenditure to be transferred to profit or loss	2,700

2)	**Carrying amount of intangible asset on 31st March, 20X2**	
	Expenditure during Development Phase will be capitalised	₹ 900
	(Recoverable amount is higher being ₹ 1,000, hence no impairment)	
3)	**Carrying amount of intangible asset on 31st March, 20X3**	
	Carrying amount of intangible asset on 31st March, 20X2	900
	Add: Further expenditure during development phase	6,000
	Total capital expenditure on development phase	6,900
4)	**Expenditure to be charged to profit or loss in 20X3-20X4**	
	Opening balance of Intangible Asset	6,900
	Less: Amortisation for the year (6,900/6)	(1,150)
	Carrying amount of intangible asset	5,750
	Less: Recoverable Amount	(5,000)
	Amount charged to profit or loss (Impairment Loss)	750
5)	**Carrying Amount of Intangible Asset on 31st March, 20X4**	
	Value of Intangible Asset will be recoverable amount i.e. ₹ 5,000	

Question 16

An entity is developing a new production process. During 20X1-20X2, expenditure incurred was ₹ 1,000, of which ₹ 900 was incurred before 1st March, 20X2 and ₹ 100 was incurred between 1st March, 20X2 and 31st March, 20X2. The entity is able to demonstrate that at 1st March, 20X2, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be ₹ 500.

During 20X2-20X3, expenditure incurred is ₹ 2,000. At the end of 20X3, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be ₹ 1,900.

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

Answer

At the end of the financial year 20X2, the production process is recognised as an intangible asset at a cost of ₹ 100 (expenditure incurred since the date when the recognition criteria were met, i.e., 1st March, 20X2). ₹ 900 expenditure incurred before 1st March, 20X2 is recognised as an expense because the recognition criteria were not met until 1st March, 20X2. This expenditure does not form part of the cost of the production process recognised in the balance sheet.

At the end of 20X3, the cost of the production process is ₹ 2,100 (₹ 100 expenditure recognised at the end of 20X2 plus ₹ 2,000 expenditure recognised in 20X3). The entity recognises an impairment loss of ₹ 200 to adjust the carrying amount of the process before impairment loss (₹ 2,100) to its recoverable amount (₹ 1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in Ind AS 36 are met.

Question 17

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 ₹ 18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset. An offer of ₹ 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 ₹ 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 ₹ 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?

Answer

Ind AS 38 '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 ₹ 15,00,000 (₹ 18,00,000 x 10/12) should be capitalised 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 ₹ 3,00,000 (2/12 x ₹ 18,00,000) should be recognised 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 ₹ 12,00,000 in perpetuity would clearly have a present value in excess of ₹ 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 ₹ 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 ₹ 7,80,000 and so ₹ 9,60,000 should be used as the recoverable amount.

So, the carrying amount should be consequently reduced to ₹ 9,60,000.

Calculation of Impairment loss:

Particulars	Amount ₹
Carrying amount (Restated)	15,00,000
Less: Recoverable amount	9,60,000
Impairment loss	5,40,000

Impairment loss of ₹ 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:

		₹	₹
Operating expenses (Research expenditure)	Dr.	3,00,000	
Operating expenses (Impairment loss of intangible assets)	Dr.	5,40,000	
To Intangible assets			8,40,000

Question 18

X Ltd. decides to revalue its intangible assets on 1st April, 20X1. On the date of revaluation, the intangible assets stand at a cost of ₹ 1,00,00,000 and accumulated amortisation is ₹ 40,00,000. The intangible assets are revalued at ₹ 1,50,00,000. How should X Ltd. account for the revalued intangible assets in its books of account using Restatement Approach?

Answer

The intangible assets are revalued to ₹ 1,50,00,000 on an amortised replacement cost basis, which is a 150% increase from its original cost. Thereby applying the existing ratio of accumulated depreciation to the cost the revalued gross amount would be ₹ 2,50,00,000 gross and ₹ 1,00,00,000 on amortisation.

Question 19

1. Saturn Ltd. acquired an intangible asset on 31st March, 20X1 for ₹ 1,00,000. The asset was revalued at ₹ 1,20,000 on 31st March, 20X2 and ₹ 85,000 on 31st March, 20X3.
2. Jupiter Ltd. acquired an intangible asset on 31st March, 20X1 for ₹ 1,00,000. The asset was revalued at ₹ 85,000 on 31st March, 20X2 and at ₹ 1,05,000 on 31st March, 20X3.

Assuming that the year-end for both companies is 31st March, and that they both use the revaluation model, show how each of these transactions should be dealt with in the financial statements. Explain the treatment for revaluation of intangible asset. Ignore computation of amortization on them for ease of understanding.

Answer

Saturn Ltd.

₹ 20,000 revaluation increase on 31st March, 20X2 should be credited to the revaluation reserve and recognised in other comprehensive income. ₹ 20,000 of the revaluation decrease on 31st March, 20X3 should be debited to revaluation reserve and remaining ₹ 15,000 should be recognised as an expense in the Statement of Profit and loss.

Jupiter Ltd.

₹ 15,000 revaluation decrease on 31st March, 20X2 should be recognised as an expense in the Statement of Profit and loss. ₹ 15,000 out of the ₹ 20,000 increase on 31st March, 20X3 should be recognised as income in the Statement of Profit and loss. The remaining ₹ 5,000 should be credited to revaluation reserve and recognised in other comprehensive income.

Question 20

X Ltd. purchased a patent right on 1st April, 20X1, for ₹ 3,00,000; which has a legal life of 15 years. However, due to the competitive nature of the product, the management estimates a useful life of only 5 years. Straight-line amortisation is determined by the management to be the best method. As at 1st April, 20X2, management is uncertain that the process can actually be made economically feasible, and decides to write down the patent to an estimated market value of ₹ 1,50,000 and decides to amortise over 2 years. As at 1st April, 20X3, having perfected the related production process, the asset is now appraised at a value of ₹ 3,00,000. Furthermore, the estimated useful life is now believed to be 4 more years. Determine the value of intangible asset at the end of each financial year?

Answer

Value as on 31st March, 20X2

Original cost	₹ 3,00,000
Less: amortisation	(₹ 60,000)
Net Value	₹ 2,40,000

Value as on 31st March, 20X3

On 1st April, 20X2, revaluation loss is recorded by writing down the asset to the estimated value of ₹ 1,50,000, which necessitates a ₹ 90,000 charge to profit & loss (carrying value, ₹ 2,40,000 less fair value ₹ 1,50,000).

Amortisation provided for the financial year 20X2-20X3 is ₹ 75,000 (₹ 1,50,000/2)

Net value is = ₹ 1,50,000 – ₹ 75,000 = ₹ 75,000

Value as on 31st March, 20X4

As of 1st April, 20X3, the carrying value of the patent is ₹ 75,000.

Revalued amount of patent is ₹ 3,00,000.

Out of total revaluation gain of ₹ 2,25,000, ₹ 90,000 will be charged to profit & loss and balance amount of ₹ 1,35,000 (₹ 2,25,000 – ₹ 90,000) will be credited to revaluation reserve.

Amortisation provided for the financial year 20X3-20X4 is ₹ 75,000 (₹ 3,00,000/4)

Net value is = ₹ 3,00,000 – ₹ 75,000 = ₹ 2,25,000

Similarly, Value as on March 31, 20X5 = ₹ 2,25,000 – ₹ 75,000 = ₹ 1,50,000

Value as on March 31, 20X6 = ₹ 1,50,000 – ₹ 75,000 = ₹ 75,000

Value as on March 31, 20X7 = ₹ 75,000 – ₹ 75,000 = ₹ Nil

Unit 7 – Ind AS 40: Investment Property

Question 1

X Limited purchased a building for ₹ 30,00,000 on 1st May, 20X1 with an intention to earn rentals. The purchase price was funded by a loan, interest on which is payable @ 5%. Property transfer taxes and direct legal costs of ₹ 1,00,000 and ₹ 20,000 respectively were incurred in acquiring the building. X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

(a) ₹ 2,00,000 planning permission.

(b) ₹ 7,00,000 construction costs (including ₹ 40,000 refundable purchase taxes)

What is the cost of the Building as per Ind AS 40?

Answer

As per Ind AS 40, the cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs).

Accordingly, cost of the Building is arrived at as under:

Particulars	Amount in ₹	Total ₹
Purchase price		30,00,000
Add: Property transfer taxes		1,00,000
Direct legal costs		20,000
Fee for planning permission		2,00,000
Construction costs	7,00,000	
Less: Refundable purchase taxes	40,000	6,60,000
Cost of the Building as per Ind AS 40		**39,80,000**

Note: The building does not qualify the substantial period criteria for redevelopment of property. Hence, borrowing cost of loan fund has not been capitalised.

Question 2

Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for ₹ 5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying ₹ 6,25,000 as a one-time joining fee. Netravati Ltd. wants to write off the one-time joining fees paid as an expense under Membership and Subscription Charges and value the investment property at ₹ 5 crores. Advise.

Would you answer change if the office space was purchased with the intention of using it as an administrative centre of the company?

Answer

Cost of Investment Property

As per Ind AS 40, the cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs). Accordingly, on initial recognition, the one-time joining fee of ₹ 6,25,000 should be added to the purchase price. Therefore, the investment property should be measured at ₹ 5,06,25,000 (i.e. cost of the commercial office space + one-time joining fee). Writing off the amount of ₹ 6,25,000 to the P&L is not appropriate.

Use as Administrative Office

If the property is used as an administrative centre, it is not an investment property, but rather an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

Even under Ind AS 16, all direct costs relating to the acquisition of the asset should be added to the purchase price. Hence, cost of the asset under Ind AS 16 would be ₹ 5,06,25,000.

Question 3

X Limited purchased a land worth of ₹ 1,00,00,000. It has option either to pay full amount at the time of purchases or pay for it over two years for a total cost of ₹ 1,20,00,000. What should be the cost of the building under both the payment methods?

Answer

Using either payment method, the cost will be ₹ 1,00,00,00. If the second payment option is used, ₹ 20,00,000 will be treated as interest expenses over the period of 2 years.

Question 4

Sun Ltd acquired a building in exchange of a warehouse whose fair value is ₹ 5,00,000 and payment of cash is ₹ 2,00,000. The fair value of the building received by the Company is ₹ 8,00,000. The company decided to keep that building for rental purposes. Pass Journal Entry.

Answer

The Building is acquired with the purpose to earn rentals. Hence, it is a case of Investment Property acquired in exchange for a combination of monetary and non-monetary asset. Therefore, Journal entry at the time of acquisition is:

Investment Property (Building) (5,00,000 + 2,00,000)	Dr	7,00,000	
To Cash			2,00,000
To PPE (Property, Plant and Equipment) i.e. Warehouse			5,00,000

Question 5

On 1st April, 20X1 an entity acquired an investment property (building) for ₹ 40,00,000. Management estimates the useful life of the building as 20 years measured from the date of acquisition. The residual value of the building is ₹ 2,00,000. Management believes that the straight-line depreciation method reflects the pattern in which it expects to consume the building's future economic benefits. What is the carrying amount of the building on 31st March, 20X2?

Answer

Cost of the asset is ₹ 40,00,000.

Depreciable amount = Cost less Residual value = ₹ (40,00,000 – 2,00,000) = ₹ 38,00,000

Depreciation for the year = Depreciable amount/useful life = ₹ 38,00,000/20 = ₹ 1,90,000

Carrying amount = Cost less accumulated depreciation = ₹ (40,00,000 – 1,90,000) = ₹ 38,10,000

Question 6

X Limited owns a building which is used to earn rentals. The building has a carrying amount of ₹ 50,00,000. X Limited recently replaced interior walls of the building and the cost of new interior walls is ₹ 5,00,000. The original walls have a carrying amount of ₹ 1,00,000. How X Limited should account for the above costs?

Answer

Under the recognition principle, an entity recognises in the carrying amount of an investment property the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and the carrying amount of those parts that are replaced is derecognised.

So, X Limited should add the cost of new walls and remove the carrying amount of old walls.

The new carrying amount of the building = ₹ 50,00,000 + ₹ 5,00,000 – ₹ 1,00,000 = ₹ 54,00,000

Question 7

Sun Ltd, an aeronautics company is having a building which is given on an operating lease. The book value of such building in the books is ₹ 2,00,000. Pass Journal Entry in books of Sun Ltd.:

(i) If Pluto Ltd. buys the building at ₹ 4,00,000.

(ii) If Pluto Ltd. takes the building on finance lease for 10 years at a lease rental of ₹ 80,000 p.a. The present value of minimum lease payments is ₹ 3,20,000.

Answer

(i) Journal Entry

Bank	Dr	4,00,000	
To Investment Property			2,00,000
To Gain on disposal			2,00,000

(ii) Journal Entry

Lease Receivable	Dr	3,20,000	
To Investment Property			2,00,000
To Gain on disposal			1,20,000

Question 8

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

The expenditure incurred on various dates is given below:

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

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

On 2nd April, 20X1 – Legal cost related to property acquisition ₹ 5,00,000.

On 6th April, 20X1 – Advertisement campaign to attract tenants ₹ 3,00,000.

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

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

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

How X Limited will account for all the above mentioned expenses in the books of account?

Answer

The cost of the property = ₹ (1,80,00,000 + 20,00,000 + 5,00,000) = ₹ 2,05,00,000

Since five houses out of six are being rented, so 5/6th of the property cost will be accounted for as an investment property and 1/6th of the property cost will be accounted for as owner occupied property.

Cost of the investment property = ₹ 2,05,00,000 x 5/6 = ₹ 1,70,83,333

Cost of the owner occupied property = ₹ (2,05,00,000 – 1,70,83,333) = ₹ 34,16,667

All other costs, i.e., advertisement expenses, ceremony expenses and repair maintenance expenses will be expensed off as and when incurred.

Question 9

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.

Answer

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	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 1st 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 or building) is held to earn rentals or for capital appreciation (or both), it is an Investment property. Ind AS 40 prescribes 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 10

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

Answer

	(₹ Million)
Carrying amount of the building after depreciation of 4 years [10 – (10/10 x 4)]	6
The company has applied cost model under Ind AS 16 till now.	
There is no impairment as the fair value is greater than the carrying amount of building.	
Revaluation Surplus credited to Other Comprehensive Income	–
(Not applicable since cost model is used under Ind AS 16)	
Building initially recognised as Investment Property (Cost model Ind AS 40)	6

Question 11

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

Answer

At 31st March, 20X1, X Limited must transfer the property from investment property to property, plant and equipment since there is a change in use of the said building.

The transfer should be made at its carrying amount i.e., ₹ 15,00,000.

Since recoverable amount of the property as on 31st March, 20X1 is ₹ 10,00,000, impairment loss ₹ 5,00,000 should be recognised in the Statement of Profit and Loss. So, the carrying amount of Investment property at 31st March, 20X1 would be ₹ 10,00,000.

The entity must disclose the reclassification.

From April, 20X1, X Limited will depreciate the building over its remaining useful life of 20 years.

Question 12

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

Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 20X6 as per Ind AS.

Answer

From 1st April, 20X1, 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 ₹ 2,00,00,000 at each year end.

On 30th September, 20X5, the property ceases to be an investment property. X Ltd. begins to develop it for sale as flats.

As per para 59 of Ind AS 40, transfers between investment property, owner occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes. Hence, the carrying value of the re-classified property will be ₹ 2,00,00,000.

Since the lease of the property is an operating lease, rental income of ₹ 10,00,000 (₹ 20,00,000 x 6/12) would be recognised in P/L for the year ended 31st March, 20X6.

The additional costs of ₹ 60,00,000 for developing the flats which were incurred up to and including 31st March, 20X6 would be added to the 'cost' of inventory to give a closing cost of ₹ 2,60,00,000.

The total selling price of the flats is expected to be ₹ 5,00,00,000 (10 x ₹ 50,00,000). Since the further costs to develop the flats total ₹ 40,00,000, their net realisable value is ₹ 4,60,00,000 (₹ 5,00,00,000 – ₹ 40,00,000), so the flats will be measured at a cost of ₹ 2,60,00,000.

The flats will be shown in inventory as a current asset.

Question 13

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

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

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

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

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

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

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

The other key inputs for valuation are as follows:

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

Assume that the fair value of properties based on discounted cash flow method is measured at ₹ 10.50 crore on 31st March, 20X2. The treatment of fair value of properties is to be given in the financials as per the requirements of Indian accounting standards.

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

Note: Present all calculations in ₹ crores.

Answer

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 Ind AS 16's requirements 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 31st March, 20X2 (₹ in crores)**
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

Amount recognised in Profit and Loss with respect to Investment Properties

Particulars	Period ending 31st March, 20X2 (₹ in crores)
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 March 31, 20X2, the fair value of the properties is ₹ 10.50 crores. The valuation is performed by independent valuers, who are specialists in valuing investment properties. A valuation model as recommended by International Valuation Standards Committee has been applied. The Company considers factors like management intention, terms of rental agreements, area leased out, life of the assets etc. to determine classification of assets as investment properties.

The Company has no restrictions on the realisability of its investment properties and no contractual obligations to purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

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

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

CHAPTER - 7
Unit 8 – Ind AS 105: Non-Current Assets Held for Sale and Discontinued Operations

Question 1

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.

Value the property at the end of 20X3 and 20X4.

Answer

(a) 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 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.

(b) 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 is 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 2

On 1st June, 20X1, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On 31st July, 20X1, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y. However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by 30th November, 20X1 and the sale is expected to be completed by 31st March, 20X2. Entity X follows December year end. The assets and liabilities attributable to this manufacturing unit are as under:

(Amount in ₹)

Particulars	**Carrying value as on 31st December, 20X0**	**Carrying value as on 31st July, 20X1**
Goodwill	500	500
Plant and Machinery	1,000	900
Building	2,000	1,850
Debtors	850	1,050
Inventory	700	400
Creditors	(300)	(250)
Loans	(2,000)	(1,850)
	2,750	2,600

The fair value of the manufacturing unit as on 31st December, 20X0 is ₹ 2,000 and as on 31st July, 20X1 is ₹ 1,850. The cost to sell is 100 on both these dates. The disposal group is not sold at the period end i.e., 31st December, 20X1. The fair value as on 31st December, 20X1 is lower than the carrying value of the disposal group as on that date.

Required:

1. Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?
2. The measurement of the manufacturing unit as on the date of classification as held for sale.
3. The measurement of the manufacturing unit as at the end of the year.

Answer

1. **Assessing whether the manufacturing unit can be classified as held for sale**

   The manufacturing unit can be classified as held for sale due to the following reasons:

   (a) The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group must be classified as held for sale is 31st July, 20X1, i.e., the date at which management becomes committed to the plan.

   (b) The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.

   (c) A firm purchase agreement has been entered with the buyer.

   (d) The sale is expected to be complete by 31st March, 20X2, i.e., within one year from the date of classification.

2. **Measurement of the manufacturing unit as on the date of classification as held for sale**

Following steps need to be followed:

Step 1: Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS.

This has been done and the carrying value of the disposal group as on 31st July, 20X1 is determined at ₹ 2,600. The difference between the carrying value as on 31st December, 20X0 and 31st July, 20X1 is accounted for as per the relevant Ind AS.

Step 2: An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The fair value less cost to sell of the disposal group as on 31st July, 20X1 is ₹ 1,750 (i.e. 1,850 – 100). This is lower than the carrying value of ₹ 2,600. Thus an impairment loss needs to be recognised and allocated first towards goodwill and thereafter pro-rata between assets of the disposal group which are within the scope of Ind AS 105 based on their carrying value. Thus, the assets will be measured as under:

Particulars	**Carrying value – 31st July, 20X1**	**Impairment**	**Carrying value as per Ind AS 105 – 31st July, 20X1**
Goodwill	500	(500)	–
Plant and Machinery	900	(115)	785
Building	1,850	(235)	1,615
Debtors	1,050	–	1,050
Inventory	400	–	400
Creditors	(250)	–	(250)
Loans	(1,850)	–	(1,850)
	2,600	(850)	1,750

3. **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.

Question 3

Following is the extract of the consolidated financial statements of A Ltd. for the year ended on:

Asset/(liability)	**Carry amount as on 31st March, 20X1 (in ₹ '000)**
Attributed goodwill	200
Intangible assets	950
Financial asset measured at fair value through other comprehensive income	300
Property, plant & equipment	1100
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	600
Current liabilities	(850)
Non-current liabilities – provisions	(300)
Total	**2,250**

On 15th September 20X1, Entity A decided to sell the business. It noted that the business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with that standard.

The disposal group is stated at the following amounts immediately prior to reclassification as held for sale.

Asset/(liability)	**Carry amount as on 15th September 20X1 (in ₹ '000)**
Attributed goodwill	200
Intangible assets	930
Financial asset measured at fair value through other comprehensive income	360
Property, plant & equipment	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 ₹ 19,00,000. It estimates that the costs to sell will be ₹ 70,000. This cost consists of professional fee to be paid to external lawyers and accountants.

As at 31st March 20X2, there has been no change to the plan to sell the disposal group and entity A still expects to sell it within one year of initial classification. Mr. X, an accountant of Entity A remeasured the following assets/liabilities in accordance with respective standards as on 31st March 20X2:

Available for sale:	**(in ₹ '000)**

Financial assets	410
Deferred tax assets	230
Current assets – Inventory, receivables and cash balances	400
Current liabilities	900
Non-current liabilities – provisions	250

The disposal group has not been trading well and its fair value less costs to sell has fallen to ₹ 16,50,000.

Required:

What would be the value of all assets/labilities within the disposal group as on the following dates in accordance with Ind AS 105?

(a) 15 September, 20X1 and

(b) 31st March, 20X2

Answer

(a) As at 15 September, 20X1

The disposal group should be measured at ₹ 18,30,000 (19,00,000 – 70,000). The impairment write down of ₹ 3,30,000 (₹ 21,60,000 – ₹ 18,30,000) should be recorded within profit from continuing operations.

The impairment of ₹ 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

The impairment loss is allocated first to goodwill and then pro rata to the other assets of the disposal group within Ind AS 105 measurement scope. Following assets are not in the measurement scope of the standard- financial asset measured at other comprehensive income, the deferred tax asset or the current assets. In addition, the impairment allocation can only be made against assets and is not allocated to liabilities.

(b) As on 31 March. 20X2:

All of the assets and liabilities, outside the scope of measurement under 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 4

CK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June, 2018. During the 3 months ended 30th June, 2018 following events occurred:

On 1st April, 2018, the Company has decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with the Company collecting any outstanding trade receivables relating to the division and settling any current liabilities.

On 1st April, 2018, the carrying amount of the assets of the division were as follows:

- Purchased Goodwill – ₹ 60,000
- Property, Plant & Equipment (average remaining estimated useful life two years) – ₹ 20,00,000
- Inventories – ₹ 10,00,000

From 1st April, 2018, the Company has started to actively market the division and has received number of serious enquiries. On 1st April, 2018 the directors estimated that they would receive ₹ 32,00,000 from the sale of the division. Since 1st April, 2018, market condition has improved and as on 1st August, 2018 the Company received and accepted a firm offer to purchase the division for ₹ 33,00,000.

The sale is expected to be completed on 30th September, 2018 and ₹ 33,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June, 2018. During the period from 1st April to 30th June inventories of the division costing ₹ 8,00,000 were sold for ₹ 12,00,000. At 30th June, 2018, the total cost of the inventories of the division was ₹ 9,00,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

The Company has approached you to suggest how the proposed sale will be reported in the interim financial statements for the quarter ended 30th June, 2018 giving relevant explanations.

Answer

The decision to offer the division for sale on 1st April, 2018 means that from that date the division has been 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 and their fair value less cost to sell. Here the division shall be measured at their existing carrying amount i.e. ₹ 30,60,000 since it is less than the fair value less cost to sell ₹ 32,00,000.

The increase in expected selling price will not be accounted for since earlier there was no impairment to division held for sale.

The assets of the division need to be presented separately from other assets in the balance sheet. Their major classes should be separately disclosed either on the face of the balance sheet or in the notes.

The Property, Plant and Equipment shall not be depreciated after 1st April, 2018 so its carrying value at 30th June, 2018 will be ₹ 20,00,000 only. The inventories of the division will be shown at ₹ 9,00,000.

The division will be regarded as discontinued operation for the quarter ended 30th June, 2018. It represents a separate line of business and is 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 on classification as held for sale.

Further, as per Ind AS 33, EPS will also be disclosed separately for the discontinued operation.

Question 5

A freehold property was originally acquired for ₹ 40,00,000. Some years later, after cumulative depreciation of ₹ 11,00,000 has been recognised, an impairment loss of ₹ 3,50,000 is recognised, taking the carrying amount to ₹ 25,50,000, which represents the estimated value in use of the property. Shortly thereafter, as a consequence of a proposed move to new premises, the freehold property is classified as held for sale. At the time of classification as held for sale, fair value less costs to sell is assessed at ₹ 25,00,000.

At the next reporting date, the property market has improved and fair value less costs to sell is reassessed at ₹ 26,50,000.

Six months after that, the property market has continued to improve, and fair value less costs to sell is now assessed at ₹ 30,00,000.

Subsequently after some time, the property is sold for ₹ 30,00,000.

Determine the relevant accounting treatments as per Ind AS 105.

Answer

At the time of classification as held for sale:

- carrying amount is ₹ 25,50,000; and
- fair value less costs to sell is assessed at ₹ 25,00,000.

Accordingly, the initial write-down on classification as held for sale is ₹ 50,000 and the property is carried at ₹ 25,00,000. Following classification as held for sale, no further depreciation is recognised.

At the next reporting date, the property market has improved and fair value less costs to sell is reassessed at ₹ 26,50,000. The gain of ₹ 1,50,000 is less than the cumulative impairment losses recognised to date (₹ 3,50,000 + ₹ 50,000 = ₹ 4,00,000). Accordingly, it is credited in profit or loss and the property is carried at ₹ 26,50,000.

Six months after that, the property market has continued to improve, and fair value less costs to sell is now assessed at ₹ 30,00,000. This further gain of ₹ 3,50,000 is, however, in excess of the cumulative impairment losses recognised to date (₹ 3,50,000 + ₹ 50,000 – ₹ 1,50,000 = ₹ 2,50,000). Accordingly, a restricted gain of ₹ 2,50,000 is credited in profit or loss and the property is carried at ₹ 29,00,000.

Subsequently, the property is sold for ₹ 30,00,000, at which time a gain of ₹ 1,00,000 is recognised.

Question 6

An entity has a Disposal group which has been classified as Held for Sale on 15th September, 2020. Following are the details related to the Disposal Group:

Disposal Group	**Carrying amount as at 31st March, 2020 before classification as held for sale** ₹	**Carrying amount as remeasured immediately before classification as held for sale** ₹
Goodwill	1,500	1,500
Property, Plant and Equipment (carried at revalued amounts)	4,600	4,000
Building (carried at cost)	5,700	5,700
Inventory	2,400	2,200
Investment in Equity Instruments	1,800	1,500
Total	**16,000**	**14,900**

The Inventory and Investment is remeasured as per Ind AS 2 and Ind AS 109 at not more than fair value at the date of remeasurement immediately classified as held for sale.

The entity estimated that fair value less costs to sell of the disposal group amounts to ₹ 13,000.

Suppose, at the end of reporting period (31st March, 2021) the fair value less cost to sell is increased and estimated at ₹ 15,500.

Determine the relevant accounting treatments as per Ind AS 105.

Answer

The entity should recognise the loss of ₹ 1,100 (₹ 16,000 – ₹ 14,900), in accordance with applicable Ind AS, immediately before classifying it as held for sale.

The entity estimated that fair value less costs to sell of the disposal group amounts to ₹ 13,000.

Since the entity has classified a disposal group as held for sale it should measure it at the lower of its carrying amount ₹ 14,900 and fair value less costs to sell ₹ 13,000 which comes to ₹ 13,000.

The entity should recognises an impairment loss of ₹ 1,900 (₹ 14,900 – 13,000) when the disposal group is initially classified as held for sale.

The Inventory and Investment is remeasured as per Ind AS 2 and Ind AS 109 at not more than fair value at the date of remeasurement immediately classified as held for sale.

This impairment loss of ₹ 1,900 is allocated to remaining assets in the proportion of their carrying value other than inventory and investment in equity instrument.

The allocation of impairment loss can be illustrated as follows:

Disposal Group	Carrying amount as remeasured immediately before classification as held for sale (as per applicable Ind AS) ₹	Allocated Impairment Loss ₹	Carrying amount after allocation of Impairment Loss ₹
Goodwill	1,500	(1,500)	-
Property, Plant and Equipment (carried atrevalued amounts)	4,000	(165)	3,835
Building (carried at cost)	5,700	(235)	5,465
Inventory	2,200	–	2,200
Investments in equity instruments	1,500	–	1,500
Total	**14,900**	**(1,900)**	**13,000**

Firstly, the impairment loss reduces the amount of goodwill in the disposal group. Then, the remaining impairment loss is recognised to other assets pro-rata based on the carrying amount of those assets.

At the end of reporting period (31st March, 2021) the fair value less cost to sell is increased and estimated at ₹ 15,500.

The maximum impairment loss reversal allowed will be ₹ 1,900 + ₹ 1,100 being cumulative impairment loss recognised earlier.

Reversal of impairment loss is not allowed on Goodwill as it will lead to recognition of self- generated goodwill which is prohibited under Ind AS 38 'Intangible Assets'.

CHAPTER - 8
Ind AS 41: Agriculture

Question 1

A farmer owned a dairy herd, of three years old cattle as at 1st April, 20X1 with a fair value of ₹ 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 ₹ 60 per cattle. The fair value of four year cattle as at 31st March, 20X2 is ₹ 75 per cattle.

Calculate the measurement of group of cattle as at 31st March, 20X2 stating price and physical change separately.

Answer

Particulars	Amount (₹)
Fair value as at 1st April, 20X1	13,750
Increase due to Price change [250 x {60 – (13,750/250)}]	1,250
Increase due to Physical change [250 x (75 – 60)]	3,750
Fair value as at 31st March, 20X2	18,750

Question 2

XYZ Ltd., on 1st December, 20X3, purchased 100 sheep from a market for ₹ 5,00,000. The transaction cost of 2% on the market price of the sheep was incurred which was paid by the seller. Sheep's fair value increased from ₹ 5,00,000 to ₹ 6,00,000 on 31st March, 20X4. Transaction cost of 2% would have to be incurred by the seller to get the sheep to the relevant market.

Determine the fair value on the date of purchase and the reporting date and pass necessary journal entries thereon.

Answer

The fair value less cost to sell of sheep's on the date of purchase would be ₹ 4,90,000 (5,00,000 – 10,000). Expense of ₹ 10,000 would be recognised in profit and loss.

On date of Purchase

Biological Asset	Dr.	4,90,000	
Loss on initial recognition	Dr.	10,000	
To Bank			5,00,000

(Being biological asset purchased)

On 31st March, 20X4 sheep would be measured at ₹ 5,88,000 as Biological Asset (6,00,000 – 12,000) and gain of ₹ 98,000 (5,88,000 – 4,90,000) would be recognised in profit or loss.

At the end of reporting period

Biological Asset	Dr.	98,000	
To Gain – Change in fair value			98,000

(Being change in fair value recognised at the end of reporting period)

Question 3

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 two 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.

Answer

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
		62,30,000
Inventory:		
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 other comprehensive income. We have followed the Cost Model.

2. **Dairy Cows:** Under 'fair value model' laid down in Ind AS 41, mature cows would be recognised in the Balance Sheet at 31st March, 20X2 at the fair value of 200 x ₹ 5,500 = ₹ 11,00,000.

   Increase in price change 200 x (5,200 – 5,000) = 40,000

   Increase in physical change 200 x (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:** Grand 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 x ₹ 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 x ₹ 24 = ₹ 72,000. This is regarded as 'cost' for the future application of Ind AS 2 to the unsold milk.

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 ₹ 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 recognised as per Ind AS.

Answer

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 x 0.312 = 5,335.20.

As at 31st March, 20X2: 16,500 x 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 or profit or loss (regardless of the fact that it has not yet been realised).

Question 5

XY Ltd. is a farming entity where cows are milked on a daily basis. Milk is kept in cold storage immediately after milking and sold to retail distributors on a weekly basis. On 1 April 20X1, XY Ltd. ad a herd of 500 cows which were all three years old.

During the year, some of the cows became sick and on 30 September 20X1, 20 cows died. On 1 October 20X1, XY Ltd. purchased 20 replacement cows at the market for ₹ 21,000 each. These 20 cows were all one year old when they were purchased.

On 31 March 20X2, XY Ltd. had 1,000 litres of milk in cold storage which had not been sold to retail distributors. The market price of milk at 31 March 20X2 was ₹ 20 per litre. When selling the milk to distributors, XY Ltd. incurs selling costs of ₹ 1 per litre. These amounts did not change during March 20X2 and are not expected to change during April 20X2.

Information relating to fair value and costs to sell is given below:

Date	Fair value of a dairy cow (aged)				Costs to sell a cow
	1 year	1.5 years	3 years	4 years	
1st April 20X1	20,000	22,000	27,000	25,000	1,000
1st October 20X1	21,000	23,000	28,000	26,000	1,000
31st March 20X2	21,500	23,500	29,000	26,500	1,100

You can assume that fair value of a 3.5 years old cow on 1st October 20X1 is ₹ 27,000.

Pass necessary journal entries of above transactions with respect to cows in the financial statements of XY Ltd. for the year ended 31st March, 20X2? Also show the amount lying in inventory if any.

Answer

Journal Entries on 1st October, 20X1

(All figures in ₹)

Loss (on death of 20 cows) (Refer W.N.)	Dr.	5,20,000	
To Biological asset			5,20,000
(Loss booked on death of 20 cows)			
Biological Asset (purchase of 20 new cows) (Refer W.N.)	Dr.	4,00,000	
To Bank			4,00,000
(Initial recognition of 20 new purchased cows at fair value less costs to sell)			

Journal Entries on 31st March, 20X2

Loss on remeasurement of old cows	Dr.	2,88,000	
To Biological asset			2,88,000
[(1,30,00,000 – 5,20,000) – 1,21,92,000]			
(Subsequent measurement of cows at fair value less costs to sell)			
Biological Asset (4,48,000 – 4,00,000)	Dr.	48,000	
To Gain on remeasurement of new cows			48,000
(Subsequent measurement of cows at fair value less costs to sell)			

Inventory (Milk) as at 31st March, 20X2 = ₹ 19,000 (1,000 x (20 – 1))

Working Note:

Calculation of Biological asset at various dates

Date	Number	Age	Fair Value (₹)	Cost to Sell (₹)	Net (₹)	Biological asset (₹)
1st April 20X1	500	3 years	27,000	1,000	26,000	1,30,00,000
1st October 20X1	(20)	3.5 years	27,000	1,000	26,000	(5,20,000)

1st October 20X1	20	1 year	21,000	1,000	20,000	4,00,000
						1,28,80,000
31st March 20X2	480	4 years	26,500	1,100	25,400	1,21,92,000
	20	1.5 years	23,500	1,100	22,400	4,48,000
						1,26,40,000

Question 6

Company X purchased 100 goat at an auction for ₹ 1,00,000 on 30 September 20X1. Subsequent transportation costs were ₹ 1,000 that is similar to the cost X would have to incur to sell the goat at the auction. Additionally, there would be a 2% selling fee on the market price of the goat to be incurred by the seller.

On 31 March 20X2, the market value of the goat in the most relevant market increases to ₹ 1,10,000. Transportation costs of ₹ 1,000 would have to be incurred by the seller to get the goat to the relevant market. An auctioneer's fee of 2% on the market price of the goat would be payable by the seller.

On 1 June 20X2, X sold 18 goat for ₹ 20,000 and incurred transportation charges of ₹ 150. In addition, there was a 2% auctioneer's fee on the market price of the goat paid by the seller.

On 15 September 20X2, the fair value of the remaining goat was ₹ 82,820. 42 goat were slaughtered on that day, with a total slaughter cost of ₹ 4,200. The total market price of the carcasses on that day was ₹ 48,300, and the expected transportation cost to sell the carcasses is ₹ 420. No other costs are expected.

On 30 September 20X2, the market price of the remaining 40 goat was ₹ 44,800. The expected transportation cost is ₹ 400. Also, there would be a 2% auctioneer's fee on the market price of the goat payable by the seller.

Pass Journal entries so as to provide the initial and subsequent measurement for all above transactions. Interim reporting periods are of 30 September and 31 March and the company determines the fair values on these dates for reporting.

Answer

Value of goat at initial recognition (30 September 20X1) **(All figures are in ₹)**

Biological asset (goat)	Dr.	97,000*	
Loss on initial recognition	Dr.	4,000	
To Bank (Purchase and cost of transportation)			
(Initial recognition of goat at fair value less costs to sell)			1,01,000

*Fair value of goat = 1,00,000 – 1,000 – 2,000 (2% of 1,00,000) = 97,000

Subsequent measurement at 31 March 20X2 **(All figures are in ₹)**

Biological Assets (Goat)	Dr.	9,800	
To Gain on Sale (Profit & Loss)			9,800
(Subsequent measurement of Goat at fair value less costs to sell (1,06,800** – 97,000))			

**Fair value of goat = 1,10,0000 – 1,000 – 2,200 (2% of 1,10,000) = 1,06,800

Sale of goat on 1 June 20X2 **(All figures are in ₹)**

Biological Assets (Goat) To Gain on Sale (Profit & Loss) (Subsequent re-measurement of 18 Goat at fair value less costs to sell just prior to the point at which they are sold [19,450 – {(1,06,800/100) x 18}]	Dr.	226	 226
Cost to Sales To Biological Assets (Goat) (Recording a cost of sales figure separately with a corresponding reduction in the value of the biological assets)	Dr.	19,450	 19,450
Bank Selling expenses (150 + 400) To Revenue (Recognition of revenue from sale of goat)	Dr. Dr.	19,450 550	 20,000

Transfer of Goat to Inventory on 15 September 20X2 **(All figures are in ₹)**

Inventory (48,300 – 420) Loss on remeasurement To Biological Asset (Goat) To Bank (Slaughtering cost) (Transfer of goat to inventory)	Dr. Dr.	47,880 1,176	 44,856# 4,200

#Note: 44,856 is calculated as the proportion of goat sold using the fair value [1,06,800 + 226 – 19,450) x 42/82]

Subsequent measurement of goat at 30 September 20X2 **(All figures are in ₹)**

Loss on remeasurement To Biological Asset (Goat) (Subsequent measurement of Goat at fair value less costs to sell [43,504## – {(1,06,800 + 226 – 19,450) – 44,856}]	Dr.	784	 784

##Fair value of goat = 44,800 – 400 – 896 (2% of 44,800) = 43,504

Question 7

Entity A purchased cattle at an auction on 30th June 2019

Purchase price at 30th June 2019	₹ 1,00,000
Costs of transporting the cattle back to the entity's farm	₹ 1,000
Sales price of the cattle at 31st March, 2020	₹ 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, 2020.

Answer

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% x 1,10,000))	1,06,800

At 31st March, 2020, 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 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.

Answer

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 recognised 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 recognised 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 recognised at the end of reporting period)			

Note: It is assumed that the transaction cost is borne by the seller.

CHAPTER - 9
Unit 1 – Ind AS 19: Employee Benefits

Question 1

Sunderam Pvt. Ltd. has a headcount of 100 employees in 20X0-20X1. As per the employee policy, the employees are entitled to:

- 30 casual leaves out of which 10 casual leaves may be carried forward to the next year; and
- 10 sick leaves out of which 2 sick leaves may be carried forward as paid leave.

At March 31, 20X1, the average unused entitlement is 5 days per employee for casual leaves and 1 day per employee for sick leave. On an average, it is found that the number of such employees who would be claiming casual leaves would be 30 and 10 employees who would claim sick leaves.

Compute the liability to be recognised in respect of sick leaves and casual leaves by the entity at the end of the financial year 20X0-20X1.

Answer

Type of leave (A)	Leave Entitlement (B)	Leaves c/f permissible (C)	Average leaves Unutilized (D)	No. of Employees (E)	Liability (F = D x E)
Casual Leave	30 days	10 days	5 days	30	150 days salary
Sick Leave	10 days	2 days	1 days	10	10 days salary

The entity will recognise liability in the books equal to 150 (30 x 5) days of paid casual leaves and 10 (10 x 1) days of paid sick leaves.

Question 2

Cisca Pvt. Ltd. has a headcount of around 1,000 employees in the organisation in 20X0-20X1. As per the company's policy, the employees are given 35 days of privilege leaves (PL), 15 days of sick leaves (SL) and 10 days of casual leaves. Out of the total PL and sick leaves, 10 PL leaves and 5 sick leaves 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.

Also the company has been incurring profits since 20XX. It has decided in 20X0-20X1 to distribute profits to its employees @ 4% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Cisca Pvt. Ltd. is expected to be around 3.5%. The profits earned during 20X0-20X1 is ₹ 2,000 crores.

Cisca Pvt. Ltd. has a post-employment benefit plan also available which is in the nature of defined contribution plan where contribution to the fund amounts to ₹ 100 crores which will fall due within 12 months from the end of accounting period.

The company has paid ₹ 20 crores to its employees in 20X0-20X1.

What would be the treatment of the short-term compensating absences, profit-sharing plan and the defined contribution plan in the books of Cisca Pvt. Ltd?

Answer

(i) Cisca Pvt. Ltd. will recognise 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 20X0-20X1 as short-term compensated absences.

(ii) Cisca Pvt. Ltd. will recognise ₹ 70 crores (2,000 x 3.5%) as a liability and expense in its books of account.

(iii) 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 ₹ 80 crores will be recognised as a liability (accrued expense), after deducting any contribution already paid (100 – 20) and an expense in the statement of profit and loss. 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).

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, they will not be discounted. However, where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they shall be discounted using the discount rate.

Question 3

AJ Ltd is engaged in the business of trading of chemicals having a net worth of ₹ 150 crores. The company's profitability is good and hence the company has introduced various benefits for its employees to keep them motivated and to ensure that they stay with the organization. The company is an associate of RJ Ltd which is listed on Bombay Stock Exchange in India.

The company initially did not have any HR function but over the last 2 years, the management set up that function and now HR department takes care of all the benefits related to the employees and how they can be structured in a manner beneficial to both the employees and the objectives of the company.

One of the employee benefits involves a lump sum payment to employee on termination of service and that is equal to 1 per cent of final salary for each year of service. Consider the salary in year 1 is ₹ 10,000 and is assumed to increase at 7 per cent (compound) each year.

Taking a discount rate at 10 per cent per year, you are required to show

(a) benefits attributed (year on year) and

(b) the obligation in respect of this benefit (year on year)

For an employee who is expected to leave at the end of year 5.

Following assumptions may be taken to solve this:

- There are no changes in actuarial assumptions.
- No additional adjustments are needed to reflect the probability that the employee may leave the entity at an earlier or later date.

Answer

(a) Computation of benefit attributed to prior years and current year: **Amount in ₹**

Year	1	2	3	4	5
Benefit attributed to:					
- Prior years	–	131	262	393	524
- Current year (Refer W.N.1)	131	131	131	131	131
Total (i.e. current and prior years)	**131**	**262**	**393**	**524**	**655**

(b) Computation of the obligation for an employee who is expected to leave at the end of year 5 (taking discount rate of 10% p.a.) **Amount in ₹**

Year	1	2	3	4	5
Opening obligation (A)	–	89	196	324	475
Interest at 10% B = (A x 10%)	–	9	20	32	47
Current service cost (C) (Refer W.N.2)	89	98	108	119	131
Closing obligation D = (A + B + C)	**89**	**196**	**324**	**475**	**653**

Figures have been rounded off in the above table.

Working Notes

1. A lump sum benefit is payable on termination of service and equal to 1 per cent of final salary for each year of service. The salary in year 1 is ₹ 10,000 and is assumed to increase at 7 per cent (compound) each year.

   The year on year salary would be as follows: ₹

Year	1	2	3	4	5
Salary	10,000	10,700 (10,000 x 107%)	11,449 (10,700 x 107%)	12,250 (11,449 x 107%)	13,108 (12,250 x 107%)

   Accordingly, for the purpose of above mentioned employee benefit, 1% of final salary to be considered for each year of service would be ₹ 131.

2. **Computation of current service cost:** ₹

Year	1	2	3	4	5
1% salary at the end of year 5	–	–	–	–	131
PV factor at the end of each year to be considered at 10% p.a. (E)	0.683	0.751	0.826	0.909	1.000
PV at the end of each year	89 (131 x E)	98 (131 x E)	108 (131 x E)	119 (131 x E)	131 (131 x E)

   Accordingly, for the purpose of above mentioned employee benefit, 1% of final salary to be considered for each year of service would be ₹ 131.

Question 4

OPQ Ltd is a listed company having its corporate office at Nagpur. The company has a branch office at

Chennai. The company has been operating in Indian market for the last 10 years.

The company operates a pension plan that provides a pension of 2.5% of the final salary for each year of service. The benefits become vested after seven years of service.

On 1st April, 20X8, the company increased the pension to 3% of the final salary for each year of service starting from 1st April, 20X1. On the date of the improvement, the present value of the additional benefits for service from 1st April, 20X1 to 1 April 20X8 was as follows:

- Employees with more than seven years' service on 1 January 20X8 – ₹ 2,75,000
- Employees with less than 7 years of service – ₹ 2,21,000 (average 4 years to go).

What would be the accounting treatment in this case?

Answer

OPQ Ltd increased the pension to 3% of the final salary for each year of service starting from 1st April, 20X1 to 1st April, 20X8.

The company would recognize the total amount of ₹ 4,96,000 (i.e. ₹ 2,75,000 + ₹ 2,21,000) immediately, as for the purpose of recognition it does not make any difference as to whether the benefits are already vested or not.

Question 5

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 ₹ 80 million. Given below is the composition of this amount:

Employees with more than 5 years of service at 1st April, 2015	₹ 60 million
Employees with less than 5 years of service at 1st April, 2015	₹ 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 ₹ 80 million of the defined benefit obligation in the financial statements as per Ind AS 19.

Answer

Under Ind AS 19, the entire past service cost of ₹ 80 million needs to be recognized and charged in profit or loss immediately. ABC Ltd. cannot defer any part of this cost.

Question 6

SA Pvt Ltd is engaged in the business of retail having 100 retail outlets across Northern and Southern India. The company's head office is located at Chennai.

SA Pvt Ltd is a subsidiary of SAG Ltd. SAG Ltd is listed on the National Stock Exchange in India.

Following information is available for SA Pvt Ltd:

Plan Assets

At 1st April, 20X1, the fair value of plan assets was ₹ 10,000.

Contribution to the plan assets done on 31st March, 20X2 – ₹ 3,000

Amount paid on 31st March, 20X2 – ₹ 300

At 31st March, 20X2, the fair value of plan assets was ₹ 14,700

Actual return on plan assets – ₹ 2,000

Defined Benefit Obligation

At 1st April, 20X1, present value of the defined benefit obligation was ₹ 12,000.

At 31st March, 20X2, present value of the defined benefit obligation was ₹ 15,500.

Actuarial losses on the obligation for the year ended 31st March, 20X2 were ₹ 100.

Current Service Cost – ₹ 2,500

Benefit paid – ₹ 300

Discount rate used to calculate defined benefit liability – 10%.

As per Ind AS 19, please suggest if there is any amount based on the above-mentioned information that would be taken to other comprehensive income (with workings). Also compute net interest on the net defined benefit liability (asset).

Answer

As per Ind AS 19, net remeasurement of ₹ 900 would be recognized in other comprehensive income.

Computation of Net remeasurement

= Remeasurement – Actuarial loss

= ₹ 1,000 (Refer WN 1) – ₹ 100 (Given in the question)

= ₹ 900

Computation of net interest expense

Particulars	**Amount in ₹**
Defined benefit liability as at 1 April 20X1 **(A) (Given in the question)**	12,000
Fair value of plan asset as at 1 April 20X1 **(B) (Given in the question)**	(10,000)
Net defined benefit liability **(A – B)**	2,000
Net interest expense (as it is net liability) (Refer note given below)	200

Note:

Net interest expense would be computed on net defined benefit liability using discount rate of 10% given in the question

= Net defined benefit liability x Discount rate

= 2,000 x 10%

= ₹ 200

Working Note:

Computation of amount of remeasurement

Particulars	Amount in ₹
Actual return on plan asset for the year ended 31 March 20X2 **(C) (Given in the question)**	2,000
Less: Interest income on ₹ 10,000 held for 12 months at 10% **(D)**	(1,000)
Remeasurement **(E = C – D)**	1,000

Question 7

On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at ₹ 20,40,000 and the present value of the defined obligation was ₹ 21,25,000. On 31st March, 20X2 the plan received contributions from XYZ Ltd amounting to ₹ 4,25,000 and paid out benefits of ₹ 2,55,000. The current service cost for the financial year ending 31 March 20X2 is ₹ 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was ₹ 23,80,000, and the present value of the defined benefit obligation was ₹ 27,20,000. Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehensive income and balance sheet?

Answer

Reconciliation of Plan assets and Defined benefit obligation

	Plan Assets (₹)	Defined benefit obligation (₹)
Fair value/present value as at 1st April 20X1	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250
Current service cost	–	5,10,000
Contributions received	4,25,000	–
Benefits paid	(2,55,000)	(2,55,000)
Return on 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 recognised:	₹
Current service cost	5,10,000
Net interest on net defined liability (₹ 1,06,250 – ₹ 1,02,000)	4,250
Defined benefit re-measurements recognised in Other Comprehensive Income:	₹
Loss on defined benefit obligation	(2,33,750)
Gain on plan assets	68,000
	(1,65,750)
In the Balance sheet, the following will be recognised:	₹

Net defined liability (₹ 27,20,000 – ₹ 23,80,000)	3,40,000

Question 8

RKA Private Ltd is an old company established in 19XX. The company started with a very small capital base and today it is one of the leading companies in India in its industry. The company has an annual turnover of ₹ 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.

₹ 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 ₹ 55 lacs. The company made a contribution of an amount of ₹ 111 lacs to the plan. No benefits were paid during the year.

Consider a discount rate of 8%.

You are required to

(a) Compute the balance(s) of the company to be included its balance sheet as on 31st March, 20X2 and amounts to be recognized in the statement of profit and loss and other comprehensive income for the year ended 31st March, 20X2.

(b) Give the journal entries in respect of amount(s) to be recognized.

Answer

(a) Extract of the Balance Sheet of RKA Private Ltd as at 31st March, 20X2

	₹ in lacs
Closing net defined liability (1,580 – 1,275) lacs	305

Extract of Statement of Profit or Loss of RKA Private Ltd for year ended 31st March, 20X2

Particulars	**₹ in lacs**
Service cost	55
Net interest **(Refer W.N.1)**	21
Profit or loss	**76**
Other comprehensive income:	
Remeasurements **(Refer W.N.2)**	80
Total	**156**

(b) Journal entries in the books of RKA Private Ltd

Particulars		**₹ in lacs**	**₹ in lacs**
Profit & Loss	Dr.	76	
Other comprehensive income	Dr.	80	
To Cash (Contribution)			111

To Net defined benefit liability **(Refer WN 3)**		45

Working Notes:

1. Computation of Net interest taken to the Statement of Profit or Loss

= Discount rate x Opening net defined benefit liability

= 8% x (1,400 – 1,140) lacs

= 8% x 260 lacs

= 21 lacs (Rounded off to nearest lacs)

2. Computation of Remeasurements

Defined Benefit Obligation Account

Particulars	₹ in lacs	Particulars	₹ in lacs
To balance c/d (given) (closing balance)	1,580	By balance b/d (given) (opening balance)	1,400
		By Current Service Cost (given)	55
		By Interest on Opening Liability (1,400 x 8%)	112
		By Actuarial loss (bal. figure)	13
	1,580		**1,580**

OR

Statement to calculate Actuarial gain or loss on defined benefit liability:

Particulars	₹ 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**

Plan Assets Account

Particulars	₹ in lacs	Particulars	₹ in lacs
To balance b/d (given) (opening balance)	1,140	By balance c/d (given) (closing balance)	1,275
To Bank Account (contribution for the year)	111		
To Surplus/Actual Return (bal. figure)	24		
	1,275		**1,275**

OR

Statement to calculate Actual return on plan assets:

Particulars	**₹ 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 = ₹ 91 lacs (i.e. ₹ 1,140 lacs x 8%) (Rounded off to nearest lacs)

Hence there is a decrease in plan assets due to remeasurement for which computation is as follows:

Actual Return – Net interest on opening plan asset

= ₹ 24 lacs – ₹ 91 lacs = ₹ 67 lacs.

Net remeasurement would be computed as follows:

Actuarial loss on liability + Loss on return

= ₹ 13 lacs + ₹ 67 lacs = ₹ 80 lacs.

3. **Computation of increase/decrease in net defined benefit liability:**

Particulars	**₹ in lacs**
Opening net liability (₹ 1,400 lacs – ₹ 1,140 lacs)	260
Closing net liability (₹ 1,580 lacs – ₹ 1,275 lacs)	305
Increase in liability	45

Question 9

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 ₹ 6,00,00,000. On the same date, the fair value of the assets of the defined benefit plan was ₹ 5,20,00,000. On 1st April, 2017, the annual market yield on government bonds was 5%. During the year ended 31st March, 2018, A Ltd. made contributions of ₹ 70,00,000 into the plan and the plan paid out benefits of ₹ 42,00,000 to retired members. Both these payments were made on 31st March, 2018.

The actuaries advised that the current service cost for the year ended 31st March, 2018 was ₹ 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 ₹ 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 ₹ 80,00,000. Before 31st March, 2018, A Ltd. made payments of ₹

75,00,000 to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.

On 31st March, 2018, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,80,00,000. On the same date, the fair value of the assets of the defined benefit plan were ₹ 5,60,00,000.

Examine and present how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 2018 as per Ind AS.

Answer

All figures are ₹ in '000.

On 31st March, 2018, A Ltd. will report a net pension liability in the statement of financial position. The amount of the liability will be 12,000 (68,000 – 56,000).

For the year ended 31st March, 2018, A Ltd. will report the current service cost as an operating cost in the statement of profit or loss. The amount reported will be 6,200. The same treatment applies to the past service cost of 1,500.

For the year ended 31st March, 2018, A Ltd. will report a finance cost in profit or loss based on the net pension liability at the start of the year of 8,000 (60,000 – 52,000). The amount of the finance cost will be 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 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, 2018, the remeasurement loss will be 3,400 (Refer W. N.).

Working Note:

Remeasurement of gain or loss

	₹ in '000
Liability at the start of the year (60,000 – 52,000)	8,000
Current service cost	6,200
Past service cost	1,500
Net finance cost	400
Gain on settlement	(500)
Contributions to plan	(7,000)
Remeasurement loss (balancing figure)	3,400
Liability at the end of the year (68,000 – 56,000)	12,000

Question 10

Mr. Rajan is working for Infotech Ltd. Consider the following particulars:

Annual salary of Mr. Rajan = ₹ 30,00,000

Total working days in 20X0-X1 = 300 days

Leaves allowed in 20X0-X1 as per company policy = 10 days

Leaves utilized by Mr. Rajan in 20X0-X1 = 8 days

The unutilized leaves are settled by way of payment and accordingly, carry forward of such leaves to the subsequent period is not allowed.

Compute the total employee benefit expense for Infotech Ltd. in respect of 20X0-X1.

Answer

Mr Rajan is entitled to a salary of ₹ 30,00,000 for 300 total working days.

Thus, per day salary works out to ₹ 30,00,000 ÷ 300 days = ₹ 10,000 per day

In the year 20X0-20X1, Mr. Rajan availed 8 out of 10 leaves allowed by the company.

Accordingly, leaves unutilized = 10 – 8 = 2 days

In line with the company policy, Infotech Ltd. will pay Mr. Rajan for the unutilized leave.

Thus, total expense for 20X0-20X1 = ₹ 30,00,000 + (2 days unutilized leaves x ₹ 10,000 per day) = ₹ 30,20,000.

Question 11

Mr. Niranjan is working for Infotech Ltd. Consider the following particulars:

	Year 20X0-20X1	Year 20X1-20X2
Annual salary	₹ 30,00,000	₹ 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 ₹ 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.

Answer

Particulars	**Year 20X0-20X1**	**Year 20X1-20X2**
Annual Salary	₹ 30,00,000	₹ 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.	₹ 30,00,000	₹ 30,00,000

Based on the evaluation above, Mr. Niranjan has worked for 6 days more (293 days – 287 days) in 20X0-X1 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 ₹ 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)	₹ 30,00,000	₹ 30,00,000
No. of working days (B)	300 days	300 days
Salary cost per day (A ÷ B)	₹ 10,000 per day	₹ 10,000 per day
No. of days worked (from above)	293 days	287 days
Expense to be recognised: **In 20X0-20X1:** ₹ 30,00,000 + [₹ 10,000 per day x 3 days (leaves unutilized expected to be utilized subsequently)]	₹ 30,30,000	
In 20X1-20X2: ₹ 30,00,000 – [₹ 10,000 per day – 3 days (excess leave utilized in 20X1-20X2)]		₹ 29,70,000

Journal Entry for 20X0-20X1

Employee Benefits Expense Account	Dr.	30,30,000	
To Bank Account			30,00,000
To Provision for Leave Encashment			30,000

Journal Entry for 20X1-20X2

Employee Benefits Expense Account	Dr.	29,70,000	
Provision for Leave Encashment Account	Dr.	30,000	
To Bank Account			30,00,000

Question 12

Mr. Niranjan is working for Infotech Ltd. Consider the following particulars:

	Year 20X0-20X1	Year 20X1-20X2
Annual salary	₹ 30,00,000	₹ 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 2 days of 20X0-20X1 subsequently.

However, in 20X1-20X2, Mr. Niranjan availed in actual all 3 days of brought forward leave.

Compute the expense to be recognised in 20X0-20X1 and 20X1-20X2. Also pass journal entries for both the years.

Answer

The expenditure to be recognized will be as under:

Particulars	**Year 20X0-20X1**	**Year 20X1-20X2**
Annual salary (A)	₹ 30,00,000	₹ 30,00,000
No. of working days (B)	300 days	300 days
Salary cost per day (A ÷ B)	₹ 10,000 per day	₹ 10,000 per day
No. of days worked (from above)	293 days	287 days
Expense to be recognised: **In 20X0-20X1:** ₹ 30,00,000 + [₹ 10,000 per day x 2 days (leaves unutilized expected to be utilized subsequently)]	₹ 30,20,000	
In 20X1-20X2: ₹ 30,00,000 – [₹ 10,000 per day x 3 days (excess leave utilized in 20X1-20X2)] + ₹ 10,000 (additional expense due to change in accounting estimate)		₹ 29,80,000

The additional ₹ 10,000 booked as an expense in 20X1-20X2 represents a change in accounting estimate (i.e. as against the entity's estimation that 2 days of unutilized leave would be utilized subsequently, actually 3 days were utilized subsequently), for which a prospective effect needs to be given, in line with Para 36 of Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Journal Entry for 20X0-20X1

Employee Benefits Expense Account	Dr.	30,20,000	
To Bank Account			30,00,000
To Provision for Leave Encashment			20,000

Journal Entry for 20X1-20X2

Employee Benefits Expense Account	Dr.	29,80,000	
Provision for Leave Encashment Account	Dr.	20,000	
To Bank Account			30,00,000

Question 13

An entity has 100 employees, who are each entitled to ten working days of paid sick leave for each year.

Unused sick leave may be carried forward for one financial year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis).

At 31 March 20X1, the average unused entitlement is two days per employee. Based on past experience, the management expects that only 20% of the employees will use 1 day from their carried forward leave. Salary per day is ₹ 2,500.

Compute the expenses in respect of the short-term compensated absences, if they are assumed to be (a) vested short-term compensated absences, and (b) non-vested short-term compensated absences.

Answer

Vested short-term compensated absences:

Employee Benefit Expense = 100 Employees x 2 Days x ₹ 2,500 = ₹ 5,00,000

Non-vested short-term compensated absences:

Employee Benefit Expense = 100 Employees x 20% x 1 Days x ₹ 2,500 = ₹ 50,000

Question 14

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates observed during past 10 years represents 6% per annum. Acer Ltd. provides the following benefits to all its employees:

Paid vacation – 10 days per year regardless of date of hiring. Compensation for paid vacation is 100% of employee's salary and unused vacation can be carried forward for 1 year. As of 31st March, 20X1, unused vacation carried forward was 3 days per employee, average salary was ₹ 15,000 per day and accrued expense for unused vacation in 20X0-20X1 was ₹ 65,00,000. During 20X1-20X2, employees took 9 days of vacation in average. Salary increase in 20X1-20X2 was 10%.

How would Acer Ltd. recognize liabilities and expenses for these benefits as of 31st March, 20X2? Pass the journal entry to show the accounting treatment.

Answer

Paid Vacation:

Step 1: Calculation of Unused Vacation in man-days as on 31st March, 20X2:

A. No. of Employees in service for the whole year (94%):

Particulars	**Man-days**
Unused vacation as on 31st March, 20X1 Entitlement to vacation for 20X1-20X2 Average vacation availed in 20X1-20X2	3 days per employee 10 days per employee (9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	**4 days per employee**
Total Unused vacation as on 31st March, 20X2 (A) (350 employees x 94% x 4 days per employee)	**1,316 man-days**

B. Newcomers (6%):

Particulars	Man-days
Entitlement to vacation for 20X1-20X2 Average vacation availed in 20X1-20X2	10 days per employee (9) days per employee
Unused vacation as on 31st March, 20X2 (being unused leaves of 20X1-20X2 on FIFO basis)	**1 day per employee**
Total Unused vacation as on 31st March, 20X2 (B) (350 employees x 6% x 1 day per employee)	**21 man-days**
Total unused vacation as on 31st March, 20X2 (A + B)	**1,337 man-days**

Step 2: Calculation of average salary per day:

Particulars	Amount (₹)
Average salary per day as on 31st March, 20X1	15,000
Salary increase in 20X1-20X2	10%
Average salary per day as on 31st March, 20X2	**16,500**

Step 3: Calculation of provision for unused paid vacation:

Particulars	Amount (₹)
Calculation of provision for unused paid vacation 20X1-20X2: (1,337 man-days x ₹ 16,500)	2,20,60,500
Provision for unused paid vacation 20X0-20X1	65,00,000

Step 4: Accounting treatment

<u>Provision for 20X1-20X2</u>

Employee Benefits Expenses A/c	Dr.	2,20,60,500	
To Provision for Leave Encashment			2,20,60,500

<u>Settlement of Liability of 20X0-20X1</u>

Provision for Leave Encashment A/c	Dr.	65,00,000	
To Cash/Bank			65,00,000

Question 15

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates as observed during past 10 years represents 6% per annum. Acer provides the following benefits to all its employees:

Annual bonus during past 10 years.

Acer paid bonus to all employees who were in service during the entire financial year. Bonus was paid in June following the financial year-end. Amount of bonus for 20X1-20X2 paid in June 20X2 represented ₹ 1,25,000 per employee. Acer Ltd. used to increase amount of bonus based on official inflation rate which is 8.5% for 20X2-20X3, although there was no legal obligation to increase the bonus by such inflation rate.

How would Acer Ltd. recognize liabilities and expenses for these employee benefits as on 31st March, 20X3? Pass the journal entry to show the accounting treatment.

Answer

Particulars	**Amount (₹)**
Bonus paid for 20X1-20X2	1,25,000 per employee
Bonus for 20X2-20X3 – increased by inflation of 8.5%: [1,25,000 x (100% + 8.5%)]	1,35,625 per employee
No. of employees in staff during the whole year [350 x (100 – 6%)]	329 employees
Provision for Bonus for 20X2-20X3	**4,46,20,625**

Accounting Treatment:

Provision for Bonus for 20X2-20X3

Employee Benefits Expenses A/c	Dr.	4,46,20,625	
To Provision for Bonus 20X2-20X3			4,46,20,625

Note:

It is given that the company is under no legal obligation to increase the bonus by the official inflation rate. However, the company has been increasing the bonus by the inflation rate over the past years. This has given rise to a constructive obligation for Acer Ltd. Informal practices, such as these, give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. Accordingly, provision is made for the amount considering the inflation rate.

Question 16

Acer Ltd. provides lump-sum remuneration upon retirement to its employees. Remuneration is paid out of the fund to which Acer Ltd. contributes 12% of annual gross salaries. Contributions are made twice a year i.e. in November of the related financial year and in June after the financial year-end. Total annual gross salaries for 20X0-X1 amounted to ₹ 50 crores. Contribution made by Acer Ltd. in November 20X0 was ₹ 2.8 crores. Remuneration depends on the number of employee's service and amount of cash in the fund at retirement date (Acer Ltd. has no further obligations except for contributions).

How should this transaction appear in the financial statements of Acer Ltd. as of 31 March 20X1?

Answer

1. **Calculation of accrual for contributions in 20X0-20X1:**

Annual gross salaries in 20X0-20X1:	₹ 50.00 crores
Amount of total contributions for 20X0-20X1 (12%):	₹ 6.00 crores
Contributions already made in November 20X0:	₹ 2.80 crores
Accrual (₹ 6 crores – ₹ 2.8 crores)	₹ 3.20 crores

2. **Accounting Treatment:**

Employee Benefits Expenses Account	Dr.	6.00 crores	
To Bank Account			2.80 crores

To Contribution Payable 3.20 crores

The contribution of ₹ 6 crores will be debited to the statement profit and loss. The contribution payable of ₹ 3.20 crores will appear as a liability as at 31st March, 20X1.

Question 17

How will the following information be presented in the Balance Sheet of Udyog Ltd.?

Particulars	**₹ in lakhs**
PV of Defined Benefit Obligations	3,500
Fair Value of Plan Assets	3,332

Answer

Particulars	**₹ in lakhs**
PV of Defined Benefit Obligations	3,500
Less: Fair Value of Plan Assets	(3,332)
Deficit, to be treated as Net Defined Benefit Liability under Non-current Liabilities as Provisions in the Balance Sheet	168

Question 18

How will the following information be presented in the Balance Sheet of Udyog Ltd.?

Particulars	**₹ in lakhs**
PV of Defined Benefit Obligations	2,750
Fair Value of Plan Assets	2,975
Asset Ceiling	175

Answer

Particulars	**₹ in lakhs**
PV of Defined Benefit Obligations	2,750
Less: Fair Value of Plan Assets	(2,975)
Surplus, to be treated as Net Defined Benefit Asset,	**225**
Asset Ceiling as per Ind AS 19	175
Least of above is Surplus to be treated as Net Defined Benefit Asset under Balance Sheet	**175**

Question 19

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 ₹ 18 (10% of ₹ 180).

Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of RS Ltd. on the basis of given information:

(i) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on current actuarial assumption.

(ii) The fair value of plan assets on the date is estimated at ₹ 5,100.

(iii) The unamortized past service cost is ₹ 180.

(iv) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.

Answer

Gain from curtailment is estimated as under:

	₹
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	₹
Reduced gross obligation (90% of ₹ 6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300
Less: Unamortised past service cost (90% of ₹ 180)	(162)
Liability to be recognised in the balance sheet	138

Question 20

At 1 April, 20X0, the fair value of the Plan Assets was ₹ 10,00,000. The Plan paid benefits of ₹ 1,90,000 and received contributions of ₹ 4,90,000 on 30 September, 20X0. The company computes the Fair Value of Plan Assets to be ₹ 15,00,000 as on 31 March, 20X1 and the Present Value of the Defined Benefit Obligation to amount to ₹ 14,79,200 on the same date. Actuarial losses on defined benefit obligation were ₹ 6,000.

Compounding happens half-yearly. The normal interest rate for 6 months period is 10% per annum, 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.

Answer

Computation of Expected Return on Plan Assets

Particulars	₹
Return on ₹ 10,00,000 for 20X0-20X1 at 10.25% = ₹ 10,00,000 x 10.25%	1,02,500
Add: Return on ₹ 3,00,000 for 6 months at 10% Normal Rate = [3,00,000 (Inflow ₹ 4,90,000 less Payments ₹ 1,90,000) x 10% x 6/12]	15,000
Expected Return on Plan Assets	**1,17,500**

Computation of Actual Return on Plan Assets

Particulars	₹
Fair Value of Plan Assets at the year-end – 31 March 20X1	15,00,000
Less: Fair Value of Plan Assets at the beginning – 1 April 20X0	(10,00,000)
Less: Contributions received during the year 20X0-20X1	(4,90,000)
Add: Benefits paid during the year 20X0-20X1	1,90,000
Actual Return on Plan Assets	**2,00,000**

Computation of Net Actuarial Gain

Particulars	₹
Actual Return on Plan Assets	2,00,000
Less: Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
Less: Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	**76,500**

CHAPTER - 9
Unit 2 – Ind AS 37: Provisions, Contingent Liabilities and Contingent Assets

Question 1

X Ltd. is operating in the telecom industry. During the Financial Year 20X1-20X2, the Income Tax authorities sent a scrutiny assessment notice under Section 143(2) of the Income-tax Act, 1961, in respect to return filed under Section 139 of this Act for Previous Year 20X0- 20X1 (Assessment Year 20X1-20X2) and initiated assessment proceedings on account of a deduction claimed by the company which in the view of the authorities was inadmissible.

During the financial year 20X1-20X2 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of ₹ 1,00,00,000 against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 20X1-20X2, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had more than 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 20X1-20X2.

Answer

Ind AS 37 provides that in rare cases it not clear whether there is a present obligation, for example, in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity should determine whether a present obligation exits at the end of the reporting period by taking account of all available evidence, for example, the opinion of experts.

In the present case, the company is not confident that whether it would win the appeal. By taking into account the opinion of the legal counsel, it is not sure that whether the company would win the appeal. On the basis of such evidence, it is more likely than not that a present obligation exists at the end of the reporting period. Therefore, the entity should recognise a provision. The company should provide for a liability of ₹ 1,00,00,000.

Question 2

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of ₹ 1 million would result. If major defects were detected in all products sold, repair costs of ₹ 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75% of the goods sold will have no defects, 20% of the goods sold will have minor defects and 5% of the goods sold will have major defects. In accordance with the standard, an entity assesses the probability of an outflow for the warranty obligations as a whole.

Answer

The expected value of the cost of repairs is:

(75% of nil) + (20% of 1 million) + (5% of 4 million) = ₹ 4,00,000

Question 3

X Telecom Ltd. has income tax litigation pending before appellate authorities. Legal advisor's opinion is that X Telecom Ltd. will lose the case and estimated that liability of ₹ 1,00,00,000 may arise in two years. The liability is recognised on a discounted basis. The discount rate at which the liability has been discounted is 10% and it is assumed that discount rate does not change over the period of 2 years.

How should X Telecom Ltd. calculate the amount of borrowing cost?

Answer

The discount factor of 10% for 2 years is 0.826. X Telecom Ltd. will initially recognise provision for ₹ 82,60,000 (₹ 1,00,00,000 x 0.826).

The discount factor of 10% at the end of year 1 is 0.909. At the end of year 1, provision amount would be ₹ 90,90,000 (₹ 1,00,00,000 x 0.909).

As per the standard, the difference between the two present values i.e., ₹ 8,30,000 (90,90,000 – 82,60,000) is recognised as a borrowing cost in year 1.

At the end of the Year 2, the liability would be ₹ 1,00,00,000.

The difference between the two present values i.e., ₹ 9,10,000 (₹ 1,00,00,000 – ₹ 90,90,000) is recognised as borrowing cost in year 2.

Question 4

X Solar Power Ltd., a power company, has a present obligation to dismantle its plant after 35 years of useful life. X Solar Power Ltd. cannot cancel this obligation or transfer to third party. X Solar Power Ltd. has estimated the total cost of dismantling at ₹ 50,00,000, the present value of which is ₹ 30,00,000. Based on the facts and circumstances, X Solar Power Ltd. considers the risk factor of 5% i.e., the risk that the actual outflows would be more from the expected present value. How should X Solar Power Ltd. account for the obligation?

Answer

The obligation should be measured at the present value of outflows i.e., ₹ 30,00,000. Further a risk adjustment of 5% i.e., ₹ 1,50,000 (₹ 30,00,000 x 5%) would be made.

So, the liability will be recognised at = ₹ 30,00,000 + ₹ 1,50,000 = ₹ 31,50,000.

Question 5

(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 ₹ 20,00,000 would result.
- If major defects are detected in all products, costs of ₹ 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.

Answer

(a) For a provision to be recognized, Para 14 of Ind AS 37 requires that:

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 required to settle the obligation, and

c) 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% x nil) + (15% x ₹ 20,00,000) + (5% x ₹ 50,00,000) = 3,00,000 + 2,50,000

= 5,50,000

Question 6

X Shipping Ltd. is required by law to overhaul its shipping fleet once in every 3 years. The company's finance team was of the view that recognising the costs only when paid would prevent matching of revenue earned all the time with certain costs of large amounts which are incurred occasional. Thereby, it has formulated an accounting policy of providing in its books of account for the future cost of maintenance (overhauls, annual inspection etc.) by calculating a rate per hours sailed on sea and accumulating a provision over time. The provision is adjusted when the expenditure is actually incurred. Is the accounting policy of X Shipping Ltd. correct?

Answer

A provision is made for a present obligation arising out of a past event. Overhauling does not arise out of past event. Even a legal requirement to overhaul does not make the cost of overhaul a liability, because no obligation exists to overhaul the ships independently of the company's future actions - the company could avoid the future expenditure by its future actions for example by selling the ships. So there is no present obligation.

As per the standard, financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's balance sheet are those that exist at the end of the reporting period.

Therefore, the accounting policy of X Shipping Ltd. is not correct. The company should adopt the component approach in Ind AS 16, Property, Plant and Equipment, for accounting for the refurbishment cost.

Question 7

X Metals Ltd. had entered into a non-cancellable contract with Y Ltd. to purchase 10,000 units of raw material at ₹ 50 per unit at a contract price of ₹ 5,00,000. As per the terms of contract, X Metals Ltd. would have to pay ₹ 60,000 to exit the said contract. X Metals Ltd. has discontinued manufacturing the product that would use the said raw material. For that X Metals Ltd. has identified a third party to whom it can sell the said raw material at ₹ 45 per unit.

How should X Metals Ltd. account for this transaction in its books of account in respect of the above contract?

Answer

These circumstances do indicate an onerous contract. The only benefit to be derived from the purchase contract costing ₹ 5,00,000 are the proceeds from the sale contact, which are ₹ 4,50,000. Therefore, a provision should be made for the onerous element of ₹ 50,000, being the lower of cost of fulfilling the contract and the penal cost of cancellation of ₹ 60,000.

Question 8

Entity XYZ entered into a contract to supply 1,000 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?

Answer

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 9

X Cements Ltd. has three manufacturing units situated in three different states of India. The board of directors of X Cements Ltd., in their meeting held on January 10, 20X1, decided to close down its operations in one particular state on account of environmental reasons. A detailed formal plan for shutting down the above unit was also formalised and agreed by the board of directors in that meeting, which specifies the approximate number of employees who will be compensated and expenditure expected to be incurred. Date of implementation of plan has also been mentioned. Meetings were also held with customers, suppliers, and workers to communicate the features of the formal plan to close down the operations in the said state, and representatives of all interested parties were present in those meetings. Do the actions of the board of directors create a constructive obligation that needs a provision for restructuring?

Answer

As per Ind AS 37, the conditions prescribed are:

(a) there should be detailed formal plan of restructuring;

(b) which should have raised valid expectations in the minds of those affected that the entity would carry out the restructuring by announcing the main features of its plans to restructure.

The board of directors did discuss and formalise a formal plan of winding up the operation in the above said state. This plan was communicated to the parties affected and created a valid expectation in their minds that X Cements Ltd. would go ahead with its plans to close down operations in that state. Thus, there is a constructive obligation that needs to be provided at year-end.

Question 10

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 authorised 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 ₹ 60 lakhs. The actual termination payments totalling to ₹ 520 lakhs were made in full on 15th May 2018. As per latest estimates made on 15th May 2018, the total relocation cost is ₹ 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 ₹ 430 lakhs. On 15th May 2018, 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 2018 was ₹ 400 lakhs. G Ltd. made further operating losses totalling ₹ 60 lakhs till 30th April 2018.

What are the provisions that the Company is required to make as per Ind AS 37?

Answer

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.

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:

(a) an entity 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 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 ₹ 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 ₹ 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 11

X Beauty Solutions Ltd. is selling cosmetic products under its brand name 'B', but it is getting its product manufactured from Y Ltd. It has an understanding (enforceable agreement) with Y Ltd. that if the company becomes liable for any damage claims, due to any injury or harm to the customer of the cosmetic products, 30% will be reimbursed to it by Y Ltd. During the financial year 20X1-20X2, a claim of ₹ 30,00,000 becomes payable to customers by X Beauty Solutions Ltd. How should X Beauty Solutions Ltd. account for the claim that becomes payable?

Answer

Since the understanding results in an enforceable agreement, the reimbursement of ₹ 9,00,000 (₹ 30,00,000 x 30%) shall be recognised as a reimbursement right and provision will be recognised for ₹ 30,00,000. The reimbursement right shall be treated as a separate asset and shall not be offset with the provision. In the statement of profit and loss, the expense may be presented as ₹ 21,00,000 after offsetting the reimbursement right.

Question 12

X Sugars Ltd. has entered into a sale contract of ₹ 3,00,00,000 with Y Chocolates Ltd. for the supply of sugar during 20X1-20X2. As per the contract the delivery is to be made within 2 months from the date of contract. In case of failure to deliver within the schedule, X Sugars Ltd. has to pay a compensation of ₹ 30,00,000 to Y Chocolates Ltd.

During the transit, the vehicle carrying the sugar met accident and X Sugar Ltd. lost the entire consignment. It is, however covered by an insurance policy. According to the report of the surveyor, the amount is collectible, subject to the deductible clause [i.e., 15% of the claim] in the insurance policy. The cost of goods lost was ₹ 2,50,00,000.

Before the financial year end, X Sugars Ltd. received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount. Meanwhile Y Chocolates Ltd. has made demand of ₹ 30,00,000 since the goods were not delivered on time.

What provision or disclosure would X Ltd. need to make at year end?

Answer

As per the standard, where an inflow of economic benefits is probable, an entity should disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect, measured using the principles set out in Ind AS 37.

So X Sugars Ltd. would need to disclose the contingent asset of ₹ 2,12,50,000 (₹ 2,50,00,000 x 85%) at the end of the financial year 20X1-20X2.

It would also need to make a provision of ₹ 30,00,000 towards the claim of Y Chocolates Ltd.

Question 13

In 2017, an entity involved in nuclear activities recognises a provision for decommissioning costs of ₹ 300 million. The provision is estimated using the assumption that decommissioning will take place in 60-70 years' time. However, there is a possibility that it will not take place until 100-110 years' time, in which case the present value of the costs will be significantly reduced. Draft the note assuming that the discounting rate is 2%.

Answer

A provision of ₹ 300 million has been recognised for decommissioning costs. These costs are expected to be incurred between 2077 and 2087; however, there is a possibility that decommissioning will not take place until 2117-2127. If the costs were measured based upon the expectation that they would not be incurred until 2117-2127 the provision would be reduced to ₹ 136 million (300 million x PVF of 40^{th} Year, i.e. 0.453). The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2%.

Question 14

ABC Ltd. has an obligation to restore the seabed for the damage it has caused in the past. It has to pay ₹ 10,00,000 cash on 31^{st} March 20X3 relating to this liability. ABC Ltd.'s management considers that 5% is an appropriate discount rate. The time value of money is considered to be material.

Calculate the amount to be provided for at 31^{st} March 20X1 for the costs of restoring the seabed.

Answer

Discounting factor of 5% for 2^{nd} year as on 31^{st} March 20X1 = $(1/1.05)^2$ = 0.907

The present value of the provision as on 31^{st} March 20X1 is = ₹ 10,00,000 x 0.907 = ₹ 9,07,000

The amount of increase in the provision resulting from unwinding of discounting to reflect the passage of time should be included as an element of borrowing cost in determining the profit or loss for the year.

The provision should be initially recognised at ₹ 9,07,000 which is the present value of ₹ 10,00,000 discounted at 5% for two years. At the end of year 1 i.e. 31^{st} March 20X2, the provision increases to ₹ 9,52,350, and the difference of ₹ 45,350 is recognised as borrowing cost. Similarly, for the year ending 31^{st} March 20X3, the provision will increase to 10,00,000 and the increase being recognised as borrowing cost. Consequently, at the end of year 2 the amount of provision will be equal to the amount due, i.e., ₹ 10,00,000.

Note: There may be some difference in amount due to approximation (limiting discounting factor to 3 place decimal), which can be overcome either by full scale calculation or adjustment at the end.

Question 15

Marico has an obligation to restore environmental damage in the area surrounding its factory. Expert advice indicates that the restoration will be carried out in two distinct phases; the first phase requiring expenditure of ₹ 2 million to remove the contaminated soil from the area and the second phase, commencing three years later from the end of first phase, to replant the area with suitable trees and vegetation. The estimated cost of replanting is ₹ 3.5 million. Marico uses a cost of capital (before taxation) of 10% and the expenditure, when incurred, will attract tax relief at the company's marginal tax rate of 30%. Marico has not recognised any provision for such costs in the past and today's date is 31 March 20X2. The first phase of the clean up will commence in a few months time and will be completed on 31 March 20X3 when the first payment of ₹ 2 million will be made. Phase 2 costs will be paid three years later from the end of first phase. Calculate the amount to be provided at 31 March 20X2 for the restoration costs.

Answer

Year	Cash Flow	10% Discount factor	Present Value
20X2-20X3	20,00,000	0.909	18,18,000
20X5-20X6	35,00,000	0.683	23,90,500
Provision required at 31 March 20X2			**42,08,500**

The provision is calculated using the pre-tax costs and a pre-tax cost of capital. The fact that the eventual payment will attract tax relief will be reflected in the recognition of a deferred tax asset for the deductible temporary difference (assuming that the recognition criteria for deferred tax assets are met.)

Question 16

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.

Answer

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 17

Sun Limited has entered into a binding agreement with Moon Limited to buy a custom- made machine for ₹ 4,00,000. At the end of 2017-18, before delivery of the machine, Sun Limited had to change its method of production. The new method will not require the machine ordered which is to be scrapped after delivery. The expected scrap value is nil. Given that the asset is yet to be delivered, should any liability be recognized for the potential loss? If so, give reasons for the same, the amount of liability as well as the accounting entry.

Answer

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 ₹ 4,00,000 i.e. the full cost of the machine.

		₹	₹
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 derecognised)			

Question 18

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 ₹ 5 crores. This estimate was revised to ₹ 5.2 crores as on 31st March, 2017 and ₹ 5.25 crores as at 15th May, 2017. This case was eventually settled on 1st June, 2017, when the Company paid damages of ₹ 5.3 crores to K.

On 1st December, 2016, QA Ltd. had estimated that it would receive damages of ₹ 3.5 crores from F. This estimate was revised to ₹ 3.6 crores as at 31st March, 2017 and ₹ 3.7 crores as on 15th May, 2017. This case was eventually settled on 1st June, 2017 when F paid ₹ 3.75 crores to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31st March, 2017, provided ₹ 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.	₹ 5.2 crores	
	To Current Liability A/c			₹ 5.2 crores
(B)	Statement of Profit and Loss A/c	Dr.	₹ 5.3 crores	
	To Non-Current Liability A/c			₹ 5.3 crores
(C)	Statement of Profit and Loss A/c	Dr.	₹ 5.25 crores	
	To Current Liability A/c			₹ 5.25 crores

(iii) What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable Ind AS?

Answer

(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 ₹ 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. ₹ 5.2 crore
To Current Liability A/c ₹ 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.

CHAPTER - 10
Unit 1 – Ind AS 12: Income Taxes

Question 1

An asset which cost ₹ 150 has a carrying amount of ₹ 100. Cumulative depreciation for tax purposes is ₹ 90 and the tax rate is 25%. Calculate the tax base and the corresponding deferred tax asset or liability, if any.

Answer

The tax base of the asset is ₹ 60 (cost of ₹ 150 less cumulative tax depreciation of ₹ 90). To recover the carrying amount of ₹ 100, the entity must earn taxable income of ₹ 100, but will only be able to deduct tax depreciation of ₹ 60. Consequently, the entity will pay income taxes of ₹ 10 (₹ 40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of ₹ 100 and the tax base of ₹ 60 is a taxable temporary difference of ₹ 40. Therefore, the entity recognises a deferred tax liability of ₹ 10 (₹ 40 at 25%) representing the income taxes that it will pay when it recovers the carrying amount of the asset.

Question 2

A company had purchased an asset at ₹ 1,00,000. Estimated useful life of the asset is 5 years and depreciation rate is 20% SLM. Depreciation rate for tax purposes is 25% SLM. The operating profit is ₹ 1,00,000 for all the 5 years. Tax rate is 30% for the next 5 years. Calculate the Book Value as per financial and tax purposes and then DTL.

Answer

Calculation of the Book Value as per financial and tax purposes.

Financial Accounting: **₹ 000's**

Year	**1**	**2**	**3**	**4**	**5**
Gross Block	100	100	100	100	100
Accumulated Depreciation	20	40	60	80	100
Carrying Amount	80	60	40	20	0

Tax Accounting: **₹ 000's**

Year	**1**	**2**	**3**	**4**	**5**
Gross Block	100	100	100	100	100
Accumulated Depreciation	25	50	75	100	100
Carrying Amount	75	50	25	0	0

Calculation of DTL: **₹ 000's**

Year	**1**	**2**	**3**	**4**	**5**
Carrying Amount	80	60	40	20	0
Tax Base	75	50	25	0	0

Difference	5	10	15	20	0
Deferred Tax Liability (Difference x 30%)	1.5	3	4.5	6	0

Question 3

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:

(i) Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of ₹ 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.

(ii) 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 ₹ 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 31st March 2019, X Ltd. expects to make taxable profits which are well in excess of ₹ 20,00,000. On 31st March, 2018, X Ltd. had taxable temporary differences from other sources which were greater than ₹ 20,00,000.

(iii) During the year ended 31st 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 ₹ 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 31st March 2018.

(iv) On 1st April 2017, X Ltd. borrowed ₹ 1,00,00,000. The cost to X Ltd. of arranging the borrowing was ₹ 2,00,000 and this cost qualified for a tax deduction on 1st April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March 2020 will be ₹ 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 ₹ 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 31st March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%.

Answer

(i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is ₹ 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 ₹ 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 ₹ 20,00,000 in the year to 31st March, 2019.

The amount of the deferred tax asset will be ₹ 4,00,000 (₹ 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 ₹ 15,20,000 (₹ 16,00,000 – (₹ 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 ₹ 3,04,000 (₹ 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 ₹ 1,07,80,000 (₹ 1,00,00,000 – ₹ 2,00,000 + (₹ 98,00,000 x 10%)).

The tax base of the loan is ₹ 1,00,00,000.

This creates a deductible temporary difference of ₹ 7,80,000 (₹ 1,07,80,000 – ₹ 1,00,00,000) and a potential deferred tax asset of ₹ 1,56,000 (₹ 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 4

On 1st April 20X1, ABC Ltd acquired 100% shares of XYZ Ltd for ₹ 4,373 crore. By 31st March, 20X5, XYZ Ltd had made profits of ₹ 5 crore, which remain undistributed. Based on the tax legislation in India, the tax base investment in XYZ Ltd is its original cost. Assume the dividend distribution tax rate applicable is 15%. Show deferred tax treatment.

Answer

A taxable temporary difference of ₹ 5 therefore exists between the carrying value of the investment in XYZ at the reporting date of ₹ 4,378 (₹ 4,373 + ₹ 5) and its tax base of ₹ 4,373. Since a parent, by definition, controls a subsidiary, it will be able to control the reversal of this temporary difference, for example – through control of the dividend policy of the subsidiary. Therefore, deferred tax on such temporary difference is generally not provided unless it is probable that the temporary difference will reverse in the foreseeable future.

Question 5

ABC Ltd. acquired 50% of the shares in PQR Ltd. on 1st January, 20X1 for ₹ 1,000 crore. By 31st March, 20X5 PQR Ltd. had made profits of ₹ 50 crore (ABC Ltd.'s share), which remained undistributed. Based on the tax legislation in India, the tax base of the investment in PQR Ltd. is its original cost. Assume the dividend distribution tax rate applicable is 15%. Show deferred tax treatment.

Answer

A taxable temporary difference of ₹ 50 therefore exists between the carrying value of the investment in PQR at the reporting date of ₹ 1,050 (₹ 1,000 + ₹ 50) and its tax base of ₹ 1,000. As ABC Ltd. does not completely control PQR Ltd. it is not in a position to control the dividend policy of PQR Ltd. As a result, it cannot control the reversal of this temporary difference and deferred tax is provided on temporary differences arising on investments in joint venture. (50 x 15%).

Question 6

A Ltd. acquired B Ltd. The following assets and liabilities are acquired in a business combination:

₹ 000's

	Fair Value	Carrying amount	Temporary Difference
Plant and Equipment	250	260	(10)
Inventory	120	125	(5)
Debtors	200	210	(10)
	570	595	(25)
9% Debentures	(100)	(100)	
	470	495	
Consideration paid	500	500	
Goodwill	30	5	(25)

Calculate Deferred Tax Asset. Tax Rate is 30%

Answer

In this case there is a Deferred Tax Asset as the Tax base of assets acquired is higher by 25,000. DTA would be ₹ 7,500 (25,000 x 30%)

Journal entry:

Plant and equipment	Dr	250	
Inventory	Dr	120	
Debtors	Dr	200	
Goodwill (30 – 7.5)	Dr	22.5	
DTA	Dr	7.5	
To 9% Debentures			100
To Bank			500

Question 7

An entity has a deductible temporary difference of ₹ 50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profits up to ₹ 60,000. The cost of implementing this tax planning strategy is ₹ 12,000. The tax rate is 30%. Compute the deferred tax asset that should be recognised.

Answer

The entity should recognise a deferred tax asset of ₹ 14,400 @ 30% of ₹ 48,000 (₹ 60,000 – ₹ 12,000).

The balance deferred tax asset of ₹ 600 @ 30% on ₹ 2,000 (₹ 50,000 – ₹ 48,000) shall remain unrecognised.

Question 8

B Limited is a newly incorporated entity. Its first financial period ends on 31st March, 20X1. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of ₹ 9,000. These are expected to reverse equally over next 3 years.

(b) Deductible temporary differences of ₹ 4,000 expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on 31st March, 20X1.

Answer

The year-wise anticipated reversal of temporary differences is as under:

Particulars	**Year ending on 31st March, 20X2**	**Year ending on 31st March, 20X3**	**Year ending on 31st March, 20X4**	**Year ending on 31st March, 20X5**
Reversal of taxable temporary difference relating to accelerated depreciation over next 3 years (₹ 9,000/3)	3,000	3,000	3,000	Nil
Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (₹ 4,000/4)	1,000	1,000	1,000	1,000

B Limited will recognise a deferred tax liability of ₹ 2,700 on taxable temporary difference relating to accelerated depreciation of ₹ 9,000 @ 30%.

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, 20X4 amounting to ₹ 900 (₹ 3,000 @ 30%). No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on 31st March, 20X5 as there are no taxable temporary differences. Further, the outlook is also a loss. However, if there are tax planning opportunities that could be identified for the year ending on 31st March, 20X5 deferred tax asset on the remainder of ₹ 1,000 (₹ 4,000 – ₹ 3,000) of deductible temporary difference could be recognised at the 30% tax rate.

Question 9

A Limited recognises 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 ₹ 10,000 and the tax rate was 25%. On 28th February, 20X2, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on 21st May, 20X2.

Discuss the treatment of deferred tax in case the reporting date of A Limited's financial statement is 31st December, 20X1 and these are approved for issued on 31st May, 20X2.

Answer

The difference of ₹ 10,000 between the carrying value of interest receivable of ₹ 10,000 and its tax base of NIL is a taxable temporary difference.

A Limited has to recognise a deferred tax liability of ₹ 2,500 (₹ 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 nor 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 10

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 30th 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	₹ 80,000
Deferred tax liability	₹ 60,000

Of the deferred tax asset balance, ₹ 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.

Answer

Calculation of Deductible temporary differences:

Deferred tax asset = ₹ 80,000

Existing tax rate = 40%

Deductible temporary differences = 80,000/40% = ₹ 2,00,000

Calculation of Taxable temporary differences:

Deferred tax liability = ₹ 60,000

Existing tax rate = 40%

Deductible temporary differences = 60,000/40% = ₹ 1,50,000

Of the total deferred tax asset balance of ₹ 80,000, ₹ 28,000 is recognized in OCI

Hence, Deferred tax asset balance of Profit & Loss is ₹ 80,000 – ₹ 28,000 = ₹ 52,000

Deductible temporary difference recognized in Profit & Loss is ₹ 1,30,000 (52,000/40%)

Deductible temporary difference recognized in OCI is ₹ 70,000 (28,000/40%)

The adjusted balances of the deferred tax accounts under the new tax rate are:

Deferred tax asset		₹
Previously credited to OCI-equity	₹ 70,000 x 0.45	31,500
Previously recognised as Income	₹ 1,30,000 x 0.45	58,500
Total DTA		90,000
Deferred tax liability		
Previously recognized as expense	₹ 1,50,000 x 0.45	67,500

The net adjustment to deferred tax expense is a reduction of ₹ 2,500. Of this amount, ₹ 3,500 is recognised in OCl and ₹ 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:		₹
DTA shown in OCI	₹ 70,000 x (0.45 – 0.40)	3,500
DTA shown in Profit or Loss	₹ 1,30,000 x (0.45 – 0.40)	6,500
DTL shown in Profit or Loss	₹ 1,50,000 x (0.45 – 0.40)	7,500

Journal Entries

	₹	₹
Deferred tax asset	3,500	

To OCI – revaluation surplus		3,500
Deferred tax asset	6,500	
To Deferred tax expense		6,500
Deferred tax expense	7,500	
To Deferred tax liability		7,500

Alternatively, a combined journal entry may be passed as follows:

		₹	₹
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 11

An entity has made an accounting profit of ₹ 1,00,000. The tax rate is 30%. In computing the accounting profit, a penalty of ₹ 10,000 has been considered which is not tax deductible. There are no other tax impacts. In this case, the taxable profits are ₹ 1,10,000 (₹ 1,00,000 + ₹ 10,000) and tax expense @ 30% is ₹ 33,000. Prepare the two types of disclosures as tax reconciliation in absolute numbers as well as the tax rate reconciliation.

Answer

Particulars	**Amount (₹)**
Accounting profit	1,00,000
Tax at the applicable tax rate of 30%	30,000
Tax effect of expenses that are not deductible in determining taxable profits:	
Penalties	3,000
Tax expense	33,000

The effective tax rate is as per the national income-tax rate.

Particulars	**%**
Applicable tax rate	30
Tax effect of expenses that are not deductible in determining taxable profits:	
Penalties	3
Average effective tax rate	33

Question 12

In 20X2, an entity has accounting profit in its own jurisdiction (country A) of ₹ 1,500 (20X1: ₹ 2,000) and in country B of ₹ 1,500 (20X1: ₹ 500). The tax rate is 30% in country A and 20% in country B. In country A, expenses of ₹ 100 (20X1: ₹ 200) are not deductible for tax purposes. Prepare the tax expense reconciliation in absolute numbers.

Answer

Particulars	Amount (₹)	
	20X2	**20X1**
Accounting profit	3,000	2,500
Tax at the domestic rate of 30%	900	750
Tax effect of expenses that are not deductible for tax purposes	30	60
Effect of lower tax rates in country B	(150)	(50)
Tax expense	780	760

Question 13

A's Ltd. profit before tax according to Ind AS for Year 20X1-20X2 is ₹ 100 thousand and taxable profit for year 20X1-20X2 is ₹ 104 thousand. The difference between these amounts arose as follows:

1. On 1st February, 20X2, it acquired a machine for ₹ 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 ₹ 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.

Answer

Current tax= Taxable profit x Tax rate = ₹ 104 thousand x 25% = ₹ 26 thousand

Computation of Taxable Profit:

	₹ in thousand
Accounting profit	100
Add: Donation not deductible	8
Less: Excess Depreciation (6 – 2)	(4)
Total Taxable profit	104

		₹ in thousand	**₹ in thousand**
Profit & loss A/c	Dr.	26	
To Current Tax			26

Deferred tax:

Machine's carrying amount according to Ind AS is ₹ 118 thousand (₹ 120 thousand – ₹ 2 thousand)

Machine's carrying amount for taxation purpose = ₹ 114 thousand (₹ 120 thousand – ₹ 6 thousand)

Deferred Tax Liability = ₹ 4 thousand x 25%

		₹ in thousand	
Profit & loss A/c	Dr.	1	
To Deferred Tax Liability			1

Tax reconciliation in absolute numbers:

	₹ in thousand
Profit before tax according to Ind AS	100
Applicable tax rate	25%
Tax	25
Expenses not deductible for tax purposes (₹ 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 14

On 1st April 20X1, S Ltd. leased a machine over a 5 year period. The present value of lease liability is ₹ 120 Cr (discount rate of 8%) and is recognized as lease liability and corresponding Right of Use (RoU) Asset on the same date. The RoU Asset is depreciated under straight line method over the 5 years. The annual lease rentals are ₹ 30 Cr payable starting 31st March 20X2. The tax law permits tax deduction on the basis of payment of rent.

Assuming tax rate of 30%, you are required to explain the deferred tax consequences for the above transaction for the year ended 31st March 20X2.

Answer

A temporary difference effectively arises between the value of the machine for accounting purposes and the amount of lease liability, since the rent payment is eligible for tax deduction.

Tax base of the machine is nil as the amount is not eligible for deduction for tax purposes.

Tax base of the lease liability is nil as it is measured at carrying amount less any future tax deductible amount.

Recognition of deferred tax on 31st March 20X2:

Carrying amount in balance sheet	
RoU Asset (120 Cr – 24 Cr (Depreciation))	₹ 96.00 Dr
Lease Liability (120 Cr + 9.60 Cr (120 Cr x 8%) – 30 Cr)	₹ 99.60 Cr
Net Amount	**₹ 3.60 Cr**

Tax Base	₹ 0.00 Cr
Temporary Difference (deductible)	₹ 3.60 Cr
Deferred Tax asset to be recognized (₹ 3.60 Cr x 30%)	₹ 1.08 Cr

Question 15

On 1 April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of ₹ 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 1 April 20X1 can be used for this purpose. On 1 April 20X1, the market value of B Ltd. share was ₹ 2.00

On 1 April 20X1, the individual financial statements of B Ltd. showed the net assets at ₹ 23 Cr.

The directors of A Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of B Ltd. at 1 April 20X1. The following matters emerged:

- Property having a carrying value of ₹ 15 Cr at 1 April 20X1 had an estimated market value of ₹ 18 Cr at that date.
- Plant and equipment having a carrying value of ₹ 1 Cr at 1 April 20X1 had an estimated market value of ₹ 13 Cr at that date.
- Inventory in the books of B Ltd. is shown at a cost of ₹ 2.50 Cr. The fair value of the inventory on the acquisition date is ₹ 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.

Answer

Purchase Consideration:	₹ 25 Cr
Non-Controlling Interest [{12 Cr x (20%/80%)} x ₹ 2 per share]	₹ 6 Cr
Computation of Net Assets of B Ltd.	
As per books	₹ 23.00 Cr
Add: Fair value differences not recognized in books of B Ltd.:	
Property (18 Cr – 15 Cr)	₹ 3.00 Cr
Plant and Equipment (13 Cr – 11 Cr)	₹ 2.00 Cr
Inventory (3 Cr – 2.5 Cr)	₹ 0.50 Cr
	₹ 28.5 Cr
Less: Deferred tax liability on fair value difference @20% [(3 Cr + 2 Cr + 0.50 Cr) x 20%]	(₹ 1.10 Cr)
Total Net Assets at Fair Value	₹ 27.40 Cr
Computation of Goodwill:	
Purchase Consideration	₹ 25.00 Cr

Add: Non-Controlling Interest	₹ 6.00 Cr
	₹ 31.00 Cr
Less: Net Assets at Fair Value	(₹ 27.40 Cr)
Goodwill on acquisition date	₹ 3.60 Cr

Question 16

On 1st April 20X1, P Ltd. had granted 1 Cr share options worth ₹ 4 Cr subject to a two-year vesting period. The income tax law permits a tax deduction at the exercise date of the intrinsic value of the options. The intrinsic value of the options at 31st March 20X2 was ₹ 1.60 Cr and at 31st March 20X3 was ₹ 4.60 Cr. The increase in the fair value of the options on 31st March 20X3 was not foreseeable at 31st March 20X2. The options were exercised at 31st March 20X3.

Give the accounting for the above transaction for deferred tax for period ending 31st March, 20X2 and 31st March, 20X3. Assume that there are sufficient taxable profits available in future against any deferred tax assets. Tax rate of 30% is applicable to P Ltd.

Answer

On 31st March 20X2:

The tax benefit is calculated as under:

Carrying amount of Share based payment	₹ 0.00 Cr
Tax Base of Share based payment (₹ 1.60 Cr x ½)	₹ 0.80 Cr
Temporary Difference (Carrying amount – tax base)	₹ 0.80 Cr
Deferred Tax Asset recognized (Temporary Difference x Tax rate) [0.80 Cr x 30%]	₹ 0.24 Cr

Journal Entry for above:

Deferred Tax Asset	Dr.	₹ 0.24 Cr	
To Tax Expense			₹ 0.24 Cr
(Being DTA recognized on equity option)			

On 31st March 20X3:

The options have been exercised and a current tax benefit will be available to the entity on the basis of intrinsic value of ₹ 4.60 Cr. Initially recognized deferred tax asset will no longer be required.

The accounting entry will be done as under:

Tax Expense	Dr.	₹ 0.24 Cr	
To Deferred Tax Asset			₹ 0.24 Cr
(Being DTA reversed on the exercise of the option)			

Question 17

A Ltd prepares financial statements to 31 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 31 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 31 March 20X1 and ₹ 75 Cr on 31 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 31 March. On 31 March 20X1, carrying value of the building (after revaluation) was ₹ 40 Cr and its tax base was ₹ 22 Cr. During the year ended 31 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 31 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 31 March 20X2

(b) The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31 March 20X2

Answer

(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 of 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 or 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 or 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 31 March 20X1 is ₹ 3.6 Cr [20% x (₹ 40 Cr – ₹ 22 Cr)].

At 31 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 18

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:

(a) 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.

(b) 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.

(c) 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%.

Answer

(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. Because 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 – ₹ 1,20,000). 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 19

An entity in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50%) with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35%. At the end of the reporting period, 31st December, 20X1, the entity does not recognise a liability for dividends proposed or declared after the reporting period. As a result, no dividends are recognised in the year 20X1. Taxable income for 20X1 is ₹ 1,00,000. The net taxable temporary difference for the year 20X1 is ₹ 40,000.

Subsequently, on 15th March, 20X2 the entity recognises dividends of ₹ 10,000 from previous operating profits as a liability.

What will be tax consequences (current and deferred) for the year ended 31st December, 20X1 and 20X2.

Answer

For the year ended 31st December, 20X1, the entity recognises a current tax liability and a current income tax expense of ₹ 50,000 (₹ 1,00,000 x 50%). No asset is recognised for the amount potentially recoverable as a result of future dividends. The entity also recognises a deferred tax liability and deferred tax expense of ₹ 20,000 (₹ 40,000 at 50%) representing the income taxes that the entity will pay when it recovers or settles the carrying amounts of its assets and liabilities based on the tax rate applicable to undistributed profits.

On 15th March, 20X2, the entity recognises the recovery of income taxes of ₹ 1,500 (15% of the dividends recognised as a liability) as a current tax asset and as a reduction of current income tax expense for 20X2.

Question 20

An asset with a cost of ₹ 100 and a carrying amount of ₹ 80 is revalued to ₹ 150. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is ₹ 30 and the tax rate is 30%. If the asset is sold for more than cost, the cumulative tax depreciation of ₹ 30 will be included in taxable income but sale proceeds in excess of cost will not be taxable.

Calculate the deferred tax liability/asset:

(i) If the entity expects to recover the carrying amount by using the asset.

(ii) If the entity expects to recover the carrying amount by selling the asset immediately for proceeds of ₹ 150.

Answer

(i) If the entity expects to recover the carrying amount by using the asset, it must generate taxable income of ₹ 150, but will only be able to deduct depreciation of ₹ 70.

The tax base of the asset is ₹ 70 and there is a taxable temporary difference of ₹ 80 (₹ 150 the revalued amount is the carrying amount).

On this basis, there is a deferred tax liability of ₹ 24 (₹ 80 at 30%).

(ii) If the entity expects to recover the carrying amount by selling the asset immediately for proceeds of ₹ 150, the deferred tax liability is computed as follows:

(a)	Sale proceeds	₹ 150
(b)	Sale proceeds in excess of cost (₹ 100)	₹ 50
(c)	Taxable proceeds	₹ 100
(d)	Tax base	₹ 70
(e)	Taxable temporary difference	₹ 30
(f)	Tax rate	30%
(g)	Deferred tax liability	₹ 9

Question 21

PQR Ltd., a manufacturing company, 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:

- QPR Ltd., a wholly owned subsidiary of PQR Ltd., incurred a loss adjusted for tax purposes of ₹ 30,00,000. QPR Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow QPR Ltd. to transfer the tax loss to other group companies. However, it allows QPR

Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of PQR Ltd. do not consider that QPR Ltd. will make taxable profits in the foreseeable future.

- During the year ended 31st March, 2018, PQR Ltd. capitalised development costs which satisfied the criteria as per Ind AS 38 'Intangible Assets'. The total amount capitalised was ₹ 16,00,000. The development project began to generate economic benefits for PQR Ltd. from 1st January, 2018. The directors of PQR 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 31st March, 2018.
- On 1st April, 2017, PQR Ltd. borrowed ₹ 1,00,00,000. The cost to PQR Ltd. of arranging the borrowing was ₹ 2,00,000 and this cost qualified for a tax deduction on 1st April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March 2020 will be ₹ 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 ₹ 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 PQR Ltd. group at 31st March, 2018 as per Ind AS. The rate of corporate income tax is 30%.

Answer

Impact on consolidated balance sheet of PQR Ltd. group at 31st March, 2018

- The tax loss creates a potential deferred tax asset for the PQR Ltd. group since its carrying value is nil and its tax base is ₹ 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.
- The development costs have a carrying value of ₹ 15,20,000 (₹ 16,00,000 – (₹ 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 ₹ 4,56,000 (₹ 15,20,000 x 30%). All deferred tax liabilities are shown as non-current.
- The carrying value of the loan at 31st March, 2018 is ₹ 1,07,80,000 (₹ 1,00,00,000 – ₹ 200,000 + (₹ 98,00,000 x 10%)). The tax base of the loan is 1,00,00,000. This creates a deductible temporary difference of ₹ 7,80,000 and a potential deferred tax asset of ₹ 2,34,000 (₹ 7,80,000 x 30%).

Question 22

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 ₹ 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 ₹ 70 crores on 31st March, 2017 and ₹ 75 crores as on 31st March, 2018. As per the applicable tax laws, profits recognised 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%.

Answer

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
31st March, 2017	70 crore	45 crore	45 crore	25 crore	5 crore	5 crore
31st March, 2018	75 crore	45 crore	45 crore	30 crore	6 crore	1 crore (6 crore – 5 crore)

Question 23

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 ₹ 8.5 crores and as on 31st March, 2017 is ₹ 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 ₹ 40 crores whereas its tax base was ₹ 22 crores. During the year ended 31st March, 2017, the Company charged depreciation in its Statement of Profit and Loss of ₹ 2 crores and claimed a tax deduction for tax depreciation of ₹ 1.25 crores. On 31st March, 2017, the property was revalued to ₹ 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%.

Answer

Computation of Deferred Tax Liability

(i) MAT credit as on 31st December of ₹ 9.75 crore will be presented in the Balance Sheet as Deferred tax asset. DTA in the current year will be ₹ 1.25 crore (₹ 9.75 crore – ₹ 8.50 crore)

(ii) (a) In case defer tax is created only on account of depreciation

	Carrying value without	Value as per tax	Tax base	Taxable/ (deductible) temporary	Total Deferred tax liability/	Credit to P&L during the

	revaluation	records		difference	(asset) @ 20%	year
a	b	c	d	e = b – d	f = e x 20%	g
31st 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 31st 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	31st 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					DTL 1.25 crore	DTA (0.15 crore) (Refer	DTL (1.40 crore) (Refer

	year (IV – I)			-			table (a))	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 ₹ 0.15 crore on account of depreciation will be charged to Profit and Loss and DTL of ₹ 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 24

The entity has an identifiable asset ASSOTA with a carrying amount of ₹ 10,00,000. Its recoverable amount is ₹ 6,50,000. The tax base of ASSOTA is ₹ 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?

Answer

As per Ind AS 36, the revised carrying amount of asset ASSOTA would be ₹ 6,50,000.

The tax base of asset ASSOTA is given as ₹ 8,00,000.

Carrying base of asset = ₹ 6,50,000

Tax base of asset = ₹ 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 ₹ 1,50,000 (₹ 8,00,000 – ₹ 6,50,000) at the given tax rate of 30%.

Hence, Deferred tax asset for the asset ASSOTA would be ₹ 1,50,000 x 30% = ₹ 45,000.

Question 25

Parent Limited, prepares consolidated financial statements of the group on 31 March every year. During the year ended 31 March 2020, the following events affected the tax position of the group:

(i) S Limited, a wholly owned subsidiary of Parent Limited, incurred a loss of ₹ 20,00,000 which is adjustable from future taxable profits of the company for tax purposes. S Limited is unable to utilize this loss against previous tax liabilities. Income Tax Act does not allow S Limited to transfer the tax loss to other group companies. However, it allows S Limited to carry forward the loss and utilize it against company's future taxable profits. The directors of Parent Limited estimate that S Limited will not make any taxable profits in the foreseeable future.

(ii) On 1 April 2019, Parent Limited borrowed ₹ 50,00,000. The cost incurred by Parent Limited for arranging the borrowing was ₹ 1,00,000 on the said date and this expenditure is qualified for deduction under the Income Tax Act for the accounting year 2019-2020. The loan was given for a three-year period. As per agreement, no principal or interest was payable on the loan during the tenure of loan but the amount repayable on 31 March 2022 will be by way of a bullet payment of ₹ 65,21,900. As per Parent Limited, this equates to an effective annual interest rate of 10% on loan. As per the Income-tax Act, a further expense of ₹ 15,21,900 will be claimable from taxable income till the loan is repaid on 31 March 2022.

The rate of corporate income tax to be assumed @ 20%.

Explain and show how each of these events would affect the deferred tax assets/liabilities in the consolidated balance sheet of Parent Limited as at 31 March 2020 as per applicable Ind AS.

You are also required to examine whether the effective rate of interest arrived at by Parent Limited for the loan of ₹ 50,00,000 is in accordance with applicable Ind AS or not?

Answer

(i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is ₹ 20,00,000.

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 carrying value of the loan at 31 March 2020 is ₹ 53,90,000 [₹ 50,00,000 – ₹ 1,00,000 + (₹ 49,00,000 x 10%)].

The tax base of the loan is ₹ 50,00,000.

This creates a deductible temporary difference of ₹ 3,90,000 (₹ 53,90,000 – ₹ 50,00,000) and a potential deferred tax asset of ₹ 78,000 (₹ 3,90,000 x 20%).

If there are prospects of availability of taxable profits in future, deferred tax asset can be recognised.

Amortisation Table for verification of effective rate of interest

Year	Opening balance (₹) (A)	Interest @ 10% (₹) (B)	Closing balance (₹) (A) + (B)
1	(50,00,000 – 1,00,000) 49,00,000	4,90,000	53,90,000
2	53,90,000	5,39,000	59,29,000
3	59,29,000	5,92,900	65,21,900

Since the closing balance calculated as per the above table on the basis of 10% matches with the bullet payment of ₹ 65,21,900, it assures that 10% rate of interest taken as effective rate of interest is correct and is in accordance with Ind AS 109. It considers the impact of cost of borrowing adjusted from the loan amount at initial recognition.

CHAPTER - 10
Unit 2 – Ind AS 21: The Effects of Changes in Foreign Exchange Rates

Question 1

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 31st 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 31st 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 and Machinery.

Answer

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		3,00,000
(Initial transaction will be recorded at exchange rate on the date of transaction)		

Exchange difference arising on translating monetary item on 31st March 20X1:

	₹	₹
Profit & Loss A/c [(5,000 x \$ 65) – (5,000 x \$ 60)] Dr.	25,000	
To Creditors-Machinery		20,000
Machinery A/c Dr.	30,000	
To Revaluation Surplus (OCI)		30,000
[Being Machinery revalued to USD 5,500; [₹ 60 x (USD 5,500 – USD 5,000)]		
Machinery A/c Dr.	27,500	
To Revaluation Surplus (OCI)		27,500
(Being Machinery measured at the rate on exchange 31-03-20X1 [USD 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			3,300
(DTL created @ of 30% of the OCI amount)			

Question 2

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 = ₹ 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 = ₹ 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.

Answer

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 i.e. 1st January, 2018. Therefore, the amount initially recognised would be ₹ 1,36,00,000 ($ 2,00,000 x ₹ 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 ₹ 1,30,00,000 ($ 2,00,000 x ₹ 65).

The gain on re-translation of ₹ 6,00,000 (₹ 1,36,00,000 – ₹ 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 ₹ 68 to $ 1.

Depreciation of ₹ 8,50,000 (₹ 1,36,00,000 x ¼ 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 ₹ 1,27,50,000 (₹ 1,36,00,000 – ₹ 8,50,000). This would be shown as a non-current asset in the statement of financial position.

Question 3

Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 2018 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, 2018. USD 30 million is received on 1st April, 2018 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, 2018 and 31st March, 2018 are ₹ 72 per USD and ₹ 75 per USD respectively.

Answer

This is the case of Revenue recognised at a single point in time with multiple payments. As per the guidance given in Appendix B to Ind AS 21:

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, 2018 i.e. ₹ 72 per USD.

A Ltd. will recognise revenue at 31st March, 2018 (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, 2018. Applying paragraph 22 of Ind AS 21, A Ltd. determines that the date of the transaction for the remainder of the revenue as 31st March, 2018.

On 31st March, 2018, 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, 2018 i.e. ₹ 72 per USD; and
- recognise revenue and a receivable for the remaining USD 30 million, using the exchange rate on 31st March, 2018 i.e. ₹ 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 4

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 = ₹ 2.50.
- 31st March, 20X2 – FCY 1 = ₹ 2.75.
- Average rate for the year ended 31st Match, 20X2 – FCY 1 = ₹ 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.

Answer

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 ₹ 2.50/FCY = ₹ 1,45,00,000

Therefore, the loan would initially be recorded at ₹ 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 ₹ 16,84,320 (6,96,000 FCY x ₹ 2.42/FCY)

The actual payment of interest would be recorded at 6,00,000 x 2.75 = ₹ 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 ₹ 2.75/FCY = ₹ 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 ₹ [1,62,14,000 – (1,45,00,000 + 16,84,320 – 16,50,000)] = ₹ 16,79,680.

This exchange difference is taken to profit and loss.

Question 5

Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).

The following balances appear in the books of Infotech Global Ltd. at the year-end prior to translation:

	USD	L$
Property, plant and equipment	50,000	
Receivables	9,35,000	
Total assets	**9,85,000**	
Issued capital	50,000	30,055
Opening retained earnings	28,000	15,274
Profit & Loss A/c (Profit for the year)	20,000	
Accounts payable	8,40,000	

Accrued liabilities	47,000	
Total equity and liabilities	**9,85,000**	

Translate the above balances of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.)

Prepare a working of the cumulative balance of the foreign currency translation reserve.

Additional information:

Relevant exchange rates are:

Rate at beginning of the year L$ 1 = USD 1.22

Average rate for the year L$ 1 = USD 1.175

Rate at end of the year L$ 1 = USD 1.13

Answer

Translation of the balances for the purpose of consolidation

	USD	Rate	L$
Property, plant and equipment	50,000	1.13	44,248
Receivables	9,35,000	1.13	8,27,434
Total assets	**9,85,000**		**8,71,682**
Issued capital	50,000	–	30,055
Opening retained earnings	28,000	–	15,274
Profit for the year	20,000	1.175	17,021
Accounts payable	8,40,000	1.13	7,43,363
Accrued liabilities	47,000	1.13	41,593
Total equity and liabilities USD	**9,85,000**		**8,47,306**
Foreign Currency Translation Reserve (Refer WN-1)			**24,376**
Total equity and liabilities L$			**8,71,682**

Working Note

1. Cumulative balance of the FCTR

Particulars	**Actual translated amount in L$**	**Amount (Refer WN-2)**	**Difference**
	A	**B**	**B-A**
Issued capital	30,055	44,248	14,193
Opening retained earnings	15,274	24,779	9,505
Profit for the year	17,021	17,699	678
	62,350	**86,726**	**24,376**

2. Translated amount if the same conversion rate is applied to following items as applied on other items

			Translated amount
Issued capital	50,000	1.13	44,248
Opening retained earnings	28,000	1.13	24,779
Profit for the year	20,000	1.13	17,699
	98,000		**86,726**

Question 6

M Ltd is engaged in the business of manufacturing of bottles for pharmaceutical companies and non-pharmaceutical companies. It has a wholly owned subsidiary, G Ltd, which is engaged in the business of pharmaceuticals. G Ltd purchases the pharmaceutical bottles from its parent company. The demand of G Ltd is very high and the operations of M Ltd are very large and hence to cater to its shortfall, G Ltd also purchases the bottles from other companies. Purchases are made at the competitive prices.

M Ltd sold pharmaceuticals bottles to G Ltd for Euro 12 lacs on 1st February, 20X1. The cost of these bottles was ₹ 830 lacs in the books of M Ltd at the time of sale. At the year-end i.e. 31st March, 20X1, all these bottles were lying as closing stock with G Ltd.

Euro is the functional currency of G Ltd. while Indian Rupee is the functional currency of M Ltd.

Following additional information is available:

Exchange rate on 1st February, 20X1 — 1 Euro = ₹ 83

Exchange rate on 31st March, 20X1 — 1 Euro = ₹ 85

Provide the accounting treatment for the above in books of M Ltd. and G Ltd.

Also show its impact on consolidated financial statements. Support your answer by Journal entries, wherever necessary. Assume NRV to be same as the cost.

Answer

Accounting treatment in the books of M Ltd (Functional Currency INR)

M Ltd will recognize sales of ₹ 996 lacs (12 lacs Euro x 83)

Profit on sale of inventory = 996 lacs – 830 lacs = ₹ 166 lacs

On balance sheet date receivable from G Ltd. will be translated at closing rate i.e. 1 Euro = ₹ 85. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ₹ 24 lacs. [i.e. (85 – 83) x 12 Lacs]

Journal Entries

Date	Particulars		₹ (in Lacs)	₹ (in Lacs)
1.2.20X1	G Ltd. A/c	Dr.	996	
	To Sales			996
	(Being revenue recorded on initial recognition)			
31.3.20X1	G Ltd. A/c	Dr.	24	
	To Foreign exchange difference (unrealised)			24

	(Being foreign exchange difference recorded at year end)		

Accounting treatment in the books of G Ltd (Functional currency EURO)

Date		in Euros	in Euros
1.2.20X1	Purchase A/c Dr.	12 lacs	
	To M Ltd.		12 lacs
	(Being purchased recorded at the date of transaction)		

G Ltd will recognize inventory on 1st February, 20X1 of Euro 12 lacs which will also be its closing stock at year end.

Accounting treatment in the consolidated financial statements

Receivable and payable in respect of above mentioned sale/purchase between M Ltd and G Ltd will get eliminated.

The closing stock of G Ltd will be recorded at lower of cost or NRV.

Since the question ask to assume that NRV is same as the cost, inventory will be measured at lower of following:

	Euro (in lacs)	Rate	₹ (in lacs)
Cost	12	83	996
NRV (Assumed Same)	12	85	1020

Therefore, no write off is required.

The amount of closing stock of ₹ 996 lacs includes two components-

- Cost of inventory for ₹ 830 lacs; and
- Profit element of ₹ 166 lacs; and

At the time of consolidation, the second element amounting to ₹ 166 lacs will be eliminated from the closing stock.

Journal Entry

	₹ (in Lacs)	₹ (in Lacs)
Consolidated P&L A/c Dr.	166	
To Inventory		166
(Being profit element of intragroup transaction eliminated)		

Question 7

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 ₹ 82/EURO and at 31st March, 20X2 was ₹

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 ₹ 83/EURO and on 31st March, 20X2 was ₹ 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.

Answer

(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 ₹ 84 = ₹ 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]	₹ 83/Euro
Unrealized profit to be eliminated [a x b]	₹ 149.40 million

As per para 39 of Ind AS 21 "income and expenses for each statement of profit and loss presented (i.e. 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 8

Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for ₹ 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is ₹ 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of ₹ 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of ₹ 180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is ₹ 20 lakhs.

Calculate P's gain on disposal in its consolidated financial statements.

Answer

P's gain on disposal in its consolidated financial statements would be calculated in following manner:

	(₹ in Lakhs)
Sale proceeds	1,500
Net assets of S	(1,000)
NCI derecognised	100
Foreign currency translation reserve	180
Gain on disposal	780

Question 9

Parent P has USD as its functional currency and Subsidiary S has Euro as its functional currency. P, whose reporting date is 31st March, lends USD 100 to S on 30th September, 20X1. S converted the loan amount received into Euro on receipt.

	USD	EURO
Exchange rate at 30th September, 20X1	1	1.5
Exchange rate at 31st March, 20X2	1	2.0

Prepare the Journal entries in the books of 'S' and 'P' according to Ind AS 21. Also explain the treatment at the time of consolidation.

Answer

Entries in the books of account of S

Date	Particulars	Debit (EURO)	Credit (EURO)
30th September, 20X1	Bank A/c Dr. To Intra-group payable (To recognize intra-group loan)	150	 150
31st March, 20X2	Exchange loss A/c Dr. To Intra-group payable (To recognize exchange loss on intra-group loan)	50	 50

In S's second entry, the liability is remeasured at 31st March, 20X2 and a translation loss is recorded.

Entries in the books of account of P

Date	Particulars	Debit (USD)	Credit (USD)
30th September, 20X1	Intra group receivable Dr. To Cash (To recognize intra-group loan on issue)	100	 100

On consolidation at 31st March, 20X2, the receivable and payable (in respect of Intra-group receivable and payable) will be eliminated. However, an exchange loss equivalent to EURO 50 for the year ended 31st March, 20X2 will remain on consolidation. This is appropriate because S will need to obtain USD in order to repay the liability. Therefore, the group has a foreign currency exposure. The exchange loss will be taken to consolidated profit or loss, unless the loan forms part of P's net investment in S in which case it will be transferred to other comprehensive income at the time of consolidation.

Question 10

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 15th March, 20X2 (there is no indicator of impairment)	200.0	–
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	30th April, 20X1
Computer software	5th 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 1st April, 20X1	1 INR = 0.0123 GBP
Closing spot rate as on 30th April, 20X1	1 INR = 0.0120 GBP
Closing spot rate as on 5th May, 20X1	1 INR = 0.0119 GBP
Closing spot rate on 15th March, 20X2	1 INR = 0.0108 GBP
Closing spot rate as on 31st March, 20X2	1 INR = 0.0109 GBP
Average exchange rate for the year ended 31st March, 20X2	1 INR = 0.0116 GBP

As the accountant of PQR India, you are required to do following for its separate financial statements:

(a) 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.

(b) Translate the trial balance of PQR India from INR to GBP.

Answer

(a) 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.

(b) 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

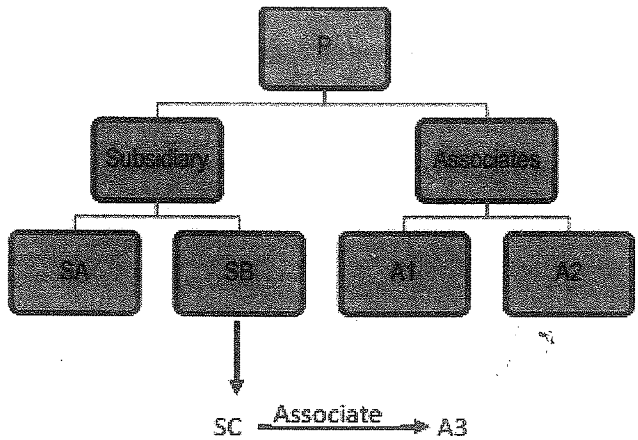
CHAPTER - 11
Unit 1 – Ind AS 24: Related Party Disclosures

Question 1

Entity P Limited has a controlling interest in subsidiaries SA Limited and SB Limited and SC Limited. SC Limited is a subsidiary of SB Limited. P Limited also has significant influence over associates A1 Limited and A2 Limited. Subsidiary SC Limited has significant influence over associate A3 Limited.

Examine related party relationships of various entities.

Answer



- In Separate Financial Statements of P Limited, SA Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SA Limited, P Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SB Limited, P Limited, SA Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SC Limited, P Limited, SA Limited, SB Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of associates A1 Limited, A2 Limited and A3 Limited; P Limited, SA Limited, SB Limited and SC Limited are related parties.
- A1 Limited, A2 Limited and A3 Limited are not related to each other.
- For Parent's consolidated financial statements, A1 Limited, A2 Limited and A3 Limited are related to the Group.

Question 2

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

(a) Examine related party relationships from the perspective of C Limited for A Limited.

(b) Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a

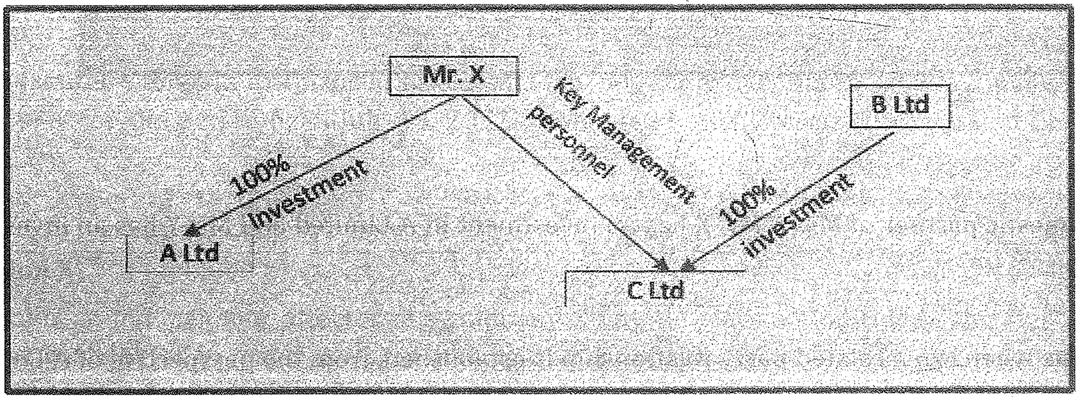
KMP of B Limited and not C Limited.

(c) Will the outcome in (a) & (b) would be different if Mr. X has joint control over A Limited.

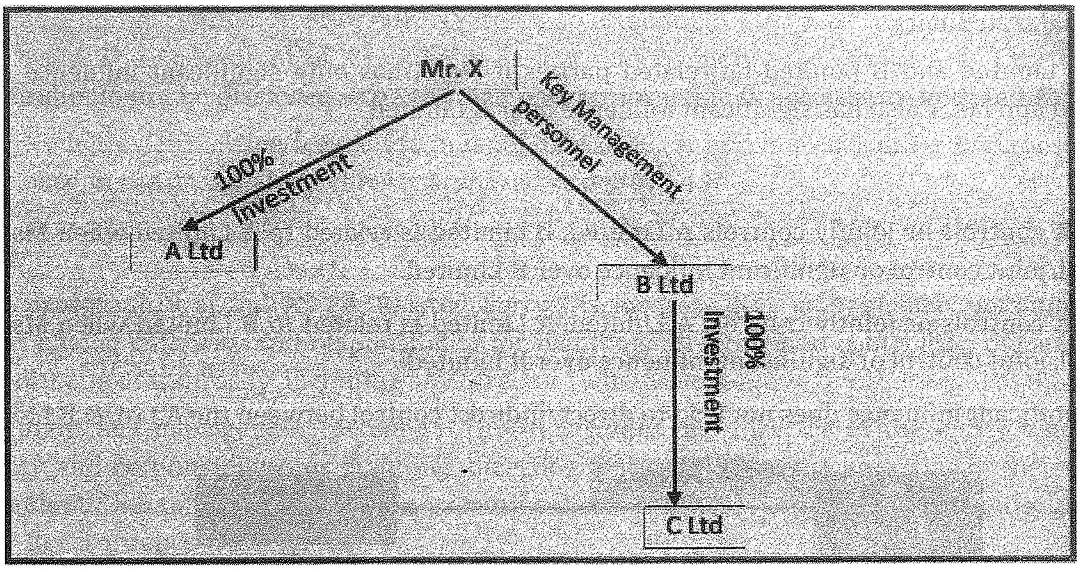
(d) Will the outcome in (a) & (b) would be different if Mr. X has significant influence over A Ltd.

Answer

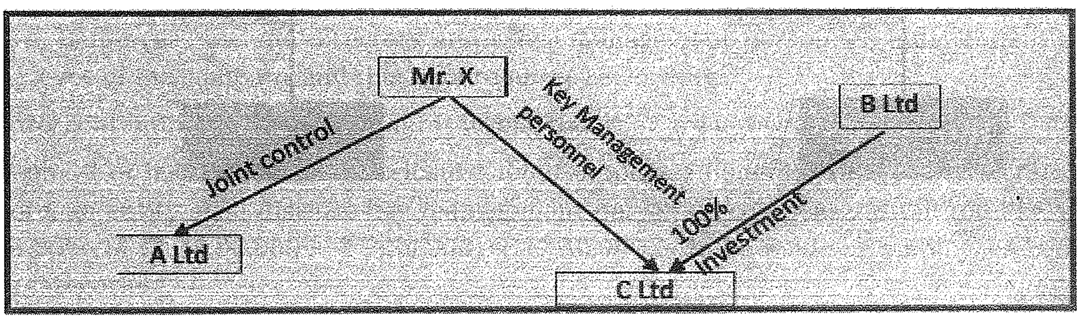
(a) A Limited is related to C Limited because Mr. X controls A Limited and is a member of KMP of C Limited.



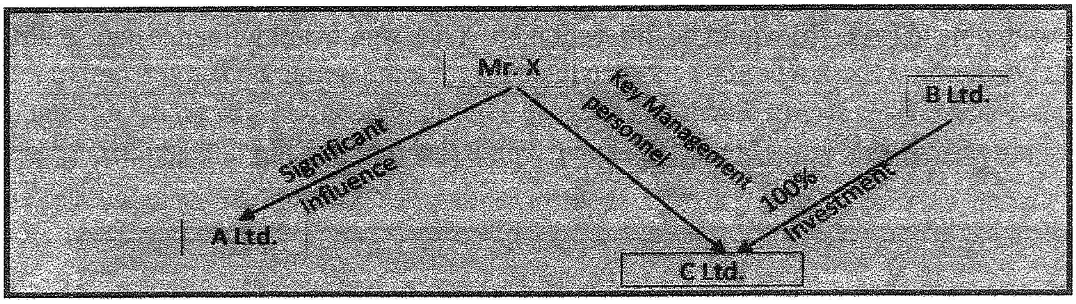
(b) Still A Limited will be related to C Limited.



(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 3

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.

Required

(a) Examine when can a related party relationship is established, from the perspective of A Limited's financial statements.

(b) Examine when can related party relationship is established, from the perspective of B Limited's financial statements.

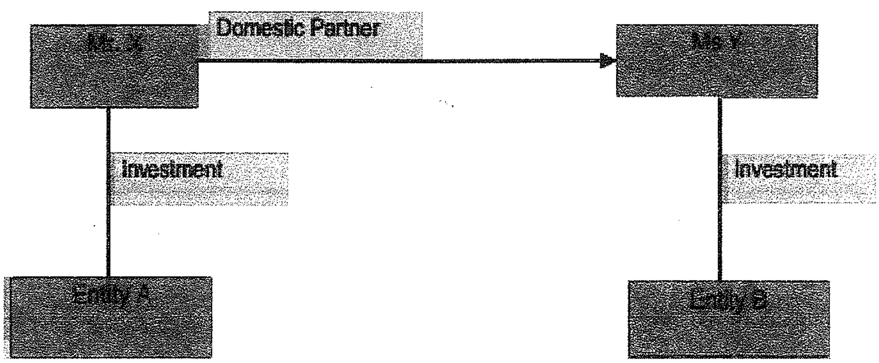
(c) Will A Limited and B Limited be related parties if Mr. X has only significant influence over A Limited and Ms. Y also has significant influence over B Limited.

Answer

(a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Ms. Y has control, joint control or significant influence over B Limited.

(b) If Mr. X controls or jointly controls A Limited, A Limited is related to B Limited when Ms. Y has control, joint control or significant influence over B Limited.

(c) No, Significant influence does not lead to direct/indirect control between the A Ltd. & B Ltd.



Question 4

Power Limited is a producer of electricity. Transmission Limited regularly purchases electricity from

Power Limited. Power Limited whose financial year ends on March 31, 20X2, acquired 100% shareholding of Transmission Limited on July 15, 20X1. However, the entire shareholding is disposed of on March 21, 20X2. Power Limited and Transmission Limited had transactions when Transmission Limited was a subsidiary of Power Limited and also in the period when it was not a subsidiary of Power Limited.

For which period, related party disclosure should Power Limited make in its financial statements for the year ended March 31, 20X2 with respect to transactions with Transmission Limited.

Answer

Power Limited should in its financial statements for the year ended March 31, 20X2 make related party disclosures for the period from July 15, 20X1 to March 21, 20X2 when Transmission Limited was its subsidiary.

Question 5

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 ₹ 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 ₹ 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 in accordance with Ind AS 24.

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?

Answer

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. Independent directors are not employee of the company and this para requires rewording.

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 (₹ 10,00,000 + ₹ 7,50,000) ₹ 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 6

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 1st June, 20X1. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 20X1 to 31st May 20X1 totalled ₹ 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 1st June 20X1 to 31st March 20X2 totalled ₹ 60,00,000. On 31st March 20X2, the trade receivables of XYZ Ltd. included ₹ 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 31st March 20X2 as per Ind AS. You are required to mention the disclosure requirements as well.

Answer

XYZ Ltd. would include the total revenue of ₹ 68,00,000 (₹ 60,00,000 + ₹ 8,00,000) from ABC Ltd. received/receivable in the year ended 31st March 20X2 within its revenue and show ₹ 18,00,000 within trade receivables at 31st March 20X2.

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 20X1, 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.

Because ABC Ltd. is a related party with whom XYZ Ltd. has transactions, then XYZ Ltd. should disclose:

- The nature of the related party relationship.
- The revenue of ₹ 60,00,000 from ABC Ltd. since 1st June 20X1.
- The outstanding balance of ₹ 18,00,000 at 31st March 20X2.

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 7

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?

Answer

(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 (i.e. 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 8

Government G directly controls Entity 1 and Entity 2. It indirectly controls Entity A and Entity B through Entity 1, and Entity C and Entity D through Entity 2. Person X is a member of the key management personnel in Entity 1.

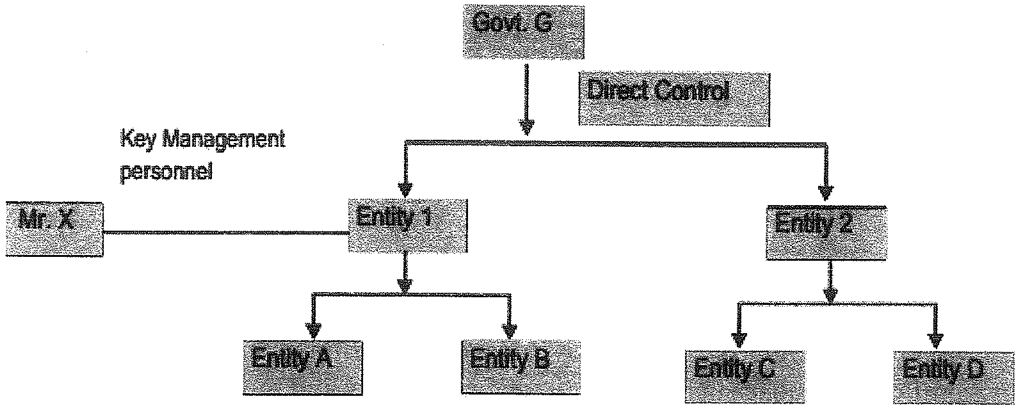
Examine the entity to whom the exemption for disclosure to be given and for transaction with whom.

Answer

For Entity A's financial statements, the exemption of Ind AS 24 applies to:

(a) transactions with Government G; and

(b) transactions with Entities 1 and 2 and Entities B, C and D. However, that exemption does not apply to transactions with Person X.



Question 9

S Ltd., a wholly owned subsidiary of P Ltd is the sole distributor of electricity to consumers in a specified geographical area. A manufacturing facility of P Ltd is located in the said geographical area and, accordingly, P Ltd is also a consumer of electricity supplied by S Ltd. The electricity tariffs for the geographical area are determined by an independent rate-setting authority and are applicable to all consumers of S Ltd, including P Ltd. Whether the above transaction is required to be disclosed as a related party transaction as per Ind AS 24, Related Party Disclosures in the financial statements of S Ltd.?

Answer

As per paragraph 9(b)(i) of Ind AS 24, each parent, subsidiary and fellow subsidiary in a 'group' is related to the other members of the group. Thus, in the case under discussion, P Ltd is a related party of S Ltd from the perspective of financial statements of S Ltd.

Paragraph 11 of Ind AS 24 states as follows:

"In the context of this Standard, the following are not related parties:

(a) two entities simply because they have a director or other member of management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.

(b) two joint venturers simply because they share joint control of a joint venture.

(c) (i) providers of finance, (ii) trade unions, (iii) public utilities, and (iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).

(d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence."

Being engaged in distribution of electricity, S Ltd is a public utility. Had the only relationship between S Ltd and P Ltd been that of a supplier and a consumer of electricity, P Ltd would not have been regarded as a related party of S Ltd. However, as per the facts of the given case, this is not the only relationship between S Ltd and P Ltd. Apart from being a supplier of electricity to P Ltd., S Ltd is also a subsidiary of P Ltd; this is a relationship that is covered within the related party relationships to which the disclosure requirements of the standard apply. In view of the above, the supply of electricity by S Ltd to P Ltd is a related party transaction that attracts the disclosure requirements contained in paragraph 18 and other relevant requirements of the standard. This is notwithstanding the fact that P Ltd is charged the electricity tariffs determined by an independent rate-setting authority (i.e., the terms of supply to P Ltd are at par with those applicable to other consumers)

Ind AS 24 does not exempt an entity from disclosing related party transactions merely because they have been carried out on an arm's length basis.

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?

Answer

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:

(a) 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.

(b) 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

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, 20X2 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:

One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period 20X1-20X2. Mr. Y owns 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.

Provide answers to the query raised by the Managing Director Mr. Y as per Ind AS.

Answer

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:

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. i.e. 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 Notes 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 12

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:

(i) In consolidated financial statements of Huge Ltd.

(ii) In individual financial statements of Huge Ltd.

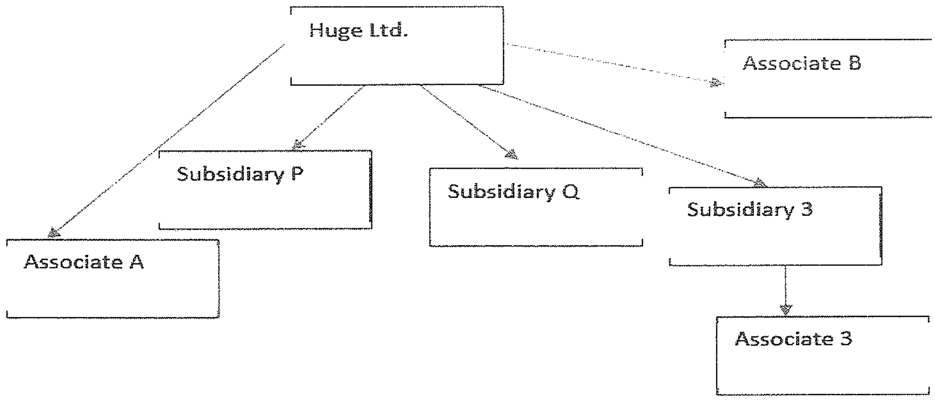
(iii) In individual financial statements of Subsidiary P

(iv) In individual financial statements of Subsidiary Q

(v) In individual financial statements of Subsidiary R

(vi) In individual financial statements of Associates A, B and C

Answer



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:

(i) 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 13

An Indian company has a parent company outside 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 ₹ 12 Lac is charged for calendar year of 2018. Parent company generates is invoice in February'18. Indian company accounts full invoice in February'18 and then for Indian financial year, accounts Reimbursement expense of ₹ 3.00 Lac during FY 17-18 (for licencing cost relating to period January'18 to March'18) and Prepaid expenses of ₹ 9 Lac for licensing cost reimbursement relating to April'18 to December'18. Prepaid expense is subsequently reversed and expense of ₹ 9 Lac is accounted for in FY 18-19.

What amount should be disclosed at Related party transaction?

Answer

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 ₹12 lac from the company to the parent towards software license. Of this transfer of resources, the company has consumed the benefits relating to ₹3 lac of software license cost which is recognise in profit or loss. The benefits relating to ₹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 ₹ 12 lac towards software license;
2. Outstanding balance of ₹ 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 ₹ 3 lac recognised 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.

CHAPTER - 11
Unit 2 – Ind AS 33: Earnings Per Share

Question 1

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 as per Ind AS 33.

S.N.	Date	Particulars	No of shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	100,000
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

Answer

The closing balance of the outstanding shares is 2,05,000 by a normal addition and subtraction. But as per weighted average concept, one need to find out for how many days each type of shares was actually held during the year.

The shares which were there on 1st April 20X1, were held for the whole year. Therefore, weighted average number of such shares will be given by the formula:

= No of shares x No of days the shares were held during the year/365

= 1,00,000 x 365/365 = 1,00,000

But the shares which were issued on 15th June 20X1, were held for only 290 days. Therefore, the weighted average number of shares will be 75,000 x 290/365 = 59,589.

Following the above formula, the weighted average number of shares for calculation of EPS for the year 20X1-20X2 will be as follows:

S.N.	Date	Particulars	No of shares	No of days shares were outstanding	Weighted average no of shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	1,00,000	365	1,00,000
2	15-Jun-20X1	Issue of equity shares	75,000	290	59,589
3	8-Nov-20X1	Conversion of convertible preference shares in Equity	50,000	144	19,726
4	22-Feb-20X2	Buy back of shares	(20,000)	(38)*	(2,082)
5	31-Mar-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 2

An entity has following preference shares in issue at the end of 20X4:

- **5% redeemable, non-cumulative preference shares:** These shares are classified as liabilities. During the year, a dividend was paid on the 5% preference shares – ₹ 1,00,000.
- **Increasing-rate, cumulative, non-redeemable preference shares issued at a discount in 20X0, with a cumulative dividend rate from 20X5 of 10%:** The shares were issued at a discount to compensate the holders, because dividend payments will not commence until 20X5. The accrual for the discount in the current year, calculated using the effective interest method amounted to, say, ₹ 18,000. These shares are classified as equity – ₹ 2,00,000.
- **8% non-redeemable, non-cumulative preference shares:** At the beginning of the year, the entity had ₹ 100,000 8% preference shares outstanding but, at 30 June 20X4, it repurchased ₹ 50,000 of these at a discount of ₹ 1,000 – ₹ 50,000.
- **7% cumulative, convertible preference shares (converted in the year):** These shares were classified as equity, until their conversion into ordinary shares at the beginning of the year. No dividend was accrued in respect of the year, although the previous year's dividend was paid immediately prior to conversion. To induce conversion, the terms of conversion of the 7% convertible preference shares were also amended, and the revised terms entitled the preference shareholders to an additional 100 ordinary shares on conversion with a fair value of ₹ 300 – Nil.

The profit after tax for the year 20X4 is ₹ 1,50,000.

Determine the adjustments for the purpose of calculating EPS.

Answer

Adjustments for the purpose of calculating EPS are made as follows:

Particulars	**Amount (₹)**	**Amount (₹)**
Profit after tax		1,50,000
Amortisation of discount on issue of increasing-rate preference shares (Refer Note 1)	(18,000)	
Discount on repurchase of 8% preference shares (Refer Note 2)	1,000	(17,000)
Profit attributable to ordinary equity holders for basic EPS (Refer Note 3-5)		1,33,000

Notes:

1. The original discount on issue of the increasing-rate preference shares is treated as amortised to retained earnings, and treated as preference dividends for EPS purposes and adjusted against profit attributable to the ordinary equity holders. There is no adjustment in respect of dividend, because these do not commence until 20X5. Instead, the finance cost is represented by the amortisation of the discount in the dividend-free period. In future years, the accrual for the dividend of ₹ 20,000 will be deducted from profits.
2. The discount on repurchase of the 8% preference shares has been credited to equity so should be added to profit.
3. The dividend on the 5% preference shares has been charged to the income statement, because

the preference shares are treated as liabilities, so no adjustment is required for it from the profit.

4. No accrual for the dividend on the 8% preference shares is required, because they are non-cumulative. If a dividend had been declared for the year, it would have been deducted from profit for the purpose of calculating basic EPS, because the shares are treated as equity and the dividend would have been charged to equity in the financial statements.

5. The 7% preference shares were converted at the beginning of the year, so there is no adjustment in respect of the 7% preference shares, because no dividend accrued in respect of the year. The payment of the previous year's cumulative dividend is ignored for EPS purposes, because it will have been adjusted for in the prior year. Similarly, the excess of the fair value of additional ordinary shares issued on conversion of the convertible preference shares over the fair value of the ordinary shares to which the shareholders would have been entitled under the original conversion terms would already have been deducted from profit attributable to the ordinary shareholders, and no further adjustment is required.

Question 3

An entity has two classes of shares in issue:

- 5,000 non-convertible preference shares
- 10,000 ordinary shares

The preference shares are entitled to a fixed dividend of ₹ 5 per share before any dividends are paid on the ordinary shares. Ordinary dividends are then paid in which the preference shareholders do not participate. Each preference share then participates in any additional ordinary dividend above ₹ 2 at a rate of 50% of any additional dividend payable on an ordinary share.

The entity's profit for the year is ₹ 100,000, and dividends of ₹ 2 per share are declared on the ordinary shares.

Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

Answer

The calculation of basic EPS is as follows:

	₹	₹
Profit		100,000
Less: Dividends payable for the period:		
Preference (5,000 x ₹ 5)	25,000	
Ordinary (10,000 x ₹ 2)	20,000	(45,000)
Undistributed earnings		55,000

Allocation of undistributed earnings:

Allocation per ordinary share = A

Allocation per preference share = B

Where, B = 50% of A

(A x 10,000) + (50% x A x 5,000) = ₹ 55,000

A = 55,000/(10,000 + 2,500) = ₹ 4.4

B = 50% of A

B = ₹ 2.2

Dividend per share are:	**Preference shares ₹ per share**	**Ordinary shares ₹ per share**
Distributed earnings	5.00	2.00
Undistributed earnings	2.20	4.40
Totals	**7.20**	**6.40**
Proof: (5,000 x ₹ 7.2) + (10,000 x ₹ 6.4) = ₹ 100,000		

Question 4

Profit attributable to equity holders of the parent entity	₹ 100,000
Ordinary shares outstanding	10,000
Non-convertible preference shares	6,000
Non-cumulative annual dividend on preference shares (before any dividend is paid on ordinary shares)	₹ 5.50 per share
After ordinary shares have been paid a dividend of ₹ 2.10 per share, the preference shares participate in any additional dividends on a 20:80 ratio with ordinary shares.	

Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

Answer

Dividends on preference shares paid (6000 x ₹ 5.50 per share) = ₹ 33,000

Dividends on ordinary shares paid (10,000 x ₹ 2.10 per share) = ₹ 21,000

Basic earnings per share is calculated as follows:	₹	₹
Profit attributable to equity holders of the parent entity		100,000
Less: Dividends paid:		
Preference	33,000	
Ordinary	21,000	(54,000)
Undistributed earnings		46,000

Allocation of undistributed earnings:

Allocation per ordinary share = A

Allocation per preference share = B;

B = 1/4 A

(A x 10,000) + (1/4 x A x 6,000) = ₹ 46,000

A = ₹ 46,000 ÷ (10,000 + 1,500)

A = ₹ 4.00

B = 1/4 A

B = ₹ 1.00

Dividend per share:	**Preference shares**	**Ordinary shares**
Distributed earnings	₹ 5.50	₹ 2.10
Undistributed earnings	₹ 1.00	₹ 4.00
Totals	**₹ 6.50**	**₹ 6.10**

Question 5

On 31 March, 20X2, the issued share capital of a company consisted of ₹ 100,000,000 in ordinary shares of ₹ 25 each and ₹ 500,000 in 10% cumulative non-redeemable preference shares (classified as equity) of ₹ 1 each. On 1 October, 20X2, the company issued 1,000,000 ordinary shares fully paid by way of capitalisation of reserves in the proportion 1:4 for the year ended 31 March, 20X3.

Profit for 20X1-20X2 and 20X2-20X3 is ₹ 450,000 and ₹ 550,000 respectively.

Calculate the basic EPS for 20X1-20X2 and 20X2-20X3.

Answer

	20X2-20X3	**20X1-20X2**
Calculation of earnings	**₹'000**	**₹'000**
Profit for the year	550	450
Less: Preference shares dividend	(50)	(50)
Earnings (A)	500	400

	No. of shares in '000	**No. of shares in '000**
Number of ordinary shares		
Shares in issue for full year	4,000	4,000
Capitalization issue at 1 October 20X2	1,000	1,000
Number of shares (B)	5,000	5,000
Earnings per ordinary share (A/B)	10 Paise	8 Paise*

*The comparative EPS for 20X1-20X2 can alternatively be calculated by adjusting the previously disclosed EPS in 20X1-20X2 (in this example, 10 Paise) by the following factor:

Number of shares before the bonus issue/ Number of shares after the bonus issue

*Adjusted EPS for 20X1-20X2 = 10 Paise x (4,000/5,000) = 8 Paise

Question 6

X Ltd.

1 January	10,00,000 shares in issue
28 February	Issued 2,00,000 shares at fair value
31 August	Bonus issue 1 share for 3 shares held
30 November	Issued 2,50,000 shares at fair value

Calculate the number of shares which would be used in the basic EPS calculation. Consider reporting date as December end.

Answer

Period	Calculations	Weighted average number of shares
1 January - 28 February	1,000,000 x 2/12 x 4/3	222,222
1 March - 31 August	1,200,000 x 6/12 x 4/3	800,000
1 September - 30 November	1,600,000 x 3/12	400,000
1 December - 31 December	1,850,000 x 1/12	154,167
		1,576,389

Question 7

ABC Ltd	1 January 20X1	Shares in issue 1,000,000
	31 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.

Answer

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) = 0.9833

Bonus fraction = Cum-rights price/Theoretical ex-rights price = 1/0.9833

	Number of shares
1 January – 31 March (1,000,000 x 3/12 x 1/0.9833)	254,237
1 April – 31 December (1,200,000 x 9/12)	900,000
	1,154,246

Question 8

Calculate Basic EPS for period ending 20X0, 20X1 and 20X2, when

	20X0	20X1	20X2
Profit attributable to ordinary equity holders of the parent entity	₹ 1,100	₹ 1,500	₹ 1,800

Shares outstanding before rights issue	500 shares
Rights issue	One new share for each five outstanding shares
Exercise price	₹ 5.00
Date of rights issue	1 January 20X1
Last date to exercise rights	1 March 20X1
Market price of one ordinary share immediately before exercise on 1 March 20X1:	₹ 11.00
Reporting date	31 December

Answer

Calculation of theoretical ex-rights value per share

$$\frac{\text{Fair value of all outstanding shares before exercise of rights + total amt. received from exercise of rights}}{\text{Number of shares outstanding before exercise + Number of shares issued in the exercise}}$$

$$\frac{(₹\ 11.00 \times 500 \text{ shares}) + (₹\ 5.00 \times 100 \text{ shares})}{500 \text{ shares} + 100 \text{ shares}}$$

Theoretical ex-rights value per share = ₹ 10.00

Calculation of adjustment factor

$$\frac{\text{Fair value per share before exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{₹\ 11.00}{₹\ 10.00} = 1.10$$

Calculation of basic earnings per share

	20X0	20X1	20X2
20X0 Basic EPS as originally reported: ₹ 1,100/500 shares	₹ 2.20		
20X0 Basic EPS restated for rights: ₹ 1,100/(500 shares x 1.1)	₹ 2.00		
20X1 Basic EPS including effects of rights issue: ₹ 1,500/[(500 x 1.1 x 2/12) + (600 x 10/12)]		₹ 2.54	
20X2 Basic EPS: ₹ 1,800/600 shares			₹ 3.00

Question 9

At 31 December 20X1, the issued share capital of a company consisted of 1.8 million ordinary shares of ₹ 10 each, fully paid. The profits for the year ended 31 December 20X1 and 20X2 amounted to ₹ 630,000 and ₹ 875,000 respectively. On 31 March 20X2, the company made a rights issue on a 1 for 4 basis at ₹ 30. The market price of the shares immediately before the rights issue was ₹ 60.

Calculate EPS.

Answer

Calculation of theoretical ex-rights price:

	Number of shares		₹
Initial holding	4	Market Value (4 x 60)	240
Rights taken up	1	Cost (1 x 30)	30
New holding	5	**Theoretical price**	270

Theoretical ex rights price = 270/5 = ₹ 54

Calculation of bonus element

The bonus element of the rights issue is given by the fraction:

Market price before rights issue/Theoretical ex-rights price = 60/54 = 10/9

This corresponds to a bonus issue of 1 for 9. The bonus ratio will usually be greater than 1 (that is, the market price of the shares immediately prior to the exercise of rights is greater than the theoretical ex-rights price). If the ratio is less than 1, it might indicate that the market price has fallen significantly during the rights period, which was not anticipated when the rights issue was announced. In this situation, the rights issue should be treated as an issue of shares for cash at full market price.

It can be demonstrated, using the figures in the question, that a rights issue of 1 for 4 at ₹ 30 is equivalent to a bonus issue of 1 for 9 combined with an issue of shares at full market price of ₹ 54 per share. Consider an individual shareholder holding 180 shares:

	Number of shares (in '000s)	**Value**	**₹ (in million)**
Original holding	1,800	Value at ₹ 60 per share	108.00
Rights shares (1:4)	450	Value at ₹ 30 per share	13.50
Holding after rights issue	2,250	Value at ₹ 54 per share	121.50

The additional 450 thousand rights shares at ₹ 30 can be shown to be equivalent to a bonus issue of 1 for 9 on the original holding, followed by an issue of 1:8 at full market price of ₹ 54 following the bonus issue, as follows:

	Number of shares (in '000s)	**Value**	**₹ (in million)**
Original holding	1,800	Value at ₹60 per share	108.00
Bonus issue of 1 for 9	200	Value Nil	Nil
	2,000	**Value at ₹ 54 per share**	**108.00**
Issue of 1 for 8 at full price (450 – 200)	250	Value at ₹ 54 per share	13.50
Total holding	**2,250**	**Value at ₹ 54 per share**	**121.50**

The shareholder is therefore indifferent as to whether the entity makes a rights issue of 1 for 4 at ₹ 30 per share, or a combination of a bonus issue of 1 for 9 followed by a rights issue of 1 for 8 at full market price of ₹ 54 per share.

Having calculated the bonus ratio, the ratio should be applied to adjust the number of shares in issue before the rights issue, both for the current year and for the previous year. Therefore, the weighted average number of shares in issue for the current and the previous period, adjusted for the bonus element, would be:

Weighted average number of shares:

	20X2	**20X1**
No of actual shares in issue before rights	1,800,000	1,800,000
Correction for bonus issue (1:9)	200,000	200,000
Deemed no of shares in issue before right issue (1.8 million x 10/9 for the whole year)	2,000,000	2,000,000
The no of shares after the rights issue would be = 1.8 million x 5/4 = 2,250,000		
Therefore, weighted average number of shares would be		
2 million for the whole year		2,000,000
1.8 million x 10/9 x 3/12 (before rights issue)	500,000	-
2.25 million x 9/12 (after rights issue)	1,687,500	-
Weighted average number	**2,187,500**	**2,000,000**

Calculation of earnings	**20X2**	**20X1 (as previously stated)**
Profits for the year	₹ 875,000	₹ 630,000
Weighted average number	2,187,500	1,800,000
Basic EPS	**₹ 40p**	**₹ 35p**
Basic EPS for 20X1 (as restated)		₹ 630,000/2,000,000 = **₹ 31.50p**

In practice, the restated EPS for 20X1 can also be calculated by adjusting the EPS figure of the previous year by the reciprocal of the bonus element factor:
* 35p x 9/10 = 31.50 p

Question 10

Entity A has in issue 25,000 4% debentures with a nominal value of Re 1. The debentures are convertible to ordinary shares at a rate of 1:1 at any time until 20X9. The entity's management receives a bonus based on 1% of profit before tax.

Entity A's results for 20X2 showed a profit before tax of ₹ 80,000 and a profit after tax of ₹ 64,000 (for simplicity, assume tax rate of 20%).

Calculate Earnings for the purpose of diluted EPS. Ignore classification of components of the convertible debenture as liabilities and equity, as required by Ind AS 32.

Answer

For the purpose of calculating diluted EPS, the earnings should be adjusted for the reduction in the interest charge that would occur if the debentures were converted, and for the increase in the management bonus payment that would arise from the increased profit.

	Amount (₹)
Profit after tax	64,000
Add: Reduction in interest cost (25,000 x 4%) (Refer Note)	1,000
Less: Tax expense (1,000 x 20%)	(200)
Less: Increase in management bonus (1,000 x 1%)	(10)
Add: Tax benefit (10 x 20%)	2
Earnings for the purpose of diluted EPS	**64,792**

Question 11

ABC Ltd. has 1,000,000 ₹ 1 ordinary shares and 1,000 ₹ 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 ₹ 4.50 per share and earnings for the period are ₹ 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.

Answer

Basic EPS is ₹ 0.50 per share (i.e. 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) = ₹ 7,900.

Incremental shares calculation

Assume all bonds are converted to shares, even though this converts ₹ 100 worth of bonds into 20 shares worth only ₹ 90 and is therefore not economically rational.

This gives 1000 x 20 = 20,000 additional shares.

Earnings per incremental share = ₹ 7,900/20,000 = ₹ 0.395

Diluted EPS = (₹ 500,000 + ₹ 7,900)/(1,000,000 + 20,000) = ₹ 0.498 per share

Question 12

At 30 June 20X1, the issued share capital of an entity consisted of 1,500,000 ordinary shares of ₹ 1 each. On 1 October 20X1, the entity issued ₹ 1,250,000 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 20X6 to 20X9, into the number of ordinary shares set out below:

30 June 20X6: 135 ordinary shares;

30 June 20X7: 130 ordinary shares;

30 June 20X8: 125 ordinary shares; and

30 June 20X9: 120 ordinary shares.

If the loan stocks are not converted by 20X9, they would be redeemed at par.

This question assumes 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 in 20X2 and 20X3 amounted to losses of ₹ 2,500 and ₹ 2,650 respectively. 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 30 June 20X2 and 20X3 amounted to ₹ 825,000 and ₹ 895,000 respectively and relate wholly to continuing operations. The rate of tax for both periods is 33%.

Calculate Basic and Diluted EPS.

Answer

Trading results

	20X3 (₹)	20X2 (₹)
Profit before interest, fair value movements and tax	895,000	825,000
Interest on 8% convertible loan stock (20X2: 9/12 x ₹ 100,000)	(100,000)	(75,000)
Change in fair value of embedded option	(2,650)	(2,500)
Profit before tax	792,350	747,500
Taxation @ 33% on (A-B)	(262,350)	(247,500)
Profit after tax	**530,000**	**500,000**

Calculation of basic EPS

	20X3	20X2
Number of equity shares outstanding	1,500,000	1,500,000
Earnings	₹ 530,000	₹ 500,000
Basic EPS	35 paise	33 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 x 8% x 67% + ₹ 2,650/12,500 = ₹ 5.36 + ₹ 0.21 = ₹ 5.57.

There will then be 135 extra shares in issue.

Therefore, the incremental EPS is 4 paise (i.e. ₹ 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 35 paise. Hence the convertibles are dilutive.

Adjusted earnings	20X3 (₹)	20X2 (₹)
Profit for basic EPS	530,000	500,000
Add: Interest and other charges on earnings saved as a result of the conversion	102,650 (100,000 + 2,650)	77,500 (75000+ 2500)
Less: Tax relief thereon	(33,000)	(24,750)
Adjusted earnings for equity	**599,650**	**552,750**

Adjusted number of shares

From the conversion terms, it is clear that the maximum number of shares issuable on conversion of ₹ 1,250,000 loan stock after the end of the financial year would be at the rate of 135 shares per ₹ 100 nominal (that is, 1,687,500 shares).

	20X3	20X2
Number of equity shares for basic EPS	1,500,000	1,500,000
Maximum conversion at date of issue (1,687,500 x 9/12)	–	1,265,625
Maximum conversion after balance sheet date	1,687,500	–
Adjusted capital	**3,187,500**	**2,765,625**
Adjusted earnings for equity	₹ 599,650	₹ 552,750
Diluted EPS (approx.)	**19 paise**	**20 paise**

Question 13

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 ₹ 1,000 per bond, giving total proceeds of ₹ 2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has given an option to bondholders 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 per cent. At the issue date, the market price of one ordinary share is ₹ 3. Income tax is ignored.

Calculate basic and diluted EPS when

Profit attributable to ordinary equity holders of the parent entity Year 1	₹ 1,000,000
Ordinary shares outstanding	1,200,000
Convertible bonds outstanding	2,000

Answer

Allocation of proceeds of the bond issue:	
Liability component (Refer Note 1)	₹ 1,848,122
Equity component	₹ 151,878

	₹ 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.

Basic earnings per share Year 1:

$$= \frac{₹\ 1{,}000{,}000}{1{,}200{,}000} = ₹\ 0.83 \text{ per ordinary share}$$

Diluted earnings per share Year 1:

It is presumed that the bondholder will convert the bond in ordinary shares. The dilutive effect is therefore calculated in accordance with the Standard.

$$= \frac{₹\ 1{,}000{,}000 + ₹\ 166{,}331}{1{,}200{,}000 + 500{,}000} = ₹\ 0.69 \text{ per ordinary share}$$

Notes:

1. This represents the present value of the principal and interest discounted at 9% – ₹ 2,000,000 payable at the end of three years; ₹ 120,000 payable annually in arrears for three years.
2. Profit is adjusted for the accretion of ₹ 166,331 (₹ 1,848,122 x 9%) of the liability because of the passage of time. However, it is assumed that interest @ 6% for year has already been adjusted.
3. 500,000 ordinary shares = 250 ordinary shares x 2,000 convertible bonds.

Question 14

1 January	Shares in issue	1,000,000
	5% Convertible bonds (terms of conversion 120 ordinary shares for ₹ 100)	₹ 100,000
31 March	Holders of ₹ 25,000 bonds converted to ordinary shares.	

Profit for the year ended 31 December is ₹ 200,000

Tax rate 30%.

Calculate basic and diluted EPS. Ignore the need to split the convertible bonds into liability and equity elements.

Answer

	Number of shares	Profit ₹
Profit		200,000
Outstanding shares	1,000,000	
New shares on conversion (weighted average) [9/12 x (₹ 25,000/100) x 120]	22,500	–
Figures for basic EPS	1,022,500	200,000

Basic EPS is = ₹ 200,000/1,022,500 = 0.196 per share

Dilution adjustments

	Number of shares	Profit ₹

Unconverted shares		
(₹ 75,000/100) x 120	90,000	
Interest: ₹ 75,000 x 5% x 0.7		2,625
Converted shares pre conversion adjustment		
3/12 x (₹ 25,000/100) x 120	7,500	
Interest: [3/12 x ₹ 25,000 x 5% x 0.7]		219
	1,120,000	**202,844**

Diluted EPS is = ₹ 202,844/1,120,000 = 0.181

Question 15

Profit attributable to ordinary equity holders of the parent entity for year 20X1	₹ 1,200,000
Weighted average number of ordinary shares outstanding during year 20X1	500,000 shares
Average market price of one ordinary share during year 20X1	₹ 20.00
Weighted average number of shares under option during year 20X1	100,000 shares
Exercise price for shares under option during year 20X1	₹ 15.00

Calculate basic and diluted EPS.

Answer

Calculation of earnings per share

	Earnings	Shares	Per share
Profit attributable to ordinary equity holders of the parent entity for year 20X1	₹ 1,200,000		
Weighted average shares outstanding during year 20X1		500,000	
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: (100,000 x ₹ 15.00) ÷ ₹ 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 16

1 January	Shares in issue	1,000,000

Profit for the year ended 31 December ₹ 100,000

Average fair value during period ₹ 8

The company has in issue 200,000 options to purchase equal ordinary shares.

Exercise price ₹ 6

Calculate the diluted EPS for the period.

Answer

Diluted EPS

	Number of shares	Profit (₹)	EPS
Basic	1,000,000	100,000	0.10
Dilution (Refer W.N.)	50,000	–	–
	1,050,000	100,000	0.095

Working Notes:

Proceeds of issue (200,000 x ₹ 6) = 1,200,000

Number that would have been issued at Fair value (1,200,000/₹ 8)	150,000
Number actually issued	200,000
Number for "free" (200,000 – 150,000)	50,000

Question 17

At 31 December 20X7 and 20X8, the issued share capital of an entity consisted of 4,000,000 ordinary shares of ₹ 25 each. The entity has granted options that give holders the right to subscribe for ordinary shares between 20Y6 and 20Y9 at ₹ 70 per share. Options outstanding at 31 December 20X7 and 20X8 were 630,000. There were no grants, exercises or lapses of options during the year. The profit after tax, attributable to ordinary equity holders for the years ended 31 December 20X7 and 20X8, amounted to ₹ 500,000 and ₹ 600,000 respectively (wholly relating to continuing operations).

Average market price of share:

Year ended 31 December 20X7 = ₹ 120

Year ended 31 December 20X8 = ₹ 160

Calculate basic and diluted EPS.

Answer

Calculation of basic EPS

	20X8	20X7
Profit after tax	₹ 600,000	₹ 500,000
Number of share	4,000,000	4,000,000
Basic EPS (approx.)	15 paise	13 paise

Calculation of diluted EPS

	20X8	20X7
Adjusted number of shares		
Number of shares under option:		
Issued at full market price:		
(630,000 x 70) ÷ 120		367,500
(630,000 x 70) ÷ 160	275,625	
Issued at nil consideration – dilutive	354,375	262,500
Total number of shares under option	630,000	630,000
Number of equity shares for basic EPS	4,000,000	4,000,000
Number of dilutive shares under option	354,375	262,500
Adjusted number of shares (A)	4,354,375	4,262,500
Profit after tax (B)	₹ 600,000	₹ 500,000
Diluted EPS (B/A)	14 paise	12 paise

Note: If options had been granted or exercised during the period, the number of 'nil consideration' shares in respect of these options would be included in the diluted EPS calculation on a weighted average basis for the period prior to exercise.

Question 18

Ordinary shares outstanding during 20X1	1,000,000 (there were no options, warrants or convertible instruments outstanding during the period)

An agreement related to a recent business combination provides for the issue of additional ordinary shares based on the following conditions:

	5,000 additional ordinary shares for each new retail site opened during 20X1
	1,000 additional ordinary shares for each ₹ 1,000 of consolidated profit in excess of ₹ 2,000,000 for the year ended 31 December 20X1
Retail sites opened during the year:	one on 1 May 20X1
	one on 1 September 20X1
Consolidated year-to-date profit attributable to ordinary equity holders of the parent entity:	₹ 1,100,000 as of 31 March 20X1
	₹ 2,300,000 as of 30 June 20X1
	₹ 1,900,000 as of 30 September 20X1 (including a ₹ 450,000 loss from a discontinued operation)
	₹ 2,900,000 as of 31 December 20X1

Calculate basic and diluted EPS.

Answer

Basic earnings per share					
	First quarter	**Second quarter**	**Third quarter**	**Fourth quarter**	**Full year**
Numerator (₹)	1,100,000	1,200,000	(400,000)	1,000,000	2,900,000
Denominator:					
Ordinary shares outstanding	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Retail site contingency	–	3,333[6]	6,667[7]	10,000	5,000[8]
Earnings contingency[9]	–	–	–	–	–
Total shares	1,000,000	1,003,333	1,006,667	1,010,000	1,005,000
Basic earnings per share (₹)	1.10	1.20	(0.40)	0.99	2.89

6 5,000 shares x 2/3

7 5,000 shares + (5,000 shares x 1/3)

8 (5,000 shares x 8/12) + (5,000 shares x 4/12)

9 The earnings contingency has no effect on basic earnings per share because it is not certain that the condition is satisfied until the end of the contingency period. The effect is negligible for the fourth-quarter and full-year calculations because it is not certain that the condition is met until the last day of the period.

Diluted earnings per share					
	First quarter	**Second quarter**	**Third quarter**	**Fourth quarter**	**Full year**
Numerator (₹)	1,100,000	1,200,000	(400,000)	1,000,000	2,900,000
Denominator:					
Ordinary shares outstanding	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Retail site contingency	–	5,000	10,000	10,000	10,000
Earnings contingency	–[10]	300,000[11]	–[12]	900,000[13]	900,000
Total shares	1,000,000	1,305,000	1,010,000	1,910,000	1,910,000
Diluted earnings per share (₹)	1.10	0.92	(0.40)[14]	0.52	1.52

10 Company A does not have year-to-date profit exceeding ₹ 2,000,000 at 31 March 20X1. The Standard does not permit projecting future earnings levels and including the related contingent shares.

11 [(₹ 2,300,000 – ₹ 2,000,000) ÷ 1,000] x 1,000 shares = 300,000 shares.

12 Year-to-date profit is less than ₹ 2,000,000.

13 [(₹ 2,900,000 – ₹ 2,000,000) ÷ 1,000] x 1,000 shares = 900,000 shares.

14 Because the loss during the third quarter is attributable to a loss from a discontinued operation, the antidilution rules do not apply. The control number (i.e. profit or loss from, continuing operations attributable to the equity holders of the parent entity) is positive. Accordingly, the effect of potential ordinary shares is included in the calculation of diluted earnings per share.

Question 19

Calculate Subsidiary's and Group's Basic EPS and Diluted EPS, when

Parent:	
Profit attributable to ordinary equity holders of the parent entity	₹ 12,000 (excluding any earnings of, or dividends paid by, the subsidiary)
Ordinary shares outstanding	10,000
Instruments of subsidiary owned by the parent	800 ordinary shares
	30 warrants exercisable to purchase ordinary shares of subsidiary
	300 convertible preference shares
Subsidiary:	
Profit	₹ 5,400
Ordinary shares outstanding	1,000
Warrants	150, exercisable to purchase ordinary shares of the subsidiary
Exercise price	₹ 10
Average market price of one ordinary share	₹ 20
Convertible preference shares	400, each convertible into one ordinary share
Dividends on preference shares	₹ 1 per share

No inter-company eliminations or adjustments were necessary except for dividends.

Ignore income taxes. Also, ignore classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS 32.

Answer

Subsidiary's earnings per share

Basic EPS ₹ 5.00 calculated: $\frac{₹\ 5{,}400\ (a) - ₹\ 400\ (b)}{1{,}000\ (c)}$

Diluted EPS ₹ 3.66 calculated: $\frac{₹\ 5{,}400\ (d)}{1{,}000 + 75\ (e) + 400(f)}$

Notes:

(a) Subsidiary's profit attributable to ordinary equity holders.

(b) Dividends paid by subsidiary on convertible preference shares.

(c) Subsidiary's ordinary shares outstanding.

(d) Subsidiary's profit attributable to ordinary equity holders (₹ 5,000) increased by ₹ 400 preference dividends for the purpose of calculating diluted earnings per share.

(e) Incremental shares from warrants, calculated: [(₹ 20 – ₹ 10) ÷ ₹ 20] x 150.

(f) Subsidiary's ordinary shares assumed outstanding from conversion of convertible preference shares, calculated: 400 convertible preference shares × conversion factor of 1.

Consolidated earnings per share

Basic EPS ₹ 1.63 calculated: $\dfrac{₹\ 12{,}000(a) + ₹\ 4{,}300(b)}{10{,}000(c)}$

Diluted EPS ₹ 1.61 calculated: $\dfrac{₹\ 12{,}000 + ₹\ 2{,}928(d) + ₹\ 55(e) + ₹\ 1{,}098(f)}{10{,}000}$

(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: (800 x ₹ 5.00) + (300 x ₹ 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 ₹ 3.66 per share).

(e) Parent's proportionate interest in subsidiary's earnings attributable to warrants, calculated: (30 ÷ 150) x (75 incremental shares x ₹ 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 ₹ 3.66 per share).

Question 20

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 (₹ 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:

(i) 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.

(ii) 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.

(iii) ₹ 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 ₹ 1 payable in four years is 0.74 and the cumulative present value of ₹ 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%.

Answer

Calculation of the liability and equity components on 6% Convertible debentures:

Present value of principal payable at the end of 4th year (₹ 1,80,000 thousand x 0.74)

= ₹ 1,33,200 thousand

Present value of interest payable annually for 4 years (₹ 1,80,000 thousand x 6% x 3.31)

= ₹ 35,748 thousand

Total liability component = ₹ 1,68,948 thousand

Therefore, equity component = ₹ 1,80,000 thousand – ₹ 1,68,948 thousand = ₹ 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 ₹ 13,733.11 thousand and closing balance as on 31.3. 20X3 is ₹ 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 ₹ 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 = ₹ 35,000 thousand/2,37,500 thousand shares = ₹ 0.147

Calculation of Diluted EPS **₹ 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 = ₹ 45,299.83 thousand/3,37,500 thousand shares

= ₹ 0.134

Question 21

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, 20X1. It has net profit after tax of ₹ 20,00,000 as per SFS & ₹ 16,00,000 as per CFS. Share capital of P Ltd. is 2,00,000 shares of ₹ 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	₹ 16,00,000
Number of equity shares attributable to Parent company ABC Ltd. (2,00,000 x 80%)	1,60,000 shares
Basic EPS	₹ 10 per share

Examine the correctness of the above presentation of Basic EPS.

Answer

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	₹ 20,00,000
No. of share issued	2,00,000 shares
Basic EPS	₹ 10 per share

Question 22

Assume the following facts for Company XY:

- Income from continuing operations: INR 30,00,000
- Loss from discontinued operations: (INR 36,00,000)
- Net loss: (INR 6,00,000)
- Weighted average Number of shares outstanding 10,00,000
- Incremental common shares outstanding relating to stock options 2,00,000

(a) You are required to calculate the basic and diluted EPS for Company XY from the above information.

(b) Assume, if in above case, Loss from continued operations is ₹ 10,00,000 and income from discontinued operations is ₹ 36,00,000 calculate the diluted EPS.

Answer

(a) Step 1:

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

= ₹ 30,00,000 / 10,00,000 = ₹ 3.00

Basic Loss per share (Discontinued operations) = Loss from discontinued operations/Weighted average Number of shares outstanding

= ₹ (36,00,000)/10,00,000 = (₹ 3.60)

Overall Basic Loss per share = (₹ 6,00,000)/10,00,000 = ₹ (0.60) (i)

Step 2: Calculation of Diluted EPS

Diluted EPS = Profit for the year/Adjusted Weighted average Number of shares outstanding

EPS (Continued Operations) = Profit from continued operations/Adjusted Weighted average Number of shares outstanding

= ₹ 30,00,000/12,00,000 = ₹ 2.50

Loss per share (Discontinued operations) = Loss from discontinued operations/Adjusted weighted average number of shares outstanding

= ₹ (36,00,000)/12,00,000 = (₹ 3.00)

Overall Diluted Loss per share = ₹ 6,00,000/12,00,000 = ₹ (0.50) (ii)

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 ₹ 3.00 to ₹ 2.50). Therefore, even though there is an anti-dilution [Loss per share reduced from ₹ 0.60 (i) to ₹ 0.50 (ii) above], diluted loss per share of ₹ 0.50 is reported.

(b) 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

= ₹ (10,00,000) + ₹ 36,00,000

= ₹ 26,00,000

Weighted average number of shares outstanding = 10,00,000

Diluted EPS = ₹ 2.60

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.

Question 23

The following information is available relating to Space India Limited for the Financial Year 2019-2020.

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.
Applicable corporate dividend tax	8%
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 2019-2020.

Answer

(i) Basic Earnings per share

		Year ended 31.3.2020
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 per share ₹	
Net profit attributable to equity shareholders	90,000	16,000	5.625	
Options		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	72,900	15,000		
	2,37,900	71,150	3.344	Anti-Dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (₹ 2.939 to ₹ 3.344), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share for the year ended 31 March 2020. Therefore, diluted earnings per share for the year ended 31 March 2020 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)]	72,900			
No. of incremental shares (2 x 7,500)		15,000	4.86	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

Note: Grossing up of preference share dividend has been ignored here. At present dividend distribution tax has been abolished. However, the question has been solved on the basis of the information given in the question.

Question 24

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 alongwith 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%.

Answer

The EPS computations for Year 1 as per Ind AS 33 are as follows.

Basic EPS	Diluted EPS
1. Determine the numerator	**1. Identify Potential Ordinary Shares (POSs)**

No adjustment is necessary until the convertible bonds are converted and ordinary shares are issued. The numerator is net profit i.e. ₹ 46,00,000.	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 30,00,000.	2. **For each POS, calculate Earnings perIncremental Share (EPIS)** Since Zio Life Limited has the choice of settlement, for the purpose of determining the EPIS, it assumes the 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 denominatorfor 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

CHAPTER - 11
Unit 3 – Ind AS 108: Operating Segments

Question 1

X Ltd. has identified the following business components:

Segment	Revenue (₹)		Profit (₹)	Assets (₹)
	External	Internal		
Pharma	97,00,000	Nil	20,00,000	55,00,000
FMCG	Nil	4,00,000	2,50,000	25,00,000
Ayurveda	3,00,000	Nil	2,00,000	4,00,000
Others	8,00,000	41,00,000	5,50,000	6,00,000
Total for the entity	1,08,00,000	45,00,000	30,00,000	90,00,000

Which of the segments would be reportable as per the criteria prescribed in Ind AS108?

Answer

Quantitative thresholds are calculated below:

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

Segment Pharma would separately reportable since they meet all three size criteria, though any one criteria is required. FMCG segment does not satisfy the revenue and profit test but does satisfy the asset test. So it would be separately reportable. Ayurveda segment does not meet any threshold. It may not be classified as reportable segment.

An entity may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria.

If the total external revenue reported by operating segments constitutes less than 75% of the entity's revenue, additional operating segments should be identified as reportable segments (even if they do not meet the criteria) until at least 75% of the entity's revenue is included in reportable segments.

Question 2

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

	External Sale (₹)	Internal Sale (₹)	Total (₹)
Segment A	30,00,000	Nil	30,00,000
Segment B	6,50,000	Nil	6,50,000
Segment C	8,50,000	1,00,000	9,50,000

Segment D	5,00,000	49,00,000	54,00,000
Total Sales	**50,00,000**	**50,00,000**	**1,00,00,000**

Additional information:

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

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

Answer

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

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

Segment D exceeds the quantitative threshold (₹ 54,00,000 > ₹ 10,00,000) and hence 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 70% (₹ 35,000/50,000 x 100) of the entity's total external revenue. If the total external revenue reported by operating segments constitutes less than 75% of the entity total external revenue, additional operating segments should be identified as reportable segments until at least 75% of the revenue is included in reportable segments.

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

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

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

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

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

Accordingly, Segments A, B and D will be reportable segments and Segment C will be shown as other segment.

Question 3

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

Segment	Profit/(Loss) (₹ in crore)
A	780

B	1,500
C	(2,300)
D	(4,500)
E	6,000
Total	**1,480**

Based on the quantitative thresholds, which of the above segments A to E would be considered as reportable segments for the year ending March 31, 20X1?

Answer

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

"The absolute amount of its reported profit or loss is 10 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:

(i) All segments in profit, i.e., A, B and E – Total profit ₹ 8,280 crores.

(ii) All segments in loss, i.e., C and D – Total loss ₹ 6,800 crores.

Greater of the above – ₹ 8,280 crores.

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

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

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

Question 4

X Ltd. is operating in coating industry. Its business segment comprise Coating and Others (consisting of chemicals, polymers and related activities). Certain information for financial year 20X1-20X2 is given below:

(₹ in lakhs)

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

Others	70,000	3,000	15,000	4,000	30,000	10,000

Additional information:

1. Unallocated income net of expenses is ₹ 30,00,00,000
2. Interest and bank charges is ₹ 20,00,00,000
3. Income tax expenses is ₹ 20,00,00,000 (current tax ₹ 19,50,00,000 and deferred tax ₹ 50,00,000)
4. Unallocated Investments are ₹ 1,00,00,00,000 and other assets are ₹ 1,00,00,00,000.
5. Unallocated liabilities, Reserve & surplus and share capital are ₹ 2,00,00,00,000, ₹ 3,00,00,00,000 & ₹ 1,00,00,00,000 respectively.
6. Depreciation amounts for coating & others are ₹ 10,00,00,000 and ₹ 3,00,00,000 respectively.
7. Capital expenditure for coating and others are ₹ 50,00,00,000 and ₹ 20,00,00,000 respectively.
8. Revenue from outside India is ₹ 6,20,00,00,000 and segment asset outside India ₹ 1,00,00,00,000.

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

Answer

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)**	**2,00,000**	**70,000**	**2,70,000**
	GST	(5,000)	(3,000)	(8,000)
	External Revenue (net)	1,95,000	67,000	2,62,000
	Other operating income	40,000	15,000	55,000
	Total Revenue	2,35,000	82,000	3,17,000
2.	**Results**			
	Segment results	10,000	4,000	14,000
	Unallocated income (net of unallocated expenses)			3,000
	Profit from operation before interest, taxation and exceptional items			**17,000**
	Interest and bank charges			(2,000)
	Profit before exceptional items			**15,000**
	Exceptional items			Nil

	Profit before taxation			**15,000**
	Income Taxes			
	- Current taxes			(1,950)
	- Deferred taxes			(50)
	Profit after taxation			**13,000**
3.	**Other Information**			
(a)	**Assets**			
	Segment Assets	50,000	30,000	80,000
	Unallocated Investments			10,000
	Unallocated assets			10,000
	Total Assets			**1,00,000**
(b)	**Liabilities/Shareholder's funds**			
	Segment liabilities	30,000	10,000	40,000
	Unallocated liabilities			20,000
	Share capital			10,000
	Reserves and surplus			30,000
	Total liabilities/shareholder's funds			**1,00,000**
(c)	**Others**			
	Capital Expenditure	(5,000)	(2,000)	
	Depreciation	(1,000)	(300)	

Geographical Information				**(₹ in lakhs)**
		India (₹)	**Outside India (₹)**	**Total (₹)**
	Revenue	2,55,000	62,000	3,17,000
	Segment assets	90,000	10,000	1,00,000
	Capital expenditure	7,000		7,000

Notes:

(i) The operating segments have been identified in line with the Ind AS 108, taking into account the nature of product, organisation structure, economic environment and internal reporting system.

(ii) Segment revenue, results, assets and liabilities include the respective amounts identifiable to each of the segments. Unallocable assets include unallocable fixed assets and other current assets. Unallocable liabilities include unallocable current liabilities and net deferred tax liability.

(iii) Corresponding figures for previous year have not been provided. However, in practical scenario the corresponding figures would need to be given.

Question 5

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 ₹)

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.

Answer

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 = ₹ 10,400 + ₹ 35,350 = ₹ 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 = ₹ 6,000 and combined reported loss (₹ 2,250). Hence, for 10% thresholds ₹ 6,000 will be considered.

10% thresholds = ₹ 6,000 x 10% = ₹ 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 = ₹ 1,02,750

10% thresholds = ₹ 1,02,750 x 10% = 10,275

Accordingly, quantitative thresholds are calculated below:

Segments	L	M	N	O	P	Q	Reportable segments
% segment sales to 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	36.50%	22.63%	15.33%	10.22%	10.22%	5.11%	L,M,N,O,P

to total assets							

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.

CHAPTER - 12
Accounting and Reporting of Financial Instruments

Question 1

NAV Limited granted a loan of ₹ 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

Note: Do calculations in ₹ lakh upto 3 decimals

Answer

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 ₹ 111.288 lakh.

Difference between fair value and transaction price will be recognized in Profit and Loss as fair value loss i.e. ₹ 120 lakh – ₹ 111.288 lakh = ₹ 8.712 lakh

Note: One may also calculate the above fair value by the way of annuity on interest amount rather than separate calculation.

Question 2

A Ltd. issued redeemable preference shares to a Holding Company – Z Ltd. The terms of the instrument have been summarized below. Account for this in the books of Z Ltd.

Nature	**Non-cumulative redeemable preference shares**
Repayment:	Redeemable after 5 years

Date of Allotment:	1-Apr-20X1
Date of repayment:	31-Mar-20X6
Total period:	5.00 years
Value of preference shares issued:	100,000,000
Dividend rate	0.0001%
Market rate of interest	12% per annum
Present value factor	0.56742686

Answer

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 (i.e., 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 A Ltd has issued preference shares to its Holding Company – Z Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by Z Ltd. in its subsidiary.

Following is the table summarising the computations on initial recognition:

Market rate of interest	12%
Present value factor	0.56742686
Present value	56,742,686
Loan component	56,742,686
Investment in subsidiary	43,257,314

Subsequently, such preference shares shall be carried at amortised cost at each reporting date. The computation of amortised cost at each reporting date has been done as follows:

Year	Date	Opening Asset	Days	Interest @ 12%	Closing balance
	1-Apr-20X1				56,742,686
1	31-Mar-20X2	56,742,686	365	6,809,122	63,551,808
2	31-Mar-20X3	63,551,808	365	7,626,217	71,178,025
3	31-Mar-20X4	71,178,025	365	8,541,363	79,719,388
4	31-Mar-20X5	79,719,388	365	9,566,327	89,285,715
5	31-Mar-20X6	89,285,715	365	10,714,285	100,000,000

Journal Entries to be done at every reporting date

Particulars		Amount	Amount
Date of transaction			
Investment - Equity portion	Dr.	43,257,314	
Redeemable Preference Shares	Dr.	56,742,686	
To Bank			100,000,000
Interest income - March 31, 20X2			
Redeemable Preference Shares	Dr.	6,809,122	
To Interest income			6,809,122
Interest income - March 31, 20X3			
Redeemable Preference Shares	Dr.	7,626,217	
To Interest income			7,626,217
Interest income - March 31, 20X4			
Redeemable Preference Shares	Dr.	8,541,363	
To Interest income			8,541,363
Interest income - March 31, 20X5			
Redeemable Preference Shares	Dr.	9,566,327	
To Interest income			9,566,327
Interest income - March 31, 20X6			
Redeemable Preference Shares	Dr.	10,714,285	
To Interest income			10,714,285
Settlement of transaction			
Bank	Dr.	100,000,000	
Redeemable Preference Shares			100,000,000

Question 3

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	10,00,000
Present value factor at the 5th year	0.567427

Answer

Date of Allotment:	
Date of repayment:	
Total period:	
Value of prefere	
Dividend rate	
Market rate	
Present val	

…nterest free deposit redeemable at the end of lease term for ₹ … n of contractual cash flows and shall be accounted at amortised

Particulars	Details
	10,00,000
	5
	12.00%
… end	0.567427
… beginning (B)	5,67,427
… at beginning (A – B)	4,32,573

Answer

Applyin… recogn… instr… inst…

Fo… e…

Journal Entries

…ing

…ars		Amount	Amount
…rity deposit a/c	Dr.	5,67,427	
…repaid 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			68,091
Lease expense (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			1,07,143
Lease expense (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 4

As part of staff welfare measures, Y Co Ltd. has contracted to lend to its employees sums of money at 5% per annum rate of interest. The amounts lent are to be repaid in five equal instalments for principle along with the interest. The market rate of interest is 10% per annum for comparable loans. Y lent ₹ 1,600,000 to its employees on 1st January 20X1.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for the year ended 31 December 20X1, for the transaction and also compute the value of loan initially to be recognised and amortised cost for all subsequent years.

For the purpose of calculation, following discount factors at interest rate of 10% per annum may be adopted –

At the end of year –

Year	Present value factor
1	.909
2	.827
3	.751
4	.683
5	.620

Answer

(i) Calculation of initial recognition amount of loan to its employees:

Year end	Cash flow		Total	PV factor	Present value
	Principal	Interest @ 5%			
20X1	320,000	80,000	400,000	.909	363,600
20X2	320,000	64,000	384,000	.827	317,568
20X3	320,000	48,000	368,000	.751	276,368
20X4	320,000	32,000	352,000	.683	240,416
20X5	320,000	16,000	336,000	.620	208,320
					1,406,272

(ii) Calculation of amortised cost of loan to employees

Year end	Amortised cost (opening balance)	Interest to be recognised	Repayment (including interest)	Amortised cost (closing balance)
20X1	1,406,272	140,627	400,000	1,146,899
20X2	1,146,899	114,690	384,000	877,589
20X3	877,589	87,759	368,000	597,348
20X4	597,348	59,735	352,000	305,083
20X5	305,083	30,917*	336,000	–

*305,083 x 10% = 30,508. Difference of ₹ 409 is due to approximation in computation.

(iii) Journal Entries to be recorded of Y Ltd. for the year ended 31 December 20X1

Date	Particulars	Debit	Credit
1 Jan 20X1	Staff loan A/c Dr.	14,06,272	
	Prepaid staff cost A/c* Dr.	1,93,728	
	[(1,600,000 – 1,406,272), Refer part (ii)]		
	To Bank A/c		16,00,000
	(Being disbursement of loans to staff and excess loan balance over present value thereof in order to reflect the loan at its present value booked as prepaid staff cost)		
31 Dec 20X1	Staff loan A/c Dr.	1,40,627	
	To Interest Income A/c		1,40,627
	(Being interest accrued on loans to staff)		
31 Dec 20X1	Staff cost A/c (P & L) Dr.	38,746	
	To Prepaid staff cost A/c		38,746
	(Being interest accrued on loans to staff)		

*Where the difference between the amount given by the Company to its employees and its fair value represents another asset, then such asset shall be recognised. Accordingly, such difference is recognised as prepaid employee cost and amortised over the period of loan.

Question 5

KK Ltd. has granted an interest free loan of ₹ 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:

(i) The Loan given by KK Ltd. to its wholly owned subsidiary YK Ltd. is interest free and such loan is repayable on demand.

(ii) 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 7.27%. Considering the same, the fair value of the loan at initial recognition is ₹ 8,10,150.

(iii) The said loan is interest free and will be repaid as and when the 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 for the above loan.

Further the Company is also planning to grant interest free loan from YK Ltd. to KK Ltd. in the subsequent period. What will be the accounting treatment of the same under applicable Ind AS?

Note: PVF @ 7.27% for year 3 is 0.81015

Answer

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.

Journal entries in the books of KK Ltd.

At origination			
Loan to YK Ltd. A/c	Dr.	₹ 10,00,000	
To Bank A/c			₹ 10,00,000
On repayment			
Bank A/c	Dr.	₹ 10,00,000	
To Loan to YK Ltd. A/c			₹ 10,00,000

Journal entries in the books of YK Ltd.

At origination			
Bank A/c	Dr.	₹ 10,00,000	
To Loan from KK Ltd. A/c			₹ 10,00,000
On repayment			
Loan from KK Ltd. A/c	Dr.	₹ 10,00,000	
To Bank A/c			₹ 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 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. 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 ₹ 10,00,000 payable at the end of 3 years using discounting factor of 7.27%. Since the question mentions fair value of the loan at initial recognition as ₹ 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.	₹ 8,10,150	
Investment in YK Ltd. A/c	Dr.	₹ 1,89,850	
To Bank A/c			₹ 10,00,000
(During periods to repayment – to recognise interest)			
Year 1 – Charging of Interest			
Loan to YK Ltd. A/c	Dr.	₹ 58,898	
To Interest income A/c			₹ 58,898
On repayment			
Bank A/c	Dr.	₹ 10,00,000	
To Loan to YK Ltd. A/c			₹ 10,00,000

Journal entries in the books of YK Ltd. (for one year)

At origination			
Bank A/c	Dr.	₹ 10,00,000	
To Loan from KK Ltd. A/c			₹ 8,10,150
To Equity Contribution in KK Ltd. A/c			₹ 1,89,850
(During periods to repayment – to recognise interest)			
Year 1 – Charging of Interest			
Interest expense A/c	Dr.	₹ 58,898	
To Loan from KK Ltd. A/c			₹ 58,898
On repayment			
Loan from KK Ltd. A/c	Dr.	₹ 10,00,000	
To Bank A/c			₹ 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 (ii).

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.

Question 6

XYZ Ltd. is a company incorporated in India. It provides INR 10,00,000 interest free loan to its wholly owned Indian subsidiary (ABC). There are no transaction costs.

How should the loan be accounted for, in the Ind AS financial statements of XYZ, ABC and consolidated financial statements of the group?

Consider the following scenarios:

a) The loan is repayable on demand.

b) The loan is repayable after 3 years. The current market rate of interest for similar loan is 10% p.a. for both holding and subsidiary.

c) The loan is repayable when ABC has funds to repay the loan.

Note: PVF @ 10% for year 3 is 0.751315

Answer

Ind AS 109 requires that a financial assets and liabilities are recognized on initial recognition at its fair value, as adjusted for the transaction cost. In accordance with Ind AS 113 Fair Value Measurement, the fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that amount could be required to be paid.

Using the guidance, the loan will be accounted for as below in various scenarios:

Scenario (a)

Since the loan is repayable on demand, it has fair value equal to cash consideration given. The parent and subsidiary recognize financial asset and liability, respectively, at the amount of loan given. Going forward, no interest is accrued on the loan.

Upon repayment, both the parent and the subsidiary reverse the entries made at origination.

Scenario (b)

Both parent and subsidiary recognize financial asset and liability, respectively, at fair value on initial recognition. 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.

Accounting in the books of XYZ Ltd (Parent)

S.N.	Particulars		Amount	Amount
	On the date of loan			
1	Loan to ABC Ltd (Subsidiary)	Dr.	7,51,315	
	Deemed Investment (Capital Contribution) in ABC Ltd	Dr.	2,48,685	
	To Bank			10,00,000
	(Being the loan is given to ABC Ltd and recognised at fair value)			
	Accrual of Interest income			
2	Loan to ABC Ltd	Dr.	75,131	
	To Interest income			75,131
	(Being interest income accrued) – Year 1			
3	Loan to ABC Ltd	Dr.	82,645	
	To Interest income			82,645
	(Being interest income accrued) – Year 2			
4	Loan to ABC Ltd	Dr.	90,909	

	To Interest income (Being interest income accrued) – Year 3		90,909
5	**On repayment of loan** Bank Dr. To Loan to ABC Ltd (Subsidiary)	10,00,000	10,00,000

Accounting in the books of ABC Ltd (Subsidiary)

S.N.	Particulars	Amount	Amount
1	**On the date of loan** Bank Dr. To Loan from XYZ Ltd (Payable) To Equity (Deemed Capital Contribution from ABC Ltd) (Being the loan is given to ABC Ltd and recognised at Fair value)	10,00,000	751,315 2,48,685
2	**Accrual of Interest** Interest expense Dr. To Loan from XYZ Ltd (Payable) (Being interest expense recognised) – Year I	75,131	75,131
3	Interest expense Dr. To Loan from XYZ Ltd (Payable) (Being interest expense recognised) – Year II	82,645	82,645
4	Interest expense Dr. To Loan from XYZ Ltd (Payable) (Being interest expense recognised) – Year III	90,909	90,909
5	**On repayment of loan** Loan from XYZ Ltd (Payable) Dr. To Bank	10,00,000	10,00,000

Working Notes:

1 Computation of Present value of loan

Rate	10%
Amount of Loan	10,00,000
Year	3
Present Value	7,51,315

2 Computation of interest for Year I

Present Value	7,51,315
Rate	10%
Period of interest - for 1 year	1
Closing value at the end of year 1	8,26,446
Interest for 1st year	75,131

3	**Computation of interest for Year 2**	
	Value of loan as at the beginning of Year 2	8,26,446
	Rate	10%
	Period of interest - for 2nd year	1
	Closing value at the end of year 2	9,09,091
	Interest for 2nd year	82,645
4	**Computation of interest for Year 3**	
	Value of loan as at the beginning of Year 3	9,09,091
	Rate	10%
	Period of interest - for 3rd year	1
	Closing value at the end of year 3	10,00,000
	Interest for 3rd year	90,909

Scenario (c)

Generally, a loan, which is repayable when funds are available, can't be stated to be repayable on demand. Rather, the entities need to estimate repayment date and determine its measurement accordingly. If the loan is expected to be repaid in three years, its measurement will be the same as in scenario (b).

In the Consolidated Financial Statements (CFS), the loan and interest income/expense will get knocked-off as intra-group transaction in all three scenarios. Hence the above accounting will not have any impact in the CFS. However, if the loan is in foreign currency, exchange difference will continue to impact the statement of profit and loss in accordance with the requirements of Ind AS 21.

Question 7

A Ltd has made a borrowing from RBC Bank for ₹ 10,000 at a fixed interest of 10% per annum. Loan processing fees were additionally paid for ₹ 500 and loan is payable after 5 years in bullet repayment of principal. Details are as follows:

Particulars	**Details**
Loan amount	₹ 10,000
Date of loan (Starting Date)	1-Apr-20X1
Date of repayment of principal amount (Finishing Date)	31-March-20X6
Interest rate	10.00%
Interest charge	Interest to be charged and paid yearly
Upfront fees	₹ 500

How would loan be accounted in books of A Ltd?

Note: The relevant present value table is as follows:

Year	1	2	3	4	5

PVF @ 10%	0.909	0.826	0.751	0.683	0.621
PVF @ 13%	0.885	0.783	0.692	0.612	0.543

Answer

The loan taken by A Ltd shall be measured at amortised cost as follows:

- Initial measurement – At transaction price less processing fees

  = 10,000 – 500

  = 9,500

- Subsequently – interest to be accrued using effective rate of interest as follows:

Year end	Opening balance	Interest @ 11.42%	Repayment of interest & principal	Closing balance
1	9,500	1,085	1,000	9,585
2	9,585	1,095	1,000	9,679
3	9,679	1,105	1,000	9,785
4	9,785	1,117	1,000	9,902
5	9,902	1,098*	11,000	–

*Difference due to approximation

Computation of EIR

EIR would be the rate using which the present value of cash flow should come out to be ₹ 9,500 i.e. (₹ 10,000 less ₹ 500).

For this, we should first compute present value of cashflows using any two rates as follows:

Year end	Opening balance	Repayment /Cashflows	Closing balance	PVF @ 10%	Present Value at 10% rate	PVF @ 13%	Present Value at 13% rate
1	9,500	1,000	8,500	0.909	909	0.885	885
2	8,500	1,000	7,500	0.826	826	0.783	783
3	7,500	1,000	6,500	0.751	751	0.693	692
4	6,500	1,000	5,500	0.683	683	0.613	612
5	5,500	11,000	(5,500)	0.621	6,830	0.543	5,973
					10,000		**8,945**

Taking 10% as discount rate, present value (PV) comes out to be ₹ 10,000.

If rate is increased by 3% over a base rate of 10%, PV decreases by ₹ 1,055 (i.e. ₹ 10,000 less ₹ 8945).

To decrease PV by ₹ 1,055, rate should be increased = 3%

To decrease PV by ₹ 1, rate should be increased = 3%/1,055

To decrease PV by ₹ 500, rate should be increased = (3% x 500)/1,055

= 1.42%

This would mean that the discount rate to get present value of cashflows equivalent to ₹ 9,500 should be 11.42% (i.e. 10% + 1.42%).

Question 8

A Ltd has made a borrowing from RBC Bank for ₹ 10,000 at a fixed interest of 12% per annum. Loan processing fees were additionally paid for ₹ 500 and loan is payable 4 half-yearly installments of ₹ 2,500 each. Details are as follows:

Particulars	Details
Loan amount	₹ 10,000
Date of loan (Starting Date)	1-Apr-20X1
Date of loan (Finishing Date)	31-March-20X3
Description of repayment	Repayment of loan starts from 30-Sept-20X1 (To be paid half yearly)
Installment amount	₹ 2,500
Interest rate	12.00%
Interest charge	Interest to be charged quarterly
Upfront fees	₹ 500

How would loan be accounted in books of A Ltd?

Consider EIR is 16.60% p.a. Assume 365 days in a year.

Answer

The loan taken by A Ltd shall be measured at amortised cost as follows:

- Initial measurement – At transaction price less processing fees
  = 10,000 – 500
  = 9,500
- Subsequently – interest to be accrued using effective rate of interest as follows:

Date	Amount of Loan	Repayment	Upfront fees paid	Amount of Interest	Days	IRR Calculation	Revised Interest computed	Loan Balance
1-Apr-20X1	10,000	–	500	–	–	9,500	–	–
30-Jun-20X1	–	–	–	300	90	(300)	389	9,589
30-Sep-20X1	–	2500	–	300	92	(2,800)	401	7,190
31-Dec-20X1	–	–	–	225	92	(225)	301	7,266
31-Mar 20X2	–	2500	–	225	90	(2,725)	297	4,838
30-Jun-20X2	–	–	–	150	91	(150)	200	4,888
30-Sep-20X2	–	2500	–	150	92	(2,650)	204	2,442
31-Dec-20X2	–	–	–	75	92	(75)	102	2,473

31-Mar-20X3	–	2500	–	75	90	(2,575)	102	–
					IRR	**16.60%**		

Question 9

XYZ issued ₹ 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 ₹ 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 ₹ 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.

Answer

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.

Under Ind AS 32 'Financial Instruments: Presentation' these instruments should be classified as financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortised cost using the effective interest rate of 18%.

Year	1 April, 20X5 (₹)	Interest @18% (₹)	Paid at 4% (₹)	31 March, 20X6 (₹)
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 ₹ 5,47,200.

Accountant has inadvertently debited interest of ₹ 19,200 in retained earnings. However, the interest of ₹ 86,400 should have been debited to profit and loss as finance charge.

Similarly, amount of ₹ 5,47,200 should be included in borrowings (non-current liabilities) and consequently, Equity should be reduced by ₹ 480,000 proceeds of issue.

Necessary adjusting journal entry to rectify the books of accounts will be:

		₹	₹
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 10

Metallics Ltd. has made an investment in equity instrument of a company – Castor Ltd. for 19% equity stake. Significant influence not exercised. The investment was made for ₹ 5,00,000 for 10,000 equity shares on 01 April 20X1. On 30 June 20X1 fair value per equity share is ₹ 45. The Company has taken an irrevocable option to measure such investment at fair value through other comprehensive income.

Answer

The Company has made an irrecoverable option to carry its investment at fair value through other comprehensive income. Accordingly, the investment shall be initially recognised at fair value and all subsequent fair value gains/losses shall be recognised in other comprehensive income (OCI).

Journal Entries

Particulars		Amount	Amount
Upon initial recognition			
Investment in equity shares of Castor Ltd.	Dr.	5,00,000	
To Bank a/c			5,00,000
(Being investment recognized at fair value plus transaction costs upon initial recognition)			
Subsequently			
Fair value loss on financial instruments	Dr.	50,000	
To Investment in equity shares of Castor Ltd.			50,000
(Being fair value loss recognised)			
Fair value reserve in OCI	Dr.	50,000	
To Fair value loss on financial instruments			50,000
(Being fair value loss recognized in other comprehensive income)			

Question 11

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 = ₹ 40 and USD 1 = ₹ 45, respectively. The weighted average exchange rate for the year is 1 USD = ₹ 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)

Answer

Computation of amounts to be recognized in the P&L and OCI:

Particulars	USD	Exchange rate	₹
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 x (45 – 40)]			5,000
Exchange gain on interest accrual [100 x (45 – 42)]			300
Total exchange gain/loss to be recognized in P&L			5,300
Fair value gain to be recognized in OCI [45 x (1,060 – 1,041)]			855

Journal entry to recognize gain/loss

Bond (₹ 47,700 – ₹ 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 12

A Ltd. invested in equity shares of C Ltd. on 15th March for ₹ 10,000. Transaction costs were ₹ 500 in addition to the basic cost of ₹ 10,000. On 31 March, the fair value of the equity shares was ₹ 11,200 and market rate of interest is 10% per annum for a 10 year loan. Analyse the measurement principle and pass necessary journal entries.

Answer

The above investment is in equity shares of C Ltd and hence, does not involve any contractual cash flows that are solely payments of principal and interest. Hence, these equity shares shall be measured at fair value through profit or loss. Also, an irrecoverable option exists to designate such investment as fair value through other comprehensive income.

Journal Entries

Particulars		Amount	Amount
Upon initial recognition			
Investment in equity shares of C Ltd.	Dr.	10,000	
Transaction cost	Dr.	500	
To Bank A/c			10,500
(Being investment recognized at fair value plus transaction costs upon initial recognition)			

Profit and Loss A/c Dr. To Transaction cost (Being transaction cost incurred on assets measured at FVTPL transferred to P&L A/c)	500	500
Subsequently		
Investment in equity shares of C Ltd. Dr. To Fair value gain on financial instruments (Being fair value gain recognized at year end in P&L)	1,200	1,200
Fair value gain on financial instruments Dr. To Profit and Loss A/c (Being fair value gain transferred to P&L A/c)	1,200	1,200

Question 13

D Ltd. issues preference shares to G Ltd. for a consideration of ₹ 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. and is payable at the end of every year.

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.

Note: Consider PV Factor upto 5 decimal places

Answer

The values of the liability and equity components are calculated as follows:

Present value of principal payable at the end of 3 years (₹ 10 lakhs discounted at 13% for 3 years) = ₹ 6,93,050

Present value of interest payable in arrears for 3 years (₹ 1,00,000 discounted at 13% for each of 3 years) = ₹ 2,36,115

Paragraph AG 31 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

= ₹ 6,93,050 + ₹ 2,36,115 = ₹ 9,29,165

Equity Component = ₹ 10,00,000 – ₹ 9,29,165 = ₹ 70,835

Question 14

K ltd. issued 500,000, 6% convertible debentures @ ₹ 10 each on 01 April 20X1. The debentures are due for redemption on 31 March 20X5 at a premium of 10%, compulsorily 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 rights was 10%. 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 Company's books at initial recognition. The following present values of Re 1 at 6% and at 10% are provided:

Interest rate	Year 1	Year 2	Year 3	Year 4
6%	0.94	0.89	0.84	0.79
10%	0.91	0.83	0.75	0.68

Answer

Computation of debt component of convertible debentures on 01 April 20X1

Particulars	Amount
Present value of principal amount repayable after 4 years	
(A) 5,000,000 x 50% x 1.10 x 0.68 (10% discount factor)	1,870,000
(B) Present value of interest [300,000 x 3.17] (4 years cumulative 10% discount factor)	951,000
Total present value of debt component (A) + (B)	2,821,000
Issue proceeds from convertible debentures	5,000,000
Value of equity component	2,179,000

Journal entry at initial recognition

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c	Dr.	5,000,000	
To 6% debenture A/c (liability component)			2,821,000
To 6% debenture A/c (equity component)			2,179,000
(Being disbursement recorded at fair value)			

Question 15

(1) QA Ltd. issued 10,00,000 of 8% Long Term bond-A Series of ₹ 1 each on 1st April, 2022. The bond tenure is 3 years. Interest is payable annually on 31st March each year. The investors expect market 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 @ 10% for year 3 as 0.751315 and 3 years cumulative discounting factor is 2.48685.

(i) What is the present value of the principal payment 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 ₹ 1 each on 1st April, 2022. The bond tenure is 3 years. Interest is payable annually on 31st March each year. However, the bond holders of this series are entitled to convert the bonds to shares of ₹ 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?

Answer

(1) **(i)** ₹ 7,51,315

(ii) ₹ 1,98,948

(iii) ₹ 9,50,263

(iv)

Interest Expenses A/c	Dr.	₹ 95,026	
To 8% LT Bond Series A A/c			₹ 15,026
To Bank A/c			₹ 80,000

Workings for the above

Since the Market 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	₹
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

= ₹ 9,50,263 x 10% = ₹ 95,026

However, interest paid is @ 8% i.e. ₹ 10,00,000 x 8% = ₹ 80,000

(2) **(a)**

Bank A/c	Dr.	₹ 10,00,000	
To 8% LT Bond Series B (Financial Liability) A/c			₹ 9,50,263
To 8% LT Bond Series B (Equity) A/c			₹ 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	₹
Present value of principal repayable after 3 years (10,00,000 x 0.751315)	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 B	I	9,50,263
Issue proceeds from convertible bond	II	10,00,000
Value of equity component	(II – I)	49,737

(b) 8% LT Bond Series B (Financial Liability) A/c ₹ 10,00,000

8% LT Bond Series B (Equity) A/c ₹ 49,737

To Share Capital A/c ₹ 10,00,000

To Share Premium A/c ₹ 49,737

Reasoning:

As per para AG32 of Ind AS 32, on conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises 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 16

A Limited issues ₹ 1 crore convertible bonds on 1 July 20X1. The bonds have a life of eight years and a face value of ₹ 10 each, and they offer interest, payable at the end of each financial year, at a rate of 6 per cent annum. The bonds are issued at their face value and each bond can be converted into one ordinary share in A Limited 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 8 per cent per annum.

Required:

(a) Provide the appropriate accounting entries for initial recognition.

(b) Calculate the stream of interest expenses across the eight years of the life of the bonds.

(c) Provide the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the third year.

Note: Consider PV Factor upto 4 decimal places

Answer

(a) Applying the guidance for compound instruments, the present value of the bond is computed to identify the liability component and then difference between the present value of these bonds & the issue price of ₹ 1 crore shall be allocated to the equity component. In determining the present value, the rate of 8 per cent will be used, which is the interest rate paid on debt of a similar nature and risk that does not provide an option to convert the liability to ordinary shares.

Present value of bonds at the market rate of debt

Present value of principal to be received in eight years discounted at 8% (10,000,000 x 0.5403)	5,403,000
Present value of interest stream discounted at 8% for 8 years (6,00,000 x 5.7466)	3,447,960

Total present value	8,850,960
Equity component	1,149,040
Total face value of convertible bonds	10,000,000

The accounting entries will be as follows:

	Dr. Amount (₹)	Cr. Amount (₹)
1 July 20X1		
Bank Dr.	10,000,000	
To Convertible bonds (liability)		8,850,960
To Convertible bonds (equity component)		1,149,040
(Being entry to record the convertible bonds and the recognition of the liability and equity components)		
30 June 20X2		
Interest expense Dr.	708,077	
To Bank		600,000
To Convertible bonds (liability)		108,077
(Being entry to record the interest expense, where the expense equals the present value of the opening liability multiplied by the market rate of interest).		

(b) The stream of interest expense is summarised below, where interest for a given year is calculated by multiplying the present value of the liability at the beginning of the period by the market rate of interest, this is being 8 per cent.

Date	Payment	Interest expense at 8%	Increase in bond liability	Total bond liability
01 July 20X1				8,850,960
30 June 20X2	600,000	708,077	108,077	8,959,037
30 June 20X3	600,000	716,723	116,723	9,075,760
30 June 20X4	600,000	726,061	126,061	9,201,821
30 June 20X5	600,000	736,146	136,146	9,337,967
30 June 20X6	600,000	747,037	147,037	9,485,004
30 June 20X7	600,000	758,800	158,800	9,643,804
30 June 20X8	600,000	771,504	171,504	9,815,308
30 June 20X9	600,000	784,692*	184,692	10,000,000

*difference is due to rounding off

(c) If the holders of the bonds elect to convert the bonds to ordinary shares at the end of the third year (after receiving their interest payments), the entries in the third year would be:

	Dr. Amount (₹)	Cr. Amount (₹)
30 June 20X4		

Interest expense To Bank To Convertible bonds (liability) (Being entry to record interest expense for the period)	Dr.	726,061	 600,000 126,061
30 June 20X4 Convertible bonds (liability) Convertible bonds (equity component) To Ordinary share capital A/c (Being entry to record the conversion of bonds into shares of A Limited)	 Dr. Dr.	 9,201,821 1,149,040	 10,350,861

Question 17

ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1 April 20X1 @ ₹ 150 each. The rate of dividend is 10% payable every year. The preference shares are convertible into 5,000 equity shares 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 options is 15% per annum. Transaction cost on the date of issuance is 2% of the value of the proceeds.

Key terms:

Date of Allotment	01-Apr-20X1
Date of Conversion	01-Apr-20X6
Number of Preference Shares	10,000
Face Value of Preference Shares	150
Total Proceeds	15,00,000
Rate of dividend	10%
Market Rate for Similar Instrument	15%
Transaction Cost	30,000
Face value of equity share after conversion	10
Number of equity shares to be issued	5,000
Effective interest rate	15.86%

You are required to compute the 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.

Note: Consider PV Factor upto 6 decimal places

Answer

This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

(a) Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-20X1		0	1	0
31-Mar-20X2	Dividend	150,000	0.869565	130,435
31-Mar-20X3	Dividend	150,000	0.756144	113,422
31-Mar-20X4	Dividend	150,000	0.657516	98,627
31-Mar-20X5	Dividend	150,000	0.571753	85,763
31-Mar-20X6	Dividend	150,000	0.497177	74,576
Total Liability Component				502,823
Total Proceeds				1,500,000
Total Equity Component (Bal fig)				997,177

(b) Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
Liability Component	502,823	10,056	492,767
Equity Component	997,177	19,944	977,233
Total Proceeds	1,500,000	30,000	1,470,000

(c) Accounting for liability at amortised cost:

- Initial accounting = Present value of cash outflows less transaction costs
- Subsequent accounting = At amortised cost, i.e., initial fair value adjusted for interest and repayments of the liability.

Assume the effective interest rate is 15.86%

	Opening Financial Liability A	Interest B	Cash Flow C	Closing Financial Liability A + B – C
01-Apr-20X1	492,767	–	–	4,92,767
31-Mar-20X2	492,767	78,153	150,000	4,20,920
31-Mar-20X3	420,920	66,758	150,000	3,37,678
31-Mar-20X4	337,678	53,556	150,000	2,41,234
31-Mar-20X5	241,234	38,260	150,000	1,29,494
31-Mar-20X6	129,494	20,506	150,000	–

(d) Journal Entries to be recorded for entire term of arrangement are as follows:

Date	Particulars	Debit	Credit
01-Apr-20X1	Bank A/c Dr.	1,470,000	
	To Preference Shares A/c		492,767
	To Equity Component of Preference shares		977,233

	(Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)		
31-Mar-20X2	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X2	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	78,153	78,153
31-Mar-20X3	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X3	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	66,758	66,758
31-Mar-20X4	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X4	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	53,556	53,556
31-Mar-20X5	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X5	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	38,260	38,260
31-Mar-20X6	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X6	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	20,506	20,506
31-Mar-20X6	Equity Component of Preference shares A/c Dr. To Equity Share Capital A/c	977,233	50,000

	To Securities Premium A/c (Being Preference shares converted in equity shares and remaining equity component is recognised as securities premium)		927,233

Question 18

On 1 April 20X1, an 8% convertible loan with a nominal value of ₹ 6,00,000 was issued at par. It is redeemable on 31 March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each ₹ 200 worth of loan.

An equivalent loan without the conversion option would have carried interest at 10%. Interest of ₹ 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 20X2?

Answer

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	20X2	48,000	0.91	43,680
Year 2	20X3	48,000	0.83	39,840
Year 3	20X4	48,000	0.75	36,063
				1,19,583
Year 4	20X5	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 ₹ 6,00,000 + ₹ 48,000 = ₹ 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 ₹ 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 ₹ 5,60,000

Interest charge (5,60,000 x 10%)	₹ 56,022
Already charged to the income statement	(₹ 48,000)
Additional charge required	₹ 8,022

Journal Entries for recording additional finance cost for year ended 31 March 20X2

Particulars	**Dr. Amount (₹)**	**Cr. Amount (₹)**
Finance cost A/c Dr.	8,022	
To Loan (Debt component) A/c		8,022
(Being interest recorded for difference between amount recorded earlier and that to be recorded per Ind AS 32)		

Question 19

On 1 July 20X1, D Ltd. issues preference shares to G Ltd. for a consideration of ₹ 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 fixed coupon of 6% p.a. and is payable every year. The prevailing market rate for similar preference shares, without the conversion feature, is 9% p.a.

(i) Calculate the value of the liability and equity components. Also give amortization schedule.

(ii) Assume that D Ltd. has an early redemption option to prepay the instrument at ₹ 11 lakhs and on 30 June 20X3, it exercises that option. At 30 June 20X3, the interest rate has changed. At that time, D Ltd. could have issued a one-year (i.e. maturity 30 June 20X4) non-convertible instrument at 5%. Calculate the amount of prepayment consideration allocated to the liability and equity components.

Note: Consider PV Factor upto 6 decimal places

Answer

(i) The values of the liability and equity components are calculated as follows:

Present value of principal payable at the end of 3 years (₹ 10 lakhs discounted at 9% for 3 years) = ₹ 7,72,183

Present value of interest payable in arrears for 3 years (₹ 60,000 discounted at 9% for each of 3 years) = ₹ 1,51,878

Total financial liability = ₹ 9,24,061

Therefore, equity component = fair value of compound instrument, say, ₹ 10,00,000 less financial liability component i.e. ₹ 9,24,061 = ₹ 75,939

In subsequent years, profit and loss account is charged with interest of 9% on debt instrument.

The amortisation schedule of the instrument is set out below:

Dates	Cash flows	Finance cost at effective interest rate	Liability
1 July 20X1	10,00,000	–	9,24,061
30 June 20X2	(60,000)	83,165	9,47,226
30 June 20X3	(60,000)	85,250	9,72,476
30 June 20X4	(10,60,000)	87,524	–

(ii) Ind AS 32 requires that the amount paid (of ₹ 11 lakhs) is split by the same method as is used in the initial recording. However, at 30 June 20X3, the interest rate has changed. At that time, D Ltd. could have issued a one-year (i.e. maturity 30 June 20X4) non-convertible instrument at 5%.

The split will be made as below:

Particulars	Amount (₹)
Present value of principal payable at 30 June 20X4 in one year's time (₹ 10 lakhs discounted at 5% for one year)	9,52,381
Present value of interest payable (₹ 60,000 discounted at 5% for one year)	57,143
Total liability component	10,09,524
Consideration paid	11,00,000
Residual – equity component	90,476

Accordingly, the difference between consideration allocated to liability component (₹ 10,09,524) less carrying amount of financial liability on date of redemption i.e. 30 June 20X3 (₹ 9,72,476), amounting to ₹ 37,048 is recognised in profit or loss.

The residual i.e. consideration allocated to equity component is recognised in equity.

Question 20

On 1st April, 20X4, Shelter Ltd. issued 5,000, 8% debentures maturing on 31st March, 20X9. The debentures are convertible at the option of the holder into equity shares of Shelter Ltd. at a conversion price of ₹ 105 per share or redeemable at face value of ₹ 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 1st April, 20X7, the convertible debentures have a fair value of ₹ 5,25,000. Shelter Ltd. makes a tender offer to debenture holders to repurchase the debentures for ₹ 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:

(i) At the time of initial recognition and

(ii) At the time of repurchase of the convertible debentures.

The following present values of ₹ 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

Answer

(i) At the time of initial recognition

	₹
Liability component	
Present value of 5 yearly interest payments of ₹ 40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of ₹ 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 (₹ 5,00,000 – ₹ 4,27,700)	72,300
Total proceeds	5,00,000

Note: Since ₹ 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ ₹ 100 each only.

Journal Entry

	₹	₹
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)		

(ii) At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	Fair Value @ 9%	Difference
	₹	₹	₹
Liability component			
Present value of 2 remaining yearly interest payments of ₹ 40,000, discounted at 12% and 9%, respectively	67,600	70,360	
Present value of ₹ 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

	₹	₹
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 Retained Earnings A/c		38,660
(Being the cash paid for the equity component recognised)		

Note: Alternatively, carrying amount of 8% Debentures (Liability component) on 1st April 20X7 can also be calculated using amortisation schedule, i.e. ₹ 4,65,912 as follows:

Dates	Cash flows	Finance cost at effective interest rate	Liability
1 April 20X4	5,00,000	–	4,27,700
1 April 20X5	(40,000)	51,324	4,39,024
1 April 20X6	(40,000)	52,683	4,51,707
1 April 20X7	(40,000)	54,205	4,65,912

Question 21

On 1st April 2020, A Ltd. lent ₹ 2 crores to a supplier in order to assist them with their expansion plans. The arrangement of the loan cost the company ₹ 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 ₹ 2.40 crores on 31st March 2022. As calculated by the finance team of the company, the effective annual rate of interest on this loan is 6.9%. On 31st March 2021, 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 2022 to ₹ 2.20 crores. Suggest the accounting and net amount charged to profit or loss in the current period as per applicable Ind AS.

Note: Consider PV Factor upto 7 decimal places

Answer

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 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 ₹ 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 ₹ 14,49,000 (₹ 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, 2021 would have been measured at ₹ 2,24,49,000 (₹ 2,10,00,000 + 14,49,000).

At 31st March 2021, 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 ₹ 2,05,79,981 (₹ 2,20,00,000/1.069). The reduction in carrying value of ₹ 18,69,019 (₹ 2,24,49,000 – 2,05,79,981) would be charged to profit or loss in the current period.

Therefore, the net charge to profit or loss in respect of the current period would be ₹ 4,20,019 (18,69,019 – 14,49,000).

Question 22

Wheel Co. Limited has a policy of providing subsidized loans to its employees for the purpose of buying or building houses. Mr. X, who's executive assistant to the CEO of Wheel Co. Limited, took a loan from the Company on the following terms:

- Principal amount: 1,000,000
- Interest rate: 4% for the first 400,000 and 7% for the next 600,000
- Start date: 1 January 20X1
- 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 annual instalments and will be first applied to 7% interest bearing principal
- The accrued interest shall be paid on an annual basis
- Mr. X must remain in service till the term of the loan ends

The market rate of a comparable loan available to Mr. X, is 12% per annum.

Following table shows the contractually expected cash flows from the loan given to Mr. X:

(amount in ₹)

		Inflows			
Date	**Outflows**	**Principal**	**Interest income 7%**	**Interest income 4%**	**Principal outstanding**
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1		200,000	42,000	16,000	800,000
31-Dec-20X2		200,000	28,000	16,000	600,000
31-Dec-20X3		200,000	14,000	16,000	400,000
31-Dec-20X4		200,000	–	16,000	200,000
31-Dec-20X5		200,000	–	8,000	–

Mr. X, pre-pays ₹ 200,000 on 31 December 20X2, reducing the outstanding principal as at that date to ₹ 400,000.

Following table shows the actual cash flows from the loan given to Mr. X, considering the pre-payment event on 31 December 20X2: **(amount in ₹)**

		Inflows			
Date	**Outflows**	**Principal**	**Interest income 7%**	**Interest income 4%**	**Principal outstanding**
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1		200,000	42,000	16,000	800,000
31-Dec-20X2		400,000	28,000	16,000	400,000
31-Dec-20X3		200,000	–	16,000	200,000
31-Dec-20X4		200,000	–	8,000	–
31-Dec-20X5		–	–	–	–

Record journal entries in the books of Wheel Co. Limited considering the requirements of Ind AS 109.

Note: Consider PV Factor upto 6 decimal places

Answer

As per requirement of 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 Mr. X 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-Dec-20X1	200,000	42,000	16,000	0.892857	2,30,357
31-Dec-20X2	200,000	28,000	16,000	0.797194	1,94,515
31-Dec-20X3	200,000	14,000	16,000	0.711780	1,63,709
31-Dec-20X4	200,000	-	16,000	0.635518	1,37,272
31-Dec-20X5	200,000	-	8,000	0.567427	1,18,025
Total (fair value)					8,43,878

Benefit to Mr. X, to be considered a part of employee cost for Wheel Co. ₹ 1,56,122 (₹ 10,00,000 – ₹ 8,43,878).

The deemed employee cost is to be amortised over the period of loan i.e. the minimum period that Mr. X must remain in service.

The amortization schedule of the ₹ 843,878 loan is shown in the following table:

Date	Loan outstanding	Total cash inflows (principal repayment + interest)	Interest @ 12%
1-Jan-20X1	843,878		
31-Dec-20X1	687,143	258,000	101,265
31-Dec-20X2	525,600	244,000	82,457
31-Dec-20X3	358,672	230,000	63,072
31-Dec-20X4	185,713	216,000	43,041
31-Dec-20X5	(0)	208,000	22,287*

*Difference is due to approximation

Journal Entries to be recorded at every period end:

a. **1 January 20X1**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Loan to employee A/c	Dr.	843,878	
Pre-paid employee cost A/c	Dr	156,122	
To Bank A/c			1,000,000
(Being loan asset recorded at initial fair value)			

b. **31 December 20X1**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c	Dr.	258,000	
To Interest income (profit and loss) @12% A/c			101,265
To loan to employee A/c			156,735
(Being first 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.	31,224	
To Pre-paid employee cost A/c		31,224
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

On 31 December 20X2, due to pre-payment of a part of loan by Mr. X, 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 31 December 20X2, first the realisation of the contractual cash flow as shown in (c) below and then the accounting for the pre-payment of ₹ 200,000 included in (d) below:

c. **31 December 20X2**

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c Dr.	244,000	
To Interest income (profit and loss) @ 12% A/c		82,457
To loan to employee A/c		161,543
(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	31,224	
To Pre-paid employee cost A/c		31,224
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

Computation of new carrying value of loan to employee:

Date	Inflows			Discount factor @12%	PV
	Principal	Interest income 7%	Interest income 4%		
31-Dec-20X3	200,000	-	16,000	0.892857	192,857
31-Dec-20X4	200,000	-	8,000	0.797194	165,816
Total (revised carrying value)					358,673
Less: Current carrying value					525,600
Adjustment required					166,927

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.

d. **31 December 20X2 prepayment**

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c Dr.	200,000	

To Pre-paid employee cost A/c		33,073
To loan to employee A/c		166,927
(Being gain to Wheel Co. Limited recorded as an adjustment to pre-paid employee cost)		

The amortisation schedule of the new carrying amount of loan shall be as follows:

Date	Loan outstanding	Total cash inflows (principal repayment + interest)	Interest @ 12%
31-Dec-20X2	358,673		
31-Dec-20X3	185,714	216,000	43,041
31-Dec-20X4	–	208,000	22,286

Amortisation of employee benefit cost shall be as follows:

Date	Balance	Amortised to P&L	Adjustment
1-Jan-20X1	156,122		
31-Dec-20X1	124,898	31,224	
31-Dec-20X2	60,601	31,224	33,073
31-Dec-20X3	30,301	30,300	
31-Dec-20X4	–	30,301	

e. **31 December 20X3**

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c Dr.	216,000	
To Interest income (profit and loss) @ 12% A/c		43,041
To loan to employee A/c		172,959
(Being third 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	30,300	
To Pre-paid employee cost A/c		30,300
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

f. **31 December 20X4**

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c Dr	208,000	
To Interest income (profit and loss) @ 12% A/c		22,286
To loan to employee A/c		185,714
(Being last 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	30,301	
To Pre-paid employee cost A/c		30,301

(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

Question 23

On 1 January 20X0, Preet Ltd. issues 10 year bonds for ₹ 10,00,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for ₹ 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 ₹ 15,00,000; and
- legal and other fees of ₹ 1,00,000 are incurred.

Preet Ltd. determines that the market interest rate on 1 January 20X5 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.

Note: Consider PV Factor upto 6 decimal places

Answer

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 ₹ 10,00,000.

On this date, Preet Ltd. will compute the present value of:

- cash flows under the new terms – i.e. ₹ 15,00,000 payable on 31 December 20Y1 and ₹ 50,000 payable for each of the 7 years ending 31 December 20Y1.
- any fee paid (net of any fee received) – i.e. ₹ 1,00,000

using the original effective interest rate of 10%.

The total of these amounts to ₹ 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 XYZ Ltd. could issue new bonds with similar terms). The estimated fair value on this basis is ₹ 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. ₹ 10,00,000 – ₹ 9,58,097 – ₹ 1,00,000 = Loss of ₹ 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 24

Wheel Co. Limited borrowed ₹ 500,000,000 from a bank on 1 January 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: ₹ 5,870,096
- Effective interest rate on loan: 11.50%

On 31 December 20X2, 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 bank as follows:

- Interest rate 15%
- Repayment of outstanding principal in 10 equal instalments starting from 31 December 20X3
- Payment of interest on an annual basis
- Before approaching bank, Wheel Co. Limited made the interest payment on 31 December 20X2

Record journal entries in the books of Wheel Co. Limited till 31 December 20X3, after giving effect of the changes in the terms of the loan on 31 December 20X2

Note: Consider PV Factor upto 8 decimals

Answer

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-Jan-20X1	(500,000,000)	5,870,096	494,129,904	
31-Dec-20X1	100,000,000	55,000,000	395,954,843	56,824,939
31-Dec-20X2	100,000,000	44,000,000	297,489,650	45,534,807
31-Dec-20X3	100,000,000	33,000,000	198,700,959	34,211,310
31-Dec-20X4	100,000,000	22,000,000	99,551,570	22,850,610
31-Dec-20X5	100,000,000	11,000,000	(0)	11,448,430

a. **1 January 20X1**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c	Dr.	494,129,904	
To Loan from bank A/c			494,129,904
(Being loan recorded at its fair value less transaction costs on the initial recognition date)			

b. **31 December 20X1**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Loan from bank A/c	Dr.	98,175,061	
Interest expense (profit and loss)	Dr.	56,824,939	
To Bank A/c			155,000,000
(Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised cost of loan)			

c. **31 December 20X2 – Before Wheel Co. Limited approached the bank**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Interest expense (profit and loss)	Dr.	45,534,807	
To Loan from bank A/c			1,534,807
To Bank A/c			44,000,000
(Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)			

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 @ 11.50	PV of cash flows
31-Dec-20X2	(400,000,000)			
31-Dec-20X3	40,000,000	60,000,000	0.89686099	89,686,099
31-Dec-20X4	40,000,000	54,000,000	0.80435963	75,609,805
31-Dec-20X5	40,000,000	48,000,000	0.72139877	63,483,092
31-Dec-20X6	40,000,000	42,000,000	0.64699441	53,053,542
31-Dec-20X7	40,000,000	36,000,000	0.58026405	44,100,068
31-Dec-20X8	40,000,000	30,000,000	0.52041619	36,429,133
31-Dec-20X9	40,000,000	24,000,000	0.46674097	29,871,422
31-Dec-20Y0	40,000,000	18,000,000	0.41860177	24,278,903
31-Dec-20Y1	40,000,000	12,000,000	0.37542760	19,522,235
31-Dec-20Y3	40,000,000	6,000,000	0.33670636	15,488,493
PV of new contractual cash flows discounted at 11.50%				451,522,792
Carrying amount of loan (297,489,650 + 100,000,000)				397,489,650
Difference				54,033,142
Percentage of carrying amount				13.59%

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. **31 December 20X2 – accounting for extinguishment**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Loan from bank (old) A/c	Dr	397,489,650	
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. **31 December 20X3**

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

On 1 January 20X0, XYZ Ltd. issues 10 year bonds for ₹ 10,00,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for ₹ 10,00,000. No costs or fees are incurred. The effective interest rate is therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ Ltd. and the bondholders agree to a modification in accordance with which:

- no further interest payments are made
- the bonds are redeemed on the original due date (31 December 20X9) for ₹ 16,00,000;
- legal and other fees of ₹ 50,000 are incurred.

Analyse whether the modification accounting will apply or not as per Ind AS. If yes, calculate the revised EIR and determine the amortised cost and interest expense to be booked in future periods.

Note: The relevant present value factor for the 5th year @ 10% is 0.620921 and @ 11% is 0.593451

Answer

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
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 ₹ 10,00,000.

On this date, XYZ Ltd. will compute the present value of:

i. cash flows under the new terms – i.e. ₹ 16,00,000 payable on 31 December 20X9

ii. any fees paid (net of any fees received) – i.e. ₹ 50,000 using the original effective interest rate of 10%.

The total of these amounts to ₹ 10,43,474 (Refer Working Note). This differs from the discounted present value of the remaining cash flows of the original financial liability by 4.35% i.e. by less than 10%. Hence, modification accounting applies.

On this basis:

i. the fees paid of ₹ 50,000 are netted against the existing liability of ₹ 10,00,000, resulting in an adjusted carrying amount of ₹ 9,50,000;

ii. the effective interest rate (EIR) is recalculated. This is the rate which discounts the future cash flows (₹ 16,00,000 in five years' time) to the adjusted carrying amount of ₹ 9,50,000. The adjusted EIR is 10.99%

iii. the adjusted EIR is used to determine the amortised cost and interest expense in future periods.

Working Note:

For testing extinguishment

Cash flows under new terms	16,00,000
PV as at 01 January 20X5 of revised cash flows @ original EIR	9,93,474
Fees incurred	50,000
PV of revised cash flows including fees incurred @ original EIR	10,43,474
Carrying amount of financial liability as at 01 January 20X5	(10,00,000)
Difference	43,474
Difference %	4.35%
Less than 10% – Indicates modification	

Accounting for revised cash flows @ Revised EIR

Year	Opening balance	Interest	Payment	Closing balance
0	10,00,000	-	-50,000	9,50,000
1	9,50,000	1,04,405	0	10,54,405
2	10,54,405	1,15,879	0	11,70,284
3	11,70,284	1,28,614	0	12,98,898
4	12,98,898	1,42,749	0	14,41,647
5	14,41,647	1,58,353*	-16,00,000	-
*Difference is due to approximation				

Question 26

JK Ltd. has an outstanding unsecured loan of ₹ 90 crores to a bank. The effective interest rate (EIR) of this loan is 10%. Owing to financial difficulties, JK Ltd. is unable to service the debt and approaches the bank for a settlement.

The bank offers the following terms which are accepted by JK Ltd.:

- 2/3rd of the debt is unsustainable and hence will be converted into 70% equity interest in JK Ltd. The fair value of net assets of JK Ltd. is ₹ 80 crores.
- 1/3rd of the debt is sustainable and the bank agrees to certain moratorium period and decrease in interest rate in initial periods. The present value of cash flows as per these revised terms calculated using original EIR is ₹ 25 crores. The fair value of the cash flows as per these revised terms is ₹ 28 crores.

Compute the gain or loss recognised by JK Ltd.

Answer

Fair value of equity instruments issued by JK Ltd. for settlement of 2/3rd debt is ₹ 56 crores (70% of ₹ 80 crores).

Accordingly, 2/3rd of the original financial liability is extinguished through issue of equity shares and terms of 1/3rd of the original financial liability have been modified. JK Ltd. will need to evaluate if this modification tantamount to "substantial modification" or not.

Applying the guidance contained in Appendix D to Ind AS 109:

- Difference between the fair value of equity instruments (₹ 56 crores) and 2/3rd of the original financial liability (2/3rd of ₹ 90 crores = ₹ 60 crores) i.e. ₹ 4 crores will be recognised as a gain in the statement of profit or loss.
- Carrying amount of original financial liability which is not extinguished (1/3rd of ₹ 90 crores = ₹ 30 crores) is compared with the present value of cash flows calculated using original EIR as per these revised terms (₹ 25 crores)
- As the difference is more than 10%, this results in substantial modification of the original financial liability. Resultantly, the existing financial liability (₹ 30 crores) will be extinguished and the new financial liability will be recognised at its fair value i.e. ₹ 28 crores.
- The difference i.e. ₹ 2 crores will be recognised as a gain in the statement of profit or loss.

Question 27

Anjali Ltd. has given a loan to Vidhya Ltd. at 12% rate of interest per annum for 6 years which has been carrying at ₹ 25 lakhs in the books of accounts and has a Fair Value of ₹ 30,42,000.

To mitigate risks but at the same time retaining control over the loan, Anjali Ltd. transferred its right to receive the principal amount of the loan on its maturity with interest, after retaining rights over 15% of principal and 2% interest that carries Fair Value of ₹ 74,000 and ₹ 4,50,300 respectively. The consideration for the transaction was ₹ 24,80,000.

The interest component retained included 1% fee towards collection of principal and interest that has a Fair Value of ₹ 1,40,200. Defaults, if any are deductible to a maximum extent of the company's claim on principal portion.

You are required to pass the journal entries to record derecognition of the Loan.

Answer

(i) Calculation of securitized component of loan

		₹	₹
Fair Value			30,42,000
Less: Principal strip receivable (fair value)		74,000	
Less: Interest strip receivable (fair value)	3,10,100		
Less: Value of service asset (fair value)	1,40,200	4,50,300	(5,24,300)
			25,17,700

(ii) Apportionment of carrying amount in the ratio of fair values

	Fair value (₹)		Apportionment (₹)
Securitized component of loan	25,17,700	$\frac{25,17,700 \times 25,00,000}{30,42,000}$	20,69,116
Principal strip receivable	74,000	$\frac{74,000 \times 25,00,000}{30,42,000}$	60,815
Interest strip receivable	3,10,100	$\frac{3,10,100 \times 25,00,000}{30,42,000}$	2,54,849
Servicing asset	1,40,200	$\frac{1,40,200 \times 25,00,000}{30,42,000}$	1,15,220

(iii) Entries to record the derecognition of the Loan

		₹	₹
Bank A/c	Dr.	24,80,000	
To Loan A/c			20,69,116
To Profit & Loss A/c			4,10,884
(Being entry for securitization of 85% principal with 17% interest)			
Interest strip A/c	Dr.	2,54,849	
Servicing asset A/c	Dr.	1,15,220	
Principal strip A/c	Dr.	60,815	
To Loan A/c			4,30,884
(Being entry for interest, servicing asset and principal strips received)			

Question 28

Entity C agrees with factoring company D to enter into a debt factoring arrangement. Under the terms of the arrangement, the factoring company D agrees to pay ₹ 91.5 crores, less a servicing charge of ₹ 1.5 crores (net proceeds of ₹ 90 crores), in exchange for 100% of the cash flows from short-term receivables.

The receivables have a face value of ₹ 100 crores and carrying amount of ₹ 95 crores.

The customers will be instructed to pay the amounts owed into a bank account of the factoring company. Entity C also writes a guarantee to the factoring company under which it will reimburse any credit losses upto ₹ 5 crores, over and above the expected credit losses of ₹ 5 crores. The guarantee is estimated to have a fair value of ₹ 0.5 crores.

(a) Calculate the amount of continuing involvement asset.

(b) Calculate the amount of associated liability.

(c) Pass the necessary Journal Entry.

Answer

(a) In this situation, the "continuing involvement asset" will be recognised at ₹ 5 crores i.e. lower of:

i. the amount of the asset – ₹ 95 crores

ii. the guarantee amount – ₹ 5 crores

(b) The amount of associated liability is recognised at ₹ 5.5 crores, as below:

i. the guarantee amount (i.e. ₹ 5 crores) plus

ii. the fair value of the guarantee (i.e. ₹ 0.5 crores).

(c) The journal entries passed by Entity C on the date of derecognition is as below:

Cash	Dr.	₹ 90 crores	
Loss on derecognition	Dr.	₹ 5.5 crores	
Continuing involvement asset	Dr.	₹ 5 crores	
To Receivables			₹ 95 crores
To Associated liability			₹ 5.5 crores

The guarantee liability of ₹ 0.5 crores shall be amortised in profit or loss over the underlying period.

Question 29

Entity A originates a single 10 year amortising loan for CU 1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Entity A estimates that the loan at initial recognition has a probability of default (PoD) of 0.5 per cent over the next 12 months. Entity A also determines that changes in the 12-month PoD are a reasonable approximation of the changes in the lifetime PoD for determining whether there has been a significant increase in credit risk since initial recognition. Loss given default (LGD) is estimated as 25% of the balance outstanding. Calculate loss allowance.

Answer

At reporting date, no change in 12-month PoD and entity assesses that there is no significant increase in credit risk since initial recognition – therefore lifetime ECL is not required to be recognised.

Particulars	**Details**
Loan	₹ 1,000,000 (A)

LGD	25% (B)
PoD – 12 months	0.5% (C)
Loss allowance (for 12-months ECL)	₹ 1,250 (A x B x C)

Question 30

Company M, a manufacturer, has a portfolio of trade receivables of CU 30 million in 20X1 and operates only in one geographical region. The customer base consists of a large number of small clients and the trade receivables are categorised by common risk characteristics that are representative of the customers' abilities to pay all amounts due in accordance with the contractual terms. The trade receivables do not have a significant financing component in accordance with Ind AS 115. In accordance with paragraph 5.5.15 of Ind AS 109 the loss allowance for such trade receivables is always measured at an amount equal to lifetime expected credit losses.

Please use the following information of debtors outstanding:

	Gross carrying amount
Current	CU 15,000,000
1–30 days past due	CU 7,500,000
31–60 days past due	CU 4,000,000
61–90 days past due	CU 2,500,000
More than 90 days past due	CU 1,000,000
	CU 30,000,000

Company M uses following default rates for making provisions:

	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%

Determine the expected credit losses for the portfolio.

Answer

To determine the expected credit losses for the portfolio, Company M uses a provision matrix. The provision matrix is based on its historical observed default rates over the expected life of the trade receivables and is adjusted for forward-looking estimates. At every reporting date the historical observed default rates are updated and changes in the forward-looking estimates are analysed. In this case it is forecast that economic conditions will deteriorate over the next year.

On that basis, Company M estimates the following provision 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 trade receivables from the large number of small customers amount to CU 30 million and are measured using the provision matrix.

	Gross carrying amount	Lifetime expected credit loss allowance (Gross carrying amount x lifetime expected credit loss rate)
Current	CU 15,000,000	CU 45,000
1–30 days past due	CU 7,500,000	CU 120,000
31–60 days past due	CU 4,000,000	CU 144,000
61–90 days past due	CU 2,500,000	CU 165,000
More than 90 days past due	CU 1,000,000	CU 106,000
	CU 30,000,000	**CU 580,000**

Question 31

Bank A originates 2,000 bullet loans with a total gross carrying amount of CU 500,000. Bank A segments its portfolio into borrower groups (Groups X and Y) on the basis of shared credit risk characteristics at initial recognition. Group X comprises 1,000 loans with a gross carrying amount per client of CU 200, for a total gross carrying amount of CU 200,000. Group Y comprises 1,000 loans with a gross carrying amount per client of CU 300, for a total gross carrying amount of CU 300,000. There are no transaction costs and the loan contracts include no options (for example, prepayment or call options), premiums or discounts, points paid, or other fees. Calculate loss rate when

Group	Historic per annum average defaults	Present value of observed loss assumed
X	4	CU 600
Y	2	CU 450

Answer

Bank A measures expected credit losses on the basis of a loss rate approach for Groups X and Y. In order to develop its loss rates, Bank A considers samples of its own historical default and loss experience for those types of loans.

In addition, Bank A considers forward-looking information, and updates its historical information for current economic conditions as well as reasonable and supportable forecasts of future economic conditions. Historically, for a population of 1,000 loans in each group, Group X's loss rates are 0.3 per cent, based on four defaults, and historical loss rates for Group Y are 0.15 per cent, based on two defaults.

	Number of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Historic per annum average defaults	Estimated total gross carrying amount at default	Present value of observed loss assumed	Loss rate
Group	A	B	C = A x B	D	E = B x D	F	G = F ÷ C

X	1,000	CU 200	CU 2,00,000	4	CU 800	CU 600	0.3%
Y	1,000	CU 300	CU 3,00,000	2	CU 600	CU 450	0.15%

Question 32

An entity purchases a debt instrument with a fair value of ₹ 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 ₹ 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 ₹ 30.

On 1st April 20X1, the entity decides to sell the debt instrument for ₹ 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.

Answer

On Initial recognition

		Debit (₹)	Credit (₹)
Financial asset – FVOCI	Dr.	1,000	
To Cash			1,000

On Impairment of debt instrument

		Debit (₹)	Credit (₹)
Impairment expense (P&L)	Dr.	30	
Other comprehensive income	Dr.	20	
To Financial asset – FVOCI			50

The cumulative loss in other comprehensive income at the reporting date was ₹ 20. That amount consists of the total fair value change of ₹ 50 (that is, ₹ 1,000 – ₹ 950) offset by the change in the accumulated impairment amount representing 12-month ECL, that was recognized (₹ 30).

On Sale of debt instrument

	Debit (₹)	Credit (₹)
Cash	950	
To Financial asset – FVOCI		950
Loss on sale (P&L)	20	
To Other comprehensive income		20

Question 33

On 1 April 20X1, Sun Limited guarantees a ₹ 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.

Provide the accounting treatment of financial guarantee as per Ind AS 109 in the books of Sun Ltd., on initial recognition and in subsequent periods till 31 March 20X3.

Answer

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 guarantee 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 34

On 1st January 20X1, SamCo. Ltd. agreed to purchase USD ($) 20,000 from JT Bank in future on 31st December 20X1 for a rate equal to ₹ 68 per USD. SamCo. Ltd. did not pay any amount upon entering into the contract. SamCo Ltd. is a listed company in India and prepares its financial statements on a quarterly basis.

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 purchase of USD.

For the purposes of accounting, please use the following information representing marked to market fair value of forward contracts at each reporting date:

As at 31st March 20X1 – ₹ (25,000)

As at 30th June 20X1 – ₹ (15,000)

As at 30th September 20X1 – ₹ 12,000

Spot rate of USD on 31st December 20X1 – ₹ 66 per USD

Answer

(i) 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:

a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').

b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

c) it is settled at a future date.

Upon evaluation of contract in question it is noted that the contract meets the definition of a derivative as follows:

a) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

b) 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 20,000 on inception.

c) 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.

(ii) Accounting on 1st January 20X1:

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.

(iii) Accounting on 31st March 20X1:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Profit and loss A/c Dr.	25,000	
To Derivative financial liability		25,000
(Being mark to market loss on forward contract recorded)		

(iv) Accounting on 30th June 20X1:

The change in value of the derivative forward contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Derivative financial liability A/c Dr.	10,000	
To Profit and loss A/c		10,000
(being partial reversal of mark to market loss on forward contract recorded)		

(v) Accounting on 30th September 20X1:

The value of the derivative forward contract shall be recorded as a derivative financial asset in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Derivative financial liability A/c Dr	15,000	
Derivative financial asset A/c Dr	12,000	
To Profit and loss A/c		27,000
(being gain on mark to market of forward contract booked as derivative financial asset and reversal of derivative financial liability)		

(vi) Accounting on 31st December 20X1:

The settlement of the derivative forward contract by actual purchase of USD 20,000 shall be recorded in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Bank (USD Account) @ 20,000 x 66 Dr.	13,20,000	
Profit and loss A/c Dr.	52,000	
To Bank @ 20,000 x 68		13,60,000
To Derivative financial asset A/c		12,000
(being loss on settlement of forward contract booked on actual purchase of USD)		

Question 35

On 1st January 20X1, SamCo. Ltd. entered into a written put option for USD ($) 20,000 with JT Corp to be settled in future on 31st December 20X1 for a rate equal to ₹ 68 per USD at the option of JT Corp. SamCo. Ltd. did not receive any amount upon entering into the contract. SamCo Ltd. is a listed company in India and prepares its financial statements on a quarterly basis.

Following the classification 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 purchase of USD.

For the purposes of accounting, please use the following information representing marked to market fair value of put option contracts at each reporting date:

As at 31st March 20X1 – ₹ (25,000)

As at 30th June 20X1 – ₹ (15,000)

As at 30th September 20X1 – ₹ NIL

Spot rate of USD on 31st December 20X1 – ₹ 66 per USD

Answer

(i) 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:

(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').

(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

(c) it is settled at a future date.

Upon evaluation of contract in question it is noted that the contract meets the definition of a derivative as follows:

(a) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

(b) the initial amount received 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 20,000 on inception.

(c) the contract is settled in future

The derivative liability is a written put option 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.

(ii) Accounting on 1st January 20X1

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.

(iii) Accounting on 31st March 20X1

The value of the derivative put option contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Profit and loss A/c Dr.	25,000	
To Derivative financial liability A/c		25,000
(Being mark to market loss on the put option contract recorded)		

(iv) Accounting on 30th June 20X1

The change in value of the derivative put option contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Derivative financial liability A/c Dr.	10,000	
To Profit and loss A/c		10,000
(Being partial reversal of mark to market loss on the put option contract recorded)		

(v) Accounting on 30th September 20X1

The change in value of the derivative option contract shall be recorded as a zero in the books of SamCo Ltd. by recording the following journal entry:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Derivative financial liability A/c Dr.	15,000	
To Profit and loss A/c		15,000
(Being gain on mark to market of put option contract booked to make the value the derivative liability as zero)		

(vi) Accounting on 31st December 20X1

The settlement of the derivative put option contract by actual purchase of USD 20,000 shall be recorded in the books of SamCo Ltd. upon exercise by JT Corp. by recording the following journal entry:

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Bank (USD Account) @ 20,000 x 66 Dr.	13,20,000	
Profit and loss A/c Dr.	40,000	
To Bank @ 20,000 x 68		13,60,000
(being loss on settlement of put option contract booked on actual purchase of USD)		

Question 36

Blueberry Ltd entered into the following transactions during the year ended 31st March, 20X2:

(a) Entered into a speculative interest rate option costing ₹ 10,000 on 1st April, 20X1 to borrow ₹ 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 ₹ 15,250.

(b) Purchased 6% debentures in Fox Ltd on 1st April, 20X1 (their issue date) for ₹ 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, 20X1 for ₹ 3.50 each as an investment. The share price on 31st March, 20X2 was ₹ 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.

Answer

Balance Sheet as at 31st March, 20X2 (Extracts)

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		₹	₹
Initial measurement (at cost)			
Financial Asset	Dr.	10,000	
To Cash A/c			10,000

At 31st March, 20X2

Particulars		₹	₹
(Re-measured to fair value)			
Financial Asset (₹ 15,250 – ₹ 10,000)	Dr.	5,250	
To Profit and loss A/c			5,250

Financial Assets (₹ 10,000 + ₹ 5,250) = **₹ 15,250 (Balance Sheet)**

Gain on interest option = **₹ 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	₹	₹
Initial measurement (at cost)		

Financial Asset To Cash A/c	Dr.	1,50,000	1,50,000

At 31st March, 20X2 (Amortized cost)

Particulars		₹	₹
Financial Asset (₹ 1,50,000 x 8%) To Finance Income	Dr.	12,000	12,000
Cash (₹ 1,50,000 x 6%) To Financial asset	Dr.	9,000	9,000

Amortized cost at 31st March, 20X2 (₹ 150,000 + ₹ 12,000 – ₹ 9,000) = **₹ 153,000 (Balance Sheet)**

Effective interest on 6% debenture = **₹ 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		₹	₹
Initial measurement (at cost) Financial Asset (₹ 50,000 x ₹ 3.50) To Cash A/c	Dr.	1,75,000	1,75,000

At 31st March, 20X2 (Re-measured at fair value)

Particulars		₹	₹
Financial Asset [(₹ 50,000 x 3.75) – 1,75,000] To OCI A/c	Dr.	12,500	12,500

Shares in Cox Ltd (₹ 1,75,000 + ₹ 12,500) = **₹ 1,87,500 (Balance Sheet)**

Gain on Fair Value = **₹ 12,500 (OCI)**

Question 37

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 ₹ 70 per kg - totalling ₹ 7,000. 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 ₹), the entity hedges its position by entering into currency futures contract for equivalent currency units at ₹ 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 ₹ 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 future 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 (₹/USD)
1st April, 20X1	76
30th June, 20X1	74
30th September, 20X1	71

Answer

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 ₹ @ ₹ 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 ₹ (b x c)	7,600	7,400	7,100
e	Difference (a – d)	0	200	500
f	Discount factor (as calculated in above table)	0.971	0.985	1
g	Fair value (e x f)	0	197	500
h	Fair value change for the period	0	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.	197	
	To Cash Flow Hedge Reserve (Other Equity) – OCI		197
	(Being Change in Fair Value of Hedging Instrument recognised in OCI accumulated in a separate component in Equity)		

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 ₹ 72 for USD 1)	7,200	7,200
30th September, 20X1	Cash Flow Hedge Reserve (Other Equity) – OCI Dr. To Profit and Loss (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 38

Entity PQR borrows ₹ 100 crores from CFDH Bank on 1 April 20X1. Interest is payable at 12% p.a. and there is a bullet repayment of principal at the end of the term.

Term of the loan is 6 years.

The loan includes an option to prepay the loan at 1st April each year with a prepayment penalty of 3%. There are no transaction costs. Without the prepayment option, the interest rate quoted by bank is 11% p.a.

Analyse whether Entity PQR needs to separate the embedded derivative from the host loan contract, if the entity determines that a difference of more than 2% will indicate that the option's exercise price is not approximately equals to the amortised cost of the host debt instrument (i.e. embedded derivative is not closely related to the host loan contract).

Note: Consider PV Factor upto 4 decimals and value in ₹ crores in 2 decimals.

Answer

Step 1: Identify the host contract and embedded derivative, if any

In the given case,

- Host is a debt instrument comprising annual interest payment at 12% p.a. and bullet principal repayment at the end of 6 years.
- Option to prepay the debt at ₹ 103 crores is an embedded derivative

Step 2: Determine the amortised cost of the host debt instrument

Whether the prepayment option is likely to be exercised or not, the amortised cost of the host debt instrument should be calculated as present value (PV) of expected cash flows using a fair market interest rate for a debt without the prepayment option (11% p.a. in this case). This is calculated below as ₹ 104.22 crores:

Year	Cash outflow	PV @ 11% p.a.	Finance cost	Amortised cost
		₹ crores		
1	12.00	10.81	11.46	103.68
2	12.00	9.74	11.40	103.08
3	12.00	8.77	11.34	102.42
4	12.00	7.90	11.27	101.69
5	12.00	7.12	11.19	100.88
6	112.00	59.88	11.10	-
		104.22	**67.78**	

Step 3: Compare the exercise price of the prepayment option with the amortised cost of the host debt instrument

Year	Amortised cost	Exercise price of prepayment option	Difference
	₹ Crores		
1	103.68	103.00	0.66%
2	103.09	103.00	0.09%
3	102.42	103.00	-0.57%
4	101.69	103.00	-1.29%
5	100.88	103.00	-2.1%
6	-	N/A	

The management of Entity PQR may formulate an appropriate accounting policy to determine what constitutes "approximately equal". In this case, if the management determines that a difference of more than 2% will indicate that the option's exercise price is not approximately equal to the amortised cost of the host debt instrument, it will need to separate the embedded derivative and account for it.

Question 39

Entity A (an ₹ functional currency entity) enters into a USD 1,000,000 sale contract on 1 January 20X1 with Entity B (an ₹ functional currency entity) to sell equipment (inventory) on 30 June 20X1.

Spot rate on 1 January 20X1: ₹/USD	45
Spot rate on 31 March 20X1: ₹/USD	57
Three-month forward rate on 31 March 20X1: ₹/USD	45
Six-month forward rate on 1 January 20X1: ₹/USD	55
Spot rate on 30 June 20X1: ₹/USD	60

Assume that this contract has an embedded derivative that is not closely related and requires separation. Please provide detailed journal entries in the books of Entity A for accounting of such embedded derivative until sale is actually made.

Answer

The contract should be separated using the 6 month USD/₹ forward exchange rate, as at the date of the contract (₹/USD = 55). The two components of the contract are therefore:

- A sale contract for ₹ 55 Million
- A six-month currency forward to purchase USD 1 Million at 55
- This gives rise to a gain or loss on the derivative, and a corresponding derivative asset or liability.

On delivery

1. Entity A records the sales at the amount of the host contract = ₹ 55 Million
2. The embedded derivative is considered to expire.
3. The derivative asset or liability (i.e. the cumulative gain or loss) is settled by becoming part of the financial asset on delivery.
4. In this case the carrying value of the currency forward at 30 June 20X1 on maturity is = ₹ (1,000,000 x 60 – 55 x 1,000,000) = ₹ 5,000,000 (profit/asset)

The table summarising the computation of gain/loss to be recorded at every period end-

Date	Transaction	Sales	Debtors	Derivative Asset/(Liability)	(Profit)/Loss
		₹	₹	₹	₹
1-Jan-20X1	Embedded Derivative	Nil Value			
31-Mar-20X1	Change in Fair Value of Embedded Derivatives MTM (55 – 45) x 1 Million			(10,000,000)	10,000,000
30-Jun-20X1	Change in Fair Value of Embedded Derivatives (60 – 45) x 1 Million			15,000,000	(15,000,000)
30-Jun-20X1	Recording sales at forward rate	(55,000,000)	55,000,000		
30-Jun-20X1	Embedded derivative- settled against debtors		5,000,000	(5,000,000)	

Journal Entries to be recorded at every period end

a. **01 January 20X1 – No entry to be made**

b. **31 March 20X1**

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Profit and loss A/c Dr.	10,000,000	
To Derivative financial liability A/c		10,000,000
(being loss on mark to market of embedded derivative booked)		

c. **30 June 20X1**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Derivative financial asset A/c	Dr.	5,000,000	
Derivative financial liability A/c	Dr.	10,000,000	
To Profit and loss A/c			15,000,000
(being gain on embedded derivative based on spot rate at the date of settlement booked)			

d. **30 June 20X1**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Trade receivable A/c	Dr.	55,000,000	
To Sales A/c			55,000,000
(being sale booked at forward rate on the date of transaction)			

e. **30 June 20X1**

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Trade receivable A/c	Dr	5,000,000	
To Derivative financial asset A/c			5,000,000
(being derivative asset re-classified as a part of trade receivables, bringing it to spot rate on the date of sale)			

Question 40

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	9 September 20X1
Delivery/payment date	31 December 20X1
Purchase price	USD 1,000,000
USD/₹ Forward rate on 9 September 20X1 for 31 December 20X1 maturity	67.8
USD/₹ Spot rate on 9 September 20X1	66.4
USD/₹ Forward rates for 31 December, on:	
30 September	67.5
31 December (spot rate)	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.

Answer

Based on the guidance above, 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 31 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 this context, an item or a commodity may be considered 'routinely denominated' in a particular 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 in this question would generally 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. In the question above, 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 September 20X1, to exchange USD 10,00,000 for ₹ at the USD/₹ forward rate of 67.8 on 31 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.	3,00,000	

	[(67.8 – 67.5) x 10,00,000] To Profit or loss		3,00,000
31-Dec-X1	**Fair value change in forward contract** Derivative asset (company B) Dr. [{(67.8 – 67) x 10,00,000} – 3,00,000] To Profit or loss	5,00,000	5,00,000
31-Dec-X1	**Recognition of machinery acquired and on settlement** Property, plant and equipment Dr. (at forward rate) To Derivative asset (company B) To Creditor (company B)/Bank	6,78,00,000	8,00,000 6,70,00,000

Question 41

On 1 January 20X1, X Ltd. enters into a contract to purchase a financial asset for ₹ 10 lakhs, which is its fair value on trade date. On 4 January 20X1 (settlement date), the fair value of the asset is ₹ 10.5 lakhs. The amounts to be recorded for the financial asset will depend on how it is classified and whether trade date or settlement date accounting is used. Pass necessary journal entries.

Answer

Journal Entries in the Buyer's Books

Trade date accounting

Dr./Cr.	Particulars	Amortised cost	Fair value through P&L	Fair value through OCI
1 January 20X1				
Dr.	Financial asset	10,00,000	10,00,000	10,00,000
Cr.	Financial liability (to pay)	(10,00,000)	(10,00,000)	(10,00,000)
4 January 20X1				
Dr.	Financial asset	–	50,000	50,000
Dr.	Financial liability (to pay)	10,00,000	10,00,000	10,00,000
Cr.	Profit or loss	–	(50,000)	–
Cr.	Other comprehensive income	–	–	(50,000)
Cr.	Cash	(10,00,000)	(10,00,000)	(10,00,000)

Settlement date accounting

Dr./Cr.	Particulars	Amortised cost	Fair value through P&L	Fair value through OCI
4 January 20X1				

Dr.	Financial asset	10,00,000	10,50,000	10,50,000
Cr.	Profit or loss	–	(50,000)	–
Cr.	Other comprehensive income	–	–	(50,000)
Cr.	Cash	(10,00,000)	(10,00,000)	(10,00,000)

The above mentioned accounting principles apply only to financial assets and Ind AS 109 does not contain any such principles for financial liabilities.

Question 42

Bonds (currently classified at Amortised Cost) for ₹ 1,00,000 reclassified as FVOCI. Fair value on reclassification is ₹ 90,000. Pass the required journal entry.

Answer

Particulars		Amount	Amount
Bonds at FVOCI	Dr.	90,000	
OCI – Loss on reclassification	Dr.	10,000	
To Bonds at amortised cost			1,00,000

Question 43

Bonds (currently classified at Amortised Cost) for ₹ 1,00,000 reclassified as FVTPL. Fair value on reclassification is ₹ 90,000. Pass the required journal entry.

Answer

Particulars		Amount	Amount
Bonds at FVTPL	Dr.	90,000	
P&L – Loss on reclassification	Dr.	10,000	
To Bonds at amortised cost			1,00,000

Question 44

Bonds (currently classified at FVTPL) for ₹ 100,000 reclassified as Amortised cost. Fair value on reclassification is ₹ 90,000. Pass the required journal entry.

Answer

Particulars		Amount	Amount
Bonds at Amortised cost	Dr.	90,000	
P&L – Loss on reclassification	Dr.	10,000	
To Bonds at FVTPL			1,00,000

Question 45

Bonds (currently classified at FVTPL) for ₹ 100,000 reclassified as FVOCI. Fair value on reclassification is ₹ 90,000. Pass the required journal entry.

Answer

Particulars		Amount	Amount
Bonds at FVOCI	Dr.	90,000	
P&L - Loss on reclassification	Dr.	10,000	
To Bonds at FVTPL			1,00,000

Question 46

Bonds (currently classified at FVOCI) for ₹ 1,00,000 reclassified as Amortised cost. Fair value on reclassification is ₹ 90,000 and ₹ 10,000 loss was recognised in OCI till date of reclassification. Pass required journal entry.

Answer

Particulars		Amount	Amount
Bonds at Amortised Cost	Dr.	10,000	
To OCI - Loss on reclassification			10,000
[Being loss recognized in OCI now reversed due to reclassification]			
Bonds (Amortised cost)	Dr.	1,00,000	
To Bonds at FVOCI			1,00,000
[Being bonds reclassified from FVOCI to Amortised cost]			

Question 47

Bonds (currently classified at FVOCI) for ₹ 1,00,000 reclassified as FVTPL. Fair value on reclassification is ₹ 90,000. Pass the required journal entry.

Answer

Particulars		Amount	Amount
P&L - Loss on reclassification	Dr.	10,000	
To Bonds at FVTOCI			10,000
Bonds at FVTPL	Dr.	90,000	
To Bonds at FVOCI			90,000

CHAPTER - 13
Business Combination and Corporate Restructuring

Question 1

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:

a. an immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;

b. 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.

i. 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 ₹ 25 lakhs.

ii. During the year ended 31 March 2017, the profit before interest and tax of B Ltd. exceeded ₹ 1 crore. As on 31 March 2017, the fair value of shares of A Ltd. is ₹ 25 per share.

(ii) Continuing with the fact pattern in (i) above except for:

a. The number of shares to be issued after one year is not fixed.

b. Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to ₹ 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds ₹ 1 crore. A Ltd. issued shares with ₹ 40 lakhs after a year.

Answer

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 recognize 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 recognized on initial recognition shall be as follows:

Fair value of shares issued (10,00,000 x ₹ 20)	₹ 2,00,00,000
Fair value of contingent consideration	₹ 25,00,000
Total purchase consideration	₹ 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:

(a) 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 unfavorable conditions (for the issuer of the instrument).

(b) If the instrument will or may be settled in the issuer's own equity instruments, then it is:

  (i) a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

  (ii) 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 ₹ 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 recognized on initial recognition shall be as follows:

Fair value shares issued (10,00,000 x ₹ 20)	₹ 2,00,00,000
Fair value of contingent consideration	₹ 25,00,000
Total purchase consideration	₹ 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 recognized 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 ₹ 15,00,000 (₹ 40,00,000 – ₹ 25,00,000) should be recognized in the profit or loss for the period. A Ltd. would recognize issuance of 1,60,000 (₹ 40,00,000/25) shares at a premium of ₹ 15 per share.

Question 2

Progressive Ltd is being sued by Regressive Ltd for an infringement of its Patent. At 31st March, 20X2, Progressive Ltd recognised a ₹ 10 million liability related to this litigation.

On 30th July, 20X2, Progressive Ltd acquired the entire equity of Regressive Ltd for ₹ 500 million. On that date, the estimated fair value of the expected settlement of the litigation is ₹ 20 million.

Answer

In the above scenario the litigation is in substance settled with the business combination transaction and accordingly the ₹ 20 million being the fair value of the litigation liability will be considered as paid for settling the litigation claim and will be not included in the business combination. Accordingly, the purchase price will reduce by 20 million and the difference between 20 and 10 will be recorded in income statement of the Progressive limited as loss on settlement of the litigation.

Question 3

ABC Ltd. acquires PQR Ltd. for a consideration of ₹ 1 crore. Four years ago, ABC Ltd. had granted a ten-year license allowing PQR Ltd. to operate in Europe. The cost of the license was ₹ 2,50,000. The contract allows either party to terminate the franchise at a cost of the unexpired initial fee plus 20%. At the date of acquisition, the settlement amount is ₹ 1,80,000 [(₹ 2,50,000 x 6/10) + 20%].

ABC Ltd. has acquired PQR Ltd., because it sees high potential in the European market and wishes to exploit it. ABC Ltd. calculates that under current economic conditions and at current prices it could grant a six-year franchise for a price of ₹ 4,50,000.

How is the license accounted for as part of the business combination?

Answer

Paragraph B51 of Ind AS 103 provides that "the acquirer and acquiree may have a relationship that existed before they contemplated the business combination, referred to here as a 'pre-existing relationship'. A pre-existing relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee) or non-contractual (for example, plaintiff and defendant)."

Further, paragraph B52 of Ind AS 103 provides that "if the business combination in effect settles a pre-existing relationship, the acquirer recognises a gain or loss, measured as follows:

(a) for a pre-existing non-contractual relationship (such as a lawsuit), fair value.

(b) for a pre-existing contractual relationship, the lesser of (i) and (ii):

   (i) the amount by which the contract is favourable or unfavourable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavourable contract is a contract that is unfavourable in terms of current market terms. It is not necessarily an onerous contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.)

   (ii) the amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavourable.

   If (ii) is less than (i), the difference is included as part of the business combination accounting.

The amount of gain or loss recognised may depend in part on whether the acquirer had previously recognised a related asset or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements."

Based on the above in the instant case, the license is recognised at ₹ 4,50,000, the fair value at market rates of a license based on the remaining contractual life.

The gain or loss on settlement of the contract is the lower of:

- ₹ 3,00,000, which is the amount by which the right is unfavorable to ABC Ltd. compared to market terms. This is the difference between the amount that ABC Ltd. could receive for granting a similar right, ₹ 4,50,000, compared to the carrying value (or the unamortised value) that it was granted for, ₹ 1,50,000 (2,50,000 x 6/10).
- ₹ 1,80,000, which is the amount that ABC Ltd. would have to pay to terminate the right at the date of acquisition.

The loss on settlement of the contract is ₹ 1,80,000. Therefore, out of the ₹ 1 crore paid, ₹ 98.2 lakh is accounted for as consideration for the business combination and ₹ 1,80,000 is accounted for separately as a settlement loss on the re-acquired right.

Question 4

ABC Ltd. acquired a beverage company PQR Ltd. from XYZ Ltd. At the time of the acquisition, PQR Ltd. is the defendant in a court case whereby certain customers of PQR Ltd. have alleged that its products contain pesticides in excess of the permissible levels that have caused them health damage.

PQR Ltd. is being sued for damages of ₹ 2 crore. XYZ Ltd. has indemnified ABC Ltd. for the losses, if any, due to the case for amount up to ₹ 1 crore. The fair value of the contingent liability for the court case is ₹ 70 lakh.

How should ABC Ltd. account for the contingent liability and the indemnification asset? What if the fair value of the liability is ₹ 1.2 crore instead of ₹ 70 lakh.

Answer

In the current scenario, ABC Ltd. measures the identifiable liability of entity PQR Ltd. at ₹ 70 lakh and also recognises a corresponding indemnification asset of ₹ 70 lakhs on its consolidated balance sheet. The net impact on goodwill from the recognition of the contingent liability and associated indemnification asset is nil.

However, in the case where the liability's fair value is more than ₹ 1 crore i.e. ₹ 1.2 crore, the indemnification asset will be limited to ₹ 1 crore only.

Question 5

ABC Ltd. acquires XYZ Ltd. in a business combination on 15th January, 20X1. Few days before the date of acquisition, one of XYZ Ltd.'s customers had claimed that certain amounts were due by XYZ Ltd. under penalty clauses for completion delays included in the contract.

ABC Ltd. evaluates the dispute based on the information available at the date of acquisition and concludes that XYZ Ltd. was responsible for at least some of the delays in completing the contract. Based on the evaluation, ABC Ltd. recognises ₹ 1 crore towards this liability which is its best estimate of the fair value of the liability to the customer based on the information available at the date of acquisition.

In October, 20X1 (within the measurement period), the customer presents additional information as per which ABC Ltd. concludes the fair value of liability on the date of acquisition to be ₹ 2 crore.

ABC Ltd. continues to receive and evaluate information related to the claim after October, 20X1. Its evaluation doesn't change till February, 20X2 (i.e. after the measurement period), when it concludes that the fair value of the liability for the claim at the date of acquisition is ₹ 1.9 crore. ABC Ltd. determines that the amount that would be recognised with respect to the claim under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets as at February, 20X2 is ₹ 2.2 crore.

How should the adjustment to the provisional amounts be made in the financial statements during and after the measurement period?

Answer

The consolidated financial statements of ABC Ltd. for the year ended 31st March, 20X1 should include ₹ 1 crore towards the contingent liability in relation to the customer claim.

When the customer presents additional information in support of its claim, the incremental liability of ₹ 1 crore (₹ 2 crore – ₹ 1 crore) will be adjusted as a part of acquisition accounting as it is within the measurement period. In its financial statements for the year ending on 31st March, 20X2, ABC Ltd. will disclose the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, it will disclose that the comparative information for the year ending on 31st March, 20X1 is adjusted retrospectively to increase the fair value of the item of liability at the acquisition date by ₹ 1 crore, resulting in a corresponding increase in goodwill.

The information resulting in the decrease in the estimated fair value of the liability for the claim in February, 20X2 was obtained after the measurement period. Accordingly, the decrease is not recognised as an adjustment to the acquisition accounting. If the amount determined in accordance with Ind AS 37 subsequently exceeds the previous estimate of the fair value of the liability, then ABC Ltd. recognises an increase in the liability. As the change has occurred after the end of the measurement period, the increase in the liability amounting to ₹ 20 lakh (₹ 2.2 crore – ₹ 2 crore) is recognised in profit or loss.

Question 6

Green Ltd acquired Pollution Ltd. as a part of the arrangement Green Ltd had to replace the Pollution Ltd.'s existing equity-settled award. The original awards specify a vesting period of five years. At the acquisition date, Pollution Ltd employees have already rendered two years of service.

As required, Green Ltd replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to 2 year (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

- original awards: ₹ 500
- replacement awards: ₹ 600

As of the acquisition date, all awards are expected to vest.

Answer

Pre-combination period

The value of the replacement awards will have to be allocated between the pre-combination and post combination period. As of the acquisition date, the fair value of the original award (₹ 500) will be multiplied by the service rendered upto acquisition date (2 years) divided by greater of original vesting period (5 years) or new vesting period (4 years). Accordingly, 500 x 2/5= 200 will be considered as pre-combination service and will be included in the purchase consideration.

Post- Combination period

The fair value of the award on the acquisition date is 600 which means the difference between the replacement award which is 600 and the amount allocated to pre-combination period (200) is 400 which will be now recorded over the remaining vesting period which is 2 years as an employee compensation cost.

Question 7

P a real estate company acquires Q another construction company which has an existing equity settled share based payment scheme. The awards vest after 5 years of employee service. At the acquisition date, Company Q's employees have rendered 2 years of service. None of the awards are vested at the acquisition date. P did not replace the existing share-based payment scheme but reduced the remaining vesting period from 3 years to 2 year. Company P determines that the market-based measure of the award at the acquisition date is ₹ 500 (based on measurement principles and conditions at the acquisition date as per Ind AS 102).

Answer

The market based measure or the fair value of the award on the acquisition date of 500 is allocated NCI and post combination employee compensation expense. The portion allocable to pre-combination period is 500 x 2/5 = 200 which will be included in pre-combination period and is allocated to NCI on the acquisition date. The amount is computed based on original vesting period.

The remaining expense which is 500 – 200 = 300 is accounted over the remaining vesting period of 2 years as compensation expenses.

Question 8

On 1st January, 20X1, A Ltd. acquires 80 per cent of the equity interests of B Ltd. in exchange for cash of ₹ 15 crore. The former owners of B Ltd. were required to dispose off their investments in B Ltd. by a specified date, and accordingly they did not have sufficient time to find potential buyers. A qualified valuation professional hired by the management of A Ltd. measures the identifiable net assets acquired, in accordance with the requirements of Ind AS 103, at ₹ 20 crore and the fair value of the 20 per cent non-controlling interest in B Ltd. at ₹ 4.2 crore. How should A Ltd. recognise the above bargain purchase?

Answer

The amount of B Ltd.'s identifiable net assets i.e., ₹ 20 crore exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in B Ltd. i.e. ₹ 19.2 crore. Therefore, A Ltd. should review the procedures it used to identify and measure the net assets acquired and the fair value of non-controlling interest in B Ltd. and the consideration transferred. After the review, A Ltd. decides that the procedures and resulting measures were appropriate.

A Ltd. measures the gain on its purchase of the 80 per cent interest at ₹ 80 lakh, as the difference between the amount of the identifiable net assets which is ₹ 20 crore and the sum of purchase consideration and fair value of non-controlling interest, which is ₹ 19.2 crore (cash consideration of ₹ 15 crore and fair value of non-controlling interest of ₹ 4.2 crore).

Assuming there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the gain on bargain purchase of 80 per cent interest calculated at ₹ 80 lakh, which will be recognised in other comprehensive income on the acquisition date and accumulated the same in equity as capital reserve.

If the acquirer chose to measure the non-controlling interest in B Ltd. on the basis of its proportionate share of identifiable net assets of the acquiree, the recognised amount of the non- controlling interest would be ₹ 4 crore (₹ 20 crore x 0.20). The gain on the bargain purchase then would be ₹ 1 crore (₹ 20 crore – (₹ 15 crore + ₹ 4 crore)).

Question 9

Company A acquired 90% equity interest in Company B on 1st April, 20X1 for a consideration of ₹ 85 crores in a distress sale. Company B did not have any instrument recognised in equity. The Company appointed a registered valuer with whose assistance, the Company valued the fair value of NCI and the fair value identifiable net assets at ₹ 15 crores and ₹ 100 crores respectively.

Find the value at which NCI has to be shown in the financial statements

Answer

In this case, Company A has the option to measure NCI as follows:

- Option 1: Measure NCI at fair value i.e., ₹ 15 crores as derived by the valuer;
- Option 2: Measure NCI as proportion of fair value of identifiable net assets i.e., ₹ 10 crores (100 crores x 10%)

Question 10

Company A acquires 70 percent of Company S on 1st January, 20X1 for consideration transferred of ₹ 5 million. Company A intends to recognise the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitably qualified valuation professional, A measures the identifiable net assets of B at ₹ 10 million. A 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 A and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process.

Answer

The amount of B's identifiable net assets exceeds the fair value of the consideration transferred plus the fair value of the NCI in B, resulting in an initial indication of a gain on a bargain purchase. Accordingly, A 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, A concludes that the procedures followed and the resulting measurements were appropriate.

(₹)

Identifiable net assets	1,00,00,000
Less: Consideration transferred	(50,00,000)
NCI (10 million x 30%)	(30,00,000)
Gain on bargain purchase	20,00,000

Question 11

Classic Ltd. acquires 60% of the ordinary shares of Natural Ltd. a private entity, for ₹ 97.5 crore. The fair value of its identifiable net assets is ₹ 150 crore. The fair value of the 40% of the ordinary shares owned by non-controlling shareholders is ₹ 65 crore. Carrying amount of Natural Ltd.'s net assets is ₹ 120 crore.

How will the non-controlling interest be measured?

Answer

Paragraph 19 of Ind AS 103 states that for each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

(a) fair value; or

(b) the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by Ind AS.

In accordance with above, non-controlling interests will be measured in either of the following manner:

(a) Non-controlling interests are measured at fair value

Under this method, goodwill represents the difference between the fair value of Natural Ltd. and the fair value of its identifiable net assets.

Thus, Classic Ltd. will recognise the business combination as follows: **(₹ in crores)**

Identifiable net assets at fair value	Dr	150	
Goodwill*	Dr	12.5	
To Non-controlling interest			65
To Investment in Natural Ltd.			97.5

*Note: Goodwill is calculated as 97.5 + 65 – 150 = 12.5 or 162.5 – 150 = 12.5

(b) Non-controlling interests are measured at proportionate share of identifiable net assets

Under this method, goodwill represents the difference between the total of the consideration transferred less the fair value of the acquirer's share of net assets acquired and liabilities assumed. The non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the Natural Ltd's net assets in the event of liquidation (i.e. the ordinary shares) are measured at the non-controlling interest's proportionate share of the identifiable net assets of Natural Ltd.

Thus, Classic will recognise the business combination as follows: **(₹ in Crores)**

Identifiable net assets at fair value	Dr	150	
Goodwill*	Dr	7.5	
To Non-controlling interest (40% x 150)			60
To Investment in Natural Ltd.			97.5

*Note: Goodwill is calculated as 97.5 + 60 – 150 = 7.5 or 97.5 – (150 x 60%) = 7.5

Question 12

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 on 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?

Answer

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.		
80 per cent interest in Beta Pvt. Ltd.	300	
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 13

ABC Ltd. prepares consolidated financial statements upto 31st March each year. On 1st July 2017, ABC Ltd. acquired 75% of the equity shares of JKL Ltd. and gained control of JKL Ltd. the issued shares of JKL Ltd. is 1,20,00,000 equity shares. Details of the purchase consideration are as follows:

- On 1st July, 2017, ABC Ltd. issued two shares for every three shares acquired in JKL Ltd. On 1st July, 2017, the market value of an equity share in ABC Ltd. was ₹ 6.50 and the market value of an equity share in JKL Ltd. was ₹ 6.
- On 30th June, 2018, ABC Ltd. will make a cash payment of ₹ 71,50,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 2017. On 1st July, 2017, ABC Ltd. would have to pay interest at an annual rate of 10% on borrowings.
- On 30th June, 2019, ABC Ltd. may make a cash payment of ₹ 3,00,00,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 2017. This payment is contingent upon the revenues of ABC Ltd. growing by 15% over the two-year period from 1st July, 2017 to 30th June, 2019. On 1st July, 2017, the fair value of this contingent consideration was ₹ 2,50,00,000. On 31st March, 2018, the fair value of the contingent consideration was ₹ 2,20,00,000.

On 1st July, 2017, the carrying values of the identifiable net assets of JKL Ltd. in the books of that company was ₹ 6,00,00,000. On 1st July, 2017, 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, 2018, JKL Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 2018 it was necessary for ABC Ltd. to recognise an impairment of the goodwill arising on acquisition of JKL Ltd., amounting to 10% of its total computed value.

Compute the impairment of goodwill in the consolidated financial statements of ABC Ltd. under both the methods permitted by Ind AS 103 for the initial computation of the non- controlling interest in JKL Ltd. at the acquisition date.

Answer

Computation of goodwill impairment

	NCI at fair value	NCI at 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
Non-controlling interest at date of acquisition:		
Fair value (3,000 x ₹ 6)	18,000	
% of net assets [68,000 (Refer W.N.) x 25%]		17,000
Net assets on the acquisition date (Refer W.N.)	(68,000)	(68,000)
Goodwill on acquisition	20,500	19,500
Impairment @ 10%	2,050	1,950

Working Note:

Net assets on the acquisition date	₹ '000
Fair value at acquisition date	70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]	(2,000)
	68,000

Question 14

Company A and Company B are in power business. Company A holds 25% of equity shares of Company B. On 1st November, Company A obtains control of Company B when it acquires a further 65% of Company B's shares, thereby resulting in a total holding of 90%. The acquisition had the following features:

- **Consideration:** Company A transfers cash of ₹ 59,00,000 and issues 1,00,000 shares on 1st November. The market price of Company A's shares on the date of issue is ₹ 10 per share. The equity shares issued as per this transaction will comprise 5% of the post-acquisition equity capital of Company A.
- **Contingent consideration:** Company A agrees to pay additional consideration of ₹ 7,00,000 if the cumulative profits of Company B exceed ₹ 70,00,000 over the next two years. At the acquisition date, it is not considered probable that the extra consideration will be paid. The fair value of the contingent consideration is determined to be ₹ 3,00,000 at the acquisition date.
- **Transaction costs:** Company A pays acquisition-related costs of ₹ 1,00,000.
- **Non-controlling interests (NCI):** The fair value of the NCI is determined to be ₹ 7,50,000 at the acquisition date based on market prices. Company A elects to measure non-controlling interest at fair value for this transaction.
- **Previously held non-controlling equity interest:** Company A has owned 25% of the shares in Company B for several years. At 1st November, the investment is included in Company A's consolidated balance sheets at ₹ 6,00,000, accounted for using the equity method; the fair value is

₹ 20,00,000.

The fair value of Company B's net identifiable assets at 1st November is ₹ 60,00,000, determined in accordance with Ind AS 103.

Determine the accounting under acquisition method for the business combination by Company A.

Answer

Identify the acquirer

In this case, Company A has paid cash consideration to shareholders of Company B. Further, the shares issued to Company B pursuant to the acquisition do not transfer control of Company A to erstwhile shareholders of Company B. Therefore, Company A is the acquirer and Company B is the acquiree.

Determine acquisition date

As the control over the business of Company B is transferred to Company A on 1st November, that date is considered as the acquisition date.

Determine the purchase consideration

The purchase consideration in this case will comprise the following:

Cash consideration	₹ 59,00,000
Equity shares issued (1,00,000 x 10 i.e., at fair value)	₹ 10,00,000
Contingent consideration (at fair value)	₹ 3,00,000
Fair value of previously held interest	₹ 20,00,000

As such, the total purchase consideration is ₹ 92,00,000.

Acquisition cost incurred by and on behalf of the Company A for acquisition of Company B should be recognised in the Statement of profit and loss. As such, an amount of ₹ 1,00,000 should be recognised in Statement of profit and loss.

Determine fair value of identifiable assets and liabilities

The fair value of identifiable net assets is determined at ₹ 60,00,000.

Measure NCI

The management has decided to recognise the NCI at its fair value. As such, the NCI will be recognised at ₹ 7,50,000.

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, the Company A exercised significant influence over Company B. 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 Statement of Profit and Loss. As such, an amount of ₹ 14,00,000 (i.e., 20,00,000 less 6,00,000) will be recognised in Statement of profit and loss.

Determination of goodwill or gain on bargain purchase

Goodwill should be calculated as follows: **(₹)**

Total consideration	92,00,000
Recognised amount of any non-controlling interest	7,50,000

Less: fair value of Lila-Domestic's net identifiable assets	(60,00,000)
Goodwill	**39,50,000**

Question 15

On 30th September, 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 30th September, 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 30th September, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non-current assets at 30th September, 20X1 is 1,500..

The 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

Assume that Entity B's earnings for the annual period ended 31st December, 20X0 were 600 and that the consolidated earnings for the annual period ended 31st December, 20X1 were 800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31st December, 20X0 and during the period from 1st January, 20X1 to the date of the reverse acquisition on 30th September, 20X1.

Calculate the fair value of the consideration transferred measure goodwill and prepare consolidated balance sheet as on September 30, 20X1. Also compute Earnings per share as on December 30, 20X1.

Answer

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 recognised 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 30th September, 20X1

The consolidated statement of financial position immediately after the business combination is:

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500
Total liabilities	2,400

Shareholders' equity	
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 31st December, 20X1 is calculated as follows:

Number of shares deemed to be outstanding for the period from 1st January, 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 31st December, 20X1	250
Weighted average number of ordinary shares outstanding [(150 x 9/12) + (250 x 3/12)]	175
Earnings per share [800/175]	4.57

Restated earnings per share for the annual period ended 31st December, 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 16

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
1st November, 20X6	15%	The shares were purchased based on the quoted price on the stock exchange on the relevant dates.
1st January, 20X7	45%	

Both the above-mentioned companies have Rupees as their functional currency. Consequently, H Ltd. acquired control over S Ltd. on 1st January, 20X7. Following is the Balance Sheet of S Ltd. as on that date:

Particulars	Carrying value (₹ in crore)	Fair value (₹ 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		
- Investments	100.0	350.0
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
Non-current asset held for sale	4.0	4.5
TOTAL ASSETS	**208**	
EQUITY AND LIABILITIES:		
Equity		
(a) Share capital (face value ₹ 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		
- Trade payables	28.0	28.0
(b) Provision for warranties	3.0	3.0
(c) Current tax liabilities	4.0	4.0
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 ₹ 1 crore and fair value of ₹ 1.2 crore. The date of inception of the lease was 1st April, 20X0. 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, 20X7 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, 20X7:

Particulars	Fair value (₹ in crore)	Remarks
Law suit filed by a customer for a claim of ₹ 2 crore	0.5	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 law suit will be tax deductible.

Income tax demand of ₹ 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 ₹ 1 crore.

₹ 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 ₹ 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, 20X7, 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, 20X7 is ₹ 10,000 per share.

On 1st January, 20X7, H Ltd. has paid ₹ 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 20X9, H Ltd. will pay ₹ 30 crore to the selling shareholders of S Ltd. if return on equity of S Ltd. for the year ended 31st March, 20X9 is more than 25% per annum. H Ltd. has estimated the fair value of this obligation as on 1st January, 20X7 and 31st March, 20X7 as ₹ 22 crore and ₹ 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, 20X6	₹ 350 per share
As on 1st January, 20X7	₹ 395 per share
As on 31st March, 20X7	₹ 420 per share

On 31st May, 20X7, H Ltd. learned that certain customer relationships existing as on 1st January, 20X7, 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, 20X7. The fair value of such customer relationships as on 1st January, 20X7 was ₹ 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, 20X7 itself, H Ltd. further learned that due to additional customer relationships being developed during the period 1st January, 20X7 to 31st March, 20X7, the fair value of such customer relationships has increased to ₹ 4 crore as on 31st March, 20X7.

On 31st December, 20X7, 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:

(a) 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, 20X7. 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, 20X7? If yes, provide relevant journal entries.

(c) What should be the accounting treatment of the contingent consideration as on 31st March, 20X7?

Answer

(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 ₹ 2.5 cr.

Since S Ltd. has indemnified for ₹ 1 cr., H Ltd. shall recognise an indemnification asset at the same time for ₹ 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.

Calculation of purchase consideration as per Ind AS 103 **₹ in crore**

Investment in S Ltd.			
On 1st Nov. 20X6	15%	[(12/100) x 395 x 15%]	7.11
On 1st Jan. 20X7	45%		
Own equity given		10,000 x 12% x 45% x 1/2	270
Cash			50
Contingent consideration			22
			349.11

(v) Calculation of deferred tax on assets and liabilities acquired as part of the business combination, including current tax and goodwill.

Item	₹ in crore				
	Book value	Fair value	Tax base	Taxable/ (deductible) temporary difference	Deferred tax asset/(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)

(vi) Calculation of identifiable net assets acquired

	₹ in crore	₹ 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 1.1.20X7 = 368.65 crore

NCI on 1.1.20X7 = 368.65 crore x 40% = 147.46 crore

Calculation of Goodwill as per Ind AS 103

Goodwill on 1.1.20X7 = Purchase consideration + NCI – Net assets

= 349.11 + 147.46 – 368.65 = 127.92 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, 20X7, 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, 20X7.

On 31st May, 20X7 (i.e. within the measurement period), H Ltd. learned that certain customer relationships existing as on 1st January, 20X7 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, 20X7. Therefore, H Ltd. shall account for the acquisition date fair value of customer relations existing on 1st January, 20X7 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, 20X7 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) ₹ 1 crore will be recognized in the Statement of Profit and Loss.

Question 17

The balance sheet of Professional Ltd. and Dynamic Ltd. as of 31st March, 20X2 is given below:

Assets	Professional Ltd	Dynamic Ltd
Non-Current Assets:		
Property, plant and equipment	300	500
Investment	400	100
Current assets:		
Inventories	250	150
Financial assets		
Trade receivables	450	300
Cash and cash equivalents	200	100
Others	400	230

Total	2,000	1,380
Equity and Liabilities		
Equity		
Share capital - Equity shares of ₹ 100 each of Dynamic Ltd. and ₹ 10 each of Professional Ltd.	500	400
Other Equity	810	225
Non-Current liabilities:		
Financial liabilities		
Long term borrowings	250	200
Long term provisions	50	70
Deferred tax	40	35
Current Liabilities:		
Financial liabilities		
Short term borrowings	100	150
Trade payables	250	300
Total	2,000	1,380

Other information

a. Professional Ltd. acquired 70% shares of Dynamic Ltd. on 1st April, 20X2 by issuing its own shares in the ratio of 1 share of Professional Ltd. for every 2 shares of Dynamic Ltd. The fair value of the shares of Professional Ltd was ₹ 40 per share.

b. The fair value exercise resulted in the following: (all nos in Lakh)

   a. Fair value of PPE on 1st April, 20X2 was ₹ 350 lakhs.

   b. Professional Ltd also agreed to pay an additional payment as consideration that is higher of 35 lakh and 25% of any excess profits in the first year, after acquisition, over its profits in the preceding 12 months made by Dynamic Ltd. This additional amount will be due after 2 years. Dynamic Ltd has earned ₹ 10 lakh profit in the preceding year and expects to earn another ₹ 20 Lakh.

   c. In addition to above, Professional Ltd also had agreed to pay one of the founder shareholder a payment of ₹ 20 lakh provided he stays with the Company for two year after the acquisition.

   d. Dynamic Ltd had certain equity settled share based payment award (original award) which got replaced by the new awards issued by Professional Ltd. As per the original term the vesting period was 4 years and as of the acquisition date the employees of Dynamic 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:

      i. Original award – ₹ 5 lakh

      ii. Replacement award – ₹ 8 lakh.

   e. Dynamic Ltd had a lawsuit pending with a customer who had made a claim of ₹ 50 lakh.

Management reliably estimated the fair value of the liability to be ₹ 5 lakh.

f. The applicable tax rate for both entities is 30%.

You are required to prepare opening consolidated balance sheet of Professional Ltd as on 1st April, 20X2. Assume 10% discount rate.

Answer

Consolidated Balance Sheet of Professional Ltd as on 1st April, 20X2 **(₹ in Lakhs)**

	Amount
Assets	
Non-Current Assets:	
Property, plant and equipment	650
Investment	500
Current assets:	
Inventories	400
Financial assets:	
Trade receivables	750
Cash and cash equivalents	300
Others	630
Total	**3,230**
Equity and Liabilities	
Equity	
Share capital – Equity shares of ₹ 100 each	514
Other Equity	1,128.62
NCI	154.95
Non-Current liabilities:	
Financial liabilities	
Long term borrowings	450
Long term provisions (50 + 70 + 28.93)	148.93
Deferred tax	28.5
Current Liabilities:	
Financial liabilities	
Short term borrowings	250
Trade payables	550
Provision for Law suit Damages	5
Total	**3,230**

Notes:

a. 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 ₹ 350 lakhs.

b. 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, 2.5 (5 x 2/4) is considered as a part of purchase consideration and is credited to Professional Ltd equity as this will be settled in its own equity. The balance of 2.5 will be recorded as employee expense in the books of Dynamic Ltd over the remaining life, which is 1 year in this scenario.

c. There is a difference between contingent consideration and deferred consideration. In the given case 35 is the minimum payment to be paid after 2 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 35 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%.

d. The additional consideration of ₹ 20 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 income statement of Dynamic Ltd.

Working Notes:

1. Computation for Purchase consideration

Particulars		**Amount**
Share capital of Dynamic Ltd		4,00,00,000
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value per share		40
		₹ in lakhs
PC (2,00,000 x 70% x ₹ 40 per share) (A)		56.00
Deferred consideration after discounting ₹ 35 lakhs for 2 years @ 10% (B)		28.93
Replacement award Market based measure of the acquiree award (5) 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 i.e. (5 x 2/4) (C)		2.50
PC in lakhs (A + B + C)		87.43

2. Allocation of Purchase price

Particulars	**Book value (A)**	**Fair value (B)**	**FV adjustment (A – B)**
Property, plant and equipment	500	350	(150)

Investment	100	100	–
Inventories	150	150	–
Financial assets:			
Trade receivables	300	300	–
Cash and cash equivalents	100	100	–
Others	230	230	–
Less: Long term borrowings	(200)	(200)	–
Long term provisions	(70)	(70)	–
Deferred tax	(35)	(35)	–
Short term borrowings	(150)	(150)	–
Trade payables	(300)	(300)	–
Contingent liability	–	(5)	(5)
Net assets (X)	625	470	(155)
Deferred tax Asset on FV adjustment (155 x 30%) (Y)		46.50	155
Net assets (X + Y)		516.5	
Non-controlling interest (516.50 x 30%) rounded off		154.95	
Capital Reserve (Net assets – NCI – PC)		274.12	
Purchase consideration (PC)		87.43	

3. Computation of consolidated amounts of Consolidated financial statements

	Professional Ltd	Dynamic Ltd (pre-acquisition)	PPA Allocation	Total
Assets				
Non-Current Assets:				
Property, plant and equipment	300	500	(150)	650
Investment	400	100		500
Current assets:				
Inventories	250	150		400
Financial assets:				
Trade receivables	450	300		750
Cash and cash equivalents	200	100		300
Others	400	230		630
Total	2,000	1,380	(150)	3,230
Equity and Liabilities				
Equity				
Share capital – Equity shares of ₹ 100 each	500			514

Shares allotted to Dynamic Ltd. (2,00,000 x 70% x ₹ 10 per share)			14	
Other Equity	810		318.62	1,128.62
Replacement award			2.5	2.5
Security Premium (2,00,000 shares x 70% x ₹ 30)			42	42
Capital Reserve			274.12	274.12
Non-controlling interest	0		154.95	154.95
Non-Current liabilities:				
Financial Liabilities				
Long term borrowings	250	200		450
Long term provisions	50	70	28.93	148.93
Deferred tax	40	35	(46.5)	28.5
Current Liabilities:				
Financial Liabilities				
Short term borrowings	100	150		250
Trade payable	250	300		550
Liability for lawsuit damages			5	5
Total	2,000	755	475	3,230

Question 18

On 1st April, 20X1, PQR Ltd. acquired 30% of the voting ordinary shares of XYZ Ltd. for ₹ 8,000 crore. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28. At 31st March, 20X2, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

	(₹ in crore)
Share of profit or loss	700
Share of exchange difference in OCI	100
Share of revaluation reserve of PPE in OCI	50

The carrying amount of the investment in the associate on 31st March, 20X2 was therefore ₹ 8,850 crore (8,000 + 700 + 100 + 50).

On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash ₹ 25,000 crore. The following additional information is relevant at that date:

	(₹ in crore)
Fair value of the 30% interest already owned	9,000

Fair value of XYZ's identifiable net assets	30,000

How should such business combination be accounted for?

Answer

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 recognise 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 recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Applying the above, PQR Ltd. records the following entry in its consolidated financial statements:

		(₹ in crore)	
		Debit	**Credit**
Identifiable net assets of XYZ Ltd.	Dr.	30,000	
Goodwill (W.N.1)	Dr.	4,000	
Foreign currency translation reserve	Dr.	100	
PPE revaluation reserve	Dr.	50	
To Cash			25,000
To Investment in associate -XYZ Ltd.			8,850
To Retained earnings (W.N.2)			50
To Gain on previously held interest in XYZ recognised in Profit or loss (W.N.3)			250
(To recognise acquisition of XYZ Ltd.)			

Working Notes:

1. Calculation of Goodwill

	₹ in crore
Cash consideration	25,000
Add: Fair value of previously held equity interest in XYZ Ltd.	9,000
Total consideration	34,000
Less: Fair value of identifiable net assets acquired	(30,000)
Goodwill	4,000

2. The credit to retained earnings represents the reversal of the unrealized gain of ₹ 50 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 XYZ Ltd. is calculated as follows: **₹ in crore**

Fair Value of 30% interest in XYZ Ltd. at 1st April, 20X2	9,000
Carrying amount of interest in XYZ Ltd. at 1st April, 20X2	(8,850)

	150
Unrealised gain previously recognised in OCI	100
Gain on previously held interest in XYZ Ltd. recognised in profit or loss	250

Question 19

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.
MicroFly 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 Cloudustries 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 **(₹ 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
(b) 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 ₹ 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 ₹ 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.

Answer

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:

(a) Net asset taken over: **(₹ 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**

(b) Treatment of difference between consideration and assets/liabilities taken over:

(₹ 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 ₹ 1.80 crore shall be transferred to capital reserve.

Question 20

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: **(₹ 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 ₹ 10 each		25	–	25
Surplus		175	(100)	75
Total		200	200	400

Division Mobiles along with its assets and liabilities was sold for ₹ 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 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:

(i) Pass journal entries in the books of Enterprise Ltd.

(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).

(iii) Prepare the Balance Sheet of Turnaround Ltd.

Answer

Journal of Enterprise Ltd. **(₹ 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 ₹ 25 crores)			

Notes:

(1) Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.

(2) 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 **(₹ 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 ₹ 10 each)		25
Other equity (Surplus)	1	175
Liabilities		
Current liabilities		
Current liabilities		25
		225

Notes to Accounts

		(₹ 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 ₹ 10 each at a premium of ₹ 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. **(₹ 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 ₹ 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

		(₹ in crores)
1.	**Share Capital:**	
	Issued and Paid-up capital	
	1 crore Equity shares of ₹ 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.

Question 21

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 20X2 was as under:

		Maxi division	Mini division	Total (in crores)
Property, Plant and Equipment				
Cost		600	300	900
Depreciation		(500)	(100)	(600)
W.D.V.	(A)	100	200	300
Current assets		400	300	700
Less: Current liabilities		(100)	(100)	(200)
	(B)	300	200	500
Total	(A+B)	400	400	800
Financed by:				
Loan funds	(A)	–	100	100
(secured by a charge on property, plant and equipment)				
Own funds:				
Equity capital				50
(fully paid up ₹ 10 per share)				
Other Equity				650
	(B)	?	?	700
Total	(A + B)	400	400	800

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division.

Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures, the assets and liabilities of that division. Mini Ltd. is to allot 5 crore equity shares of ₹ 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

(a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 20X2, showing corresponding previous year's figures.

(b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.

(c) Comment on the impact of demerger on "shareholders wealth".

Answer

Demerged Company: Mini Division of "Maxi Mini Ltd"

Resulting Company: "Mini Ltd."

(a) Journal of Maxi Mini Ltd. (Demerged Company)

		(₹ in crores)	
		Dr.	**Cr.**
Current liabilities A/c	Dr.	100	
Loan fund (secured) A/c	Dr.	100	
Provision for depreciation A/c	Dr.	100	
Loss on reconstruction (Balancing figure)	Dr.	300	
To Property, Plant and Equipment A/c			300
To Current assets A/c			300
(Being the assets and liabilities of Mini division taken out of the books on transfer of the division to Mini Ltd., the consideration being allotment to the members of the company of one equity share of ₹ 10 each of that company at par for every share held in the company vide scheme of reorganisation)			

Note: Any other alternatives set of entries, with the same net effect on various accounts, may be given by the students. In the absence of additional information on fair value of the assets transferred it has been assumed that the group of shareholders control both the demerged and the resultant entity. It is expected that students should evaluate all reorganization from common control parameters and aptly highlight the assumptions in the note while solving the question.

Journal of Mini Ltd.

		(₹ in crores)	
		Dr.	**Cr.**
Property, Plant and Equipment (300 – 100) A/c	Dr.	200	
Current assets A/c	Dr.	300	
To Current Liabilities A/c			100
To Secured loan funds A/c			100
To Equity share capital A/c			50
To Capital reserve			250
(Being the assets and liabilities of Mini division of Maxi Mini Ltd. taken over and allotment of 5 crores equity shares of ₹ 10 each at part as fully paid up to the members of Maxi Mini Ltd.)			

Maxi Mini Ltd.

Balance Sheet as at 1st November, 20X2 ₹ in crore

ASSETS	Note No.	After Reconstruction	Before Reconstruction
Non-current assets			
Property, Plant and Equipment	2	100	300
Current assets			
Other current assets		400	700
		500	1,000
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of ₹ 10 each)		50	50
Other equity	1	350	650
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings		–	100
Current liabilities			
Current liabilities		100	200
		500	1,000

Notes to Accounts

		After Reconstruction	Before Reconstruction
1.	**Other Equity**		
	Other Equity	650	650
	Less: Loss on reconstruction	(300)	–
		350	650
2.	**Property, Plant and Equipment**	600	900
	Less: Depreciation	(500)	(600)
		100	300

Notes to Accounts: Consequent on reconstruction of the company and transfer of Mini division to newly incorporated company Mini Ltd., the members of the company have been allotted 5 crores equity shares of ₹ 10 each at part of Mini Ltd. The demerged entity and the resultant entity are common control and accordingly the transaction has been accounted at book values of the assets transferred in both the entity.

Mini Ltd.

Balance Sheet as at 1st November, 20X2 ₹ in crore

ASSETS	Note No.	After reconstruction
Non-current assets		
Property, Plant and Equipment		200
Current assets		
Other current assets		300
		500
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	50
Other equity (capital reserve)		250
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		100
Current liabilities		
Current liabilities		100
		500

Notes to Account

	(₹ in crores)
1. Share Capital:	
Issued and paid up:	
5 crores Equity shares of ₹ 10 each fully paid up	50
(All the above shares have been issued for consideration other than cash, to the members of Maxi Mini Ltd., on takeover of Mini division from Maxi Mini Ltd.)	

(b) Net asset value of an equity share

	Pre-demerger	Post-demerger
Maxi Mini Ltd. :	$\frac{₹\ 700 \text{ crores}}{5 \text{ crores}} = ₹\ 140$	$\frac{₹\ 400 \text{ crores}}{5 \text{ crores}} = ₹\ 80$
Mini Ltd.:		$\frac{₹\ 300 \text{ crores}}{5 \text{ crores}} = ₹\ 60$

(c) Demerger into two companies has had no impact on "net asset value" of shareholding. Pre-demerger, it was ₹ 140 per share. After demerger, it is ₹ 80 plus ₹ 60 i.e. ₹ 140 per original share.

It is only yield valuation that is expected to change because of separate focusing on two distinct businesses whereby profitability is likely to improve on account of demerger.

Question 22

AX Ltd. and BX Ltd. amalgamated on and from 1st January, 20X2. A new Company ABX Ltd. with shares of ₹ 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-20X2 **₹ in '000**

ASSETS	Note No.	AX Ltd	BX Ltd
Non-current assets			
Property, Plant and Equipment		8,500	7,500
Financial assets			
Investment		1,050	550
Current assets			
Inventory		1,250	2,750
Trade receivables		1,800	4,000
Cash and Cash equivalent		450	400
		13,050	15,200
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of ₹ 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

Note:

1.	**Other equity**	**AX Ltd**	**BX 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

ABX 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

ABX Ltd:

a. Assuming that both the entities are under common control

b. Assuming BX Ltd is a larger entity and their management will take the control of entity ABX Ltd.

The fair value of net assets of AX and BX limited are as follows:

Assets	AX Ltd. ('000)	BX Ltd. ('000)
Property, Plant and Equipment	9,500	1,000
Inventory	1,300	2,900
Fair value of the business	11,000	14,000

Answer

(a) (Assumption: Common control transaction)

1. Calculation of Purchase Consideration

		AX Ltd.		BX Ltd.
		₹'000		₹'000
Assets taken over:				
Property, Plant and Equipment		85,00		75,00
Investment		10,50		5,50
Inventory		12,50		27,50
Trade receivables		18,00		40,00
Cash & Cash equivalent		4,50		4,00
Gross Assets		130,50		152,00
Less: Liabilities				
12% Debentures	30,00		40,00	
Trade payables	10,00	(40,00)	15,00	(55,00)
Net Assets taken over		90,50		97,00
Less: Other Equity:				
General Reserve	15,00		20,00	
P & L A/c	10,00		5,00	
Investment Allowance Reserve	5,00		1,00	
Export Profit Reserve	50	(30,50)	1,00	(27,00)
Purchase Consideration		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 AX Ltd =

$$\frac{\text{Net Assets taken over of AX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \times \text{Purchase Consideration}$$

No. of shares to be issued to BX Ltd =

$$\frac{\text{Net Assets taken over of BX Ltd.}}{\text{Net Assets taken over of AX Ltd. and BX Ltd.}} \times \text{Purchase Consideration}$$

	AX Ltd. ₹ '000	BX Ltd. ₹ '000
$130,00 \times \frac{90,50}{187,50}$ = 6,27,500* Equity shares of ₹ 10 each	62,75	
$130,00 \times \frac{97,00}{187,50}$ = 6,72,500 Equity shares of ₹ 10 each		67,25

*The total purchase consideration is to be discharged by ABX Ltd. in such a way that the rights of the shareholders of AX Ltd. and BX Ltd. remain unaltered in the future profits of ABX Ltd.

3. **Balance Sheet of ABX Ltd. as on 1.1.20X2** **₹ in '000**

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		16,000
Financial assets		
Investments		1,600
Current assets		
Inventory		4,000
Trade receivable		5,800
Cash and Cash equivalent		850
		28,250
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	13,000
Other equity	2	5,750
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings	3	7,000
Current liabilities		
Trade payable		2,500
		28,250

Notes to Accounts

		(₹' 000)	(₹' 000)
1.	**Share Capital**		
	13,00,000 Equity Shares of ₹ 10 each		130,00
2.	**Other Equity**		
	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

(b) Assuming BX Ltd is a larger entity and their management will take the control of the entity ABX Ltd.

In this case BX Ltd. and AX 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 ABX Ltd which is issuing the shares or AX Ltd. or BX 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 ABX Ltd. is issuing the shares but BX Ltd. post-merger will have control and is bigger in size which is a clear indicator that BX Ltd. will be an accounting acquirer. This can be justified by the following table:

(in '000s)

	AX Ltd.	BX 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 ABX Ltd. = 2,500 thousand shares		
Thus, % Held by each Company in Combined Entity	44%	56%

Note: It is a case of Reverse Acquisition.

Accordingly, BX Ltd. assets will be recorded at historical cost in the merged financial statements.

(1) Calculation of Purchase Consideration (All figures are in thousands)

We need to calculate the number of shares to be issued by BX Ltd. to AX Ltd. to maintain the same percentage i.e. 56%:

Thus, 700 thousand shares of BX Ltd. (given in the balance sheet) represents 56%. This means that total no. of shares would be 1,250 thousand shares i.e. 700 thousand shares/56%.

This implies BX Ltd. would need to issue 550 thousand shares (1,250 less 700) to AX Ltd.

Purchase Consideration = 550 thousand shares x ₹ 20 per share (i.e. 14,000 thousand/700 thousand shares) = ₹ 11,000 thousand.

(2) **Balance Sheet of ABX Ltd. as on 1.1.20X2** **₹ in '000**

ASSETS	**Note No.**	**Amount**
Non-current assets		
Goodwill (Refer Working Note)		900
Property, Plant and Equipment (9,500 + 7,500)		17,000
Financial assets		
Investment (1,050 + 550)		1,600
Current assets		
Inventory (1,300 + 2,750)		4,050
Trade receivables (1,800 + 4,000)		5,800
Cash and Cash equivalent (450 + 400)		850
		30,200
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 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

		(₹' 000)	**(₹' 000)**
1.	**Share Capital**		
	1,250,000 Equity Shares of ₹ 10 each (700,000 to BX Ltd and 550,000 as computed above to AX LTD)		1,25,00
2.	**Other Equity**		
	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 10)	<u>5,500</u>	8,200
3.	**Long Term Borrowings**		

12% Debentures		70,00

Working Note:

Goodwill Computation:

Assets:	₹ in 000s
Property, Plant and Equipment	9,500
Investment	1,050
Inventory	1,300
Trade Receivable	1,800
Cash & Cash Equivalent	450
Total Assets	14,100
Less: Liabilities:	
Borrowings	3,000
Trade Payable	1,000
Net Assets	10,100
Purchase Consideration	11,000
Goodwill	900

Question 23

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

The fair value of assets acquired and Liabilities assumed are as follows:

Building - ₹ 1000 Crores

Cash and Cash Equivalent - ₹ 200 Crores

Financial Liabilities - ₹ 800 Crores

DTL - ₹ 150 crores

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

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

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

Answer

i) Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held) = 300 + 120 + 80 = ₹ 500 Crores

ii) Fair value of liability assumed (excluding deferred tax) – ₹ 800 crores

iii) Cash and cash equivalent – ₹ 200 crores.

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

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

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

Question 24

Sita Ltd and Beta Ltd decides to combine together for forming a Dual Listed Corporation (DLC). As per their shareholder's agreement, both the parties will retain original listing and Board of DLC will be comprised of 10 members out of which 6 members will be of Sita Ltd and remaining 4 board members will be of Beta Ltd.

The fair value of Sita Ltd is ₹ 100 crores and fair value of Beta Ltd is ₹ 80 crores. The fair value of net identifiable assets of Beta Limited is ₹ 70 crores. Assume non-controlling Interest (NCI) to be measured at fair value.

You are required to determine the goodwill to be recognised on acquisition.

Answer

Sita Ltd has more Board members and thereby have majority control in DLC. Therefore, Sita Ltd is identified as acquirer and Beta Ltd as acquiree.

Since no consideration has been transferred, the goodwill needs to be calculated as the difference of Part A and Part B:

Part A:

1) Consideration paid by Acquirer – Nil
2) Controlling Interest in Acquiree – ₹ 80 crores
3) Acquirer's previously held interest – Nil

Part B:

Fair value of net identifiable asset – ₹ 70 crores

Goodwill is recognised as ₹ 10 crores (80 – 70 crores) in business combination achieved through contract alone when NCI is measured at fair value.

Question 25

On 1 January 2020, entity H acquired 100% share capital of entity S for ₹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 ₹'000	Tax base ₹'000	Fair values ₹'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.

Answer

Calculation of Net assets acquired (excluding the effect of deferred tax liability):

Net assets acquired	**Tax base ₹'000**	**Fair values ₹'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

	₹'000	**₹'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 (₹ 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 ₹ 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 26

In March 2018, Pharma Ltd. acquires Dorman Ltd. in a business combination for a total cost of ₹ 12,000 lakhs. At that time Dorman Ltd.'s assets and liabilities are as follows:

Item	₹ 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 ₹ 8,000 lakhs and a tax written down value of ₹ 6,000 lakhs. The receivables are short-term trade receivables net of a doubtful debts allowance of ₹ 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 ₹ 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.

Answer

Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

Item	₹ 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	3,60[7]			
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., (₹ 5,200 + ₹ 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 ₹ 360 lakhs, comprised of ₹ 90 lakhs in relation to the receivables and ₹ 270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is ₹ 1,890 lakhs calculated as follows:

₹ 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) x 30%]	300 (1,000 x 30%)	600
Brand names	0	1,290 (4,300 x 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 ₹ 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 ₹ 9,900 lakhs.

Question 27

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 ₹ 10 each. The quoted market price of shares of Nafa Ltd. was ₹ 12 on the date of acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 20X1 was ₹ 80,00,000.

Bima Ltd. wired ₹ 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 ₹ 25 per share.

Bima Ltd. also agrees to pay additional consideration of ₹ 15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds ₹ 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 ₹ 9,80,000. Nafa Ltd. incurred ₹ 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.

Answer

Computation of Goodwill/Capital reserve on consolidation as per Ind AS 103

Particulars	₹
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, ₹ 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:

		₹	₹
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 28

Monsoon Limited acquired, on 30 September, 20X2, 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Monsoon Limited is Indian Rupee and its financial year ends on 31 March, 20X3.

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 30 September, 20X2.

The exchange rates as on 30 September, 20X2 was ₹ 82 per EURO and at 31 March, 20X3 was ₹ 84 per EURO.

On acquisition of Mark limited, what is the value at which the goodwill/capital reserve has to be recognized in the financial statements of Monsoon Limited as on 31 March 20X3?

Answer

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 (Purchase consideration)			₹ 17.5 million
To NCI (23 x 30%)			₹ 6.9 million

Thus, goodwill on reporting date in the books of Monsoon Limited would be

= 1.4 million EURO x ₹ 84 = ₹ 117.6 million.

Question 29

Company X is engaged in the business of exploration & development of Oil & Gas Blocks.

Company X currently holds participating interest (PI) 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 & Company Z are the Joint Operators. Company Y incurs all the expenditure on behalf of Joint Venture and raise cash call to Company X &

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 01.04.20X1. However, company Z has filed the appeal with arbitrator on 30.04.20X1.

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 & 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 ₹ Lacs 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 given the industry in which the joint-operators operate.

Balance sheet of Company X & Company Z are as follows:

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 equivalents). 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 ventures 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.

Answer

(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 an integrated set of assets and activities 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 the 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	Dr.	1,66,650	
Right-of-use Asset	Dr.	6,666	
Development CWIP	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			29,997
To Cash & Cash Equivalent (Purchase consideration)			1,00,000
To Gain on bargain purchase (OCI)			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 30.6.20X1	Adjustments	Post-Acquisition 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**		**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**		**9,09,994**
Total Assets	**23,00,000**		**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**		**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**		**12,29,987**
Current Liabilities			
Financial liabilities			
Trade Payables	6,00,000	66,660	6,66,660

Total Current Liabilities	6,00,000		6,66,660
Total Equity and Liabilities	23,00,000		25,16,635

Working Notes

1. **Determination of Company Z's balance acquired by Company X on 30.6.20X1 (Acquisition Date)**

Particulars	**As per Company Z Books 30.6.20X1**	**Carrying Value 33.33% Share**	**Acquisition Date Value**	**Remarks**
	₹	₹	₹	
Assets				
Non-Current Assets				
Property Plant & Equipment	3,00,000	99,990	1,66,650	Note 1
Right of Use Asset	20,000	6,666	6,666	
Development CWIP	1,00,000	33,330	66,660	Note 2
Financial Assets				
Loan receivable	50,000	16,665	16,665	
Total Non-Current Assets	**4,70,000**	**1,56,651**	**2,56,641**	
Current assets				
Inventories	30,000	9,999	9,999	
Financial Assets				
Trade receivables	1,00,000	33,330	33,330	
Cash and cash equivalents	2,00,000	66,660	66,660	
Other Current Assets	50,000	16,665	16,665	
Total Current Assets	**3,80,000**	**1,26,654**	**1,26,654**	
Liabilities				
Non-Current Liabilities				
Provisions	2,00,000	66,660	66,660	
Other Liabilities	1,00,000	33,330	33,330	
Total Non-Current Liabilities	**3,00,000**	**99,990**	**99,990**	
Current Liabilities				
Financial liabilities				
Trade Payables	2,00,000	66,660	66,660	
Total Current Liabilities	**2,00,000**	**66,660**	**66,660**	

Note 1: Fair Value of PPE:

Fair Value of PPE in Company Z Books	₹ 5,00,000
33.33% Share acquired by Company X	₹ 1,66,650

Note 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

2. **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.

3. **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**

Note: 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 & company holds only 30% PI rights in Block AWM/01 through unincorporated joint venture, this is not a case of step acquisition.

Question 30

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 ₹ 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 ₹ 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 ₹ 4,00,000, if the cumulative profits of S Limited exceeds ₹ 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 ₹ 2,00,000 at the acquisition date.

(iii) P Limited spent acquisition-related costs of ₹ 2,00,000.

(iv) The fair value of the NCI is determined to be ₹ 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 ₹ 8,00,000. The fair value of previous holdings accounted for using the equity method is arrived at ₹ 18,00,000.

The fair value of S Limited's net identifiable assets at 31 December 2019 is ₹ 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.

Answer

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	₹ 50,00,000
Equity shares issued (90,000 x 10 i.e., at fair value)	₹ 9,00,000
Contingent consideration (at fair value)	₹ 2,00,000
Fair value of previously held interest	₹ 18,00,000
Total purchase consideration	₹ 79,00,000

Acquisition cost incurred by and on behalf of P Limited for acquisition of S Limited should be recognised in the Statement of Profit and Loss. As such, an amount of ₹ 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) ₹ 45,00,000.

Non-Controlling Interest

The management has decided to recognise NCI at its fair value, which is given in the question as ₹ 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 ₹ 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: **(₹)**

Total consideration	79,00,000
Recognised amount of any non-controlling interest	5,00,000
Less: Fair value of net identifiable assets	(45,00,000)
Goodwill	39,00,000

Question 31

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%.

Answer

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 32

As part of its business expansion strategy, KK Ltd. is in process of setting up a pharma intermediates business which is at very initial stage. For this purpose, KK Ltd. has acquired on 1st April, 2018, 100% shares of ABR Ltd. that manufactures pharma intermediates. The purchase consideration for the same was by way of a share exchange valued at ₹ 35 crores. The fair value of ABR Ltd.'s net assets was ₹ 15 crores, but does not include:

(i) A patent owned by ABR Ltd. for an established successful intermediate drug that has a remaining life of 8 years. A consultant has estimated the value of this patent to be ₹ 10 crores. 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 ₹ 15 crores.

(ii) ABR Ltd. has developed and patented a new drug which has been approved for clinical use. The cost of developing the drug was ₹ 12 crores. Based on early assessment of its sales success, the valuer has estimated its market value at ₹ 20 crores.

(iii) ABR 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 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 a valuable asset which assures guaranteed sales and the value for the same is estimated at ₹ 10 crores.

KK Ltd. has requested you to suggest the accounting treatment of the above transaction under applicable Ind AS.

Answer

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 ABR Ltd.: The patent owned will be recognised at fair value by KK Ltd. even though it was not recognised by ABR Ltd. in its financial statements. The patent will be amortised over the remaining useful life of the asset i.e. 8 years. Since the company is awaiting the outcome of the trials, the value of the patent cannot be estimated at ₹ 15 crore and the extra ₹ 5 crore should only be disclosed as a Contingent Asset and not recognised.

(ii) Patent internally developed by ABR 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 i.e ₹ 20 crore on acquisition date.

(iii) Grant of Licence to ABR 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 KK Ltd. On acquisition date, the fair value of the license is ₹ 10 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 no conditions with respect to compliance of grant (if any) have been passed to the acquirer. Hence, the fair value of the liability with respect to grant, for acquirer would be nil. Only, the grant asset (license) would be recognised at ₹ 10 crore in the books of acquirer KK Ltd.

Hence the revised working would be as follows:

	₹
Fair value of net assets of ABR Ltd.	15 crore
Add: Patent (10 + 20)	30 crore
Add: License	10 crore
Less: Grant for License	(Nil)
	55 crores
Less: Purchase Consideration	(35 crores)
Bargain purchase	20 crore

Question 33

On 31st March, 20X1, Earth India Ltd. paid ₹ 50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd.'s net assets had a fair value of ₹ 30,00,000. In addition, Sun Ltd. also held the following rights:

- Trade Mark named "GRAND" – valued at ₹ 1,80,000 using a discounted cash flow technique.
- Sole distribution rights to an electronic product; future cash flows from which are estimated to be ₹ 1,50,000 per annum for the next 6 years.

10% is considered an appropriate discount rate.

The 6 year, 10% annuity factor is 4.36.

Calculate goodwill and other Intangible assets arising on acquisition.

Answer

Particulars	Amount	Amount
Purchase Consideration (A)		50,00,000
Net Asset acquired	30,00,000	
Trade Mark	1,80,000	
Distribution Rights (1,50,000 x 4.36)	6,54,000	
Total (B)		(38,34,000)
Goodwill on Acquisition		11,66,000

Question 34

X Ltd. is engaged in the business of publishing Journals. They acquired 100% stake in Y Ltd., a company in the same industry. X Ltd. paid purchase consideration of ₹ 10,00,00,000 and fair value of net assets acquired is ₹ 8,50,00,000. The purchase consideration includes payment for the following as well:

(a) ₹ 30,00,000 for obtaining the skilled staff of Y Ltd.

(b) ₹ 50,00,000 by way of payment towards 'Non-compete Fee' so as to restrict Y Ltd. to compete in the same line of business for next 5 years.

However, the above items (a) and (b) are not forming part of the net assets acquired of ₹ 8,50,00,000.

How should the above transactions be accounted for by X Ltd?

Answer

X Ltd. should recognise an intangible asset in respect of the consideration paid towards 'Non- Compete Fee'.

However, amount paid for obtaining skilled staff amounting to ₹ 30,00,000 does not meet the definition of intangible asset since X Ltd. has not established any right over the resource and should be expensed. The entity has insufficient control over the expected future economic benefits arising from a team of skilled staff.

Therefore, ₹ 50,00,000 will be separately recognised as an intangible asset, whereas amount paid for obtaining skilled staff does not meet the recognition criteria. However, since it is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date.

The value of goodwill is ₹ 1,00,00,000 (₹ 1,50,00,000 – ₹ 50,00,000).

Question 35

X Limited in a business combination, purchased the net assets of Y Limited for ₹ 4,00,000 on 31st March, 20X1. The assets and liabilities position of Y Limited just before the acquisition is as follows:

Assets	Cost (in ₹)
Property, Plant & Equipment	1,00,000
Intangible asset 1	20,000
Intangible asset 2	50,000
Cash & Bank	1,30,000
Liabilities	
Trade payable	50,000

The fair market value of the PPE, intangible asset 1 and intangible asset 2 is available and they are ₹ 1,50,000, ₹ 30,000 and ₹ 70,000 respectively.

How would X Limited account for the net assets acquired from Y Limited?

Answer

X Limited will account for the assets acquired from Y Limited in following manner:

Assets	Amount (₹)
Property, plant and equipment	1,50,000
Goodwill (Note 1)	70,000
Intangible asset 1	30,000
Intangible asset 2	70,000
Cash & Bank	1,30,000
Liabilities	
Trade payable	50,000

Note 1- Goodwill is the difference between fair value of net assets acquired and purchase consideration paid when is calculated as follow:

Goodwill = ₹ 4,00,000 – ₹ (1,50,000 + 70,000 + 30,000 + 1,30,000 – 50,000) = ₹ 70,000

CHAPTER - 14
Consolidated Financial Statements

Question 1

DEF Ltd. acquired 100% ordinary shares of ₹ 100 each of XYZ Ltd. on 1st October 20X1. On March 31, 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**
Equities & Liabilities		
Equity Capital (Shares of ₹ 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 ₹ 3,00,000 on 1st April 20X1 out of which a dividend of 10% was paid on 1st November; DEF Ltd. has recognised the dividend received to profit or loss account; Fair Value of P&M as on 1st October 20X1 was ₹ 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

Note:

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.

Prepare consolidated Balance Sheet as on March 31, 20X2.

Answer

Consolidated Balance Sheet of DEF Ltd. and its subsidiary, XYZ Ltd. as on 31st March, 20X2

Particulars	Note No.	₹
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

			₹
1.	**Property Plant & Equipment**		
	Land & Building	43,00,000	
	Plant & Machinery	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:

5. **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

6. **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 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 ₹ 18,85,000.

Working Notes:

1. **Adjustments of Fair Value**

   The Plant & Machinery of XYZ Ltd. would stand in the books at ₹ 14,25,000 on 1st October, 20X1, considering only six months' depreciation on ₹ 15,00,000 total depreciation being ₹ 1,50,000. The value put on the assets being ₹ 20,00,000 there is an appreciation to the extent of ₹ 5,75,000.

2. **Acquisition date profits of XYZ Ltd.** ₹

Reserves on 1.4. 20X1	10,00,000
Profit & Loss Account Balance on 1.4. 20X1	3,00,000
Profit for 20X2: Total ₹ 8,20,000 less ₹ 1,00,000 (3,00,000 – 2,00,000) i.e. ₹ 7,20,000; for 6 months i.e. upto 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.** ₹

Profit after 1.10. 20X1 [8,20,000 – 1,00,000] x 6/12	3,60,000
Less: 10% depreciation on ₹ 20,00,000 for 6 months less depreciation already charged for 2nd half of 20X1-20X2 on ₹ 15,00,000 (1,00,000 – 75,000)	(25,000)
Share of DEF Ltd.	3,35,000

4. **Consolidated total comprehensive income** ₹

DEF Ltd.	
Retained earnings on 31.3.20X2	5,72,000
Less: Retained earnings as on 1.4.20X1	(0)
Profits for the year 20X1-20X2	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** ₹

Amount paid for 20,000 shares		34,00,000
Par value of shares	20,00,000	
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**

		₹
DEF Ltd.		24,00,000
XYZ Ltd.	13,50,000	
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 ₹ 20,00,000 for 6 months	(1,00,000)	19,00,000
		43,00,000

8. **Consolidated retained earnings**

₹

	DEF Ltd.	XYZ Ltd.	Total
As given	5,72,000	8,20,000	13,92,000
Consolidation Adjustments:			
(i) Elimination of pre-acquisition element [3,00,000 + 3,60,000]	0	(6,60,000)	(6,60,000)
(ii) Elimination of intra-group dividend	(2,00,000)	2,00,000	0
(iii) Impact of fair value adjustments	0	(25,000)	(25,000)
Adjusted retained earnings consolidated	3,72,000	3,35,000	7,07,000

Assumptions:

1. Investment in XYZ Ltd is carried at cost in the separate financial statements of DEF Ltd.
2. Appreciation of ₹ 10 lakhs in land & buildings is entirely attributable to land element only.
3. Depreciation on plant and machinery is on WDV method.
4. 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.

Question 2

Ram Ltd. acquired 60% ordinary shares of ₹ 100 each of Krishan Ltd. on 1st October 20X1. On March 31, 20X2 the summarised Balance Sheets of the two companies were as given below:

	Ram Ltd.	Krishan Ltd.
Assets		
Property, Plant and Equipment		

Land & Buildings	3,00,000	3,60,000
Plant & Machinery	4,80,000	2,70,000
Investment in Krishan Ltd.	8,00,000	-
Inventory	2,40,000	72,800
Financial Assets		
Trade Receivables	1,19,600	80,000
Cash	29,000	16,000
Total	**19,68,600**	**7,98,800**
Equity & Liabilities		
Equity Capital (Shares of ₹ 100 each fully paid)	10,00,000	4,00,000
Other Equity		
Other Reserves	6,00,000	2,00,000
Retained earnings	1,14,400	1,64,000
Financial Liabilities		
Bank Overdraft	1,60,000	-
Trade Payable	94,200	34,800
Total	**19,68,600**	**7,98,800**

The Retained earnings of Krishan Ltd. showed a credit balance of ₹ 60,000 on 1st April 20X1 out of which a dividend of 10% was paid on 1st November; Ram Ltd. has credited the dividend received to its Retained earnings; Fair Value of P& M as on 1st October 20X1 was ₹ 4,00,000; 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	20,000	Land & Buildings	2,00,000
		Inventories	30,000

Note:

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 as on 31st March 20X2 are the same as was on 1st April 20X1.

Prepare consolidated Balance Sheet as on March 31, 20X2.

Answer

Consolidated Balance Sheet of Ram Ltd. and its subsidiary, Krishan Ltd. as on 31st March, 20X2

Particulars	Note No.	₹
I. Assets		

	(1) Non-current assets		
	(i) Property, Plant & Equipment	1	17,20,000
	(ii) Goodwill	2	1,65,800
	(2) Current Assets		
	(i) Inventories	3	3,42,800
	(ii) Financial Assets		
	(a) Trade Receivables	4	1,99,600
	(b) Cash & Cash equivalents	5	45,000
	Total Assets		**24,73,200**
II.	**Equity and Liabilities**		
	(1) Equity		
	(i) Equity Share Capital	6	10,00,000
	(ii) Other Equity	7	7,30,600
	(2) Non-controlling Interest (WN 5)		4,33,600
	(3) Current Liabilities		
	(i) Financial Liabilities		
	(a) Trade Payables	8	1,49,000
	(b) Short term borrowings	9	1,60,000
	Total Equity & Liabilities		**24,73,200**

Notes to accounts

			₹
1.	**Property Plant & Equipment**		
	Land & Building	8,60,000	
	Plant & Machinery	8,60,000	17,20,000
2.	**Goodwill**		1,65,800
3.	**Inventories**		
	Ram Ltd.	2,40,000	
	Krishan Ltd.	1,02,800	3,42,800
4.	**Trade Receivables**		
	Ram Ltd.	1,19,600	
	Krishan Ltd.	80,000	1,99,600
5.	**Cash & Cash equivalents**		
	Ram Ltd.	29,000	
	Krishan Ltd.	16,000	45,000
8.	**Trade Payables**		

	Ram Ltd.	94,200	
	Krishan Ltd.	54,800	1,49,000
9.	**Short-term borrowings**		
	Bank overdraft		1,60,000

Statement of Changes in Equity:

6. **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
10,00,000	0	10,00,000

7. **Other Equity**

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Other Reserves	
Balance at the beginning of the reporting period				0	6,00,000	6,00,000
Total comprehensive income for the year			0	1,14,400		1,14,400
Dividends			0	(24,000)		(24,000)
Total comprehensive income attributable to parent			0	40,200		40,200
Gain on Bargain purchase				0		0
Balance at end of reporting period				1,30,600	6,00,000	7,30,600

Working Notes:

1. **Adjustments of Fair Value**

The Plant & Machinery of Krishan Ltd. would stand in the books at ₹ 2,85,000 on 1st October, 20X1, considering only six months' depreciation on ₹ 3,00,000 total depreciation being ₹ 30,000. The value put on the assets being ₹ 4,00,000 there is an appreciation to the extent of ₹ 1,15,000.

2. **Acquisition date profits of Krishan Ltd.**

Reserves on 1.4.20X1	2,00,000
Profit & Loss Account Balance on 1.4.20X1	60,000
Profit for 20X1-20X2: Total (₹ 1,64,000 less ₹ 20,000) x 6/12 i.e. ₹ 72,000; upto 1.10.20X1	72,000
Total Appreciation	3,25,000
Total	6,57,000
Holding Co. Share (60%)	3,94,200

3. Post-acquisition profits of Krishan Ltd.

Profit after 1.10.20X1 [1,64,000 – 20,000] x 6/12	72,000
Less: 10% depreciation on ₹ 4,00,000 for 6 months less depreciation already charged for 2nd half of 20X1-20X2 on ₹ 3,00,000 (20,000 – 15,000)	(5,000)
Total	67,000
Share of holding Co. (60%)	40,200

4. Non-controlling Interest

Par value of 1,600 shares	160,000
Add: 2/5 Acquisition date profits (6,57,000 – 40,000)	2,46,800
2/5 Post-acquisition profits [WN 4]	26,800
	4,33,600

5. Goodwill:

Amount paid for 2,400 shares		8,00,000
Par value of shares	2,40,000	
Acquisition date profits share of Ram Ltd.	3,94,200	(6,34,200)
Goodwill		1,65,800

6. Value of Plant & Machinery:

Ram Ltd.		4,80,000
Krishan Ltd.	2,70,000	
Add: Appreciation on 1.10.20X1	1,15,000	
	3,85,000	
Add: Depreciation for 2nd half charged on pre-revalued value	15,000	
Less: Depreciation on ₹ 4,00,000 for 6 months	(20,000)	3,80,000
		8,60,000

7. Profit & Loss account consolidated

Ram Ltd. (as given)	1,14,400	
Less: Dividend	(24,000)	90,400
Share of Ram Ltd. in post-acquisition profits		40,200
		1,30,600

Question 3

On 31 March 20X2, Blue Heavens Ltd. acquired 100% ordinary shares carrying voting rights of Orange County Ltd. for ₹ 6,000 lakh in cash and it controlled Orange County Ltd. from that date. The acquisition-date statements of financial position of Blue Heavens Ltd. and Orange County Ltd. and the fair values of the assets and liabilities recognised on Orange County Ltd. balance sheet were:

	Blue Heavens Ltd.	Orange County Ltd.	
	Carrying Amount (₹ in lakh)	**Carrying Amount (₹ in lakh)**	**Fair Value (₹ in lakh)**
Assets			
Non-current assets			
Building and other PPE	7,000	3,000	3,300
Investment in Orange County Ltd.	6,000		
Current assets			
Inventories	700	500	600
Trade receivables	300	250	250
Cash	1,500	700	700
Total assets	**15,500**	**4,450**	
Equity and liabilities			
Equity			
Share capital	5,000	2,000	
Retained earnings	10,200	2,300	
Current liabilities			
Trade payables	300	150	150
Total liabilities and equity	**15,500**	**4,450**	

Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd.

Answer

Blue Heavens Ltd. consolidated balance sheet at 31 March 20X2 will be calculated as follows: **(in lakhs)**

	Blue Heavens Ltd.	Orange County Ltd.	Consolidation adjustments	Consolidated Blue Heavens Ltd.

	Carrying amount	Carrying amount		
Assets				
Non-current assets				
Goodwill			1,300 (WN 1)	1,300
Buildings and other PPE	7,000	3,000	300	10,300
Financial Assets				
Investment in Orange County Ltd.	6,000		(6,000)	
Current assets				
Inventories	700	500	100	1,300
Financial Assets				
Trade receivables	300	250		550
Cash	1,500	700		2,200
Total assets	**15,500**	**4,450**		**15,650**
Equity and liabilities				
Equity				
Share capital	5,000	2,000	(2,000)	5,000
Other Equity	10,200	2,300	(2,300)	10,200
Trade payable	300	150		450
Total liabilities and equity	**15,500**	**4,450**		**15,650**

Consolidation involves:

- Adding the statement of financial position of the parent and its subsidiary together line by line.
- Eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets, liabilities and contingent liabilities acquired) and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased) and recognising the fair value adjustments together with the goodwill asset that arose on acquisition of the subsidiary.

1. Working for goodwill:

	(₹ in lakhs)
Consideration paid	6,000
Less: Acquisition date fair value of Orange County Ltd. net assets	(4,700)
Goodwill	1,300

2. Working for the acquisition date fair value of Orange County Ltd. net assets:

Buildings and other PPE	3,300
Inventories	600
Trade receivables	250
Cash	700

Less: fair value of trade payables	(150)
Fair value of net assets acquired	4,700

Question 4

The facts are the same as in Question 3 above. However, Blue Heavens Ltd. acquires only 75% of the ordinary shares, to which voting rights are attached of Orange County Ltd. Blue Heavens Ltd. pays ₹ 4,500 lakhs for the shares. Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd.

Answer

Non-controlling interest

= 25% x Orange County Ltd. identifiable net assets at fair value of ₹ 4,700

= ₹ 1,175

Blue Heavens Ltd. consolidated balance sheet at 31 March 20X2 will be calculated as follows: **(in lakhs)**

	Blue Heavens Ltd.	**Orange County Ltd.**	**Consolidation adjustments**	**Consolidated Blue Heavens Ltd.**
	Carrying amount	**Carrying amount**		
Assets				
Non-current assets				
Goodwill			975 (WN 1)	975
Buildings and other PPE	7,000	3,000	300	10,300
Financial Assets				
Investment in Orange County Ltd.	4,500		(4,500)	
Current assets				
Inventories	700	500	100	1,300
Financial Assets				
Trade receivables	300	250		550
Cash	3,000	700		3,700
Total assets	**15,500**	**4,450**		**16,825**
Equity and liabilities				
Equity	5,000	2,000	(2,000)	5,000
Share capital	10,200	2,300	(2,300)	10,200
Other Equity			1,175	1,175
Non- controlling interest				
Current liabilities				

Financial Liabilities				
Trade payables	300	150		450
Total liabilities and equity	**15,500**	**4,450**		**16,825**

Note: In this question, Blue Heavens Ltd.'s (and consequently the group's) cash balance is ₹ 1,500 lakh higher than in Question above because, in this question, Blue Heavens Ltd. paid ₹ 1,500 less to acquire Orange County Ltd. (i.e. ₹ 6,000 less ₹ 4,500).

Working for goodwill:	**(₹ in lakhs)**
Consideration paid	4,500
Non- controlling interest	1,175
Less: Acquisition date fair value of Orange County Ltd. net assets (cal. as above)	4,700
Goodwill	975

(Goodwill recognized in the consolidated balance sheet relates solely to the acquirer's proportion of the subsidiary; it does not include the non-controlling interest's share).

Question 5

Facts are same as in Question 3 and 4 above, Blue Heavens Ltd. acquires 75% of Orange County Ltd. Blue Heavens Ltd. pays ₹ 4,500 lakhs for the shares. At 31 March 20X3, i.e. one year after Blue Heavens Ltd. acquired Orange County Ltd., the individual statements of financial position and statements of comprehensive income of Blue Heavens Ltd. and Orange County Ltd. are:

	Blue Heavens Ltd. Carrying Amount (₹ in lakh)	**Orange County Ltd.** Carrying Amount (₹ in lakh)
Assets		
Non-current assets		
PPE (Building and others)	6,500	2,750
Investment in Orange County Ltd.	4,500	-
	11,000	2,750
Current assets		
Inventories	800	550
Financial Asset – Trade receivables	380	300
Cash	4,170	1,420
	5,350	2,270
Total assets	**16,350**	**5,020**
Equity and liabilities		
Equity		
Share capital	5,000	2,000

Retained earnings	11,000	2,850
	16,000	4,850
Current liabilities		
Financial Liabilities-Trade payables	350	170
	350	170
Total liabilities and equity	**16,350**	**5,020**

Statements of Profit and Loss for the year ended 31 March 20X3:

	Blue Heavens Ltd. Carrying Amount (₹ in lakh)	Orange County Ltd. Carrying Amount (₹ in lakh)
Revenue	3,000	1,900
Cost of sales	(1,800)	(1,000)
Administrative expenses	(400)	(350)
Profit for the year	**800**	**550**

Note: Blue Heavens Ltd. estimates that goodwill has impaired by 98. The fair value adjustment to buildings and other PPE is in respect of a building; all buildings have an estimated remaining useful life of 20 years from 31 March 20X2 and estimated residual values of zero. Blue Heavens Ltd. uses the straight-line method for depreciation of PPE. All the inventory held by Orange County Ltd. at 31 March 20X2 was sold during 20X3.

Prepare the Consolidated Balance Sheet as on March 31, 20X3 of group of entities Blue Heavens Ltd. and Orange County Ltd.

Answer

Alternative I for calculation of Non-controlling Interest:

The Non-controlling Interest proportion of Orange County Ltd. is 25 %.

At 31 March 20X3, the NCI in the consolidated balance sheet would be calculated as:

	₹ (lakh)
NCI at date of acquisition (31 March 20X2) (see solution to Question 4)	1,175
NCI's share of profit for the year ended 31 March 20X3, being 25% of ₹ 435 lakh (being ₹ 550 profit of Orange County Ltd. as per Orange County Ltd. financial statements less ₹ 100 group inventory Fair value adjustment less ₹ 15 group depreciation on building fair value adjustment)*	109
NCI as at 31 March 20X3	1,284

*In calculating the NCI's share of profit for the year ended 31 March 20X3, no deduction is made for goodwill amortisation because, as explained above, the goodwill arising on consolidation relates solely to the acquirer's proportion of the subsidiary and does not include the non-controlling interest's share.

Alternative II for calculation of Non-controlling Interest:

As an alternative to the above three-step approach, at 31 March 20X3 the NCI in the consolidated statement of financial position is calculated as 25% (the NCI's proportion) of ₹ 5,135, which is ₹ 1,284. ₹ 5,135 is Orange County Ltd. net assets at 31 March 20X3 as shown in Orange County Ltd. statement of financial position (₹ 4,850, being ₹ 5,020 assets less ₹ 170 liabilities) plus the fair value adjustment to those assets as made in preparing the group statement of financial position (₹ 285, being the fair value adjustment in respect of Orange County Ltd. building, ₹ 300, less one year's depreciation of that adjustment, ₹ 15).

Blue Heavens Ltd. consolidated statement of comprehensive income for the year ended 31 March 20X3 will be computed as follows:

	Blue Heavens Ltd.	**Orange County Ltd.**	**Consolidated adjustments**	**Consolidated**
Revenue	3,000	1,900		4,900
Cost of sales	(1,800)	(1,000)	(100) (WN 1)	(2,900)
Profit for the year	1,200	900		2,000
Administrative expenses	(400)	(350)	(113) (WN 2)	(863)
Total comprehensive income for year	800	550		1,137

Total comprehensive income attributable to:

Owners of the parent (75%)	1,028
Non-controlling interest (25%)	109
	1,137

Consolidation involves:

- Adding the statement of comprehensive income of the parent and its subsidiary together line by line
- Recognising the fair value adjustments and/or amortisation thereof together with amortisation of the goodwill asset that arose on acquisition of the subsidiary.

Blue Heavens Ltd. consolidated balance sheet at 31 March 20X3 will be computed as follows:

(₹ in lakh)

	Blue Heavens Ltd.	**Orange County Ltd.**	**Consolidation adjustments**	**Consolidated Blue Heavens Ltd.**
	Carrying amount	**Carrying amount**		
Assets				
Non-current assets				
Goodwill			975 – 98 (WN 3)	877
Buildings and other PPE	6,500	2,750	285 (WN 4)	9,535
Financial Assets				
Investment in Entity B	4,500		(4,500)	
Current assets				

Inventories	800	550		1,350
Financial Assets				
Trade receivables	380	300		680
Cash	4,170	1420		5,590
Total assets	**16,350**	**5,020**		**18,032**
Equity and liabilities Equity				
Share capital	5,000	2,000	(2,000)	5,000
Other Equity	11,000	2,850	(2,622) (WN 5)	11,228
Non-controlling interest			1,284	1,284
Current liabilities				
Financial Liabilities				
Trade payables	350	170		520
Total liabilities and equity	**16,350**	**5,020**		**18,032**

Consolidation involves:

- Adding the statement of financial position of the parent and its subsidiary together line by line.
- Eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets, liabilities and contingent liabilities acquired) and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased), and recognising the fair value adjustments together with the goodwill asset that arose on acquisition of the subsidiary as adjusted to reflect the first year post-acquisition
- Recognising the non-controlling interest in the net assets of Entity B.

Working Notes:

(1) Cost of sales adjustment:

₹ 100 = fair value adjustment in respect of inventories at 31 March 20X2

(2) Administrative expenses adjustment:

₹ 113 = Amortisation of goodwill ₹ 98 (WN 3) + additional depreciation on building ₹ 15 (WN 4)

For simplicity it is assumed that all the goodwill amortisation and the additional buildings depreciation is adjusted against administrative expenses.

(3) Working for goodwill:

Goodwill at the acquisition date, ₹ 975, less accumulated impairment, ₹ 98 = ₹ 877

(4) Working for building consolidation adjustment:

The fair value adjustment at 31 March 20X2 in respect of Orange County Ltd. building was ₹ 300, that is, the carrying amount at 31 March 20X2 was ₹ 300 lower than was recognised in the group's consolidated statement of financial position. The building is being depreciated over 20 years from 31 March 20X2. Thus at 31 March 20X3 the adjustment required on consolidation to the statement of financial position will be ₹ 285, being ₹ 300 x 19/20 years estimated useful life remaining. The additional depreciation recognised in consolidated statement of comprehensive income is ₹ 15 (being ₹ 300 x 1/20).

(5) **Reserves adjustment:**

₹ 2,300 adjustment at the acquisition date (Question 4)

plus ₹ 98 (WN 3) impairment of goodwill

plus ₹ 15 (WN 4) additional depreciation on building

plus ₹ 100 (WN 1) fair value adjustment in respect of inventories

plus ₹ 109 NCI's share of Orange County Ltd. profit for the year (as included in the consolidated statement of comprehensive income)

= ₹ 2,622

Question 6

Given below are the financial statements of P Ltd and Q Ltd as on 31.3.20X1:

Balance Sheets **(₹ in lakhs)**

	P Ltd.	Q Ltd.
Assets		
Non-current Assets		
Property Plant Equipment	1,07,000	44,000
Financial Assets:		
Non-Current Investments	5,000	1,000
Loans	10,000	
Current Assets		
Inventories	20,000	10,000
Financial Assets:		
Trade Receivables	8,000	10,000
Cash and Cash Equivalents	38,000	1,000
Total Assets	1,88,000	66,000
Equity and Liabilities		
Shareholders Fund		
Share Capital	20,000	10,000
Other equity	1,20,000	40,000
Non-current Liabilities		
Financial liabilities:		
Long term liabilities	30,000	10,000
Deferred tax liabilities	5,000	1,000
Long term provisions	5,000	1,000

Current Liabilities		
Financial liabilities:		
Trade Payables	6,000	2,000
Short term Provisions	2,000	2,000
Total Equity & Liabilities	1,88,000	66,000
Notes to Financial Statements	**P Ltd**	**Q Ltd**
Reserve & Surplus		
General Reserve	1,00,000	30,000
Retained earnings	20,000	10,000
	1,20,000	40,000
Inventories		
Raw Material	10,000	5,000
Finished Goods	10,000	5,000
	20,000	10,000

Statement of Profit and Loss For the year ended on 31 March, 20X2 **(₹ in lakhs)**

	Notes	P Ltd	Q Ltd
I. Statement of Profit and Loss for the year ended on 31 March 20X2			
Sales	1	2,00,000	80,000
Other Income	2	3,000	-
Total Revenue		**2,03,000**	**80,000**
Expenses			
Raw Material Consumed	3	1,10,000	48,000
Change in inventories finished stock	4	(5,000)	(3,000)
Employee benefit expenses		30,000	10,000
Finance Costs	5	2,700	1,000
Depreciation		7,000	4,000
Other Expenses	6	10,350	6,040
Total expenses		**1,55,050**	**66,040**
Profit Before Tax		47,950	13,960
Tax Expense:			
Current Tax	11	15,000	4,000
Deferred Tax		2,000	1,000
		17,000	5,000
Profit After Tax		**30,950**	**8,960**

II. Statement of Other Comprehensive Income			
Fair value gain on investment in subsidiary	8	1,000	0
Fair value gain on other non-current investments	8	500	250
		1,500	250

Statement of changes in Equity For the year ended on 31 March 20X2

P Ltd.	Share Capital	General Reserve	Profit & Loss	Fair Value Reserve	Total
Balance as on 1.4.20X1	20,000	1,00,000	20,000		1,40,000
Dividend for the year 20X1-20X2			(8,000)		(8,000)
Dividend distribution tax			(1,350)		(1,350)
Dividend received from subsidiary			1,680		1,680
Profit for the year 20X1-20X2			30,950		30,950
Fair value gain on investment in subsidiary See Note 7				1,000	1,000
Fair value gain on other non-current investments see note 7				500	500
Transfer to reserve		20,000	(20,000)		
Balance as on 31.3.20X2	**20,000**	**1,20,000**	**23,280**	**1,500**	**1,64,780**
Q Ltd					
Balance as on 1.4.20X1	10,000	30,000	10,000		50,000
Dividend for the year 20X1-20X2			(2,400)		(2,400)
Dividend distribution tax			(400)		(400)
Profit for the year 20X1-20X2			8,960		8,960
Fair value gain on other non-current investments see note 7				250	250
Transfer to reserve		5,000	(5,000)		
Balance as on 31.3.20X2	**10,000**	**35,000**	**11,160**	**250**	**56,410**

Balance Sheet as on 31 March, 20X2	Note	P Ltd	Q Ltd
Assets			
Non-current Assets			
Property Plant Equipment	7	1,17,000	45,000
Financial Assets:			
Non-Current Investments	8	42,500	1,250
Long term loans		10,000	
Current Assets			

Inventories		35,000	15,000
Financial Assets:			
Trade Receivables		10,000	8,000
Cash and Cash Equivalents			
(See Statement of cash flows)		930	4,200
		45,930	27,200
Total Assets		**2,15,430**	**73,450**
Equity and Liabilities			
Share Capital		20,000	10,000
Other Equity (See Statement of changes in Equity)		1,44,780	46,410
		1,64,780	56,410
Non-current Liabilities			
Financial Liabilities:			
Borrowings		30,000	10,000
Deferred tax liabilities		7,000	2,000
Long term provisions	9	4,600	930
		41,600	12,930
Current Liabilities			
Financial Liabilities:			
Trade Payables		8,000	4,000
Short term Provisions	10	1,050	110
		9,050	4,110
Total Liabilities		**50,650**	**17,040**
Total Equity & Liabilities		**2,15,430**	**73,450**

Statement of Cash Flows For the year ended on 31 March 20X2

		P Ltd	Q Ltd
I.	**Cash flows from operating activities**		
	Profit after Tax	30,950	8,960
	Add Back:		
	Current Tax	15,000	4,000
	Deferred Tax	2,000	1,000
	Depreciation	7,000	4,000
	Finance Costs	2,700	1,000
	Change in Provisions	(1,350)	(1,960)
	Reversal of Interest Income	(1,000)	0

Working capital adjustments		
Inventories	(15,000)	(5,000)
Trade Receivables	(2,000)	2,000
Trade Payables	2,000	2,000
	40,300	16,000
Less: Advance Tax	(15,000)	(4,000)
	25,300	12,000
II. Cash flows from investment activities		
Purchase of Property Plant Equipment	(17,000)	(5,000)
Acquisition of subsidiary	(36,000)	0
Interest Income	1,000	
Dividend Income	1,680	-
	(50,320)	(5,000)
III. Cash flow from financing activities		
Dividend Payment	(8,000)	(2,400)
Dividend distribution tax	(1,350)	(400)
Interest payment	(2,700)	(1,000)
	(12,050)	(3,800)
Net Changes in Cash Flows (I+II+III)	**(37,070)**	**3,200**
Balance of Cash and Cash Equivalents as on 1.4.20X1	38,000	1,000
Balance of Cash and Cash Equivalents as on 31.3.20X2	930	4,200

Notes	**P Ltd.**	**Q Ltd.**
Note 1- Sales		
Sales to Q Ltd.	20,000	
Other Sales	1,80,000	80,000
	2,00,000	**80,000**
Note 2- Other Income		
Interest from Q Ltd	1,000	
Royalty from Q Ltd	2,000	
	3,000	
Note 3- Raw Material Consumed		
Opening Stock	10,000	5,000
Purchases from P Ltd		20,000
Other Purchases	1,20,000	30,000
Closing Stock	20,000	7,000

	1,10,000	48,000
Note 4- Change in inventories of finished stock		
Opening Stock	10,000	5,000
Closing Stock	15,000	8,000
	(5,000)	(3,000)
Note 5- Finance costs		
Interest	2,700	
Interest to P Ltd	-	1,000
	2,700	1,000
Note 6- Other Expenses		
Long term provisions	100	30
Short term provisions	50	10
Royalty to P Ltd		2,000
Others	10,000	4,000
Acquisition Expenses	200	-
	10,350	6,040
Note 7- Property Plant Equipment		
New Purchases	17,000	5,000
Note 8- Fair value of non-current investments		
Investments in subsidiary	37,000	
Other Investments	5,500	1,250
	42,500	1,250
Fair value gain		
Investments in subsidiary	1,000	0
Other investments	500	250
	1,500	250
Note 9- Long term provisions		
Balance as on 1.4.20X1	5,000	1,000
Transfer to short term provisions	(500)	(100)
New Provision	100	30
Balance as on 31.3.20X2	4,600	930
Note 10- Short term provisions		
Balance as on 1.4.20X1	2,000	2,000
Transfer from long term provisions	500	100
Payment	(1,500)	(2,000)

New	50	10
Balance as on 31.3.20X2	**1,050**	**110**
Note 11- Provision for Tax & Advance Tax		
Tax Provision	15,000	4,000
Less: Advance Tax	15,000	4,000
	0	0

On 1.4.20X1, P Ltd acquired 70% of equity shares (700 lakhs out of 1,000 lakhs shares) of Q Ltd. at ₹ 36,000 lakhs. The company has adopted an accounting policy to measure Non-controlling interest at fair value (quoted market price) applying Ind AS 103. Accordingly, the company computed full goodwill on the date of acquisition. Shares of both the companies are of face value ₹ 10 each. Market price per share of Q Ltd. as on 1.4.20X1 is ₹ 55. Entire long term borrowings of Q Ltd. is from P Ltd. The fair value of net identifiable assets is at ₹ 50,000 lakhs.

P Ltd has decided to account for investment in subsidiary at fair value as per Ind AS 27. Other non-current investments are classified as financial assets at fair value through profit and loss by irrevocable choice as per Ind AS 109. There is no tax on long term capital gains.

The group has paid dividend for the year 20X0-20X1 and transferred to reserve out of profit for 20X1-20X2 as follows: (₹ in lakhs)

	P Ltd	**Q Ltd**		
Dividend for the year 20X0-20X1		**Share of P Ltd.**	**Non-Controlling interest**	**Total**
Dividend	8,000	1,680	720	2,400
Dividend distribution tax	1,350	280	120	400
	9,350	1,960	840	2,800
Transfer to Reserve out of profit for the year 20X1-20X2	20,000			

Trade Receivables of P Ltd, includes ₹ 3,000 lakhs due from Q Ltd.

Based on the above financial statements for the year ended on 31 March, 20X2 and information given, prepare Consolidated Financial Statements.

Answer

Consolidated Financial Statements of P Ltd. Group **(₹ in lakhs)**

Consolidated Statement of Comprehensive Income For the year ended on 31 March, 20X2

I. Statement of Profit and loss	**Notes**	**P Ltd**	**Q Ltd**	**Workings**	**Group**
Sales	1	2,00,000	80,000	2,00,000 + 80,000 – 20,000	2,60,000
Other Income	2	3,000	0	3,000 – 3,000	0
Total Revenue		**2,03,000**	**80,000**		**2,60,000**
Expenses					

Raw materials consumed	3	1,10,000	48,000	1,10,000 + 48,000 – 20,000	1,38,000
Change in inventories finished stock	4	–5,000	–3,000	(–5,000 – 3,000)	-8,000
Employee benefit expenses		30,000	10,000	30,000 + 10,000	40,000
Finance Costs	5	2,700	1,000	2,700 + 1,000 – 1,000	2,700
Depreciation		7,000	4,000	7,000 + 4,000	11,000
Other expense	6	10,350	6,040	10,350 + 6,040 – 2,000	14,390
Total Expenses		**1,55,050**	**66,040**		**1,98,090**
Profit Before Tax		47,950	13,960		61,910
Tax Expense:					
Current Tax		15,000	4,000	15,000 + 4,000	19,000
Deferred Tax		2,000	1,000	2,000 + 1,000	3,000
		17,000	5,000		22,000
Profit After Tax		**30,950**	**8,960**		**39,910**
Profit attributable to:					
Parent					37,222
Non-controlling interest					2,688
II. Statement of Other Comprehensive Income					
Fair value gain on investment in subsidiary	8	1,000	0	1,000 + 0 – 1,000	0
Fair value gain on other non-current investments	8	500	250	500 + 250	750
		1,500	**250**		**750**
Other comprehensive income attributable to:					
Parent					675
Non-Controlling Interests					75

Consolidated Statement of changes in Equity For the year ended on 31 March 20X2

	Share Capital	General Reserve	Retained earnings	Fair Value Reserve	Total	Non-Controlling Interest	Group Total
Balance as on 1.4.20X1	20,000	1,00,000	20,000		1,40,000	16,500	1,56,500
Dividend for the year 20X0-20X1			(8,000)		(8,000)		(8,000)
Dividend distribution tax			(1,350)		(1,350)		(1,350)
Dividend received			1,680		1,680		1,680

from subsidiary							
Profit for the year 20X1-20X2			37,222		37,222	2,688	39,910
Fair value gain on other non-current investments				675	675	75	750
Transfer to reserve		20,000	(20,000)		0		0
Dividend from subsidiary			(1,680)		(1,680)	(720)	(2,400)
Dividend distribution tax of subsidiary			(280)		(280)	(120)	(400)
Balance as on 31.3.20X2	**20,000**	**1,20,000**	**27,592**	**675**	**1,68,267**	**18,423**	**1,86,690**

Dividend and dividend distribution tax paid by the subsidiary is deducted from profit and non-controlling interest.

Note: As per the response to Issue 1 given in ITFG Bulletin 9, in the consolidated financial statements of parent company, the dividend income earned by parent company from subsidiary company and dividend recorded by subsidiary company in its equity will both get eliminated as a result of consolidation adjustments. DDT paid by subsidiary company outside the consolidated Group i.e. to the tax authorities should be charged as expense in the consolidated statement of Profit and Loss of holding company.

If DDT paid by the subsidiary is allowed as a set off against the DDT liability of its parent (as per the tax laws), then the amount of such DDT should be recognised in the consolidated statement of changes in equity of parent company.

Consolidated Balance Sheet As on 31 March 20X2 (Amount in ₹ lakhs)

	P Ltd	Q Ltd	Workings	Group
Assets				
Non-Current Assets				
Fixed Assets				
Property Plant Equipment	1,17,000	45,000	1,17,000 + 45,000	1,62,000
Goodwill				2,500
Financial Assets:				
Non-Current Investments	42,500	1,250	5,500 + 1,250	6,750
Long term loans	10,000	0	10,000 + 0 – 10,000	0
	1,69,500	46,250		1,71,250
Current Assets				
Inventories	35,000	15,000	35,000 + 15,000	50,000

Financial Assets:				
Trade Receivables	10,000	8,000	10,000 + 8,000 – 3,000	15,000
Cash and Cash Equivalents	930	4,200	930 + 4,200	5,130
	45,930	27,200		70,130
Total Assets	**2,15,430**	**73,450**		**2,41,380**
Equity and Liabilities				
Share Capital	20,000	10,000	SOCE	20,000
Other Equity	1,44,780	46,410	SOCE	1,48,267
Non-controlling interest	–	–	SOCE	18,423
	1,64,780	56,410		1,86,690
Non-current Liabilities				
Financial Liabilities:				
Borrowings	30,000	10,000	30,000 + 10,000 – 10,000	30,000
Deferred tax liabilities	7,000	2,000	7000 + 2,000	9,000
Long term provisions	4,600	930	4,600 + 930	5,530
	41,600	12,930		44,530
Current Liabilities				
Financial Liabilities:				
Trade Payables	8,000	4,000	8,000 + 4,000 – 3,000	9,000
Short term Provisions	1,050	110	1,050 + 110	1,160
	9,050	4,110		10,160
Total Liabilities	50,650	17,040		54,690
Total Equity & Liabilities	**2,15,430**	**73,450**		**2,41,380**

Statement of Cash Flows For the year ended on 31 March 20X2

	P Ltd	Q Ltd	Workings	Group
I. Cash flows from operating activities				
Profit after Tax	30,950	8,960		39,910
Add Back				
Current Tax	15,000	4,000	15,000 + 4,000	19,000
Deferred Tax	2,000	1,000	2,000 + 1,000	3,000
Depreciation	7,000	4,000	7,000 + 4,000	11,000
Finance Costs	2,700	1,000	2,700 + 1,000 – 1,000	2,700
Change in Provisions	(1,350)	(1,960)	(1350) + 1960	(3,310)
Reversal of Interest Income	(1,000)	0	(1,000) + 0 + 1,000	0
Working capital adjustments				

Inventories	(15,000)	(5,000)	30,000 – 50,000	-20,000
Trade Receivables	(2,000)	2,000	18,000 – 15,000	3,000
Trade Payables	2,000	2,000	8,000 – 9,000	1,000
	40,300	16,000		56,300
Less: Advance Tax	(15,000)	(4,000)	15,000 + 4,000	(19,000)
	25,300	12,000		37,300
II. Cash flows from investment activities				
Purchase of Property Plant Equipment	(17,000)	(5,000)	(17,000) – 5,000	(22,000)
Acquisition of subsidiary	(36,000)	0	(36,000) + 0	(36,000)
Interest Income	1,000		1,000 – 1,000	0
Dividend Income	1,680	–	1,680 – 1,680	0
	(50,320)	(5,000)		(58,000)
III. Cash flow from financing activities				
Dividend Payment	(8,000)	(2,400)	(8,000) – 2,400 + 1,680	(8,720)
Dividend distribution tax	(1,350)	(400)	(1,350) – 400	(1,750)
Interest payment	(2,700)	(1,000)	(2,700) – 1,000 + 1,000	(2,700)
	(12,050)	(3,800)		(13,170)
Net Changes in Cash Flows (I+II+III)	(37,070)	3,200		(33,870)
Balance of Cash and Cash Equivalents as on 1.4.20X1	**38,000**	**1,000**	**38,000 + 1,000**	**39,000**
Balance of Cash and Cash Equivalents as on 31.3.20X2	**930**	**4,200**		**5,130**

While preparing Consolidated Statement of Cash flows also intra-group transactions are eliminated.

Question 7

Prepare the consolidated Balance Sheet as on 31st March, 20X2 of a group of companies comprising P Limited, S Limited and SS Limited. Their balance sheets on that date are given below: ₹ in lakhs

	P Ltd.	S Ltd.	SS Ltd.
Assets			
Non-Current Assets			
Property, Plant and Equipment	320	360	300
Investment:			
32 lakhs shares in S Ltd.	340		
24 Lakhs shares in SS Ltd.		280	

<u>Current Assets</u>			
Inventories	220	70	50
Financial Assets			
Trade Receivables	260	100	220
Bills Receivable	72	–	30
Cash in hand and at Bank	228	40	40
	1440	**850**	**640**
Equity and Liabilities			
<u>Shareholder's Equity</u>			
Share capital (₹ 10 per Share)	600	400	320
Other Equity			
Reserves	180	100	80
Retained earnings	160	50	60
<u>Current Liabilities</u>			
Financial Liabilities			
Trade Payables	470	230	180
Bills Payable			
P Ltd.		70	
SS Ltd.	30	–	–
	1440	**850**	**640**

The following additional information is available:

(i) P Ltd. holds 80% shares in S Ltd. and S Ltd. holds 75% shares in SS Ltd. Their holdings were acquired on 30th September, 20X1.

(ii) 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.

(iii) On 1st April, 20X1 the following balances stood in the books of S Limited and SS Limited.

₹ in lakhs

	S Limited	**SS Limited**
Reserves	80	60
Retained earnings	20	30

(iv) ₹ 10 lakhs included in the inventory figure of S Limited, is inventory which has been purchased from SS Limited at cost plus 25%.

(v) The parent company has adopted an accounting policy to measure non-controlling interest at fair value (quoted market price) applying Ind AS 103. Assume market prices of S Limited and SS Limited are the same as respective face values.

Answer

Consolidated Balance Sheet of the Group as on 31st March, 20X2

Particulars	Note No.	(₹ in lakh)
ASSETS		
Non-current assets		
Property, plant and equipment	1	980
Current assets		
(a) Inventory	2	338
(b) Financial assets		
Trade receivables	3	580
Bills receivable	4	2
Cash and cash equivalents	5	308
Total assets		2,208
EQUITY & LIABILITIES		
Equity attributable to owners of the parent		
Share capital		600
Other Equity		
Reserves (W.N.5)		194
Retained Earnings (W.N.5)		179.8
Capital Reserve (W.N.3)		188
Non-controlling interests (W.N.4)		166.2
Total equity		1,328
LIABILITIES		
Non-current liabilities		Nil
Current liabilities		
(a) Financial Liabilities		
(i) Trade payables	6	880
Total liabilities		880
Total equity and liabilities		2,208

Notes to Accounts (₹ in lakh)

1.	**Property Plant & Equipment**		
	P Ltd.	320	
	S Ltd.	360	
	SS Ltd.	300	980
2.	**Inventories**		
	P Ltd.	220	

	S Ltd. (70 – 2)	68	
	SS Ltd.	50	338
3.	**Trade Receivables**		
	P Ltd.	260	
	S Ltd.	100	
	SS Ltd.	220	580
4.	**Bills Receivable**		
	P Ltd. (72 – 70)	2	
	SS Ltd. (30 – 30)	-	2
5.	**Cash & Cash equivalents**		
	P Ltd.	228	
	S Ltd.	40	
	SS Ltd.	40	308
6.	**Trade Payables**		
	P Ltd.	470	
	S Ltd.	230	
	SS Ltd.	180	880

Working Notes:

1. Analysis of Reserves and Surplus (₹ in lakh)

		S Ltd.		SS Ltd.
Reserves as on 31.3.20X1		80		60
Increase during the year 20X1-20X2	20		20	
Increase for the half year till 30.9.2017		10		10
Balance as on 30.9.20X1 (A)		**90**		**70**
Total balance as on 31.3.20X2		100		80
Post-acquisition balance		**10**		**10**
		S Ltd.		**SS Ltd.**
Retained Earnings as on 31.3.20X1		20		30
Increase during the year 20X1-20X2	30		30	
Increase for the half year till 30.9.20X1		15		15
Balance as on 30.9.20X1 (B)		**35**		**45**
Total balance as on 31.3.20X2		50		60
Post-acquisition balance		15		15
Less: Unrealised Gain on inventories (10 x 25%)		-		(2)

Post-acquisition balance for CFS		**15**		**13**
Total balance on the acquisition date i.e. 30.09.20X1 (A + B)		**125**		**115**

2. Calculation of Effective Interest of P Ltd. in SS Ltd.

Acquisition by P Ltd. in S Ltd. = 80%

Acquisition by S Ltd. in SS Ltd. = 75%

Acquisition by Group in SS Ltd. (80% x 75%) = 60%

Non-Controlling Interest = 40%

3. Calculation of Goodwill/Capital Reserve on the acquisition date

	S Ltd.	**SS Ltd.**
Investment or consideration	340	(280 x 80%) 224
Add: NCI at Fair value		
(400 x 20%)	80	
(320 x 40%)	=	128
	420	352
Less: Identifiable net assets (Share capital + Increase in Reserves and Surplus till acquisition date)	(400 + 125) (525)	(320 + 115) (435)
Capital Reserve	105	83
Total Capital Reserve (105 + 83)	188	

4. Calculation of Non-Controlling Interest

	S Ltd.	**SS Ltd.**
At Fair Value (See Note 3)	80	128
Add: Post Acquisition Reserves (See Note 1)	(10 x 20%) 2	(10 x 40%) 4
Add: Post Acquisition Retained Earnings (See Note 1)	(15 x 20%) 3	(13 x 40%) 5.2
Less: NCI share of investment in SS Ltd.	(280 x 20%) (56)*	
	29	137.2
Total (29 + 137.2)	166.2	

***Note:** The Non-controlling interest in S Ltd. will take its proportion in SS Ltd. so they have to bear their proportion in the investment by S Ltd. (in SS Ltd.) also.

5. Calculation of Consolidated Other Equity

	Reserves	**Retained Earnings**
P Ltd.	180	160
Add: Share in S Ltd.	(10 x 80%) 8	(15 x 80%) 12
Add: Share in SS Ltd.	(10 x 60%) 6	(13 x 60%) 7.8
	194	179.8

Note: It is assumed that the sale of goods by SS Ltd. is done after acquisition of shares by S Ltd. Alternatively, it may be assumed that the sale has either been done before acquisition of shares by S Ltd. in SS Ltd. or sale has been throughout the year. Accordingly, the treatment for unrealized gain may vary.

Question 8

A Ltd. acquired 70% of equity shares of B Ltd. on 1.04.20X1 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and other equity of ₹ 80,000. In the four consecutive years B Ltd. fared badly and suffered losses of ₹ 2,50,000, ₹ 4,00,000, ₹ 5,00,000 and ₹ 1,20,000 respectively. Thereafter in 20X5-20X6, B Ltd. experienced turnaround and registered an annual profit of ₹ 50,000. In the next two years i.e. 20X6-20X7 and 20X7-20X8, B Ltd. recorded annual profits of ₹ 1,00,000 and ₹ 1,50,000 respectively. Show the non-controlling interests and goodwill at the end of each year for the purpose of consolidation.

Assume that the assets are at fair value.

Answer

Year	Profit/loss	Non-controlling Interest (30%)	Additional Consolidated P&L (Dr.)/Cr.	Goodwill
At the time of acquisition in 20X1		3,24,000 (W.N.)		2,44,000 (W.N.)
20X1-20X2	(2,50,000)	(75,000)	(1,75,000)	2,44,000
		2,49,000		
20X2-20X3	(4,00,000)	(1,20,000)	(2,80,000)	2,44,000
		1,29,000		
20X3-20X4	(5,00,000)	(1,50,000)	(3,50,000)	2,44,000
		(21,000)		
20X4-20X5	(1,20,000)	(36,000)	(84,000)	2,44,000
		(57,000)		
20X5-20X6	50,000	15,000	35,000	2,44,000
		(42,000)		
20X6-20X7	1,00,000	30,000	70,000	2,44,000
		(12,000)		
20X7-20X8	1,50,000	45,000	1,05,000	2,44,000
		33,000		

Working Note:

Calculation of Non-controlling interest:	₹
Share Capital	10,00,000
Other equity	80,000

Total	10,80,000
NCI (30% x 10,80,000)	3,24,000

NCI is measured at NCI's proportionate share of the acquiree's identifiable net assets. (Considering the carrying amount of share capital & other equity to be fair value).

Calculation of Goodwill:	₹
Consideration	10,00,000
Non-controlling interest	3,24,000
Less: Net Assets	(10,80,000)
Goodwill	2,44,000

Question 9

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st April, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was ₹ 1,00,000 and the balance in the Statement of Profit and Loss was ₹ 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. has earned a profit of ₹ 20,000 and later on, it declared and paid a dividend of ₹ 30,000.

Assume, the fair value of non-controlling interest is same as the fair value on a per-share basis of the purchased interest. All net assets are identifiable net assets, there are no non-identifiable assets. The fair value of identifiable net assets is ₹ 1,50,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd. whenever it is received after approval in the ensuing annual general meeting.

What is the amount of non-controlling interest as on 1st April, 20X1 (using Fair Value Method) and 31st March, 20X2. Also pass a journal entry on the acquisition date.

Answer

XYZ Ltd.'s share of dividend = ₹ 30,000 x 80% = ₹ 24,000

		₹	₹
Bank A/c	Dr.	24,000	
To Profit & Loss A/c			24,000

Calculation of Non- controlling interest and Journal Entry

NCI on 1st April 20X1 = 20% of Fair value on a per-share basis of the purchased interest.

= 20% x ₹ 1,75,000 (W.N 1) = ₹ 35,000

The journal entry recorded on the acquisition date for the 80% interest acquired is as follows:

		₹	₹
Identifiable net assets	Dr.	1,50,000	
Goodwill (Balancing Figure)	Dr.	25,000	
To Cash			1,40,000
To NCI			35,000

Working Note 1

Fair value on a per-share basis of the purchased interest/Fair Value of Identifiable net assets

= Consideration transferred x 100/80

= 1,40,000 x 100/80 = ₹ 1,75,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1-20X2

= 35,000 + (20,000 x 20%) = ₹ 39,000

Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting.

Question 10

From the following data, determine in each case:

(1) Non-controlling interest at the date of acquisition (using proportionate share method) and at the date of consolidation

(2) Goodwill or Gain on bargain purchase.

(3) Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own retained earnings to be ₹ 2,00,000 in each case

Case	Subsidiary company	% of shares owned	Cost	Date of Acquisition 1.04.20X1		Consolidation date 31.03.20X2	
				Share Capital [A]	Retained earnings [B]	Share Capital [C]	Retained earnings [D]
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	56,000

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.

Answer

(1) 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 + Statement of Profit & Loss (Assuming it to be the net aggregate value of identifiable assets in accordance with Ind AS)

	% 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%	15,000	17,000

Case 2 [100 – 85]	15%	19,500	18,000
Case 3 [100 – 80]	20%	14,000	14,000
Case 4 [100 – 100]	Nil	Nil	Nil

(2) Calculation of Goodwill or Gain on bargain purchase

	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	1,40,000	15,000	1,50,000	5,000	–
Case 2	1,04,000	19,500	1,30,000	–	6,500
Case 3	56,000	14,000	70,000	Nil	Nil
Case 4	1,00,000	0	90,000	10,000	–

(3) On 31.03.20X2 in each case the following amount shall be added or deducted from the balance of holding Co.'s Retained earnings.

	% Share Holding [K]	Retained earnings as on 31.03.20X1 [L]	Retained earnings as on consolidation Date [M]	Retained earnings post-acquisition [N] = [M] – [L]	Amount to be added/(deducted) from holding's Retained earnings [O] = [K] x [N]
1	90%	50,000	70,000	20,000	18,000
2	85%	30,000	20,000	(10,000)	(8,500)
3	80%	20,000	20,000	Nil	Nil
4	100%	40,000	56,000	16,000	16,000

Question 11

A parent owns 60% of a subsidiary. The subsidiary sells some inventory to the parent for ₹ 35,000 and makes a profit of ₹ 15,000 on the sale. The inventory is in the parent's balance sheet at the year end. Examine the treatment of intra-group transaction and pass the necessary journal entry.

Answer

The parent must eliminate 100% of the unrealized profit on consolidation. The inventory will, therefore, be carried in the group's balance sheet at ₹ 20,000 (₹ 35,000 – ₹ 15,000). The consolidated income statement will show a corresponding reduction in profit of ₹ 15,000.

	₹' 000	
	Dr.	**Cr.**
Consolidated revenue Dr.	35	
To Cost of sales		20

To Inventory		15

The reduction of group profit of ₹ 15,000 is allocated between the parent company and non-controlling interest in the ratio of their interests 60% and 40%.

Question 12

A parent owns 60% of a subsidiary. The parent sells some inventory to the subsidiary for ₹ 35,000 and makes a profit of ₹ 15,000. On the sale the inventory is in the subsidiary's balance sheet at the year end. Examine the treatment of intra-group transaction and pass the necessary journal entry.

Answer

The parent must eliminate 100% of the unrealized profit on consolidation. The inventory will, therefore, be carried in the group's balance sheet at ₹ 20,000. (₹ 35,000 – ₹ 15,000). The consolidated income statement will show a corresponding reduction in profit of ₹ 15,000.

The double entry on consolidation is as follows:

	₹' 000	
	Dr.	**Cr.**
Consolidated revenue Dr.	35	
To Cost of sales		20
To Inventory		15

In this case, since it is the parent that has made the sale, the reduction in profit of ₹ 15,000 is allocated entirely to the parent company.

Question 13

A Ltd, a parent company sold goods costing ₹ 200 lakh to its 80% subsidiary B Ltd. at ₹ 240 lakh. 50% of these goods are lying at its stock. B Ltd. has measured this inventory at cost i.e. at ₹ 240 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.

Answer

A Ltd., shall reduce the inventories of ₹ 120 lakh of B Ltd., by ₹ 20 lakh in CFS. This will increase expenses and reduce consolidated profit by ₹ 20 lakh. It shall also create deferred tax asset of ₹ 6 lakh since accounting base of inventories (₹ 100 lakh) is lower than its tax base (₹ 120 lakh).

Question 14

Ram Ltd., a parent company purchased goods costing ₹ 100 lakh from its 80% subsidiary Shyam Ltd. at ₹ 120 lakh. 50% of these goods are lying at the godown. Ram Ltd. has measured this inventory at cost i.e. at ₹ 60 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.

Answer

Ram Ltd., shall reduce the inventories of ₹ 60 lakh of Shyam Ltd., by ₹ 10 lakh in CFS. This will increase expenses and reduce consolidated profit by ₹ 10 lakh. It shall also create deferred tax asset of ₹ 3 lakh since accounting base of inventories (₹ 50 lakh) is lower than its tax base (₹ 60 lakh).

Question 15

Airtel Telecommunications Ltd. owns 100% share capital of Airtel Infrastructures Pvt. Ltd. On 1 April 20X1 Airtel Telecommunications Ltd. acquired a building from Airtel Infrastructures Pvt. Ltd., for ₹ 11,00,000 that the group plans to use as its new headquarters office.

Airtel Infrastructures Pvt. Ltd. had purchased the building from a third party on 1 April 20X0 for ₹ 10,25,000. At that time the building was assessed to have a useful life of 21 years and a residual value of ₹ 5,00,000. On 1 April 20X1 the carrying amount of the building was ₹ 10,00,000 in Airtel Infrastructures Pvt. Ltd.'s individual accounting records.

The estimated remaining useful life of the building measured from 1 April 20X1 is 20 years and the residual value of the building is now estimated at ₹ 3,50,000. The method of depreciation is straight-line.

Pass necessary accounting entries in individual and consolidation situations.

Answer

Journal Entries in Airtel Infrastructures Pvt. Ltd.

1.	Assets (Building) A/c	Dr.	10,25,000	
	To cash			10,25,000
2.	Depreciation (P/L) A/c	Dr.	25,000	
	To Asset (Building)			25,000
3.	Cash A/c	Dr.	11,00,000	
	To Asset (Building)			10,00,000
	To Gain on sale of asset (P/L)			1,00,000

Journal Entries in Airtel Telecommunications Ltd.

1.	Assets (Building) A/c	Dr.	11,00,000	
	To cash			11,00,000
2.	Depreciation (P/L) A/c	Dr.	37,500	
	To Assets (Building)			37,500

Journal entry for consolidation:

1.	Gain on sale of asset (P/L)	Dr.	1,00,000	
	To Asset (Building) A/c			1,00,000
2.	Asset (Building) A/c	Dr.	5,000 (WN 1)	
	To Consolidated P&L			5,000

Working Note:

To be depreciated on original value	(10,00,000 – 3,50,000)/20	32,500

Depreciation charged	(11,00,000 – 3,50,000)/20	37,500
Reversal of depreciation		**5,000**

Particulars	**Consolidated financial statements**	**Individual Financial statements**	
		Airtel Telecommunications Ltd.	**Airtel Infrastructures Pvt. Ltd.**
31st March 20X1	10,00,000	0	10,00,000
1st April 20X1 purchase sale	0	11,00,000	(10,00,000)
Depreciation	(32,500)	(37,500)	0
31st March 20X2	9,67,500	10,62,500	0

Question 16

Entity A acquired 60% of entity B two years ago for ₹ 6,000. At the time entity B's fair value was ₹ 10,000. It had net assets with a fair value of ₹ 6,000 (which is assumed as book value). Goodwill of ₹ 2,400 was recorded [being ₹ 6,000 – (60% x ₹ 6,000)]. On 1 October 20X0, entity A acquires a further 20% interest in entity B, taking its holding to 80%. At that time the fair value of entity B is ₹ 20,000 and entity A pays ₹ 4,000 for the 20% interest. At the time of the purchase the fair value of entity B's net assets is ₹ 12,000 and the carrying amount of the non-controlling interest is ₹ 4,000.

Pass journal entries to record the transaction.

Answer

The accounting entry recorded for the purpose of the non- controlling interest is as follows:

		₹	
		Dr.	**Cr.**
Non-controlling interest	Dr.	2,000	
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	2,000	
To Cash			4,000

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (₹ 2,000) is adjusted and fair value of consideration received (₹ 4,000) to be attributed to parent in other equity i.e. ₹ 2,000.

Note: This question mentions two types of fair values:

- Fair value of Entity B, and
- Fair value of net assets of Entity B

It should be borne in mind that the two fair values are different concepts. The former is used only for the purpose of determining the consideration to be paid for purchase of equity interests. It can be seen that for the initial stake purchase, Entity A paid 60% of the "fair value of Entity B" i.e. 60% of ₹ 10,000 = ₹ 6,000. Further, for the second purchase transaction, Entity A paid 20% of the "fair value of Entity B" i.e. 20% of ₹ 20,000 = ₹ 4,000.

The latter i.e. fair value of net assets of Entity B is used for the purpose of accounting. It can be seen that the goodwill arising on acquisition of Entity B is determined as difference between consideration paid i.e. ₹ 6,000 and Entity A's share in fair value of net assets of Entity B on date of acquisition i.e. 60% of ₹ 6,000 = ₹ 6,000 minus ₹ 3,600 = ₹ 2,400. The fair value of net assets after the date of acquisition (i.e. ₹ 12,000 in this question) is not relevant for accounting purposes.

Question 17

A Ltd. acquired 10% additional shares of its 70% subsidiary. The following relevant information is available in respect of the change in non-controlling interest on the basis of Balance sheet finalized as on 1.4.20X0:

	₹ in thousand
Separate financial statements	**As on 31.3.20X0**
Investment in subsidiary (70% interest) – at cost	14,000
Purchase price for additional 10% interest	2,600
Consolidated financial statements	
Non-controlling interest (30%)	6,600
Consolidated profit & loss account balance	2,000
Goodwill	600

The reporting date of the subsidiary and the parent is 31 March, 20X0. Prepare note showing adjustment for change of non-controlling interest. Should goodwill be adjusted for the change?

Answer

The following accounting entries are passed:

		₹ '000	
		Dr.	**Cr.**
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	400	
Non-controlling interest (6,600 ÷ 30 x 10)	Dr.	2,200	
To Cash			2,600

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (₹ 22,00,000) is adjusted and fair value of consideration received (₹ 26,00,000) to be attributed to parent in other equity i.e. ₹ 4,00,000.

Consolidated goodwill is not adjusted.

Question 18

A Ltd. acquired 70% of shares of B Ltd. On 1.4.20X0 when fair value of net assets of B Ltd. was ₹ 200 lakh. During 20X0-20X1, B Ltd. made profit of ₹ 100 lakh. Individual and consolidated balance sheets as on 31.3.20X1 are as follows: **(₹ in lakhs)**

	A	B	Group
Assets			
Goodwill			10
PPE	627	200	827
Financial Assets:			
Investments	150		
Cash	200	30	230
Other Current Assets	23	70	93
	1,000	**300**	**1,160**
Equity and Liabilities			
Share Capital	200	100	200
Other Equity	800	200	870
Non-controlling interest	–	–	90
	1,000	**300**	**1,160**

A Ltd. acquired another 10% stake in B ltd on 1.4.20X1 at ₹ 32 lakh. The proportionate carrying amount of the non-controlling interest is ₹ 30 lakh. Show the individual and consolidated balance sheet of the group immediately after the change in non-controlling interest.

Answer

(₹ in lakhs)

	A	B	Workings	Group
Assets				
Goodwill				10
PPE	627	200		827
Financial Assets:				
Investments (150 + 32)	182	0		
Cash* (200 – 32)	168	30	(200 + 30) – 32	198
Other Current Assets	23	70		93
	1,000	**300**		**1,128**
Share Capital	200	100		200
Other Equity	800	200	870 – 2	868
Non-controlling interest	–	–	90 – 30	60
	1,000	**300**		**1,128**

*Cash has been adjusted through Individual Balance Sheet.

Journal entry

		₹ '000

		Dr.	Cr.
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	2	
Non-controlling interest (90 ÷ 30 x 10)	Dr.	30	
To Cash			32

Question 19

Amla Ltd. purchased a 100% subsidiary for ₹ 10,00,000 at the end of 20X1 when the fair value of the subsidiary's Lal Ltd. net asset was ₹ 8,00,000.

The parent sold 40% of its investment in the subsidiary in March 20X4 to outside investors for ₹ 9,00,000. The parent still maintains a 60% controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is ₹ 18,00,000 (including net assets of ₹ 16,00,000 & goodwill of ₹ 2,00,000).

Calculate gain or loss on sale of interest in subsidiary as on 31st March 20X4.

Answer

As per Ind AS 110, a change in ownership that does not result in a loss of control. The identifiable net assets (including goodwill) remain unchanged and any difference between the amount by which the non-controlling interest is recorded (including the non-controlling interest portion of goodwill) and a fair value of the consideration received is recognized directly in equity and attributed to the controlling interest. For disposals that do not result in the loss of control, the change in the non-controlling interest is recorded at its proportionate interest of the carrying value of the subsidiary.

Gain on the sale of the investment of ₹ 5,00,000 in parent's separate financial statements calculated as follows:

	₹'000
Sale proceeds	900
Less: Cost of investment in subsidiary (₹ 10,00,000 x 40%)	(400)
Gain on sale in the parent's separate financial statement	500

As discussed above, the group's consolidated income statement for 31st March 20X4 would show no gain on the sale of the interest in the subsidiary. Instead, the difference between the fair value of the consideration received and the amount by which the non-controlling interest is recorded is recognized directly in equity.

	₹'000
Sale proceeds	900
Less: Recognition of non-controlling interest (₹ 18,00,000 x 40%)	(720)
Credit to other equity	180

The entry recognized in the consolidated accounts under Ind AS 110 is:

		₹'000	
		Dr.	Cr.
Cash	Dr.	900	

To Non-controlling interest (1,800 x 40%)		720
To Other Equity (Gain on sale of interest on subsidiary)		180

The difference between the gain in the parent's income statement and the increase reported in the group's consolidated equity is ₹ 3,20,000. This difference represents the share of post- acquisition profits retained in the subsidiary ₹ 3,20,000 [(that is, 18,00,000 – 10,00,000) x 40%] that have been reported in the group's income statement upto the date of sale.

Question 20

Entity P sells a 20% interest in a wholly- owned subsidiary to outside investors for ₹ 100 lakh in cash. The carrying value of the subsidiary's net assets is ₹ 300 lakh, including goodwill of ₹ 65 lakh from the subsidiary's initial acquisition.

Pass journal entries to record the transaction.

Answer

The accounting entry recorded on the disposition date for the 20% interest sold as follows:

	₹ lakh	
	Dr.	**Cr.**
Cash Dr.	100	
To Non-controlling interest (20% x 300 lakh)		60
To Other Equity (Gain on sale of interest in subsidiary)		40

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (60 lakhs) is adjusted and fair value of consideration received (100 lakhs) to be attributed to parent in other equity i.e. 40 lakhs.

Question 21

Entity A sells 30% interest in its wholly-owned subsidiary to outside investors in an arm's length transaction for ₹ 500 crore in cash and retains a 70% controlling interest in the subsidiary. At the time of the sale, the carrying value of the subsidiary's net assets in the consolidated financial statements of Entity A is ₹ 1,300 crore, additionally, there is a goodwill of ₹ 200 crore that arose on the subsidiary's acquisition. Entity A initially accounted for NCI representing present ownership interests in the subsidiary at fair value and it recognises subsequent changes in NCI in the subsidiary at NCI's proportionate share in aggregate of net identifiable assets and associated goodwill. How should Entity A account for the transaction?

Answer

As per paragraph 23 of Ind AS 110, changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). Thus, changes in ownership interest that do not result in loss of control do not impact goodwill associated with the subsidiary or the statement of profit and loss.

Paragraph B96 of Ind AS 110 states that when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Thus, at the time of sale of 30% of its equity interest, consolidated financial statements include an amount of ₹ 1,500 crore in respect of the subsidiary. Accordingly, in the present case, the accounting entry on the date of sale of the 30% interest would be as follows:

		₹ in crore	
		Dr.	**Cr.**
Cash	Dr.	900	
To Non-controlling interest (1,500 x 30%)			450
To Other Equity (Gain on sale of interest in subsidiary)			50

Question 22

In March 20X1 a group had a 60% interest in subsidiary with share capital of 50,000 ordinary shares. The carrying amount of goodwill is ₹ 20,000 at March 20X1 calculated using the partial goodwill method. On 31 March 20X1, an option held by the minority shareholders exercised the option to subscribe for a further 25,000 ordinary shares in the subsidiary at ₹ 12 per share, raising ₹ 3,00,000. The net assets of the subsidiary in the consolidated balance sheet prior to the option's exercise were ₹ 4,50,000, excluding goodwill.

Calculate gain or loss on loss of interest in subsidiary due to option exercised by minority shareholder.

Answer

	Before		After	
Shareholdings	**No**	**%**	**No**	**%**
Group	30,000	60	30,000	40
Other party	20,000	40	45,000	60
	50,000	100	75,000	100
Net assets	**₹'000**	**%**	**₹'000**	**%**
Group's share	270	60	300	40
Other party's share	180	40	450	60
	450	100	750	100

Calculation of group gain on deemed disposal	**₹'000**
Fair value of 40% interest retained (₹ 12 x 30,000)*	360
Less: Net assets derecognized	(450)
Non-controlling interest derecognized	180
Goodwill	(20)

Gain on deemed disposal

*Note: For simplicity, it has been assumed the fair value per share is equal to the subscription price.

As control of the subsidiary is lost, the retained interest is recognized at its fair value at the date control is lost. The resulting remeasurement gain is recognized in profit and loss.

Question 23

A parent purchased an 80% interest in a subsidiary for ₹ 1,60,000 on 1 April 20X1 when the fair value of the subsidiary's net assets was ₹ 1,75,000. Goodwill of ₹ 20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of ₹ 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 ₹ 2,00,000. The book value of the subsidiary's net assets in the consolidated financial statements on the date of the sale was ₹ 2,25,000 (not including goodwill of ₹ 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 parent's separate and consolidated financial statements as on 31st March 20X4.

Answer

The parent's separate statement of profit and loss for 20X3-20X4 would show a gain on the sale of investment of ₹ 40,000 calculated as follow:

	₹ '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 ₹ 8,000 calculated as follows:

		₹'000
Sale proceeds		200
Less: Share of net assets at date of disposal (₹ 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:

		₹'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 24

AT Ltd. purchased a 100% subsidiary for ₹ 50,00,000 on 31st March 20X1 when the fair value of the BT Ltd. whose net assets was ₹ 40,00,000. Therefore, goodwill is ₹ 10,00,000. The AT Ltd. sold 60% of its investment in BT Ltd. on 31st March 20X3 for ₹ 67,50,000, leaving the AT Ltd. with 40% and significant influence. At the date of disposal, the carrying value of net assets of BT Ltd., excluding goodwill is ₹ 80,00,000. Assume the fair value of the investment in associate BT Ltd. retained is proportionate to the fair value of the 60% sold, that is ₹ 45,00,000.

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd.'s separate and consolidated financial statements as on 31st March 20X3.

Answer

AT Ltd.'s statement for profit or loss of 20X2-20X3 would show a gain on the sale of investment of ₹ 37,50,000 calculated as follows:

	₹' lakhs
Sale proceeds	67.5
Less: Cost on investment in subsidiary (₹ 50,00,000 x 60%)	(30.0)
Gain on sale in the parent's financial statement	37.5

In the consolidated financial statements, the group will calculate the gain or loss on disposal differently. The carrying amount of all of the assets including goodwill is derecognized when control is lost. This is compared to the proceeds received and the fair value of the investment retained.

The gain on the disposal will, therefore, be calculated as follows:

	₹' lakhs
Sale proceeds	67.5
Fair value of 40% interest retained	45.0
	112.5
Less: Net assets disposed, including goodwill (80,00,000 + 10,00,000)	(90.0)
Gain on sale in the group's financial statements	22.5

The gain on loss of control would be recorded in profit or loss. The gain or loss includes the gain of ₹ 13,50,000 [₹ 67,50,000 – (₹ 90,00,000 x 60%)] on the portion sold. However, it also includes a gain on remeasurement of the 40% retained interest of ₹ 9,00,000 (₹ 36,00,000* to ₹ 45,00,000). The entity will need to disclose the portion of the gain that is attributable to remeasuring any remaining interest to fair value, that is, ₹ 9,00,000.

* 90,00,000 x 40% = 36,00,000

Question 25

The facts of this Question are same as Question 24, except that the group AT Ltd. disposes of a 90% interest for ₹ 85,50,000, leaving the AT Ltd. with a 10% investment. The fair value of the remaining interest is ₹ 9,50,000 (assumed for simplicity to be pro rata to the fair value of the 90% sold).

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd.'s separate and consolidated financial statements as on 31st March 20X1.

Answer

The parent's AT Ltd. income statement in its separate financial statements for 20X1 would show a gain on the sale of the investment of ₹ 40,50,000 calculated as follows:

	₹' lakhs
Sale proceeds	85.5
Less: Cost on investment in subsidiary (₹ 50,00,000 x 90%)	(45.0)
Gain on sale in the parent's financial statement	40.5

In the consolidated financial statements, all of the assets, including goodwill are derecognized when control is lost. This is compared to the proceeds received and the fair value of the investment retained.

	₹' lakhs
Sale proceeds	85.5
Fair value of 10% interest retained	9.5
	95.0
Less: Net assets disposed, including goodwill (80,00,000 + 10,00,000)	(90.0)
Gain on sale in the group's financial statements	5.0

The gain on loss of control would be recorded in profit or loss. The gain or loss includes the gain of ₹ 4,50,000 related to the 90% portion sold* [₹ 85,50,000 – (₹ 90,00,000 x 90%)] as well as ₹ 50,000 related to the remeasurement to fair value of 10% retained interest (₹ 9,00,000 to ₹ 9,50,000)

Question 26

P Pvt. Ltd. has a number of wholly-owned subsidiaries including S Pvt. Ltd. at 31st March 20X2. P Pvt. Ltd. consolidated balance sheet and the group carrying amount of S Pvt. Ltd. assets and liabilities (i.e. the amount included in that consolidated balance sheet in respect of S Pvt. Ltd. assets and liabilities) at 31st March 20X2 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, 20X2 when P Pvt. Ltd. group sold 100% shares of S Pvt. Ltd. to independent party for ₹ 3,000 millions.

Answer

When 100% shares sold to independent party

Consolidated Balance Sheet of P Pvt. Ltd. and its remaining subsidiaries as on 31st March, 20X2

Particulars	**Note No.**	**(₹ in millions)**
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	1,900
(ii) Goodwill	2	200
(2) Current Assets		
(i) Inventories	3	100
(ii) Financial Assets		
(a) Trade Receivables	4	800
(b) Cash & Cash equivalents	5	5,100
Total Assets		**8,100**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	6	1,600

(ii) Other Equity	7	4,700
(2) Non-controlling Interest		
(3) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	1,800
Total Equity & Liabilities		**8,100**

Notes to accounts:

			(₹ in millions)
1.	**Property Plant & Equipment**		
	Land & Building	3,240	
	Less: S Pvt. Ltd.	(1,340)	1,900
2.	**Goodwill**	380	
	Less: S Pvt. Ltd.	(180)	200
3.	**Inventories**		
	Group	140	
	Less: S Pvt. Ltd.	(40)	100
4.	**Trade Receivables**		
	Group	1,700	
	Less: S Pvt. Ltd.	(900)	800
5.	**Cash & Cash equivalents**		
	Group (WN 2)	5,100	5,100
8.	**Trade Payables**		
	Group	2,700	
	Less: S Pvt. Ltd.	900	1,800

Statement of changes in Equity:

6. 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
1,600	0	1,600

7. 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			
Dividends			0			
Total comprehensive income attributable to parent			0			
Gain on disposal of S Pvt. Ltd.				440		440
Balance at the end of reporting period			0	4,700		4,700

Working Notes:

1. When sold, the carrying amount of all assets and liabilities attributable to S Pvt. Ltd. were eliminated from the consolidated balance sheet.

2. Cash on hand (in millions):

Cash before disposal of S Pvt. Ltd.	3,100
Less: S Pvt. Ltd. Cash	(1,000)
Add: Cash realized from disposal	3,000
Cash on Hand	5,100

3. Gain/Loss on disposal of entity (in millions):

Proceeds from disposal	3,000
Less: Net assets of S Pvt. Ltd.	(2,560)
Gain on disposal	440

4. Retained Earnings (in millions):

Retained Earnings before disposal	4,260
Add: Gain on disposal	440
Retained earnings after disposal	4,700

Question 27

Reliance Ltd. has a number of wholly-owned subsidiaries including Reliance Jio Infocomm Ltd. at 31st March 20X2.

Reliance Ltd. consolidated balance sheet and the group carrying amount of Reliance Jio Infocomm Ltd. assets and liabilities (i.e. the amount included in that consolidated balance sheet in respect of Reliance Jio Infocomm Ltd. assets and liabilities) at 31st March 20X2 are as follows:

Particulars	**Consolidated (₹ in '000)**	**Group carrying amount of Reliance Jio Infocomm Ltd. asset and liabilities Ltd. (₹ in '000)**
Assets		

Non-current Assets		
Goodwill	190	90
Buildings	1,620	670
Current Assets		
Inventories	70	20
Financial Assets		
Trade Receivables	850	450
Cash	1,550	500
Total Assets	**4,280**	**1,730**
Equity & Liabilities		
Equity		
Share Capital	800	
Other Equity		
Retained Earnings	2,130	
	2,930	
Current liabilities		
Financial liabilities		
Trade Payables	1,350	450
Total Equity & Liabilities	**4,280**	**450**

Prepare consolidated Balance Sheet after disposal as on 31st March, 20X2 when Reliance Ltd. group sold 90% shares of Reliance Jio Infocomm Ltd. to independent party for ₹ 1,000 thousand.

Answer

When 90% shares sold to independent party

Consolidated Balance Sheet of Reliance Ltd & its remaining subsidiaries as on 31st March, 20X2

Particulars	**Note No.**	**(₹ in '000)**
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	950
(ii) Goodwill	2	100
(iii) Financial Assets		
(a) Investments	3	128
(2) Current Assets		
(i) Inventories	4	50
(ii) Financial Assets		
(a) Trade Receivables	5	400

(b) Cash & Cash equivalents	6	2,050
Total Assets		3,678
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	7	
(ii) Other Equity	8	800
(2) Current Liabilities		1,978
(i) Financial Liabilities		
(a) Trade Payables	9	900
Total Equity & Liabilities		3,678

Notes to accounts:

			(₹ in '000)
1.	**Property Plant & Equipment**		
	Land & Building	1620	
	Less: Reliance Jio Infocomm Ltd.	(670)	950
2.	**Goodwill**	190	
	Less: Reliance Jio Infocomm Ltd.	(90)	100
3.	**Investments**		
	Investment in Reliance Jio Infocomm Ltd. (WN 2)	128	128
4.	**Inventories**		
	Group	70	
	Less: Reliance Jio Infocomm Ltd.	(20)	50
5.	**Trade Receivables**		
	Group	850	
	Less: Reliance Jio Infocomm Ltd.	(450)	400
6.	**Cash & Cash equivalents**		
	Group (WN 3)	2,050	2,050
9.	**Trade Payables**		
	Group	1,350	
	Less: Reliance Jio Infocomm Ltd.	450	900

Statement of changes in Equity:

7. 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
800	0	800

8. **Other Equity**

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				2,130		2,130
Total comprehensive income for the year			0			
Dividends			0			
Total Comprehensive income attributable to parent			0			
Loss on disposal of Reliance Jio Infocomm Ltd.				(152)		(152)
Balance at the end of reporting period			0	1,978		1,978

Working Notes:

1. When 90% being sold, the carrying amount of all assets and liabilities attributable to Reliance Jio Infocomm Ltd. were eliminated from the consolidated balance sheet and further financial asset is recognized for remaining 10%.

2. Fair value of remaining investment (in '000):

Net Assets of Reliance Jio Infocomm Ltd.	1,280
Less: 90% disposal	(1152)
Financial Asset	128

3. Cash on hand (in '000):

Cash before disposal of Reliance Jio Infocomm Ltd.	1,550
Less: Reliance Jio Infocomm Ltd. Cash	(500)
Add: Cash realized from disposal	1,000
Cash on Hand	2,050

4. Gain/Loss on disposal of entity (in '000):

Proceeds from disposal	1,000
Less: Proportionate (90%) Net assets of Reliance Jio Infocomm Ltd. (90% of 1,280)	(1,152)
Loss on disposal	(152)

5. Retained Earnings (in '000):

Retained Earnings before disposal	2,130
Less: Loss on disposal	(152)
Retained earnings after disposal	1,978

Question 28

As at the beginning of its current financial year, AB Limited holds 90% equity interest in BC Limited. During the financial year, AB Limited sells 70% of its equity interest in BC Limited to PQR Limited for a total consideration of ₹ 56 crore and consequently loses control of BC Limited. At the date of disposal, fair value of the 20% interest retained by AB Limited is ₹ 16 crore and the net assets of BC Limited are fair valued at ₹ 60 crore.

These net assets include the following:

(a) Debt investments classified as fair value through other comprehensive income (FVOCI) of ₹ 12 crore and related FVOCI reserve of ₹ 6 crore.

(b) Net defined benefit liability of ₹ 6 crore that has resulted in a reserve relating to net measurement losses of ₹ 3 crore.

(c) Equity investments (considered not held for trading) of ₹ 10 crore for which irrevocable option of recognising the changes in fair value in FVOCI has been availed and related FVOCI reserve of ₹ 4 crore.

(d) Net assets of a foreign operation of ₹ 20 crore and related foreign currency translation reserve of ₹ 8 crore.

In consolidated financial statements of AB Limited, 90% of the above reserves were included in equivalent equity reserve balances, with the 10% attributable to the non-controlling interest included as part of the carrying amount of the non-controlling interest.

What would be the accounting treatment on loss of control in the consolidated financial statements of AB Limited?

Answer

Paragraph 25 of Ind AS 110 states that if a parent loses control of a subsidiary, the parent:

(a) derecognises the assets and liabilities of the former subsidiary from the consolidated balance sheet.

(b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind ASs. That fair value 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.

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest."

Paragraph B98(c) of Ind AS 110 states that on loss of control over a subsidiary, a parent shall reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind AS, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis specified in paragraph B99.

As per paragraph B99, if a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities.

Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

In view of the basis in its consolidated financial statements, AB Limited shall:

(a) re-classify the FVOCI reserve in respect of the debt investments of ₹ 5.4 crore (90% of ₹ 6 crore) attributable to the owners of the parent to the statement of profit or loss in accordance with paragraph B5.7.1A of Ind AS 109, Financial Instruments which requires that the cumulative gains or losses previously recognised in OCI shall be recycled to profit and loss upon derecognition of the related financial asset. This is reflected in the gain on disposal. Remaining 10% (i.e., ₹ 0.6 crore) relating to non-controlling interest (NCI) is included as part of the carrying amount of the non-controlling interest that is derecognised in calculating the gain or loss on loss of control of the subsidiary;

(b) transfer the reserve relating to the net measurement losses on the defined benefit liability of ₹ 2.7 crore (90% of ₹ 3 crore) attributable to the owners of the parent within equity to retained earnings. It is not reclassified to profit or loss. The remaining 10% (i.e., ₹ 0.3 crore) attributable to the NCI is included as part of the carrying amount of NCI that is derecognised in calculating the gain or loss on loss of control over the subsidiary. No amount is reclassified to profit or loss, nor is it transferred within equity, in respect of the 10% attributable to the non-controlling interest.

(c) reclassify the cumulative gain on fair valuation of equity investment of ₹ 3.6 crore (90% of ₹ 4 crore) attributable to the owners of the same parent from OCI to retained earnings under equity as per paragraph B5.7.1 of Ind AS 109, Financial Instruments, which provides that in case an entity has made an irrevocable election to recognise the changes in the fair value of an investment in an equity instrument not held for trading in OCI, it may subsequently transfer the cumulative amount of gains or loss within equity. Remaining 10% (i.e., ₹ 0.4 crore) related to the NCI are derecognised along with the balance of NCI and not reclassified to profit and loss.

(d) reclassify the foreign currency translation reserve of ₹ 7.2 crore (90% × ₹ 8 crore) attributable to the owners of the parent to statement of profit or loss as per paragraph 48 of Ind AS 21, The Effects of Changes in Foreign Exchange Rates, which specifies that the cumulative amount of exchange differences relating to the foreign operation, recognised in OCI, shall be reclassified from equity to profit or loss on the disposal of foreign operation. This is reflected in the gain on disposal. Remaining 10% (i.e., ₹ 0.8 crore) relating to the NCI is included as part of the carrying amount of the NCI that is derecognised in calculating the gain or loss on the loss of control of subsidiary, but is not reclassified to profit or loss in pursuance of paragraph 48B of Ind AS 21, which provides that the cumulative exchange differences relating to that foreign operation attributed to NCI shall be derecognised on disposal of the foreign operation, but shall not be reclassified to profit or loss.

The impact of loss of control over BC Limited on the consolidated financial statements of AB Limited is summarised below: (₹ in crore)

Particular		Amount (Dr)	Amount (Cr)	PL Impact	RE Impact
Gain/Loss on Disposal on Investments					
Bank	Dr.	56			
Non-controlling interest (Derecognised)	Dr.	6			
Investment at FV (20% Retained)	Dr.	16			
To Gain on Disposal (PL) (balancing figure)			18	18	
To De-recognition of total net assets of subsidiary			60		
Reclassification of FVTOCI reserve on debt instruments to profit or loss					
FVTOCI reserve on debt instruments (6 cr. x 90%)	Dr.	5.4			
To Profit and loss			5.4	5.4	
Reclassification of net measurement loss reserve to profit or loss					
Retained Earnings	Dr.	2.7			–2.7
To Net measurement loss reserve (FVTOCI) (3 cr. x 90%)			2.7		
Reclassification of FVTOCI reserve on equity instruments to retained earnings					
FVTOCI reserve on equity instruments (4 cr. x 90%)	Dr.	3.6			
To Retained Earnings			3.6		3.6
Foreign currency translation reserve reclassified to profit or loss					
Foreign currency translation reserve (FVOCI) [8 cr. x 90%]	Dr.	7.2			
To Profit and loss			7.2	7.2	
Total				30.6	0.9

Question 29

P and Q form a joint arrangement PQ using a separate vehicle. P and Q each own 50% of the Capital in PQ. However, the contractual terms of the joint arrangement state that P has the rights to all of Machinery and the obligation to pay Bank Loan in Q. P and Q have rights to all other assets in PQ, and obligations for all other liabilities in PQ in proportion to their capital share (i.e., 50% each).

PQ's balance sheet is as follows:

Balance Sheet

Liabilities	₹	Assets	₹
Capital	1,50,000	Machinery	2,50,000

Bank Loan	75,000	Cash	50,000
Other Loan	75,000		
	3,00,000		3,00,000

How should P record in its financial statements its rights and obligations in PQ?

Answer

Under Ind AS 111, we would record the following in its financial statements, to account for its rights to the assets in PQ and its obligations for the liabilities in PQ.

Machinery	250,000
Cash	25,000
Capital	75,000
Bank Loan	75,000
Other Loan	37,500

Question 30

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 balance sheet is as follows:

Liabilities and equity	₹	**Assets**	₹
Debt owed to XYZ	240	Cash	40
Employee benefit plan obligation	100	Building 1	240
Equity	140	Building 2	200
Total	480	Total	480

How should AB Ltd. record in its financial statements its rights and obligations in PQR?

Answer

Under Ind AS 111, AB Ltd. should record the following in its financial statements, to account for its rights in the assets of PQR and its obligations for the liabilities of PQR.

	Amount

Assets	
Cash	20
Building 1*	240
Building 2	100
Liabilities	
Debt (third party)^	240
Employees benefit plan obligation	50
Equity	70

^AB Limited has obligation for the debt owed by PQR to XYZ in its entirety.

*Since AB Limited has the rights to all of Building No. 1, it records the amount in its entirety.

Question 31

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 ₹ 40 crores. Besides internal accruals, the cost was partly funded by way of loan of ₹ 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 ₹ 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.

Answer

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) of which ₹ 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 ₹ 1,01,25,000 (₹ 40,50,00,000 x 1/20 x 6/12) of which ₹ 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 ₹ 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 or loss of Alpha Ltd. and Gama Ltd. in equal proportions- ₹ 27,00,000 each.

Question 32

Amar Ltd. acquires 40% shares of Ram Ltd. On 1 April, 20X1, the price paid is ₹ 10,00,000. Ram Ltd has reported a profit of ₹ 2,00,000 and paid dividend of ₹ 1,00,000. Calculate Carrying Amount of Investment as per Equity Method?

Answer

Cost	10,00,000
Add: Share in Post-Acquisition Profits (2,00,000 x 40%)	80,000
Less: Distribution of Dividend (1,00,000 x 40%)	(40,000)
	10,40,000

Question 33

Entity A holds a 20% equity interest in Entity B (an associate) that in turn has a 100% equity interest in Entity C. Entity B recognised net assets relating to Entity C of ₹ 1,000 in its consolidated financial statements. Entity B sells 20% of its interest in Entity C to a third party (a non-controlling shareholder) for ₹ 300 and recognises this transaction as an equity transaction in accordance with paragraph 23 of Ind AS 110, resulting in a credit in Entity B's equity of ₹ 100.

The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

Before

A's consolidated financial statements

Assets	₹	Liabilities	₹
Investment in B	200	Equity	200
Total	200	Total	200

B's consolidated financial statements

Assets	₹	Liabilities	₹
Assets (from C)	1,000	Equity	1,000
Total	1,000	Total	1,000

The financial statements of B after the transaction are summarised below:

After

B's consolidated financial statements

Assets	₹	Liabilities			₹

Assets (from C)	1,000	Equity	1,000	
Cash	300	Equity transaction with non-controlling interest	100	
		Equity attributable to owners		1,100
		Non-controlling interest		200
Total	1,300	Total		1,300

Although Entity A did not participate in the transaction, Entity A's share of net assets in Entity B increased as a result of the sale of B's 20% interest in C. Effectively, A's share in B's net assets is now ₹ 220 (20% of ₹ 1,100) i.e., ₹ 20 in addition to its previous share.

How is an equity transaction that is recognised in the financial statements of Entity B reflected in the consolidated financial statements of Entity A that uses the equity method to account for its investment in Entity B?

Answer

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 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 A recognises ₹ 20 as change in other equity instead of in statement of profit and loss and maintains the same classification as of its associate, Entity B, i.e., a direct credit to equity as in its consolidated financial statements.

Question 34

A Ltd. (which is involved in the business of selling capital equipment) a parent company sold a capital equipment costing ₹ 100 lakh to its 80% subsidiary B Ltd. At ₹ 120 lakh. The capital equipment is recorded as PPE by B Ltd. The useful life of the PPE on the date of transfer was 10 years. Show the necessary adjustment in the consolidated financial statements (CFS).

Answer

A Ltd. shall reduce the value of PPE of ₹ 120 lakh of B Ltd., by ₹ 20 lakh in CFS. This will increase expenses and reduce consolidated profit by ₹ 20 lakh. Further, A Ltd. should also reduce the depreciation charge of B Ltd. to the extent of value of PPE reduced as above. Hence, A Ltd. should reduce the depreciation by ₹ 2 lakh (₹ 20 lakh ÷ 10 years). Further, the sales and cost of goods sold recorded by parent A Ltd. shall also be eliminated.

The double entry on consolidation is as follows:

		₹' lakh	
		Dr.	**Cr.**
Consolidated revenue	Dr.	120	
To Cost of sales			100

To PPE		18
To Depreciation		2

Question 35

M Limited holds 90% interest in subsidiary N Limited. N Limited holds 25% interest in an associate O Limited. As at 31 March 20X1, the net assets of O Limited was ₹ 300 lakhs including profit of ₹ 40 lakhs for the year ended 31 March 20X1. Calculate how the investment in O Limited will be accounted in the consolidated financial statements of M Limited?

Answer

Since N Limited is a subsidiary of M Limited, the consolidated financial statements of M Limited will include 100% amounts of the consolidated financial statements of N Limited (including investment in O Limited accounted for using equity method). Accordingly, the investment in O Limited will be accounted as follows in the consolidated financial statements of M Limited:

	₹' lakh	
Investment in O Limited (300 x 25%)		75
Share in profit of O Limited		
Attributable to M Limited (40 x 25% x 90%)	9	
Attributable to Non-controlling interest of N Limited (50 x 25% x 10%)	1	10

Question 36

AB Limited holds 30% interest in an associate which it has acquired for a cost of ₹ 300 lakhs. On the date of acquisition of that stake, the fair value of net assets of the associate was ₹ 900 lakh. The value of goodwill on acquisition was ₹ 30 lakhs. After the acquisition, AB Limited accounted for the investment in the associate as per equity method of accounting and now the carrying value of such investment in the consolidated financial statements of AB Limited is ₹ 360 lakhs. The associate has now issued equity shares to some investors other than AB Limited for a consideration of ₹ 800 lakhs. This has effectively reduced the holding of AB Limited to 20%. Determine how AB Limited should account for such reduction in interest in the associate?

Answer

Because of the issue of shares by associate to other investors, AB Limited has effectively sold 10% (30 – 20) of its interest in the associate. The gain/loss on reduction in interest in associate in calculated as follows:

	₹' lakhs
AB Limited's share in the consideration received by the associate for issue of shares (800 x 20%)(1)	160
Less: Carrying value of interest sold (360 x 1/3)(2)	(120)
Gain on reduction in interest in associate(3)	**40**

Notes:

(1) The share in the consideration received by associate on issue of shares (i.e. ₹ 160 lakhs) would be recorded as part of investment in associate.

(2) The carrying amount of interest sold (i.e. ₹ 120 lakhs) will be derecognised, including proportionate goodwill of ₹ 10 lakhs (30 x 1/3).

(3) Gain of ₹ 40 lakhs will be recorded in the profit or loss.

Question 37

MN Ltd. was holding 80% stake in UV Ltd. Now, MN Ltd. has disposed of the entire stake in UV Ltd. in two different transactions as follows:

- Transaction 1: Sale of 25% stake for a cash consideration of ₹ 2,50,000
- Transaction 2: Sale of 55% stake for a cash consideration of ₹ 5,50,000

Both the transactions have happened within a period of one month. In accordance with the guidance given in Ind AS 110, both the transactions have to be accounted as a single transaction.

The net assets of UV Ltd. and non-controlling interest on the date of both the transactions was ₹ 9,00,000 and ₹ 1,80,000 respectively (assuming there were no earnings between the period of two transactions).

How MN Ltd. should account the transaction?

Answer

MN Ltd. will account for the transaction as follows:

		₹
Recognise:		
Fair value of consideration (2,50,000 + 5,50,000)		8,00,000
Derecognise:		
Net assets of UV Ltd.	(9,00,000)	
Non-controlling interest	1,80,000	(7,20,000)
Gain to be recorded in profit or loss		**80,000**

If MN Ltd. loses control over UV Ltd. on the date of transaction 1, then the above gain is recorded on the date of transaction 1 and MN Ltd. will stop consolidating UV Ltd. from that date. The consideration of ₹ 5,50,000 receivable in transaction 2 will be shown as consideration receivable.

If MN Ltd. loses control over UV Ltd. on the date of transaction 2, then the above gain is recorded on the date of transaction 2 and MN Ltd. will stop consolidating UV Ltd. from that date. The consideration of ₹ 2,50,000 received in transaction 1 will be shown as advance consideration received.

Question 38

A Limited ceased to be in investment entity from 1st April 20X1 on which date it was holding 80% of B Limited. The carrying value of such investment in B Limited (which was measured at fair value through profit or loss) was ₹ 4,00,000. The fair value of non-controlling interest on the date of change in status was ₹ 1,00,000. The value of subsidiary's identifiable net assets as per Ind AS 103 was ₹ 4,50,000 on the date of change in status. Determine the value of goodwill and pass the journal entry on the date of change in status of investment entity. (Assume that non-controlling interest is measured at fair value method)

Answer

Goodwill calculation:

	₹
Deemed consideration (i.e. fair value of subsidiary on the date of change in status)	4,00,000
Fair value of non-controlling interest	1,00,000
	5,00,000
Value of subsidiary's identifiable net assets as per Ind AS 103	(4,50,000)
Goodwill	**50,000**

Journal entry

		₹	
		Dr.	Cr.
Net identifiable assets	Dr.	4,50,000	
Goodwill	Dr.	50,000	
To Investment in B Limited (on date of change in status)			4,00,000
To Non-controlling interest			1,00,000

Question 39

CD Ltd. purchased a 100% subsidiary for ₹ 20,00,000 on 31st March 20X1 when the fair value of the net assets of KL Ltd. was ₹ 16,00,000. Therefore, goodwill was ₹ 4,00,000. CD Ltd. becomes an investment entity on 31st March 20X3 when the carrying value of its investment in KL Ltd. (measured at fair value through profit or loss) was ₹ 25,00,000. At the date of change in status, the carrying value of net assets of KL Ltd. excluding goodwill was ₹ 19,00,000.

Calculate gain or loss with respect to investment in KL Ltd. on the date of change in investment entity status of CD Ltd.

Answer

The gain on the disposal will be calculated as follows:

	₹
Fair value of retained interest (100%)	25,00,000
Less: Net assets disposed, including goodwill (19,00,000 + 4,00,000)	(23,00,000)
Gain on the date of change in investment entity status of CD Ltd.	2,00,000

Question 40

A Ltd. is one of the parties to a joint operation holding 60% interest in a joint operation and the balance 40% interest is held by another joint operator. A Ltd. has contributed an asset held by it to the joint operation for the activities to be conducted in joint operation. The carrying value of the asset sold was ₹ 100 and the asset was actually sold for ₹ 80 i.e. at a loss of ₹ 20. How should A Ltd. account for the sale of asset to joint operation in its books?

Answer

A Ltd. should record the loss on the transaction only to the extent of other party's interest in the joint operation.

The total loss on the transaction is ₹ 20. Hence, A Ltd. shall record loss on sale of asset to the extent of ₹ 8 (₹ 20 x 40%) which is the loss pertaining to the interest of other party to the joint operation. The loss of ₹ 12 (₹ 20 – ₹ 8) shall not be recognised as that is unrealised loss.

Further, while accounting its interest in the joint operation, A Ltd. shall record its share in that asset at value of ₹ 60 [A Ltd. share of asset ₹ 48 (₹ 80 x 60%) plus unrealised loss of ₹ 12].

The journal entry for the transaction would be as follows:

Bank	Dr.	₹ 32	
Loss on sale	Dr.	₹ 8	
To Asset			₹ 40

Question 41

A Ltd. is one of the parties to a joint operation holding 60% interest in the joint operation and the balance 40% interest is held by another joint operator. A Ltd. has purchased an asset from the joint operation. The carrying value of the asset in the books of joint operation was ₹ 100 and the asset was actually purchased for ₹ 80 i.e. at a loss of ₹ 20. How should A Ltd. account for the purchase of asset from joint operation in its books?

Answer

A Ltd. should not record its share of the loss until the asset is resold to a third party.

The joint operation has sold the asset at ₹ 80 by incurring a loss of ₹ 20. Hence, A Ltd. shall record the asset at ₹ 92 [Purchase price ₹ 80 + A Ltd.'s share in loss ₹ 12 (₹ 20 x 60%)].

Further, while accounting its interest in the joint operation, A Ltd. shall not record any share in the loss incurred in sale transaction by the joint operation.

The journal entry for the transaction would be as follows:

Asset	Dr.	₹ 32	
To Bank			₹ 32

Question 42

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.

Answer

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 income A/c (P&L) 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 43

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.

Answer

(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	(1,00,000)

acquisition (4,00,000 x 25%)	
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 Green 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 44

KL Ltd. has invested in 50% voting power of a joint venture MN Ltd. MN Ltd. has also issued 10% cumulative preference shares to other investors worth ₹ 10,00,000. During the year, MN Ltd. earned profit of ₹ 4,00,000. Also, MN Ltd. has not declared any dividend on the preference shares for current year. Calculate KL Ltd.'s share in the net profit of MN Ltd. for the year.

Answer

If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity should compute its share of profit or loss after adjusting for dividend on such shares, whether or not the dividends have been declared.

In current case, KL Ltd.'s share in net profit of MN Ltd. would be as follows.

	₹
Profit of MN Ltd. for the year	4,00,000
Dividend on cumulative preference shares (10,00,000 x 10%)	(1,00,000)
Net profit attributable to the holders of equity share	3,00,000
KL Ltd.'s 50% share in net profit of MN Ltd.	1,50,000

Question 45

Scenario A

M Ltd. has invested in 40% share capital of N Ltd. and hence N Ltd. is an associate of M Ltd. During the year, N Ltd. sold inventory to M Ltd. for a value of ₹ 10,00,000. This included profit of 10% on the transaction price i.e. profit of ₹ 1,00,000. Out the above inventory, M Ltd. sold inventory of ₹ 6,00,000 to outside customers. Hence, the inventory of ₹ 4,00,000 purchased from N Ltd. is still lying with M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Scenario B

Assume the same facts as per Scenario A except that the inventory is sold by M Ltd. to N Ltd. instead of N Ltd. selling to M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Answer

Scenario A

Firstly, as part of its equity method accounting for investment in N Ltd., M Ltd. will pass this journal entry:

Investment in N Ltd.	Dr.	40,000	
To Share in profit of N Ltd.			40,000

Out of the inventory of ₹ 10,00,000, M Ltd. has sold inventory worth ₹ 6,00,000 to outside customers. Hence, the profit of ₹ 60,000 (6,00,000 x 10% profit margin) on such inventory is realised. However, the inventory worth ₹ 4,00,000 is still held by M Ltd. which consists profit of ₹ 40,000 (4,00,000 x 10%). Hence, M Ltd.'s share in such profit i.e. ₹ 16,000 (40,000 x 40%) is considered as unrealised.

Accordingly, after recording of share in total profit of N Ltd., M Ltd. should pass following adjustment entry to reverse the unrealised profit margin:

Share in profit of N Ltd.	Dr.	16,000	
To Inventory			16,000

In subsequent period, when this inventory of ₹ 4,00,000 is sold by N Ltd. to an outside customer then the above profit margin of ₹ 16,000 will be treated as realised and hence the above entry will be reversed in that period.

[**Note:** in the separate financial statements of M Ltd., inventory is carried at ₹ 4,00,000 whereas in its consolidated financial statements, inventory is carried at ₹ 3,84,000 (due to elimination entry above in respect of unrealized profit). In the subsequent period, when the inventory is sold, Inventory Account is credited by ₹ 4,00,000 whereas for the purpose of consolidated financial statements, it should have been credited by only ₹ 3,84,000. The difference is adjusted by debiting back ₹ 16,000 to the Inventory Account and a corresponding recognition of share in profit of associate.]

Scenario B

Out of the inventory of ₹ 10,00,000, N Ltd. has sold inventory worth ₹ 6,00,000 to outside customers. Hence, the profit of ₹ 60,000 (6,00,000 x 10% profit margin) on such inventory is realised. However, the inventory worth ₹ 4,00,000 is still held by N Ltd. which consists profit of

₹ 40,000 (4,00,000 x 10%). Out of this profit of ₹ 40,000, profit to the extent of other investor's interest in the investee is treated as realised profit i.e. ₹ 24,000 (40,000 x 60%) is treated as realised profit. Balance profit of ₹ 16,000 (40,000 x 40%) is considered as unrealised. Hence, M Ltd. should pass following adjustment entry to reverse the unrealised profit:

Sales	Dr.	160,000	
To Cost of material consumed			144,000
To Investment in N Ltd.			16,000

In subsequent period, when this inventory of ₹ 4,00,000 is sold by N Ltd. to an outside customer then the above profit margin of ₹ 16,000 will be treated as realised and hence the above entry will be reversed in that period.

Question 46

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.

Answer

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 47

An entity has following three type interests in an associate:

- Equity shares: 25% of the equity shares to which equity method of accounting is applied
- Preference shares: Non-cumulative preference shares that form part of net investment in the associate. Such preference shares are measured at fair value as per Ind AS 109.

- Long-term loan: The loan carrying interest of 10% p.a. The interest income is received at the end of each year. The long-term loan is accounted as per amortised cost as per Ind AS 109. This loan also forms part of net investment in the associate.

At the start of year 1, the carrying value of each of the above interests is as follows:

- Equity shares – ₹ 10,00,000
- Preference shares – ₹ 5,00,000
- Long-term loan – ₹ 3,00,000

Following table summarises the changes in the fair value of preference shares as per Ind AS 109, impairment loss on long-term loan as per Ind AS 109 and entity's share in profit/loss of associate for year 1-5.

₹

End of Year	Increase/(Decrease) in fair value of preference shares as per Ind AS 109	Impairment loss/(reversal) on long-term loan as per Ind AS 109	Entity's share in profit/(loss) of associate
1	(50,000)	(50,000)	(16,00,000)
2	(50,000)	-	(2,00,000)
3	1,00,000	50,000	-
4	50,000	-	10,00,000
5	30,000	-	10,00,000

Throughout year 1 to 5, there has been no objective evidence of impairment in the net investment in the associate. The entity does not have any legal or constructive obligation to share the losses of the associate beyond its interest in the associate.

Based on above, determine the closing balance of each of the above interests at the end of each year.

Answer

Year 1

Below table summarises the closing balance of each of the interest at the end of year 1:

₹

Type of interest	Opening balance at the start of year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit/(loss) of associate	Closing balance at the end of the year
	(A)	(B)	C = (A + B)	(D)	E = (C + D)
Equity shares	10,00,000	NA	10,00,000	(10,00,000)	-
Preference shares	5,00,000	(50,000)	4,50,000	(4,50,000)	-
Long-term loan	3,00,000	(50,000)	2,50,000	(1,50,000)	1,00,000
Total	**18,00,000**	**(1,00,000)**	**17,00,000**	**(16,00,000)**	**1,00,000**

The entire loss of ₹ 16,00,000 is recognised. Hence, there is no unrecognized loss at the end of year 1.

Year 2

Below table summarises the closing balance of each of the interest at the end of year 2:

₹

Type of interest	Opening balance at the start of year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit/(loss) of associate	Closing balance at the end of the year
	(A)	(B)	C = (A + B)	(D)	E = (C + D)
Equity shares	–	NA	–	–	–
Preference shares	–	(50,000)	(50,000)	50,000*	–
Long-term loan	1,00,000	–	1,00,000	(1,00,000)	–
Total	**1,00,000**	**(1,00,000)**	**17,00,000**	**(50,000)**	–

*Recognition of changes in fair value as per Ind AS 109 has resulted in the carrying amount of Preference shares being negative ₹ 50,000. Consequently, the entity shall reverse a portion of the associate's losses previously allocated to Preference shares.

Out of the total loss of ₹ 2,00,000 for the year, loss of only ₹ 50,000 is recognized. Hence, there is recognized loss to the extent of ₹ 1,50,000 at the end of year 2.

Year 3

Below table summarises the closing balance of each of the interest at the end of year 3:

₹

Type of interest	Opening balance at the start of year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit/(loss) of associate	Closing balance at the end of the year
	(A)	(B)	C = (A + B)	(D)	E = (C + D)
Equity shares	–	NA	–	–	–
Preference shares	–	1,00,000	1,00,000	(1,00,000)	–
Long-term loan	–	50,000	50,000	(50,000)	–
Total	–	**1,50,000**	**1,50,000**	**(1,50,000)**	–

The share in profit/loss for the year is nil. However, there was previously unrecognized loss of ₹ 1,50,000 which is allocated in current year. After recognising the above loss, there is no unrecognized loss at the end of year 3.

Year 4

Below table summarises the closing balance of each of the interest at the end of year 4:

₹

Type of interest	Opening balance at the start of year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit/(loss) of associate	Closing balance at the end of the year

	(A)	(B)	C = (A + B)	(D)	E = (C + D)
Equity shares	–	NA	–	2,00,000	2,00,000
Preference shares	–	50,000	50,000	5,00,000	5,50,000
Long-term loan	–	–	–	3,00,000	3,00,000
Total	–	**50,000**	**50,000**	**10,00,000**	**10,50,000**

The entity's share in profit of associate for the year is ₹ 10,00,000. The entity shall allocate such profit to each of the instruments in order of their seniority in liquidation. The entity should limit the amount of profit to be allocated to preference shares and long-term loan to the extent of losses previously allocated to them. Hence, the entity has allocated ₹ 5,00,000 to preference shares and ₹ 3,00,000 to long-term debt.

There is no unrecognized loss at the end of year 4.

Year 5

Below table summarises the closing balance of each of the interest at the end of year 5:

₹

Type of interest	Opening balance at the start of year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit/(loss) of associate	Closing balance at the end of the year
	(A)	(B)	C = (A + B)	(D)	E = (C + D)
Equity shares	2,00,000	NA	2,00,000	10,00,000	12,00,000
Preference shares	5,50,000	30,000	5,80,000	–	5,80,000
Long-term loan	3,00,000	–	3,00,000	–	3,00,000
Total	**10,50,000**	**30,000**	**10,80,000**	**10,00,000**	**20,80,000**

The entity's share in profit of associate for the year is ₹ 10,00,000. The entire profit is allocated to equity shares since there is no loss previously allocated to either preference shares or long-term loan.

There is no recognized loss at the end of year 5.

Year 1 to 5

The interest accrual on long-term loan would be done in each year at 10% p.a. This will be done without taking into account any adjustment done in the carrying value of long-term loan as per Ind AS 28. Hence, the entity will accrue interest of ₹ 30,000 (3,00,000 x 10%) in each year.

Question 48

CD Ltd. held 50% of the voting power of RS Ltd. which is a joint venture of CD Ltd. The carrying value of the investment in RS Ltd. is ₹ 1,00,000. Now out of the 50% stake, CD Ltd. has sold 20% stake in RS Ltd. to a third party for a consideration of ₹ 80,000. The fair value of the retained 30% interest is ₹ 1,20,000. Determine how much gain/loss should be recorded in profit or loss of CD Ltd.

Answer

CD Ltd. Shall record in profit or loss difference between below:

- the fair value of any retained interest (i.e. ₹ 1,20,000) and any proceeds from disposing of a part interest in the joint venture (i.e. ₹ 80,000); and
- the carrying amount of the investment at the date the equity method was discontinued (i.e. ₹ 1,00,000).

Hence, CD Ltd. Shall record gain of ₹ 1,00,000 in profit or loss.

Question 49

On 1st April 2019, 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, 2020. 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, 2020 as per the relevant Ind AS.

Answer

Calculation of Investor Ltd.'s investment in XYZ Ltd. under equity method:

	₹	₹
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	
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 50

A Limited acquires 80% of B Limited by paying cash consideration of ₹ 120 crore. The fair value of non-controlling interest on the date of acquisition is ₹ 30 crore. The value of subsidiary's identifiable net assets as per Ind AS 103 is ₹ 130 crore. Determine the value of goodwill and pass the journal entry.

Answer

The amount of non-controlling interest can be measured as per i) Fair value method or ii) Proportionate share method (i.e. proportionate share in the net identifiable assets of the acquiree). The value of goodwill will be different under both the methods. The goodwill is calculated as per both the methods below:

Fair value method	**₹ crore**
Fair value of consideration transferred	120
Fair value of non-controlling interest	30
	150
Value of subsidiary's identifiable net assets as per Ind AS 103	(130)
Goodwill	**20**
Proportionate share method	**₹ crore**
Fair value of consideration transferred	120
Proportional share of non-controlling interest in the net identifiable assets of acquiree (130 x 20%)	26
	146
Value of subsidiary's identifiable net assets as per Ind AS 103	(130)
Goodwill	**16**

Journal entries

Fair value method		**₹ crore**	
		Dr.	**Cr.**
Net identifiable assets	Dr.	130	
Goodwill	Dr.	20	
To Cash			120
To Non-controlling interest			30
Proportionate share method		**₹ crore**	
		Dr.	**Cr.**
Net identifiable assets	Dr.	130	
Goodwill	Dr.	16	

To Cash		120
To Non-controlling interest		26

Question 51

Ram Ltd. acquires 60% of Raja Ltd. by paying cash consideration of ₹ 750 lakh (including control premium). The fair value of non-controlling interest on the date of acquisition is ₹ 480 lakh. The value of subsidiary's identifiable net assets as per Ind AS 103 is ₹ 1,000 lakh. Determine the value of goodwill and pass the journal entry.

Answer

The amount of non-controlling interest can be measures wither as per i) Fair value method or ii) Proportionate share method (i.e. proportionate share in the net identifiable assets of the acquiree). The value of goodwill will be different under both the methods. The goodwill is calculated as per both the methods below:

Fair value method	**₹ lakh**
Fair value of consideration transferred	750
Fair value of non-controlling interest	480
	1,230
Value of subsidiary's identifiable net assets as per Ind AS 103	(1,000)
Goodwill	**230**
Proportionate share method	**₹ lakh**
Fair value of consideration transferred	750
Proportional share of non-controlling interest in the net identifiable assets of acquiree (1,000 x 40%)	400
	1,150
Value of subsidiary's identifiable net assets as per Ind AS 103	(1,000)
Goodwill	**150**

Journal entries

Fair value method		**₹ lakh**	
		Dr.	**Cr.**
Net identifiable assets	Dr.	1,000	
Goodwill	Dr.	230	
To Cash			750
To Non-controlling interest			480
Proportionate share method		**₹ lakh**	
		Dr.	**Cr.**
Net identifiable assets	Dr.	1,000	
Goodwill	Dr.	150	

To Cash		750
To Non-controlling interest		400

Question 52

X Ltd. acquires 80% of Y Ltd. by paying cash consideration of ₹ 400 lakh. The fair value of non-controlling interest on the date of acquisition is ₹ 100 lakh. The value of subsidiary's identifiable net assets as per Ind AS 103 is ₹ 520 lakh. Determine the value of gain on bargain purchase and pass the journal entry.

Answer

The amount of non-controlling interest can be measures wither as per i) Fair value method or ii) Proportionate share method (i.e. proportionate share in the net identifiable assets of the acquiree). The value of gain on bargain purchase will be different under both the methods. The gain is calculated as per both the methods below:

Fair value method	**₹ lakh**
Fair value of consideration transferred	400
Fair value of non-controlling interest	100
	500
Value of subsidiary's identifiable net assets as per Ind AS 103	(520)
Gain on bargain purchase	**(20)**
Proportionate share method	**₹ lakh**
Fair value of consideration transferred	400
Proportional share of non-controlling interest in the net identifiable assets of acquiree (520 x 20%)	104
	504
Value of subsidiary's identifiable net assets as per Ind AS 103	(520)
Gain on bargain purchase	**(16)**

Journal entries

Fair value method		**₹ lakh**	
		Dr.	**Cr.**
Net identifiable assets	Dr.	520	
To Cash			400
To Gain on bargain purchase*			20
To Non-controlling interest			100
Proportionate share method		**₹ lakh**	
		Dr.	**Cr.**
Net identifiable assets	Dr.	520	
To Cash			400

To Gain on bargain purchase*		16
To Non-controlling interest		104

*Gain on bargain purchase is either recognised in OCI or is recognised directly in equity as a capital reserve.

Question 53

M Ltd. acquires 100% of N Ltd. by paying cash consideration of ₹ 100 lakh. The value of subsidiary's identifiable net assets as per Ind AS 103 is ₹ 80 lakh. Determine the value of goodwill.

Answer

The value of goodwill is calculated as follows:

Determination of goodwill	₹ lakh
Fair value of consideration transferred	100
Value of subsidiary's identifiable net assets as per Ind AS 103	(80)
Goodwill	**20**

Question 54

RS Ltd. holds 30% stake in PQ Ltd. This investment in PQ Ltd. is accounted as an investment in associate in accordance with Ind AS 28 and the carrying value of such investment in ₹ 100 lakh. RS Ltd. Purchases the remaining 70% stake for a cash consideration of ₹ 700 lakh. The fair value of previously held 30% stake is measured to be ₹ 300 lakh on the date of acquisition of 70% stake. The value of PQ Ltd.'s identifiable net assets as per Ind AS 103 on that date is ₹ 800 lakh. How should RS Ltd. Account for the business combination?

Answer

The amount of goodwill is calculated as follows:

Determination of goodwill	₹ lakh
Fair value of consideration transferred	700
Fair value of previously held equity interest	300
	1,000
Value of subsidiary's identifiable net assets as per Ind AS 103	(800)
Goodwill	**200**

RS Ltd. Should record the difference between the fair value of previously held equity interest in the subsidiary and the carrying value of that interest in the profit or loss i.e. ₹ 200 lakh (300 – 100) should be recognised in profit or loss.

Journal entries

Fair value method	₹ lakh

		Dr.	Cr.
Net identifiable assets	Dr.	800	
Goodwill	Dr.	200	
To Cash			700
To Investment in associate			100
To Gain on fair valuation of previously held equity interest			200

Question 55

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st April, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was ₹ 1,00,000 and the balance in the Statement of Profit and Loss was ₹ 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. has earned a profit of ₹ 20,000 and later on, it declared and paid a dividend of ₹ 30,000.

The fair value of identifiable net assets is ₹ 1,50,000.

Calculate the amount of non-controlling interest as on 1st April, 20X1 (Using NCI's proportionate share method) and 31st March, 20X2.

Also pass a journal entry on the acquisition date.

Answer

NCI on 1st April 20X1 = 20% of the fair value on identifiable assets

= 20% x ₹ 1,50,000 = ₹ 30,000

The journal entry recorded on the acquisition date for the 80% interest acquired is as follows:

		₹	₹
Identifiable net assets	Dr.	1,50,000	
Goodwill (Balancing Figure)	Dr.	20,000	
To Cash			1,40,000
To NCI			30,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1-20X2

= 30,000 + (20,000 x 20%) = ₹ 34,000

Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting.

Question 56

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st April, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was ₹ 1,00,000 and the balance in the Statement of Profit and Loss was ₹ 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. has earned a profit of ₹ 20,000 and later on, it declared and paid a dividend of ₹ 30,000.

Assume, the fair value of non-controlling interest is same as the fair value on a per-share basis of the purchased interest. All net assets are identifiable net assets, there are no non-identifiable assets. The fair value of identifiable net assets is ₹ 1,60,000.

What is the amount of non-controlling interest as on 1st April, 20X1 (using Fair Value Method) and 31st March, 20X2. Also pass a journal entry on the acquisition date.

Answer

Calculation of Non-controlling interest and Journal Entry

NCI on 1st April 20X1 = 20% of Fair value on a per-share basis of the purchased interest.

= 20% x ₹ 1,75,000 (W.N 1) = ₹ 35,000

The journal entry recorded on the acquisition date for the 80% interest acquired is as follows:

		₹	₹
Identifiable net assets	Dr.	1,60,000	
Goodwill (Balancing Figure)	Dr.	15,000	
To Cash			1,40,000
To NCI			35,000

Working Note 1

Fair value on a per-share basis of the purchased interest/Fair Value of Identifiable net assets

= Consideration transferred x 100/80

= 1,40,000 x 100/80 = ₹ 1,75,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1-20X2

= 35,000 + (20,000 x 20%) = ₹ 39,000

Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting.

Question 57

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st April, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was ₹ 1,00,000 and the balance in the Statement of Profit and Loss was ₹ 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. has earned a profit of ₹ 20,000 and later on, it declared and paid a dividend of ₹ 30,000.

The fair value of identifiable net assets is ₹ 1,60,000.

Calculate the amount of non-controlling interest as on 1st April, 20X1 (Using NCI's proportionate share method) and 31st March, 20X2.

Also pass a journal entry on the acquisition date.

Answer

NCI on 1st April 20X1 = 20% of the fair value on identifiable assets

= 20% x ₹ 1,60,000 = ₹ 32,000

The journal entry recorded on the acquisition date for the 80% interest acquired is as follows:

		₹	₹
Identifiable net assets	Dr.	1,60,000	
Goodwill (Balancing Figure)	Dr.	12,000	
To Cash			1,40,000
To NCI			32,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1-20X2

= 32,000 + (20,000 x 20%) = ₹ 36,000

Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting.

Question 58

Summarized Balance Sheets of PN Ltd. and SR Ltd. as on 31 March 2020 were given as below:

(Amount in ₹)

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 ₹ 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**

(i) PN Ltd. acquired 70% equity shares of ₹ 100 each of SR Ltd. on 1 October 2019.

(ii) The Retained Earnings of SR Ltd. showed a credit balance of ₹ 93,600 on 1 April 2019 out of which a dividend of 12% was paid on 15 December 2019.

(iii) PN Ltd. has credited the dividend received to its Retained Earnings.

(iv) Fair value of Plant & Machinery of SR Ltd. as on 1 October 2019 was ₹ 6,24,000. The rate of depreciation on Plant & Machinery was 10% p.a.

(v) Following are the increases on comparison of Fair Value as per respective Ind AS with book value as on 1 October 2019 of SR Ltd. which are to be considered while consolidating the Balance Sheets:

(a) Land & Buildings ₹ 3,12,000

(b) Inventories ₹ 46,800

(c) Trade Payables ₹ 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 31 March 2020 are the same as was on 1 April 2019.

(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 31 March 2020 of the group of entities PN Ltd. and SR Ltd.

Answer

Consolidated Balance Sheet of PN Ltd. and its subsidiary SR Ltd. as on 31 March 2020

Particulars	**Note No.**	**₹**
III. Assets		
(1) Non-current assets		
(i) Property, Plant & Equipment	1	26,83,200
(ii) Goodwill	2	89,402
(2) Current Assets		
(i) Inventories	3	5,34,800
(ii) Financial Assets		
(a) Trade Receivables	4	3,11,300
(b) Cash & Cash equivalents	5	70,100
Total Assets		**36,88,802**
IV. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	6	15,60,000
(ii) Other Equity	7	11,39,502
(2) Non-controlling Interest (W.N.3)		5,07,300
(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

			₹
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	26,83,200
2.	**Goodwill (W.N.4)**		89,402
3.	**Inventories**		
	PN Ltd.	3,74,400	
	SR Ltd. (1,13,600 + 46,800)	1,60,400	5,34,800
4.	**Trade Receivables**		
	PN Ltd.	1,86,500	
	SR Ltd.	1,24,800	3,11,300
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:

6. 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
15,60,000	0	15,60,000

7. Other Equity

	Reserves & Surplus			Total (₹)
	Capital reserve ₹	Retained Earnings ₹	Other Reserves ₹	
Balance at 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 (W.N.2)	0	77,518		77,518

Gain on Bargain purchase		0		0
Balance at the end of reporting period	0	2,03,502	9,36,000	11,39,502

Working Notes:

8. Adjustments of Fair Value

The Plant & Machinery of SR Ltd. would stand in the books at ₹ 4,44,600 on 1 October, 2019, considering only six months' depreciation on ₹ (4,21,200/90%) = 4,68,000; total depreciation being ₹ 4,68,000 x 10% x 6/12 = 23,400. Being the fair value of the asset ₹ 6,24,000, there is an appreciation to the extent of ₹ 1,79,400 (₹ 6,24,000 – ₹ 4,44,600).

9. Acquisition date profits of SR Ltd.

Reserves on 1.4.2019	3,12,000
Profit & Loss Account Balance on 1.4.2019	93,600
Profit for 2019-2020: Total [₹ 2,55,800 – (93,600 – 74,880)] x 6/12 i.e. ₹ 1,18,540 upto 1.10.2019	1,18,540
Total Appreciation	5,07,000*
Total	10,31,140
Holding Co. Share (70%)	7,21,798
NCI	3,09,342

*Appreciation = Land & Building ₹ 3,12,000 + Inventories ₹ 46,800 + Plant & Machinery ₹ 1,79,400 – Trade Payables (₹ 31,200) = ₹ 5,07,000

10. Post-acquisition profits of SR Ltd.

Profit after 1.10.2019 [2,55,800 – (93,600 – 74,880)] x 6/12	1,18,540
Less: 10% depreciation on ₹ 6,24,000 for 6 months less depreciation already charged for 2nd half of 2019-2020 on ₹ 4,68,800 (i.e. 31,200 – 23,400)	(7,800)
Total	1,10,740
Share of holding Co. (70%)	77,518
Share of NCI (30%)	33,222

11. Non-controlling Interest

Par value of 1,872 shares	1,87,200
Add: 30% Acquisition date profits [(10,31,140 – 74,880) x 30%]	2,86,878
30% Post-acquisition profits [W.N.2]	33,222
	5,07,300

12. Goodwill:

Amount paid for 4,368 shares		12,48,000
Less: Par value of shares	4,36,800	

Acquisition date profits-share of PN Ltd. (W.N.1)	7,21,798	(11,58,598)
Goodwill		89,402

13. Value of Plant & Machinery:

PN Ltd.		7,48,800
SR Ltd.	4,21,200	
Add: Appreciation on 1.10.2019	1,79,400	
	6,00,600	
Add: Depreciation for 2nd half charged on pre-revalued value	23,400	
Less: Depreciation on ₹ 6,24,000 for 6 months	(31,200)	5,92,800
		13,41,600

14. Consolidated Profit & Loss account

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

Question 59

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?

Answer

(i) On the date of change, i.e., 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 i.e. Praja Ltd. shall be treated as if the investment entity had disposed off the subsidiary at the date of change in status, i.e., 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 60

On 1st April 2017, 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 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, 2019:

	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
	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:

(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 31st March, 2019. (Notes to Account on Consolidated Balance Sheet is not required).

Answer

Consolidated Balance Sheet of A Ltd. and its subsidiary, S Ltd. as at 31st March, 2019

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 2018-2019 and entries are yet to be made.

Working Notes:

1. Calculation of purchase consideration at the acquisition date i.e. 1st April, 2017

	₹ 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, 2017

	₹ 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, 2017 and 31st March, 2019

	₹ 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 2017	1,290.00
Less: Impairment (as given in the question)	258.00
Goodwill as on 31st March 2019	1,032.00

4. Calculation of Property, Plant and Equipment as on 31st March 2019

			₹ 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 2019

	₹ 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) x 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 2019**

	₹ 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 2019	1,190.85

7. **Calculation of value of deferred consideration as on 31st March 2019**

	₹ in 000s
Value of deferred consideration as on 1st April 2017 (W.N.1)	375.00
Add: Finance cost for the year 2017-2018 (375 x 10%)	37.50
	412.50
Add: Finance cost for the year 2018-2019 (412.50 x 10%)	41.25
Deferred consideration as on 31st March 2019	453.75

8. **Calculation of current Liability as on 31st March 2019**

	₹ in 000s
A Ltd.	1,250.00
S Ltd.	650.00
Deferred consideration as on 31st March 2019 (W.N.7)	453.75
Current Liability as on 31st March 2019	2,353.75

Question 61

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 31st March 2020 under the relevant method.

Answer

Calculation of Big Ltd.'s interest in Dig Ltd at the year ended 31st March, 2020 as per Equity method:

	Amount (₹)
Cost of investment (35%)	3,00,000
Share in profit after 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

CHAPTER - 15
Analysis of Financial Statements

Question 1

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 ₹ 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at ₹ 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of ₹ 2 lakhs on repairing and re-packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of ₹ 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:

₹ lakhs

Cost	8.00
Net realisable value (9.6 – 2)	7.60
Inventories (lower of cost and net realisable value)	7.60

Analyse whether the above accounting treatment made by the accountant in regard to financial year ending on 31.03.20X2 is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

Answer

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, favourable and unfavourable, 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 recognised in its financial statements to reflect non- adjusting events after the reporting period".

Further, paragraph 6 of Ind AS 2 defines:

"Net realisable 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 realisable value".

Accountant of Jupiter Ltd. has re-measured the 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 recognised 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 ₹ 8 Lakhs calculated below: **₹' lakhs**

Cost	8.00
Net realisable value	9.60
Inventories (lower of cost and net realisable value)	8.00

Question 2

Venus Ltd. is a multinational entity that owns three properties. All three properties were purchased on 1st April, 20X1. The details of purchase price and market values of the properties are given as follows:

Particulars	**Property 1**	**Property 2**	**Property 3**
	Factory	Factory	Let-Out
Purchase price	15,000	10,000	12,000
Market value 31.03.20X2	16,000	11,000	13,500
Life	10 Years	10 Years	10 Years
Subsequent Measurement	Cost Model	Revaluation Model	Revaluation Model

Property 1 and 2 are used by Venus Ltd. as factory building whilst property 3 is let-out to a non-related party at a market rent. The management presents all three properties in balance sheet as 'property, plant and equipment'.

The Company does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognise the difference between purchase price and fair value in Statement of Profit and Loss.

Required:

Analyse whether the accounting policies adopted by the Venus Ltd. in relation to these properties is in accordance with Ind AS. If not, advise the correct treatment alongwith working for the same.

Answer

The above 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'.

Property '1' and '2'

Para 6 of Ind AS 16 'Property, Plant and Equipment' defines:

"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."

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".

Further, 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".

Further, 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 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".

Further, paragraph 52 of Ind AS 16 states that:

"Depreciation is recognised 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".

Property '3'

Para 6 of Ind AS 40 'Investment property' defines:

"Investment property is property (land or a building or part of a building or both) held (by the owner or by the lessee under a finance lease) 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".

Further, 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".

Further, paragraph 79 (e) of Ind AS 40 requires that:

"An entity shall disclose the fair value of investment property".

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;

As per the facts given in the question, Venus Ltd. has

(a) presented all three properties in balance sheet as 'property, plant and equipment';

(b) applied different accounting policies to Property '1' and '2';

(c) revaluation is charged in statement of profit and loss as profit; and

(d) applied revaluation model to Property '3' being classified as Investment Property.

These accounting treatment is neither correct nor in accordance with provision of Ind AS 1, Ind AS 16 and Ind AS 40.

Accordingly, Venus Ltd. shall apply the same accounting policy (i.e. either revaluation or cost model) to entire class of property being property '1' and '2". It also required to depreciate these properties irrespective of 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, Venus ltd. is required to disclose the fair value of the property in the Notes to Accounts. Also the property '3' shall be presented as separate line item as Investment Property.

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 is as follows:

Case 1: Venus Ltd. has applied Cost Model to entire class of PPE

Balance Sheet extracts as at 31st March, 20X2

Assets		₹
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	13,500	
Property '2'	9,000	22,500
Investment Properties		
Property '3'		10,800

Case 2: Venus Ltd. has applied Revaluation Model to entire class of PPE

Balance Sheet extracts as at 31st March, 20X2

Assets		₹
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	16,000	
Property '2'	11,000	27,000
Investment Properties		
Property '3'		10,800
Equity and Liabilities		
Other Equity		
Revaluation Reserve		
Property '1'	2,500	
Property '2'	2,000	4,500

The revaluation reserve should be routed through Other Comprehensive Income (subsequently not reclassified to Profit and Loss) in Statement of Profit and Loss and Shown as a separate column in Statement of Changes in Equity.

Question 3

Pluto Ltd. has purchased a manufacturing plant for ₹ 6 lakhs on 1st April, 20X1. The useful life of the plant is 10 years. On 30th September, 20X3, Pluto 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 Pluto ltd. decided to treat the plant as held for sale until the demands picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell.

Also, the accountant has also stopped charging the depreciation for the rest of period considering the plant as held for sale. The fair value less cost to sell on 30th September, 20X3 and 31st March, 20X4 was ₹ 4 lakhs and ₹ 3.5 lakhs respectively.

The accountant has performed the following working:

Carrying amount on initial classification as held for sale		
Purchase Price of Plant	6,00,000	
Less: Accumulated dep (6,00,000/10 Years) x 2.5 years	(1,50,000)	4,50,000
Fair Value less cost to sell as on 30th September, 20X3		4,00,000
The value will be lower of the above two		4,00,000

Balance Sheet extracts as on 31st March, 20X4

Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	3,50,000

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment alongwith the necessary workings.

Answer

The above treatment needs to be examined in the light of the provisions given in Ind AS 16 'Property, Plant and Equipment' and Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'.

Para 6 of Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' states that:

"An entity shall classify a non-current asset (or disposal group) 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 (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. Thus, an asset (or disposal group) cannot be classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a 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."

Paragraph 13 of Ind AS 105 states that:

"An entity shall not classify as held for sale a non-current 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 Pluto 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. Pluto 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, 20X4	
Purchase Price of Plant	6,00,000
Less: Accumulated depreciation (6,00,000/10 Years) x 3 Years	(1,80,000)
	4,20,000
Less: Impairment loss	(70,000)
	3,50,000

Balance Sheet extracts as on 31st March, 20X4

Assets	
Non-Current Assets	
Property, Plant and Equipment	3,50,000

Working Note:

Fair value less cost to sell of the Plant = ₹ 3,50,000

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. ₹ 3,50,000

Impairment loss = Carrying amount – Recoverable amount Impairment loss

= ₹ 4,20,000 – ₹ 3,50,000 = ₹ 70,000

Question 4

Mercury Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April, 20X1, the company has received a government grant for ₹ 10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years. Eucalyptus trees are not considered as bearer plant in this case.

The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus tree for specified period of five years and accordingly it recognises proportionate grant for ₹ 2 lakhs 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.

Analyse whether the above accounting treatment made by the management is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

Answer

As per given facts, the company is engaged in plantation and farming. Hence Ind AS 41 Agriculture shall be applicable to this company.

The above facts need to be examined in the light of the provisions given in Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance' and Ind AS 41 'Agriculture'.

Para 2(d) of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance' states:

"This Standard does not deal with government grants covered by Ind AS 41, Agriculture".

Further, paragraph 1 (c) of Ind AS 41 'Agriculture', states:

"This Standard shall be applied to account for the government grants covered by paragraphs 34 and 35 when they relate to agricultural activity".

Further, paragraph 1 (c) of Ind AS 41 'Agriculture', states:

"If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met".

Understanding of the given facts, The Company has recognised the proportionate grant for ₹ 2 lakhs in Statement of Profit and Loss before the conditions attaching to government grant are met which is not correct and nor in accordance with provision of Ind AS 41 'Agriculture'.

Accordingly, the accounting treatment of government grant received by the Mercury Ltd. is governed by the provision of Ind AS 41 'Agriculture' rather Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance'.

Government grant for ₹ 10 lakhs shall be recognised in profit or loss when, and only when, the conditions attaching to the government grant are met i.e. after the expiry of specified period of five years of continuing engagement in the plantation of eucalyptus tree.

Balance Sheet extracts showing the presentation of Government Grant as on 31st March, 20X2

Liabilities	₹
Non-Current liabilities	
Other Non-Current Liabilities	
Government Grants	10,00,000

Question 5

On 1st January, 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September, 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March, 20X2, that there was a 75% probability they would have to pay damages of ₹ 10 lakhs to the customer.

However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of ₹ 12 lakhs to the customer on 15th May, 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May, 20X2.

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.

Answer

The above treatment needs to be examined in the light of the provisions given in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' and Ind AS 10 'Events After the Reporting Period'.

Para 10 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' defines:

"Provision is a liability of uncertain timing or amount.

Liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits".

Further, paragraph 14 of Ind AS 37, states:

"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".

Further, paragraph 36 of Ind AS 37, states:

"The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period".

Further, paragraph 3 of Ind AS 10 'Events after the Reporting Period' defines:

"Events after the reporting period are those events, favourable and unfavourable, 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 8 of Ind AS 10 states that:

"An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period."

The Accountant of Sun Ltd. has not recognised the provision and accordingly not adjusted the amounts recognised in its financial statements to reflect adjusting events after the reporting period is not correct and nor in accordance with provision of Ind AS 37 and Ind AS 10.

As per given facts, the potential payment of damages to the customer is an obligation arising out of a past event which can be reliably estimated. Therefore, following the provision of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' – a provision is required. The provision should be for the best estimate of the expenditure required to settle the obligation at 31st March, 20X2 which comes to ₹ 7.5 lakhs (₹ 10 lakhs x 75%).

Further, following the principles of Ind AS 10 'Events After the Reporting Period' evidence of the settlement amount is an adjusting event. Therefore, the amount of provision created shall be increased to ₹ 12 lakhs and accordingly be recognised as a current liability.

Question 6

On 1 April 20X1, Star Limited has advanced a housing loan of ₹ 15 lakhs 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 lakhs. 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 lakhs).

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 31 March 20X2.

Answer

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
31 March 20X2	15,00,000	3,00,000	90,000	3,90,000	0.909	3,54,510
31 March 20X3	12,00,000	3,00,000	72,000	3,72,000	0.826	3,07,272
31 March 20X4	9,00,000	3,00,000	54,000	3,54,000	0.751	2,65,854
31 March 20X5	6,00,000	3,00,000	36,000	3,36,000	0.683	2,29,488
31 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 service 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 on 31 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:

1. **On 1 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 31 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 toprofit 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 31 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

Deferred tax on temporary differences arising on the above-mentioned account balances (appearing in the balance sheet) should be recognised. However, in the absence of any tax rate in the question no deferred tax has been recognised.

Question 7

Mercury Ltd. has sold goods to Mars Ltd. at a consideration of ₹ 10 lakhs, the receipt of which receivable in three equal installments of ₹ 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. ₹ 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 ₹ 10 Lakhs and hence, the management has recognised the revenue from sale of goods for ₹ 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.

Answer

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: ₹

Year	Consideration (Installment)	Present value factor	Present value of consideration
Time of sale	3,33,333	–	3,33,333
End of 1st year	3,33,333	0.949	3,16,333
End of 2nd 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			
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 year ended 31st March, 20X2 and 31st March, 20X3 ₹

	As at 31st March, 20X2	As at 31st 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 ₹

	As at 31st March, 20X2	As at 31st March, 20X3
Assets		
Current Assets		
Financial Assets		
Trade Receivables	3,16,387	–

Question 8

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 statuary 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 31st 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 statuary 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.

Answer

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 (4800 + 300)	5,100
Current liabilities	
Financial liabilities	
Trade payables	11,000
Other financial liabilities (Refer note 5)	15,000
Other current liabilities (Govt. statuary 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 31st March, 20X1	–
Changes in equity share capital during the year	1,00,000
As at 31st March, 20X2	1,00,000

B. Other Equity

	Reserves & Surplus Retained Earnings (₹)
As at 31st 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 31st 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. 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.

4. 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 statuary 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 9

Mumbai Challengers Ltd., a listed entity, is a sports organization owning several cricket and hockey teams. The issues below pertain to the reporting period ending 31 March 20X2.

(a) Owing to the proposed schedules of Indian Hockey League as well as Cricket Premier Tournament, Mumbai Challengers Ltd. needs a new stadium to host the sporting events. This stadium will form a part of the Property, Plant and Equipment of the company. Mumbai Challengers Ltd. began the construction of the stadium on 1 December, 20X1. The construction of the stadium was completed in 20X2-20X3. Costs directly related to the construction amounted to ₹ 140 crores in December 20X1. Thereafter, ₹ 350 crores have been incurred per month until the end of the financial year. The company has not taken any specific borrowings to finance the construction of the stadium, although it has incurred finance costs on its regular overdraft during the period, which were avoidable had the stadium not been constructed. Mumbai Challengers Ltd. has calculated that the weighted average cost of the borrowings for the period 1 December 20X1 to 31 March 20X2 amounted to 15% per annum on an annualized basis.

The company seeks advice on the treatment of borrowing costs in its financial statements for the year ending 31 March 20X2.

(b) Mumbai Challengers Ltd. acquires and sells players' registrations on a regular basis. For a player to play for its team, Mumbai Challengers Ltd. must purchase registrations for that player. These player registrations are contractual obligations between the player and the company. The costs of acquiring player registrations include transfer fees, league levy fees, and player agents' fees incurred by the club.

At the end of each season, which happens to also be the reporting period end for Mumbai Challengers Ltd., the club reviews its contracts with the players and makes decisions as to whether they wish to sell/transfer any players' registrations. The company actively markets these registrations by circulating with other clubs a list of players' registrations and their estimated selling price. Players' registrations are also sold during the season, often with performance conditions attached. In some cases, it becomes clear that a player will not play for the club again because of, for example, a player sustaining a career threatening injury or being permanently removed from the playing squad for any other reason. The playing registrations of certain players were sold after the year end, for total proceeds, net of associated costs, of ₹ 175 crores. These registrations had a net book value of ₹ 49 crores.

Mumbai Challengers Ltd. seeks your advice on the treatment of the acquisition, extension, review and sale of players' registrations in the circumstances outlined above.

(c) Mumbai Challengers Ltd. measures its stadiums in accordance with the revaluation model. An airline company has approached the directors offering ₹ 700 crores for the property naming rights of all the stadiums for five years. Three directors are on the management boards of both Mumbai Challengers Ltd. and the airline. Additionally, statutory legislations regulate the financing of both the cricket and hockey clubs. These regulations prevent contributions to the capital from a related party which 'increases equity without repayment in return'. Failure to adhere to these legislations could lead to imposition of fines and withholding of prize money.

Mumbai Challengers Ltd. wants to know how to take account of the naming rights in the valuations of the stadium and the potential implications of the financial regulations imposed by the legislations.

Answer

(a) Borrowing Costs

As per Ind AS 23 Borrowing Costs, an entity shall capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (i.e. an asset that necessarily takes a substantial period of time to get ready for its intended use or sale) as part of the cost of that asset. The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. 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 capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period.

The capitalization rate of the borrowings of Mumbai Challengers Ltd. during the period of construction is 15% per annum (as given in the question), and therefore, the total amount of borrowing costs to be capitalized is the expenditures incurred on the asset multiplied by the capitalization rate, which is as under:

Particulars	₹ in crores
Costs incurred in December 20X1: (₹ 140 crores x 15% x 4/12)	7.000
Costs incurred in January 20X2: (₹ 350 crores x 15% x 3/12)	13.125
Costs incurred in February 20X2: (₹ 350 crores x 15% x 2/12)	8.750
Costs incurred in March 20X2: (₹ 350 crores x 15% x 1/12)	4.375
Borrowing Costs to be capitalized in 20X1-X2	**33.250**

OR

Weighted average carrying amount of the stadium during 20X1-X2 is:

₹ (140 + 490 + 840 + 1,190) crores/4 = ₹ 665 crores

Applying the weighted average rate of borrowings of 15% per annum, the borrowing cost to be capitalized is computed as:

₹ 665 crores x (15% x 4/12) = ₹ 33.25 crores

(b) Players' Registrations

Acquisition

As per Ind AS 38 Intangible Assets, an entity should recognize an intangible asset where it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably. Accordingly, the costs associated with the acquisition of players' registrations would need to be capitalized which would be the amount of cash or cash equivalent paid or the fair value of other consideration given to acquire such registrations. In line with Ind AS 38 Intangible Assets, costs would include transfer fees, league levy fees, and player agents' fees incurred by the club, along with other directly attributable costs, if any. Amounts capitalized would be fully amortized over the period covered by the player's contract.

Sale of registrations

Player registrations would be classified as assets held for sale under Ind AS 105 Non- Current Assets Held for Sale and Discontinued Operations when their carrying amount is expected to be recovered principally through a sale transaction and a sale is considered to be highly probable. To consider a sale to be 'highly probable', the assets (in this case, player registrations) should be actively marketed for sale at a price that is reasonable in relation to its current fair value. In the given case, it would appear that the management is committed to a plan to sell the registration, that the asset is available for immediate sale and that an active plan to locate a buyer is already in place by circulating clubs. Ind AS 105 stipulates that it should be unlikely that the plan to sell the registrations would be significantly changed or withdrawn. To fulfil this requirement, it would be prudent if only those registrations are classified as held for sale where unconditional offers have been received prior to the reporting date.

Once the conditions for classifying assets as held for sale in accordance with Ind AS 105 have been fulfilled, the player registrations would be stated at lower of carrying amount and fair value less costs to sell, with the carrying amount stated in accordance with Ind AS 38 prior to application of Ind AS 105, subjected to impairment, if any.

Profits and losses on sale of players' registrations would be computed by deducting the carrying amount of the players' registrations from the fair value of the consideration receivable, net of transactions costs. In case a portion of the consideration is receivable on the occurrence of a future performance condition (i.e. contingent consideration), this amount would be recognized in the Statement of Profit and Loss only when the conditions are met.

The players registrations disposed of, subsequent to the year end, for ₹ 175 crores, having a corresponding book value of ₹ 49 crores would be disclosed as a non-adjusting event in accordance with Ind AS 10 Events after the Reporting Period.

Impairment review

Ind AS 36 Impairment of Assets requires companies to annually test their assets for impairment. An asset is said to be impaired if the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is higher of the asset's fair value less costs to sell and its value in use (which is the present value of future cash flows expected to arise from the use of the asset). In the given scenario, it is not easy to determine the value in use of any player in isolation as that player cannot generate cash flows on his/her own unless via a sale transaction or an insurance recovery. Whilst any individual player cannot really be separated from the single cash-generating unit (CGU), being a cricket team or a hockey team in the instant case, there may be certain instances where a player is taken out of the CGU when it becomes clear that he/she will not play for the club again. If such circumstances arise, the carrying amount of the player should be assessed against the best estimate of the player's fair value less any costs to sell and an impairment charge should be recognized in the profit or loss, which reflects any loss arising.

(c) Valuation of stadiums

In terms of Ind AS 113 Fair Value Measurement, stadiums would be valued at the price which would be received to sell the asset in an orderly transaction between market participants at the measurement date (i.e. exit price). The price would be the one which maximizes the value of the asset or the group of assets using the principle of the highest and best use. The price would essentially use Level 2 inputs which are inputs other than quoted market prices included within Level 1 which are observable for the asset or liability, either directly or indirectly. Property naming rights present complications when valuing property. The status of the property indicates its suitability for inviting sponsorship attached to its name. It has nothing to do with the property itself but this can be worth a significant amount. Therefore, Mumbai Challengers Ltd. could include the property naming rights in the valuation of the stadium and write it off over three years.

Ind AS 24 Related Party Disclosures lists the criteria for two entities to be treated as related parties. Such criteria include being members of the same group or where a person or a close member of that person's family is related to a reporting entity if that person has control or joint control over the reporting entity. Ind AS 24 deems that parties are not related simply because they have a director or a key manager in common. In this case, there are three directors in common and in the absence of any information to the contrary, it appears as though the entities are not related. However, the regulator will need to establish whether the sponsorship deal is a related party transaction for the purpose of the financial control provisions. There would need to be demonstrated that the airline may be expected to influence, or be influenced by, the club or a related party of the club. If the deal is deemed to be a related party transaction, the regulator will evaluate whether the sponsorship is at fair value or not.

Question 10

Following are the Financial Statements of Abraham Ltd.:

Balance Sheet

Particulars	**Note No.**	**As at 31st March, 2019 (₹ in lakh)**
EQUITY AND LIABILITIES:		
Shareholders' funds		
Share capital (shares of ₹ 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

Particulars	**Note No.**	**Year ended 31st March, 2019 (₹ 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 **(₹ 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:

(i) Share capital comprises of 100 lakh shares of ₹ 10 each.

(ii) Term Loan from bank for ₹ 5,700 lakh also includes interest accrued and due of ₹ 700 lakh as on the reporting date.

(iii) Reserve for foreseeable loss is created against a service contract due within 6 months.

(iv) Inventory should be valued at cost ₹ 1,500 lakh, NRV as on date is ₹ 1,200 lakh.

(v) A dividend of 10% was declared by the Board of directors of the company.

(vi) Accrued Interest income of ₹ 300 lakh is not booked in the books of the company.

(vii) 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.

Answer

Following adjustments/rectifications are required to be done

1. Reserve for foreseeable loss for ₹ 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 ₹ 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 ₹ 1,200 lakh and write down of ₹ 300 lakh (₹ 1,500 lakh – ₹ 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 ₹ 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

Particulars	Note No.	(₹ 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

Particulars	Note No.	(₹ in lakh)
Revenue from operations		6,000
Other income		300
Total income		6,300
Expenses		
Operating costs		3,199
Change in inventories cost	9	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 ₹ 10 each)		100 lakh

Statement of Changes in Equity of Abraham Ltd. For the year ended 31st March, 2019

3. Equity Share Capital **(₹ 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 **(₹ 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.

Notes to Accounts

1. Deferred Tax **(₹ in lakh)**

Deferred Tax Asset	700
Deferred Tax Liability	400
	300

2. Trade Receivables **(₹ 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

5. Long Term Borrowings **(₹ in lakh)**

Term Loan from Bank (5,700 – 700)	5,000

Total	5,000

6. **Other Financial Liabilities** **(₹ in lakh)**

Unclaimed dividends	10
Interest on term loan	700
Total	710

7. **Short-term provisions** **(₹ in lakh)**

Provisions	300
Foreseeable loss against a service contract	400
Total	700

8. **Other Current Liabilities** **(₹ in lakh)**

Billing in Advance	150
Other	40
Total	190

9. **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. ₹ 1 per equity share. This proposed dividend is subject to the approval of shareholders in the ensuing annual general meeting.

Question 11

UK Ltd. has purchased a new head office property for ₹ 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 ₹ 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 ₹ 3 crores. The remaining cost of ₹ 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 ₹ 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.

Answer

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 that 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 crore x 30% = 4.50 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	(3/50) = 0.06
Carrying value as on 31st March, 2018		1.75	5.145	2.94
Impairment loss		No impairment loss since fair value is more than the cost		

Question 12

ABC Ltd. works out translation gain/loss over the years on its investment in foreign subsidiary 2014-15: ₹ 2 lakhs, 2015-16: ₹ 4 lakhs, 2016-17: ₹ 3 lakhs. The foreign subsidiary is sold on 30th June 2017. The translation gain on sale of such investment as on that date is ₹ 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?

Answer

	Statement of Profit and loss		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 13

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	₹
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:

1. On 1st April 20X1, 8% convertible loan with a nominal value of ₹ 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 ₹ 200 worth of loan.

   An equivalent loan without the conversion option would have carried interest at 10%. Interest of ₹ 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

2. After the reporting period, the board of directors have recommended dividend of ₹ 50,000 for the year ending 31st March, 20X1. However, the same has not been yet accounted by the company in its financials.

3. 'Other current financial liabilities' consists of the following:

Particulars	Amount (₹)
Wages payable	21,890
Salary payable	61,845
TDS payable	81,265
Interest accrued on trade payables	35,564

4. Property, Plant and Equipment consists following items:

Particulars	Amount (₹)	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.

5. The composition of 'other current financial assets' is as follows:

Particulars	Amount (₹)
Interest accrued on bank deposits	57,720
Prepaid expenses	90,000

Royalty receivable from dealers	69,650

6. 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 ₹ 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 ₹ 60,000.
7. 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 ₹ 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.

Answer

Balance Sheet of Master Creator Private Limited as at 31st March, 20X2

Particulars	**Working/Note reference**	**(₹)**
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		
Other financial assets (Security deposits)		4,62,500
Other non-current assets (capital advances)	4	17,33,480
Current assets		
Inventories		5,98,050
Financial assets		
Investments (55,000 + 5,000)	5	60,000
Trade receivables	6	7,25,000

Cash and cash equivalents	7	1,16,950
Other financial assets	8	1,27,370
Other current assets (Prepaid expenses)	8	90,000
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 (₹)
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 (₹)	**Equity component of Compound Financial Instrument (₹)**	**Total (₹)**
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)

1. 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 (₹ 37,50,250) and Vehicles (₹ 12,37,500), since those assets are held for administrative purposes.
2. 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.
3. 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, ₹ 5,000 (60,000 – 55,000) increase in fair value of financial asset will be recognised 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 (₹)**
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 recognised as a liability				59,75,040
Initial proceeds				(64,00,000)
Amount to be recognised as equity				4,24,960

*In year 4, the loan note will be redeemed; therefore, the cash outflow would be ₹ 69,12,000 (₹ 64,00,000 + ₹ 5,12,000).

Presentation in the Financial Statements:

In Statement of Profit and Loss for the year ended on 31 March 20X2

Finance cost to be recognised in Statement of Profit and Loss (59,75,040 x 10%)	₹ 5,97,504
Less: Already charged to the Statement of Profit and Loss	(₹ 5,12,000)
Additional finance charge required to be recognised in Statement of Profit & Loss	₹ 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 (₹)
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 (₹)**
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 14

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?

Answer

(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 31st 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 31st 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 31st 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 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 recognised 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 15

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 31st 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 tor 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.

Answer

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 31st March, 2021	₹ 6,75,000	₹ 9,80,000	₹ 11,20,000
Fair Value as on 31st 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)	

Question 16

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

(i) On 1st April 2019, 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.

(ii) On 4th May 2019, 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 2019-2020. The projected future revenues for financial year 2020-2021 is ₹ 25,00,000 and ₹ 30,00,000 p.a. for remaining 3 years thereafter.

(iii) On 4th July 2019, Super Sounds Limited was granted a Copyright that had been applied for by Music Limited. During financial year 2019-2020, 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.

You are required to prepare:

(i) A Schedule showing the intangible section in Super Sound Limited Balance Sheet as on 31st March 2020, 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 2019-2020.

Answer

(i) **Super Sounds Limited**

Balance Sheet (Extract relating to intangible asset) as at 31st March 2020

	Note No.	₹
Assets		
(1) Non-current asset		
Intangible assets	1	69,45,000

(ii) **Super Sounds Limited**

Statement of Profit and Loss (Extract) for the year ended 31st March 2020

	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**

CHAPTER - 16
Integrated Reporting

Question 1

State the categories defined in the International IR Framework for capitals. Comment whether an organisation has to follow these categories rigidly.

Answer

Various categories of capital are:

- Financial
- Manufactured
- Intellectual
- Human
- Social and Relationship
- Natural

Organizations preparing an integrated report are not required to adopt this categorization or to structure their report along the above lines of the capitals.

Question 2

Can a Not-for Profit organisation do the Integrated Reporting as per the Framework?

Answer

The Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

Question 3

Can an Integrated reporting be done in compliance to the requirements of the local laws to prepare a management commentary or other reports?

Answer

An integrated report may be prepared in response to existing compliance requirements. For example, an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework, it can be considered an integrated report. If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.

Question 4

What are the guiding principles for preparation and presentation of Integrated Report?

Answer

The following Guiding Principles underpin the preparation and presentation of an integrated report, informing the content of the report and how information is presented:

1. **Strategic Focus and Future Orientation**

   An integrated report should provide insight into the organization's strategy and how it relates to the organization's ability to create value and to its use of and effects on the capitals in short, medium and long term period. The report should clearly show the linkages between strategy, risks and opportunities, current performance, as well as future outlook and targets.

2. **Connectivity of Information**

   An integrated report shows the connections between the different components:

   - Organisation's business model
   - External factors that affect the organisation
   - Various resources and relationships on which the organisation and its performance are dependent upon

3. **Stakeholder Relationships**

   An integrated report should provide insight into nature and quality of the organization's relationships with its key stakeholders including how and to what extent the organization understands, takes into account and responds to their legitimate needs and inte rests.

4. **Materiality**

   A focus on materiality should assist in avoiding irrelevant and detailed information from cluttering the report. The integrated report is a high-level, concise report that contains only the most material matters and information affecting the organisation and its ability to create value over time. Additional information can be placed in supporting reports.

5. **Conciseness**

   An integrated report should be concise. It implies that the information should be accessible through crisp presentation, the omission of immaterial information, and a logical easy-to-follow structure.

6. **Reliability and Completeness**

   An integrated report should include all material matters, both positive and negative, in a balanced way and without material error. Integrated reporting requires that consideration is given to both good and bad news and performance. Furthermore, both the increases and reductions in the value of the important capitals should be reflected.

Question 5

What is Integrated Reporting and what are its salient features?

Answer

Integrated reporting is a concept that has been created to better articulate the broader range of measures that contribute to long-term value and the role organizations play in society. Integrated Reporting is enhancing the way organizations think, plan and report the story of their business. Central to this is the proposition that value is increasingly shaped by factors additional to financial performance, such as reliance on the environment, social reputation, human capital skills and others.

This value creation concept is the backbone of integrated reporting and is the direction for the future of corporate reporting. In addition to financial capital, integrated reporting examines five additional capitals that should guide an organization's decision-making and long-term success – its value creation in the broadest sense.

An integrated report is a concise communication about how an organization's:

- Strategy
- Governance
- Performance And
- Prospects

In the context of its external environment leads to the creation of value over:

- Short
- Medium And
- Long term

It's a portal by which the organisation communicates a holistic view of:

- Its Current position
- Where it's going And
- How it intends to get there

The report enables readers to make an assessment of the organisation's ability to create value in the future, with value creation referring to the value created for both the organisation and for others.

Salient features of Integrated Reporting Framework

Principle Based Approach

The International <IR> Framework (the Framework) takes a principles-based approach. This Framework identifies information to be included in an integrated report for use in assessing an organization's ability to create value; it does not set benchmarks for such things as the quality of an organization's strategy or the level of its performance.

It intent to strike an appropriate balance between flexibility and prescription that recognizes the wide variation in individual circumstances of different organizations while enabling a sufficient degree of comparability across organizations to meet relevant information needs.

Targets the Private Sector or Profit Making Companies

This Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

Identifiable Communication

An integrated report may be prepared in response to existing compliance requirements, and may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication. It should include, transitionally on a comply or explain basis, a statement by those charged with governance accepting responsibility for the report.

An integrated report is intended to be more than a summary of information in other communications (e.g., financial statements, a sustainability report, analyst calls, or on a website); rather, it makes explicit the connectivity of information to communicate how value is created over time.

Financial and Non-financial Items

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time. It, therefore, contains relevant information, both financial and other.

Value Creation

Value created by an organization over time manifests itself in increases, decreases or transformations of the capitals caused by the organization's business activities and outputs. That value has two interrelated aspects – value created for:

- The organization itself, which enables financial returns to the providers of financial capital
- Others (i.e., stakeholders and society at large)

Question 6

With respect to Integrated Reporting, state whether following statements are true or false with reason for your answer:

(i) An integrated report is necessarily to be a stand-alone report;

(ii) The framework of Integrated reporting is written primarily for private companies;

(iii) A report prepared as required by local law containing a management commentary or other report that provides context for its financial statements can serve the purpose of Integrated reporting; and

(iv) An integrated report should include only positive material matters.

Answer

(i) **False.** An integrated report may be prepared in response to existing compliance requirements and may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication.

(ii) **True.** The Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

(iii) **True.** If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.

(iv) **False.** An integrated report should include all material matters, both positive and negative, in a balanced way and without material error. Both the increases and reductions in the value of the important capital should be reflected. Where the information is not perfectly accurate, estimates should be used and appropriate processes should be in place to insure that the risk of material misstatement is reduced.

Question 7

What is the organisational structure and role of IIRC in relation to integrated reporting. What considerations are kept in mind by IIRC while developing the framework.

Answer

In 2010, the International Integrated Reporting Council (IIRC) was set up which aims to create the globally accepted integrated reporting framework.

The International Integrated Reporting Council (IIRC) is a global coalition of:

- Regulators
- Investors
- Companies
- Standard setters
- The accounting profession and NGOs

Together, this coalition shares the view that communication about value creation should be the next step in the evolution of corporate reporting. With this purpose, they issued the International Integrated Reporting (IR) Framework.

The framework has been developed keeping in mind the greater flexibility to be given to the entity and the management in the reporting but at the same time should target to report the value created by the organisation through various capital.

CHAPTER - 17
Corporate Social Responsibility

Question 1

ABC Ltd. is a company which is formed with charitable objects under Section 8 of the Companies Act, 2013. As a result, the management of the company believes that as all the activities of the company will be with the intent of charity, the CSR provisions are not applicable to ABC Ltd. as these activities are activities in normal course of business.

Whether the provisions of CSR are applicable to ABC Ltd. provided it fulfils the criteria of Section 135 of the Act?

Answer

Section 135 of the Companies Act is applicable to every company meeting the specified criteria. As per section 2(20) of the Companies Act, 'company' means a company incorporated under the Companies Act or under any other previous company law. This would imply that companies set up for the purposes of CSR/public welfare are also required to comply with the provisions of CSR.

Question 2

ABC Ltd. is a company which has a net worth of ₹ 200 crore, it manufactures rubber parts for automobiles. The sales of the company are affected due to low demand of its products.

Required financial details of the following financial years are as follows (₹ in crore)

	March 31, 20X4 (Current year) projected	March 31, 20X3	March 31, 20X2	March 31, 20X1
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

Does ABC Ltd. has an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year?

Answer

A company which meets the net worth, turnover or net profits criteria in immediate preceding financial year will need to constitute a CSR Committee and comply with provisions of sections 135(2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee -

1) Net worth greater than or equal to ₹ 500 Crore: This criterion is not satisfied.
2) Sales greater than or equal to ₹ 1000 Crore: This criterion is not satisfied.
3) Net profit greater than or equal to ₹ 5 crore: This criterion is satisfied in financial year ended March 31, 20X3 i.e. immediate preceding financial year.

Hence, the Company will be required to form a CSR committee.

Question 3

How can companies with small CSR funds take up CSR activities in a project/program mode?

Answer

It has been clarified that companies can combine their CSR programs with other similar companies by pooling their CSR resources.

As per Rule 4 of the CSR Rules, a company may collaborate with other companies for undertaking projects or for CSR activities in such a manner that the CSR committees of the relevant companies are in a position to report separately on such projects in accordance with the prescribed Rules.

Question 4

Due to immense loss to Nepal in the recent earthquake, one FMCG Company undertakes various commercial activities with considerable discounts and concessions at the related affected areas of Nepal for a continuous period of 3 months after earthquake. In the Financial Statements for the year 20X1-X2, the Management has shown the expenditure incurred on such activity as expenditure incurred to discharge Corporate Social Responsibility.

State whether the treatment done by the management of management is correct. Explain with reasons.

Answer

The statutory guidelines relating to CSR require the deployment of funds for the benefit of the local area of the Company. Since Nepal is another country the expenditure done there i.e. in Nepal shall not qualify to be accounted as CSR expenditure.

Further, it is presumed that the commercial activities performed at concessional rates are not permissible as CSR activities. Therefore, the treatment done by the Management by showing the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

Question 5

After the havoc caused by flood in Jammu and Kashmir, a group of companies undertakes during the period from October, 20X1 to December, 20X1 various commercial activities, with considerable concessions/discounts, along the related affected areas. The management intends to highlight the expenditure incurred on such activities as expenditure incurred on activities undertaken to discharge corporate social responsibility, while publishing its financial statements for the year 20X1-20X2.

State whether the management's intention is correct or not and why?

Answer

Corporate Social Responsibility (CSR) Reporting is an information communiqué .with respect to discharge of social responsibilities of corporate entity. Through 'CSR Report' the corporate enterprises disclose the manner in which they are discharging their social responsibilities. More specifically, it is addressed to the public or society at large, although it can be squarely used by other user groups also.

Section 135 of the Companies Act, 2013 mandated the companies fulfilling the criteria mentioned in the said section to spend certain amount of their profit on activities as specified in the Schedule VII to the Act. Companies not falling within that criteria can also spend on CSR activities voluntarily. However, besides the requirements of constitution of a CSR committee and a CSR policy, the corporate entities should also take care that expenditure incurred for CSR should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

Here, it is assumed that the commercial activities performed at concessional rates are the activities done in the ordinary course of business of the companies. Therefore, the intention of the management to highlight the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

Question 6

ABC Ltd. is a company which is covered under the ambit of CSR rules. As part of its CSR contribution an amount of ₹ 15,00,000 was spent as CSR expense towards the education of girl child. The average net profit of the company for the past three years was ₹ 7 crore. As the company incurred a CSR expense in excess of what is required by the rules, it decided to utilise this expense as a carry forward to the next year and reduce next year's CSR spend by ₹ 1,00,000.

Can the excess expenditure towards CSR be carried forward to next financial year?

Answer

As per the current law of land, carry forward of excess amount over 2% of average profits, will be allowed, if the company decides to adjust such excess against future obligation.

If the company decides not to carry forward such excess spend in full or in part, the same to the extent not carried forward is to be recognized as expense.

Question 7

ABC Ltd. is a company which comes under the ambit of Section 135 and CSR Rules. The Board of ABC Ltd did not appropriate the CSR funds and as a result there was no annual report on CSR in the Board's report for financial year ended March 31, 20X1.

Is this a non-compliance as per the Act?

Answer

It has been clarified that as per Rule 9 of the CSR Rules, the Board's Report of a company qualifying under section 135 shall include an annual report on CSR, containing particulars specified in Annexure to CSR Rules. Reporting of CSR policy of the company in the Board's Report is a mandatory requirement. If the disclosure requirements are not fulfilled, penal consequences may be attracted under section 134(8) of the Companies Act.

Question 8

ABC Ltd. carries out CSR activities from rented premises in Pune. The rent paid for such premises is disclosed as CSR expenditure and subsequently ABC Ltd. also claimed deduction of the same under the Income-tax Act. Is this permissible?

Answer

CSR expenditure which is of the nature described under the section 30 to 36 of the Income-tax Act shall be allowed as a deduction. Rent expenses can be claimed under section 30 of the Act and hence it can be claimed as a deduction.

Question 9

ABC Ltd. manufactures consumable goods like bath soap, tooth brushes, soap cases etc. As part of its CSR policy, it has decided that for every pack of these goods sold, ₹ 0.80 will go towards the 'Save Trees Foundation' which will qualify as a CSR spend as per Schedule VII. Consequently, at the year end, the company sold 25,000 such packs and a total of ₹ 20,000 was recognised as CSR expenditure. However, this amount was not paid to the Foundation at the end of the financial year.

Will the amount of ₹ 20,000 qualify to be a CSR expenditure?

Answer

By earmarking the amount from such sale for CSR expenditure, the company cannot show it as CSR expenditure. To qualify the amount to be CSR expenditure, it has to be spent. Hence, ₹ 20,000 will not be automatically considered as CSR expenditure until and unless it is spent on CSR activities.

Question 10

A building is used for CSR activities of the company. The same is capitalised as 'an asset' in the books and depreciation is charged on the same as per the Companies Act, 2013. The Company claims the cost of the building as 'CSR expenditure' and also the depreciation thereon.

Is this the correct treatment as per the Act?

Answer

In case the expenditure incurred by the company is of such nature which may give rise to an 'Asset', it should be recognised by the company in its balance sheet, provided the control over the asset is with the Company and future economic benefits are expected to flow to the company. Where any CSR asset is recognized in its balance sheet, the same may be classified under natural head (e.g. Building, Plant & Machinery etc.) with specific sub-head of 'CSR Asset' if the expenditure satisfies the definition of 'asset'.

For example, a building used for CSR activities where the beneficial interest has not been relinquished for lifetime by a company and from which any economic benefits flow to a company, may be recognised as 'CSR Building' for the purpose of reflecting the same in the balance sheet.

If an amount spent on an asset has been shown as CSR spend, then the depreciation on such asset cannot be claimed as CSR spend again. Once cost of the asset is included for CSR spend, then the depreciation on such asset will not be included for CSR spend even if the asset is capitalized in the books of accounts and depreciation charged thereon.

Question 11

A property is being constructed to operate CSR activities by a company. At the balance sheet date, the cost of construction is treated as revenue expenditure. Are there any additional disclosures required in the financials regarding this?

Answer

General Instructions for Preparation of Statement of Profit and Loss under Schedule III to the Companies Act, 2013, requires that in case of companies covered under Section 135, the amount of expenditure incurred on 'Corporate Social Responsibility Activities' shall be disclosed by way of a note to the statement of profit and loss. The note should also disclose the details with regard to the expenditure incurred in construction of a capital asset under a CSR project.

Question 12

Baby Limited manufactures consumable goods for infants like bath soap, cream, powder, oil etc. As part of its CSR policy, it has decided that for every pack of these goods sold, ₹ 0.75 will go towards the "Swachh Bharat Foundation" which will qualify as a CSR spend as per Schedule VII. Consequently, at the year end, the company sold 40,000 such packs and a total of ₹ 30,000 was recognized as CSR expenditure. However, this amount was not paid to the Foundation at the end of the financial year. Will the amount of ₹ 30,000 qualify to be CSR expenditure?

Answer

Baby Ltd. has earmarked 75 paise per pack to spend as CSR activities. However, only by earmarking the amount from such sale for CSR expenditure, the company cannot show it as CSR expenditure. To qualify the amount as CSR expenditure, it has to be spent. Hence, ₹ 30,000 will not be automatically considered as CSR expenditure till the time it is spent on CSR activities i.e. it is deposited to 'Swachh Bharat Foundation'.

Question 13

In the year 20X1, XYZ Ltd. falls within the purview of CSR provisions as per the Companies Act, 2013 since its net profit for the financial year exceeded ₹ 5 crore. The company discharged CSR obligations in the year 20X2. However, the net profit of the year 20X2 was less than ₹ 5 crores. Also, it was also not satisfying the other two criteria of the section 135 for CSR compliance. Therefore, the company stopped performing CSR activities from the year 20X3 onwards. Comment on the company's accountability for CSR.

Answer

Once a company has fulfilled the net worth/turnover/net profit criterion for one year it has to fulfil its CSR obligations for the subsequent three financial years, even if it does not fulfil any of these criteria in those years.

In the given case, XYZ Ltd. falls in the ambit of CSR obligations by fulfilling the criteria of net profit exceeding ₹ 5 crores in the year 20X1. So it has to discharge its CSR obligations by spending two percent of its average profit every year starting from 20X2 till 20X4. It cannot stop spending on CSR activities as per the Act after 20X2.

Question 14

Royal Ltd. is a company which has a net worth of ₹ 200 crore engaged in the manufacturing of rubber products. The sales of the company are badly affected due to pandemic during the Financial year 2019-2020.

Relevant financial details of the following financial years are as follows: (₹ in crore)

Particulars	31 March 2020 (Current year) estimated	31 March 2019	31 March 2018	31 March 2017
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

During the pandemic period (till 31 March 2020) various commercial activities were undertaken with considerable concessions/discounts, along the related affected areas. The management intends to highlight the expenditure incurred on such activities as expenditure incurred, on activities undertaken to discharge corporate social responsibility, while publishing its financial statements for the year 2019-2020.

You are requested to advise CFO of Royal Ltd on the below points along with reasons for your advise:

(i) Whether the Company has an obligation to form a CSR committee since the applicability criteria are not satisfied in the current financial year?

(ii) The accounting of expenditure during the pandemic period is to be treated as expenditure on CSR in the financial statement according to the view of the accountant of the company.

Answer

(i) A company which meets the net worth, turnover or net profits criteria in immediate preceding financial year will need to constitute a CSR Committee and comply with provisions of sections 135(2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee –

(1) Net worth should be greater than or equal to ₹ 500 Crore: This criterion is not satisfied as per the facts given in the question.

(2) Sales should be greater than or equal to ₹ 1,000 Crore: This criterion is not satisfied as per the facts given in the question.

(3) Net profit should be greater than or equal to ₹ 5 Crore: as per the facts given in the question, this criterion is satisfied in financial year ended 31 March 2019 i.e. immediate preceding financial year.

Hence, the Company will be required to form a CSR committee.

(ii) The Companies Act, 2013 mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

Further, it is presumed that the commercial activities performed at concessional rates are the activities done in the ordinary course of business of the company other than the activities defined in Schedule VII of the Companies Act, 2013. Therefore, the treatment done by the Management by showing the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

Question 15

Discuss whether any unspent amount of CSR expenditure is to be provided for?

Answer

Section 135 (5) of the Companies Act, 2013, requires that the Board of every eligible company, "shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years [or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years], by giving preference to the local area and areas around it where it operates."

Any amount remaining unspent, pursuant to any ongoing project, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within thirty days from the end of the financial year to a special account (opened by the company in that behalf for that financial year in any scheduled bank) to be called the Unspent Corporate Social Responsibility Account. Such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within thirty days from the date of completion of the third financial year.

Any amount remaining unspent under sub-section (5), pursuant to an activity other than any ongoing project as per section 135(6) has to transfer such unspent amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year. As per the said amendment, the company have an obligation to transfer the unspent amount of "other than relating to an ongoing project" to a specified fund. Accordingly, a provision for liability for the amount representing the extent to which the amount is to be transferred, needs to be recognised in the financial statements.

However, In respect of both "ongoing projects" and "other than ongoing projects" if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, a provision for liability for the amount representing the extent to which the CSR activity was completed during the year needs to be recognised in the financial statements even though the payment for the same has not been made during the year.

For the above purpose, the amount transferred to separate bank account will be the full amount, but provision created under it will be after deducting the provision created for liability already incurred, if applicable, and as provided.

Question 16

State whether any unspent amount of CSR expenditure (any shortfall in the amount that was expected to be spent as per the provisions of the Companies Act on CSR activities) at the reporting date shall be provided for? Also state in case the excess amount has been spent (i.e. more than what is required as per the provisions of the Companies Act on CSR activities), can it be carry forward to set-off against future CSR expenditure.

Answer

(i) Treatment of any unspent amount of CSR expenditure

Section 135 (5) of the Companies Act, 2013, requires that the Board of every eligible company, "shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years [or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years], by giving preference to the local area and areas around it where it operates."

Any amount remaining unspent, pursuant to any ongoing project, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within thirty days from the end of the financial year to a special account (opened by the company in that behalf for that financial year in any scheduled bank) to be called the Unspent Corporate Social Responsibility Account. Such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within thirty days from the date of completion of the third financial year.

Any amount remaining unspent under sub-section (5), pursuant to an activity other than any ongoing project as per section 135(6) has to transfer such unspent amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year. As per the said amendment, the company have an obligation to transfer the unspent amount of "other than relating to an ongoing project" to a specified fund. Accordingly, a provision for liability for the amount representing the extent to which the amount is to be transferred, needs to be recognised in the financial statements.

However, In respect of both "ongoing projects" and "other than ongoing projects" if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, a provision for liability for the amount representing the extent to which the CSR activity was completed during the year needs to be recognised in the financial statements even though the payment for the same has not been made during the year.

For the above purpose, the amount transferred to separate bank account will be the full amount, but provision created under it will be after deducting the provision created for liability already incurred, if applicable, and as provided.

(ii) Treatment of excess amount spent on CSR Activities

As per 3rd Proviso to Sub-section (5) of section 135 of the Act, the excess amount spent would be allowed to be carried forward to next year.

If the company decides to adjust such excess against future obligation, then to the extent of such excess, an asset will have to be recognized for the amount which is spent in excess of 2%.

If the company decides not to carry forward such excess spend in full or in part, the same to the extent not carried forward is to be recognized as expense.

Question 17

What are the provisions of section 135 of the Companies Act, 2013 regarding constitution of a Corporate Social Responsibility (CSR) Committee. Also explain the role of Corporate Social Responsibility (CSR) Committee and Board.

XYZ Limited is a company which has net worth of ₹ 250 crore. It manufactures parts for automobiles. The sales of the company are affected due to low demand of the products. The previous year's financial state of company are as below:

(₹ in crore)

	31st March 2021 (Current Year)	31st March 2020	31st March 2019	31st March 2018
Net Profit	4.25	8.00	3.50	3.25
Turnover	500.00	900.00	400.00	350.00

Examine, whether the company has an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year.

Answer

A. As per section 135 of the Companies Act 2013

Every company having either

- net worth of ₹ 500 crore or more, or
- turnover of ₹ 1,000 crore or more or
- a net profit of ₹ 5 crore or more

during the immediate preceding financial year shall constitute a Corporate Social Responsibility (CSR) Committee of the Board consisting of three or more directors (including at least one independent director).

B. Role of Corporate Social Responsibility (CSR) Committee

The CSR Committee shall –

(a) formulate and recommend to Board –

  a. a CSR Policy indicating the activities to be undertaken by the company as specified in Schedule VII;

  b. the amount of expenditure to be incurred on the above activities and

(b) monitor the CSR Policy of the company from time to time.

C. Role of Board

Board shall disclose –

(a) The composition of CSR Committee in its report

(b) Approve the recommended CSR Policy for the company

(c) Disclose the contents of such Policy in its report and place it on the company's website

(d) Ensure that the activities included in CSR Policy of the company are duly executed by the company

(e) Ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years [or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years], by giving preference to the local area and areas around it where it operates

(f) If the company spends an amount in excess of the requirements then it may set off such excess amount against the requirement to spend for such number of succeeding financial years and in such manner, as may be prescribed

(g) Any amount remaining unspent, pursuant to any ongoing project, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within thirty days from the end of the financial year to a special account (opened by the company in that behalf for that financial year in any scheduled bank) to be called the Unspent Corporate Social Responsibility Account.

Such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within thirty days from the date of completion of the third financial year.

(h) If a company defaults in complying with section 135(5) and 135(6), the company shall be liable to a penalty of twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, or one crore rupees, whichever is less.

In addition to it, every officer of the company who is in default shall be liable to a penalty of one-tenth of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent Corporate Social Responsibility Account, as the case may be, or two lakh rupees, whichever is less.

Note: Where the amount to be spent by a company under sub-section (5) does not exceed fifty lakh rupees, the requirement for constitution of the Corporate Social Responsibility Committee shall not be applicable and the functions of such Committee be discharged by the Board of Directors of such company.

D. In the given scenario

A company which meets the net worth, turnover or net profits criteria in immediate preceding financial year will need to constitute a CSR Committee and comply with provisions of sections 135(2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee –

(1) Net worth should be greater than or equal to ₹ 500 Crore: This criterion is not satisfied as per the facts given in the question.

(2) Sales should be greater than or equal to ₹ 1,000 Crore: This criterion is not satisfied as per the facts given in the question.

(3) Net profit should be greater than or equal to ₹ 5 Crore: as per the facts given in the question, this criterion is satisfied in financial year ended 31 March 2020 i.e. immediate preceding financial year.

Hence, the XYZ Ltd. is required to form a CSR committee.

Question 18

Sun Shine Limited is a company which seems to be covered under the ambit of CSR rules. As part of its CSR contribution an amount of ₹ 40,000 p.m. was spent by way of adoption of 2 families of drought hit area.

The average net profits of immediately preceding financial year was ₹ 1,80,00,000. Please note that the company commenced its commercial activities only on the first day of the immediately preceding financial year. The Accountant of the company says that CSR provisions are not applicable to his company since it is one year old and in case if it is applicable he wants to carry forward the excess amount spent on account of CSR activities to future years.

You are required to comment with the figures, whether the contention of the Accountant is correct in context of CSR provisions?

Answer

As per section 135 of the Companies Act 2013, every company having either

- net worth of ₹ 500 crore or more, or
- turnover of ₹ 1,000 crore or more or
- a net profit of ₹ 5 crore or more

during the immediately preceding financial year shall constitute a Corporate Social Responsibility (CSR) Committee.

In the given case, the average net profits of immediate preceding financial year of Sun Shine Limited is ₹ 1,80,00,000 (i.e. ₹ 1.80 crore). Hence, net profit criteria is not met.

Company is covered under the ambit of CSR rules (assuming that net worth or turnover criteria is met):

Since it is given in the question that the company seems to be covered under the ambit of CSR rules, it is assumed that either the net worth of Sun Shine Limited might have exceeded ₹ 500 crore or more, or turnover might have exceeded ₹ 1,000 crore or more during immediate preceding financial year. Accordingly, CSR provisions are applicable to Sun Shine Limited irrespective of the fact that the company is in second year of operations.

If the company meets any one of the thresholds in the immediately preceding previous year, then the contention of accountant is incorrect that CSR provisions will not be applicable to the company as it is only one year old.

The accountant wants to carry forward the excess amount spent on account of CSR activities to future years which is ₹ 1,20,000 [₹ 40,000 x 12 – (₹ 1,80,00,000 x 2%)].

As per 3rd Proviso to Sub-section (5) of section 135 of the Act, the excess amount spent would be allowed to be carried forward to next year.

If the company decides to adjust such excess against future obligation, then to the extent of such excess, an asset will have to be recognized for the amount which is spent in excess of 2%.

If the company decides not to carry forward such excess spend in full or in part, the same to the extent not carried forward is to be recognized as expense.

Hence, here the contention of the accountant is correct. The excess expenditure made will be allowed if the company decides to adjust such excess against future obligation.

Question 19

Nice Limited is a company incorporated on 1st April 2019. The Company has a net worth of ₹ 350 crore. The business of the company was affected due to low demand of its products. The following financial data is available as on 31st March 2021:

₹ in crore

	31st March 2020 Audited	31st March 2020 Provisional
Net Profit	7.10	4.80
Turnover	550.00	1,050.00

During the financial year 2020-2021:

- The Company has spent ₹ 55,000 per month for developing vocational skills of local youth;
- The Company has also provided its products at a considerable discount for the benefit of the under-privileged, the cost of which to the Company is ₹ 3,50,000.

The Company wants to carry forward its entire expenditure to next year as it is of the opinion that it does not have to spend anything on CSR activities during the current year.

Comment on the Company's applicability under Corporate Social Responsibility as per section 135 of the Companies Act, 2013 for the financial year 2020-2021. Does it have any obligation to transfer any amount to any fund?

Answer

Applicability of CSR:

A company which meets the net worth, turnover or net profits criteria in immediately preceding financial year will need to comply with provisions of sections 135(2) to (5) read with the CSR Rules.

According to the Act, the Board of every company shall ensure that the company spends, in every financial year, at least two percent of the average net profits of the company made during the three immediately preceding financial years or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

Analysis of given case:

As per the criteria

(1) Net worth greater than or equal to ₹ 500 crore: This criterion is not satisfied.

(2) Sales greater than or equal to ₹ 1,000 crore: This criterion is not satisfied.

(3) Net profit greater than or equal to ₹ 5 crore: This criterion is satisfied in financial year ended 31st March 2020 i.e. immediate preceding financial year.

Hence, the Board has to spend on CSR Activities.

Quantification and mode of utilisation:

As per the facts given in the question amount spent on CSR Activities during the year 2020-2021 pertains to the average net profits of the immediately preceding financial year i.e. 2019-2020. Accordingly, the company is under the obligation to transfer/expense 2% of ₹ 7.10 crore i.e. 0.142

crore = ₹ 14,20,000 in the year 2020-2021.

Nice Limited has spent ₹ 6,60,000 during the financial year 2020-2021 for developing vocational skills of local youth which is a permissible activity of Corporate Social Responsibility under Schedule VII to the Companies Act, 2013. However, expenditure of ₹ 3,50,000 spent on commercial activities at concessional rate does not qualify as expenditure on CSR activity. Hence, the amount spent of ₹ 6,60,000 by Nice Limited for financial year 2020-2021 is less than the required expenditure of ₹ 14,20,000 to be spent as per the provisions of CSR Rules.

Decision:

Since the company fails to spend such amount, the Board has to report the reasons for not spending the amount as per section 135(5). Further, because the company does not have any on-going project, the unspent amount of ₹ 7,60,000 (₹ 14,20,000 – ₹ 6,60,000) will be transferred to a Fund specified in Schedule VII to the Companies Act, 2013 within a period of 6 months of the expiry of the financial year 2020-2021.