1. INTRODUCTION TO IND AS & ROADMAP TO IND AS

1. Ind AS are International Financial Reporting Converged Standards which are notified by Ministry of corporate Affairs under Companies (Indian Accounting standards) Rules, 2015. These standards are prepared by accounting standard Board of ICAI.

2. Our Govt has decided not to apply IFRS directly instead frame our own set of converged standards which are in line with IFRS. These standards are titles as IND AS.

3. The Difference between IND AS v/s IFRS are as Under
   a. Carve outs
   b. Carve ins
   c. Other Minor changes / Differences

4. **About International standards**: - Initially International Accounting standard committee (IASC) has issued standard titled as International Accounting standards (IAS). Subsequently International Accounting Standards Board (IASB) was formed which has issued standards titled as IFRS. The IAS, IFRS and the Interpretations (referred as SIC, IFRIC) issued by these bodies are over all referred as International standards.

5. **NUMBERING:** Ind AS are numbered in a similar manner as compared to IFRS.

   International Accounting Standard Committee (IASC) continued issuing standards under heading “International Accounting standards” (IAS) and they were numbered chronologically from 1. Eg: IAS 1, IAS 2 etc. Till 2000, it had notified 41 IAS (some of them are now repealed or omitted). Post incorporation of IASB on 1st July 2000., standards issued are known as IFRS and a new numerical series was started i.e. IFRS 1, IFRS 2 etc

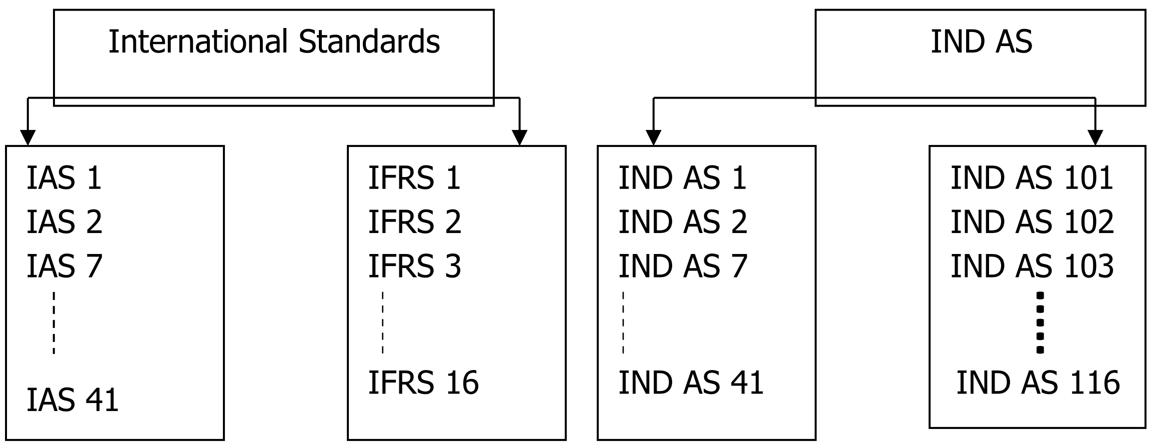
   In Indian context, **numbers for IAS are retained**. **For IFRS, a new series starting after 100 was used.**Further, IFRS Interpretations Committee (IFRIC) is the interpretative body of the IASB. Its main work is to address application issues and suggest official IFRS Interpretations, which are eventually approved by the IASB. These interpretations are titled ‘IFRIC’ and numbered as IFRIC 1,2 etc. Interpretations issued before 2003 were titled ‘SIC’ and some of them are still in force today. **IFRIC and SICs are included in Ind AS as part of Appendix in relevant Ind AS.**

- Total reporting standards issued under IFRS are 41. Total reporting standards issued under Ind AS are 39. IFRS 17 Insurance Contracts and IAS 26 Accounting and Reporting by Retirement Benefit Plans are yet not notified in India as Ind AS.

- Total interpretations under IFRS (IFRIC + SIC) are 18. Total interpretation included under

Ind AS (Appendix to relevant standards) are 17. IFRIC 2 – Members' Shares in Co-operative Entities and Similar Instruments and SIC -7 Introduction of the Euro are neither included under Ind AS nor notified. However, Appendix C to Ind AS 103 – Business Combinations was developed and additionally included in India for which no corresponding IFRIC or SIC is available.

The IND AS issued in India are numbered in line with the numbering of IFRS.



6. STRUCTURE OF IND AS:

Ind AS have followed the structure of IFRS and IAS and have not changed the same. Ind AS retained the paragraph numbers of IFRS and IAS too to allow readers to refer back similar guidance under IFRS and IAS while also appreciating the carve out and carve in.

Ind AS have following components and they are generally structured as follows:

1) **Objective** – The main purpose for which the Ind AS is formed, it mentions the issues dealt by it and what objective it seeks to achieve from laying the principles in it.
2) **Scope –** What the standard intends to cover in its ambit is mentioned in the scope heading. In many cases, it defines specifically what it intends not to cover.
3) **Definitions –** It includes definitions of various terms used in the standards. For standards which are converged from International Accounting standards, definition is a part of structure while for standards which are converged from International Financial Reporting standards (Ind AS 101 onwards), the definitions are included in appendices.
4) **Content of the Standard –** This includes the main principles of the standard. It generally contains principle of recognition, measurement, subsequent measurement along with any other standard specific contents grouped in appropriate headings.

5) **Disclosure –** This section covers what qualitative / quantitative information required to be disclosed in financial statements pertaining to the matter covered in the standard. Wherever applicable, it also contains how a particular asset / liability / income / expense should be presented in financial statements.

6) **Transitional provisions and effective date –**For any Ind AS notified, it mentions effective date and transitional provisions from which it would be applicable. Under Ind AS, transitional provisions are mentioned mainly at two places. Firstly, it is broadly mentioned in **Ind AS 101-** First-time Adoption of Indian Accounting Standard and secondly in the **individual Ind AS** wherever applicable. In many standards, transitional provisions and effective date are mentioned in Appendices

7) **Appendices –** As and where applicable, the Ind AS also has appendices which are integral part of the standard. They mainly consist of:

a. Explanation on industry specific issues which require detailed guidance. For e.g.: Appendix to Ind AS 16 contains treatment of stripping costs in the production phase of a surface mine

b. Application Guidance – These are mainly in standards which are converged from International Financial Reporting Standards (Ind AS 101 and onwards). It contains detailed guidance in applying the principles mentioned in the standard

c. Defined terms – It mentions definition of terms mentioned in the standard

d. References to matters contained in other Ind AS - It lists the appendix which is a part of another Indian Accounting Standard and makes reference to the particular standard.

e. Comparison with IFRS – Differences with IFRS are explained in this section

f. IFRIC and SIC applicable and relevant for the respective Ind AS

In each Ind AS, certain texts are highlighted in bold while certain are in plain. The text in bold mentions the principle while the text in plain mentions its application guidance / other explanation. Paragraphs set in bold type and plain type, have equal authority. In Ind AS 101, principles are numbered in chronological order while detailed explanation or guidance applicable to these principles are included in the respective Appendices, as applicable

ROAD MAP FOR IND AS

1) **Voluntary adoption of IND AS** can be done from **01.04.2015** by any company. The Holding Co, Subsidiary, Joint Venture and Associate of that company will also be covered under IND AS.

2) For other Companies – **Mandatory Application**

Phase I: From 01.04.2016

All Companies whose **Net worth ≥ 500 Cr** are covered, whether listed or unlisted, Even [H + S + JV + A] of such company are also covered.

Net worth limit should be checked at the end of 31.03.2014 (or) 31.03.15 (or) 31.03.2016. Net worth limit should be satisfied on any of the above dates.

Phase II: From 01.04.2017

All Remaining listed companies are covered and **other unlisted companies having Net worth ≥ 250 Cr** are also covered, Even H+S+JV+A of such company are also covered.

Net worth limit should be checked / satisfied at ANY of the following dates

31.03.14 (or) 31.03.15 (or) 31.03.2016 (or) 31.03.2017 or any subsequent 31.03

3) **For NBFC's:**

Phase I: - From 01.04.2018

All companies whose **Net worth ≥ 500Cr** whether listed or unlisted. Even H + S + JV + A of such companies are also covered.

Note:- Net worth should be checked at the end of ANY of the following dates → 31.03.2016 (or) 31.03.2017 (or) 31.03.2018.

Phase II: From 01.04.2019

All Remaining listed Companies and

unlisted companies having Net worth ≥ 250 Cr are also covered. Even H+S+JV+A of such companies are also covered.

Note 1: Net worth criteria should be satisfied at the end of ANY of the following dated → 31.03.16 (or) 31.03.17 (or) 31.03.18 (or) 31.03.19 or subsequent 31.03

4) **For Banks [Except RRB's]** → deferred.
5) **For Insurance Companies** → deferred.

6) Any company which is not getting covered in 1 to 5 above will apply existing Accounting standards issued under Companies (Accounting standards) Rules, 2006.

ADDITIONAL NOTES:

1) Once a company applies **IND AS whether voluntarily or mandatorily on the basis of criteria specified, it should apply IND AS for all subsequent financial statements** even if such criteria are not satisfied on a future date.

2) When a company prepares financial statements based on IND AS for the first time, it has to **present previous year comparative figures** in accordance with Ind AS.

Eg:- A Ltd is a company covered under Phase – I. Therefore it applied IND AS for the first time in the FY 2016-17. It has to present the comparative figures for previous year 2015-16 also restated according to IND AS.

3) The Beginning date of earliest Reporting period, when the Entity applies IND AS for the first time is called as **Date of Transition.**

Eg:-B Ltd gets covered in phase – II and apply IND AS for the first item during 2017-18. Since they have to present comparatives for 2016-17, the Date of transition would be 01.04.2016.

4) NET WORTH:-

Net worth = Paid up share capital [Equity + preference] + Reserves & surplus Θ Accumulated losses & Fictitious assets

a) Do not consider calls in arrears, share application money pending allotment, Money received against share warrants.
b) Reserves & surplus will Include General Reserve, profit & loss A/c Securities premium or any other force Reserve Created out of profits. DO NOT include Revaluation Reserve & Capital Reserve arising on amalgamation.

c) ESOP outstanding A/c and capital Reserve created out of Government Grants in nature of promoter's contribution shall be Included.
d) The above calculation of Net worth has to be based on financial statements prepared under Existing AS.

5) Listing criteria:

a) Any company whose Equity / Debt Instruments are listed or in the process of listing on any recognized stock exchange, whether inside / outside India are treated as listed entities for the purpose of IND AS applicability.
b) Small companies which are listed or in the process of listing on SME platform or on Institutional Trading Platform without IPO are exempted from applicability of IND AS.

6) NBFC's include Housing finance companies, Stock broker companies, Securitization & Reconstruction companies, Pension fund companies, chit fund companies, leasing and hire purchase companies, Investment management companies, Micro finance companies, CORE Investment companies [CIC] Etc. For NBFC's IND AS has to be applied in accordance with Phase I & Phase II as discussed earlier. <u>**Early Adoption of IND AS is not permitted**</u>. RBI has given certain relaxations and exemptions to certain NBFCs from procedural and registration requirements. Even such NBFCs also must comply with IND AS if they are covered under roadmap.

7) Early or Voluntary adoption of IND AS is not permitted for NBFCs, Banks and Insurance companies. In no case Banking/Insurance and NBFCs will be covered under IND AS before the date IND AS has been mandated to them.

8) IND AS FOR GROUP COMPANIES:

a) If IND AS is applicable to any company due to Networth limit or Listing criteria, then IND AS shall be applied to its Holding, Subsidiary, Associate and Joint Venture companies also.
b) When an entity applies IND AS either voluntarily or mandatorily, it has to be applied for **stand alone financial statements and also for consolidated financial statements.**

c) If the Holding/Subsidiary/Associate or Joint venture company is incorporated outside India then such companies may prepare financial statements as per their local jurisdiction but the Indian company applying IND AS shall prepare Consolidated Financial Statements along with its group companies only by applying IND AS.

9) When holding company and subsidiary company are preparing financial statements on different basis [one is preparing in existing AS and other preparing in Ind AS] then the subsidiary has to prepare additional set of financial statements in the manner prepared by its Holding company to Facilitate consolidation.

Eg 1A Ltd is a manufacturing company having Net worth Rs 600 Cr and covered in Phase I. It has a subsidiary B Ltd which is a NBFC. Examine the applicability of IND AS for the F.Y. 2016-17.

Solution:

A Ltd → Prepares FS on the basis of IND AS.

B Ltd (subsidiary) → Normally IND AS should be applied from F.Y. 2016-17. However, since it is an NBFC, IND AS can be applied only from FY 2018-19. Therefore, for F.Y. 2016-17, B Ltd will prepare FS in accordance with Existing AS.

B Ltd should also prepare FS as per IND AS and submit it to A Ltd to Facilitate Preparation of Consolidated FS.

Eg 2: X Ltd is an NBFC, having a Net worth of Rs 100Cr. It has a subsidiary Z Ltd a Manufacturing company whose Net worth is Rs 600 r and covered in phase – I.

Examine the applicability of IND AS for FY 2016-17

Solution:

Z Ltd → Prepares FS on the basis of IND AS

X Ltd (Holding Co) → Normally IND AS should be applied from F.Y. 2016-17. However since it is an NBFC, IND AS can be applied only from F.Y (2018-19). Therefore, for 2016-17, X Ltd will prepare Financial statements as per Existing AS.Z Ltd should also prepare Financial statements as per Existing AS and submit to X Ltd to Facilitate the preparation of consolidated financial statements.

10) The Relationship of Holding – Subsidiary → JV – Associate must be Existing at any time during the first of applicability of IND AS. If the shares are sold before time application of IND AS, IND AS will not be applicable to H + S + JV + A

11) **IND AS FOR MUTUAL FUNDS**: Though mutual funds are incorporated as trusts, SEBI has notified in 2022 that the financial statements and accounts of the mutual fund shall be prepared in accordance with IND AS. SEBI has provided guidelines on accounting with respect to IND AS &has also given the format of financial statements to be prepared for Mutual fund schemes under IND AS. This notification is applicable from 1 April 2023.

12) **Sec 8 companies**: Not for profit companies covered under sec 8 have no exemption from application of IND AS. They have to follow IND AS if they are covered under phase I or phase II.

SCHEDULE III

1. As per **Sec 129** of companies Act 2013, All the companies must prepare FS in accordance with the format specified in schedule III, Except for
   a) Banking Companies
   b) Insurance Companies
   No Exemption is given to sec 8 companies from application of Schedule III.

2. STRUCTURE OF SCHEDULE III

SCHEDULE III

- Division - I → To be followed by companies adopting Existing AS
- Division - II → To Be following by companies adopting IND AS

3. **MEANING OF FINANCIAL STATEMENTS**
   FS Should include
   i. Balance sheet
   ii. Statement of Profit & Loss
   iii. Statement of changes in Equity
   iv. Statement of cash flows
   v. Notes on financial statements
   vi. Comparatives (At least for one year)
   vii. Opening Balance sheet of previous year (when there is a restatement) due to change in Accounting policy or rectification of Error)
   viii. If a company has subsidiary, Associate or a Joint Venture It has to additionally prepare consolidated Financial statements

4. AUTHORITY OF SCHEDULE – III
The format of schedule III can be modified to suit the Requirements of any IND AS or any requirements of law

5. Rounding Off:

If TOTAL INCOME is	Rounding off can be done to nearest :
<Rs 100 cr	00's, 000's, lac's or millions or decimals thereof.
≥100 Cr	lac's or millions or crores or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in Financial Statements.

6. DEFINITION OF CURRENT ASSET:

An asset is classified as a current asset if any of the following four criteria is met:

1) It is Expected to be Realized or Intended for consumption / sale within the Normal operating cycle of the company.

   Note: Operating cycle criteria is to be applied only for assets related to operating activities like trade Receivables, Inventory, Prepaid Expense A/c. Etc.

2) It is primarily held for purpose of being Traded.

   Note: Since Inventories are meant for sale, they are always classified as current Assets.

3) It is expected to be Realised within 12 months from Reporting date.

   Note: 12 month criteria can be applied on any asset.

4) Cash & Cash Equivalents, unless there is a restriction on usage for next 12 months

Note: The term cash equivalents covers Investments which are convertible into cash and doesn't have an maturity of more than 3 months from the date of investment. Bank Deposits convertible into cash beyond 3 months but not exceeding 12 months are current assets and they are shown separately as OTHER BANK BALANCES"

7. NON-CURRENT ASSETS:

Any asset which cannot be classified as current Asset is a Non Current Asset

Example:Date of sale 01.01.2018,

Credit period allowed = 18 months

Normal operating cycle of company = 14 months

Classify Trade Receivable on 31.03.2018.

Expected date of Realisation = 01.01.2018 + 18 months = 30.06.2019

Test 1- Operating cycle criteria

This Test should be done from date of origination of asset

= 01.01.2018 + 14 months = 01.03.2019.

∴ Test 1 Not satisfied.

Test 2- 12 months criteria

12 months from Reporting date=31.03.18 + 12m = 31.03.2019

∴ Test 2 Not satisfied.

Conclusion: The Trade Receivable should be classified as noncurrent Asset

Example:A Ltd has point and machinery on 31.03.2018, which it has classified as held for sale. Classify Machinery on 31.03.2018.

Mere Intention to sell is not sufficient to be classified as current. It should be expected to be realised within next 12m from the Balance Sheet to be classified as current Asset.

	Item of Asset	Current or Non Current
1.	Property, plant & Equipment, capital WIP, Intangible assets, Intangible assets under developments, Investment Properties	Always classified as Non-current Assets, unless they are expected to be sold & Realised within 12months from Balance sheet date
2.	Capital Advances [Advance Given for purchase of Fixed Assets]	Classified as NON CURRENT ASSETS even if delivery of asset sis within 12months from B/s date.
3.	Inventories	Always CURRENT ASSETS, Even though there are any slow moving items.
4.	Investments	a) If Expected to Realize within 12 months → CURRENT ASSETS b) ELSE → NON CURRENT ASSET
5.	Trade Receivables	a) If expected to be realised within normal operating cycle or within 12m from Balance Sheet date → CURRENT ASSET b) ELSE → NON CURRENT ASSETS
6.	Advances given for Goods / Services	a) If Goods / services expected to be consumed within normal operating cycle → CURRENT ASSET b) ELSE → NON CURRENT ASSET
7.	Deferred tax Asset/ Deferred tax liability	Always NON CURRENT.

8. CURRENT LIABILITIES

Any Liability is classified as current liability if any of the following Four criteria is satisfied.

a) It is Expected to be settled within Normal operating cycle of the company.

b) It is held primarily for the purpose of being traded. [Eg: Writer of an option contract]

c) It is due for settlement within next 12 months from the Reporting date.

d) The company does not have an unconditional right to before the settlement of liability beyond a period of 12 month form Balance sheet date.

9. Any liability which cannot be classified as current liability is a NON CURRENT LIABILITY

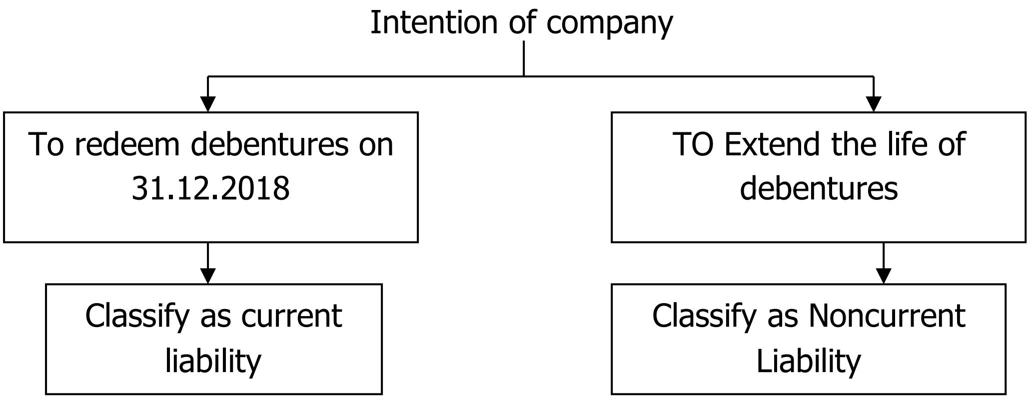
Example On 31st March 2019 A Ltd has 12% debentures of Rs 10,00,000 which are due for redemption on 31st December 2018. The Debenture Holders have a right to extend the life of debentures by another 3 years.

Classify the Debentures as on 31.03.2018.

The debentures are due to be settled within the next 12 months. Therefore it should be classified as a current liability. The Right to Extend the life of debentures is within debenture holders and not by the company.

What if, in the above case the right to extend the life of debentures is within the company instead of debenture holders.

Since the company has a right to postpone the settlement beyond 12m from Balance Sheet date, It can be classified as current liability, However we have to also consider the Intention of the company.



ExampleOn 01.04.2017. A Ltd has taken a loan of Rs 5,00,000 @ 10%, Interest The loan is repayable in 5 Equal Installments.
∴ Outstanding Balance of the loan of as at 31.03.2018 is Rs 4,00,000 classify the loan on 31.03.2018.
Out of the o/s amount of Rs 4,00,000, Rs 1,00,000 is payable within next 12 months. This is called as <u>current Maturity of long term Borrowing</u>. It should be classified as a current liability under the sub heading other Financial liabilities.The Remaining Balance of Rs 3,00,000 is a Non current Liability.

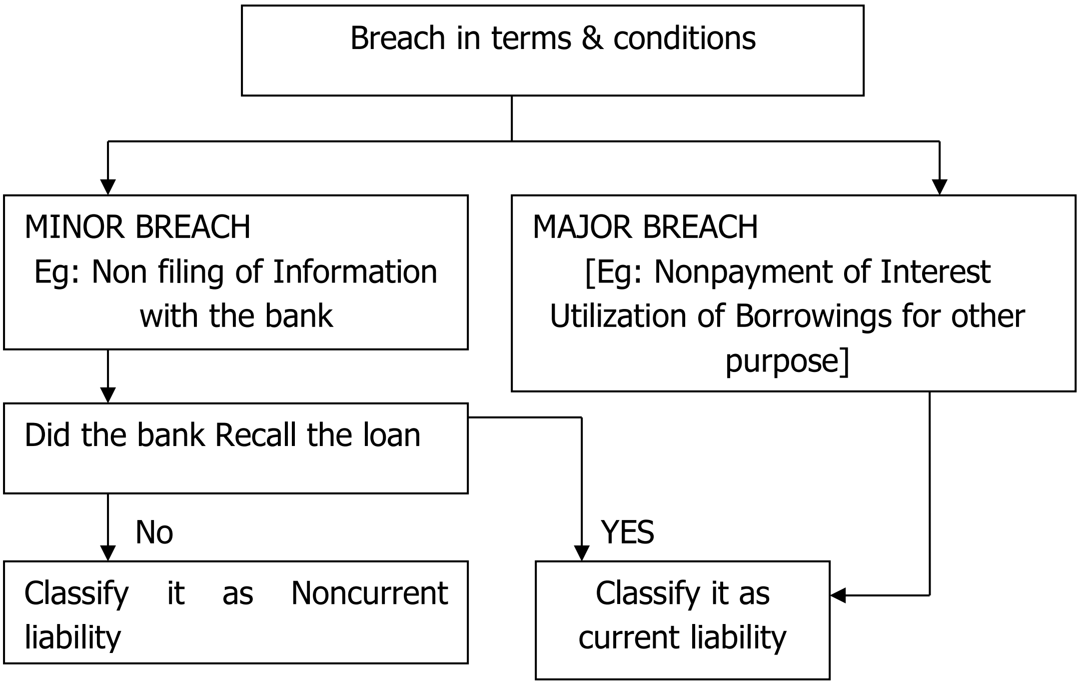
TRADE RECEIVABLE & TRADE PAYABLE

a) A receivable shall be classified as a trade receivable if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.

b) A payable shall be classified as a trade payable if it is in respect of amount due on account of goods purchased or services received in the normal course of business.

CARVE OUT – BREACH OF CONVENANTS [TERMS & CONDITIONS} IN A LONG TERM BORROWINGS.

While advancing loan to a customer, banks keeps certain conditions like filing of Information, payment of Interest on due date etc, If any of the conditions are violated, banks will a right to recall the loan amount Immediately.



In case of a material breach of loan covenants as on Balance sheet date, if the Borrower rectifies the Breach after the balance sheet but before the date of approval of FS and the bank has agreed not to demand repayment, the loan should be classified as a NON CURRENT LIABILITY (AS per IND AS 1 & IND AS 10).**However, As per IAS 1 and IAS 10 the loan would be still classified as a CURRENT LIABILITY. This is a CARVE OUT**

LIQUIDITY BASED CLASIFICATION:

a) In schedule III for classifying current and Noncurrent we have operating cycle criteria and also 12months criteria. Even in IND AS – PRESENTATION OF FINANCIAL STATEMENTS, both the criteria are available
b) As per IND AS 1, if appropriate, the company may adopt liquidity based classification i.e., Purely on the basis of 12months criteria.
c) We have to follow only schedule III i.e., both the criteria will be applied for current / Noncurrent.
d) If any item of current Asset/ Current liability in the Balance sheet is expected to be realised / settled beyond 12months from balance sheet date, additional disclosure is required in notes to accounts.

Example A Ltd has an Inventory of Rs 5,00,000 on 31st march, 2018. Of these slow moving stocks are worth Rs 1,00,000 which are expected to be realized after 2 years. Advise Disclosure Requirements

Total Inventory of Rs 5,00,000 will be shown as a current Asset, in the notes to accounts we have to give a disclosure that stocks of Rs 1,00,000 are Expected to be realised beyond a period of 12 months.

OPERATING CYCLE: It is the time taken from the acquisition of assets for processing to their ultimate realisation into cash and cash Equivalents.
Operating cycle = Raw material holding period + WIP holding period + FG Holding Period + Average collection period from Debtors. While computing above holding periods, we have to consider the Average Holding Period.

Example X Ltd made the following sales to its customers A and B Determine Average collection period.

Particulars	Sale value	Credit period
A	5,00,000	6m
B	3,00,000	3m

ACP = $\frac{(5L \text{ X } 6m)+(3L \text{ x } 3m)}{8L}$ = 4.9 months

→ If a company has multiple business, It will have different operating cycle for each business.

EQUITY

I. EQUITY SHARE CAPITAL

Balance @ beginning of the period	Changes in current year	Balance @ end of the period

II. OTHER EQUITY

1. Share application money pending for allotment 2. Equity component of compound Financial Instrument 3. Reserves & Surplus a) General Reserve b) Securities Premium c) Capital Reserve d) Retained Earnings e) Debenture Redemption Reserve f) Capital Redemption Reserve 4. Other comprehensive Income 5. Money Received against share warrants	→ Opening Balances → Restatements Restated Opening Balance → Total comprehensive Income → Transfer to Reserves → Dividends declared → Other Adjustments Closing balance

Other Comprehensive Income

OCI Items	Remarks
I. Re-classifiable a) Gains / losses on Investment in Debt Securities b) Exchange Gain / losses on translation of Foreign Currency Operation c) Gains / losses in a cash flow Hedge	
II. Non-Re-classifiable a) Revaluation surplus b) Gains or losses relating to Investment in equity shares valued through OCI c) Gains or losses arising on Remeasurment of defined Benefit obligations d) Change in the Fair value of Financial Liabilities due to Entities own credit Risk	

Other Comprehensive Income shall be classified into-

A. Items that will not be reclassified to profit or loss:
   i. **Changes in revaluation surplus;**
   ii. **Re-measurements of the defined benefit plans;**
   iii. **Equity Instruments through Other Comprehensive income;**
   iv. **Fair value changes relating to own credit risk** of financial liabilities designated at fair value through profit or loss;
   v. **Share of Other Comprehensive Income in Associates and Joint Ventures,** to the extent not to be classified into profit or loss; and (vi) Others (specify nature).

B. **items that will be reclassified to profit or loss:**
   i. **Exchange differences** in translating the financial statements of a foreign operation;
   ii. **Debt instruments through Other Comprehensive Income;**
   iii. The effective portion of **gains and loss on hedging instruments** in a cash flow hedge;
   iv. **Share of Other Comprehensive Income in Associates and Joint Ventures,** to the extent to be classified into profit or loss; and

others (specify nature).

ILLUSTRATIVE STANDALONE FINANCIAL STATEMENTS

	Balance Sheet as at			
	Particulars	**Note No.**	**Figures as at the end of current reporting period**	**Figures as at the end of the previous reporting period**
	1	**2**	**3**	**4**
1.	**NON-CURRENT ASSETS**			
	a) Property, Plant and Equipment			
	b) Capital work-in-progress			
	c) Investment Property			
	d) Goodwill			
	e) Other Intangible assets			
	f) intangible assets under development			
	g) Biological Assets other than bearer plants			
	h) Financial Assets			
	i. Investments			
	ii. Trade receivables			
	iii. Loans			
	iv. Others (to be specified)			
	i) Deferred tax assets (net)			
	j) Other non - current assets			
2.	**CURRENT ASSETS**			
	a) Inventories			
	b) Financial Assets			
	i. Investments			
	ii. Trade receivables			
	iii. Cash and cash equivalents			
	iv. Bank balances other than above			
	v. Loans			
	vi. Others (to be specified)			
	c) Current Tax Assets (net)			
	d) Other current assets			
	TOTAL ASSETS			
	EQUITY & LIABILITIES			
1.	**EQUITY**			
	a) Equity share capital			
	b) Instruments entirely equity in nature			
	c) Other Equity			

	LIABILITIES			
2.	**Non-Current Liabilities**			
	a) Financial Liabilities			
	i. Borrowings			
	ii. Lease liabilities			
	iii. Trade payables A) Total outstanding dues towards micro enterprises & small enterprises. B) Total outstanding dues other than towards micro enterprises & small enterprises.			
	iv. Other financial liabilities (other than those specified in item (b), to be specified)			
	b) Provisions			
	c) Deferred tax liabilities (net)			
	d) Other Non-current liabilities			
3.	**Current liabilities**			
	a) Financial Liabilities			
	i. Borrowings			
	ii. Lease liabilities			
	iii. Trade payables A. Total outstanding dues towards micro enterprises & small enterprises. B. Total outstanding dues other than towards micro enterprises & small enterprises.			
	iv. Other financial liabilities (other than those specified in item(c))			
	b) Other current liabilities			
	c) Provisions			
	d) Current Tax Liabilities (net)			
	Total Equity and Liabilities			

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED

A. 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

B. Instruments entirely equity in nature

a. Compulsorily Convertible Preference Shares

Balance at the beginning of the reporting period	Changes in compulsorily convertible preference shares during the period	Balance at the end of the reporting period

b. Compulsorily Convertible Debentures

Balance at the beginning of the reporting period	Changes in compulsorily convertible debentures during the period	Balance at the end of the reporting period

c. [Instrument] (Any other instrument entirely equity in nature)

Balance at the beginning of the reporting period	Changes in Instrument during the period	Balance at the end of the reporting period

The above statements are to be given for current year and also for the previous year

SOCIE (1ST PAGE, FOR REMAINING PART P.T.O)

	Share application money pending allotment	Equity component of compound financial instruments	Reserves and Surplus			
			Capital Reserve	Securities Premium	Other Reserves (Specify nature)	Retained Earnings
Balance at the beginning of the reporting period						
Changes in accounting policies/rectification of errors						
Restated balance at the beginning of the reporting period						
Total Comprehensive Income for the year						
Dividends						
Transfer to/from retained earnings						
Any other change (to be specified)						
Balance at the end of the reporting period						

Debt instruments through Other Comprehensive Income	Equity Instruments through Other Comprehensive Income	Effective portion of Cash flow hedge	Revaluation surplus	Exchange differences on translating the financial statements of a foreign operation	Other items of other Comprehensive Income (Specify nature)	Money received against share warrants	TOTAL

STATEMENT OF PROFIT AND LOSS FOR THE YEAR ENDED

	Particulars	Note	current reporting period	previous reporting period
I.	Revenue From Operations			
II.	Other Income			
III.	Total Income (1 + II)			
IV.	**EXPENSES**			
	Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods,			
	Stock-in-Trade and work-in- progress			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expense			
	Other expenses			
	Total expenses			
V	Profit / (loss) before exceptional items and tax (III- IV)			
VI	Exceptional Items			
VII	Profit / Loss before tax (V - VI)			
VIII	Tax expense: (1) Current tax (2) Deferred tax			
IX	Profit (Loss) for the period from continuing operations (VII-VIII)			
X	Profit/(loss) from discontinued operations			
XI	Tax expense of discontinued operations			
XII	Profit (Loss) from Discontinued operations (after tax) (X – XI)			
XIII	Profit OR (loss) for the period (IX + XII)			
XIV	**OTHER COMPREHENSIVE INCOME**			
	A. (i) Items that **will not be reclassified** to profit or loss (ii) Income tax relating to items that will be not be reclassified to profit or loss			
	B. (ii) Items that **will be reclassified** to profit or loss			
	(ii) Income tax relating to items that will be reclassified to profit or loss			

XV	**TOTAL COMPREHENSIVE INCOME** for the period (XIII + XIV) [Comprising Profit (Loss) and other Comprehensive Income for the period]			
XVI	Earnings per equity share (for continuing operation);			
	1) Basic			
	2) Diluted			
XVII	Earnings per equity share (for discontinued operation):			
	1) Basic			
	2) Diluted			
XVIII	Earnings per equity share (for discontinued & continuing operations)			
	1) Basic			
	2) Diluted			

FUNDAMENTAL PRINCIPLES OF IND AS

1. More concrete and strict application of substance over form.
2. Fair value Accounting – All assets and liabilities in the Balance sheet should appear at fair values. Rarely IND AS gives an option to follow cost Based Accounting.
   This has led to creation of a separate section in P&L A/c called as "OTHER COMPREHENSIVE INCOME"

Statement of profit & Loss	=	Statement of profit (or) loss	+	Other Comprehensive Income

Total comprehensive Income

3. Restatement of Financial statements:

Restatement of Financial statements would be required if there is any rectification of Error or a change in accounting policy.

Example 1
A Ltd has purchased an investment for its face value of Rs 1,00,000 on 01.04.2015. On this Investment, each year an Interest of Rs 10,000 is a earned. However this Interest will be received in lumpsum at the end of 5th year. The company did not account for the Interest Income during the years 2015-16 , 2016-17 and 2017-18. It's current year is 2018-19. Show the treatment of Rectification of error & also give extracts of SPL, Balance sheet and statement of changes in Equity.

4. Recycling / Reclassification:

a) As per Several IND AS, some of the Gains / losses relating to Assets and Liabilities is recorded in OCI Section of SPL.
b) These gains / Losses gets accumulated in the balance Sheet and when they are realized in future. They may be allowed to be reclassified to P or L. This is called as recycling. In certain cases recycling / reclassification to P or L is not allowed. In such cases the balance in OCI will be transferred directly into Retained Earnings.

Example 2

A Ltd has purchased an Investment on 01.03.2018 for Rs 100. On 31.03.2018, its fair value is 120. On 30.04.2018, the Investment is sold at 125. Show the Accounting and extracts of SPL and SOCIE for the years 2017-18 and 2018-19 under the following assumptions.

1. The Investment is to be fair valued through OCI and the accumulated Gain / loss is Re-classifiable.
2. The Investment is to be fair valued through OCI and the accumulated Gain / Losses not allowed to be Reclassified.

SCHEDULE III [complete annexure]

Division II

Financial Statements for a company whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015.

GENERAL INSTRUCTIONS FOR PREPARATION OF FINANCIAL STATMENT OF A COMPANY REQUIRED TO COMPLY WITH Ind AS

1. Every company to which Indian Accounting Standards apply, shall prepare its financial statements in accordance with this Schedule or with such modification as may be required under certain circumstances.
2. Where compliance with the requirements of the Act including Indian Accounting Standards (except the option of presenting assets and liabilities in the order of liquidity as provided by the relevant Ind AS) as applicable to the companies require any change in treatment or disclosure including addition, amendment substitution or deletion in the head or sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements under this Schedule shall stand modified accordingly.
3. The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Indian Accounting Standards. Additional disclosures specified in the Indian Accounting Standards shall be made in the Notes or by way of additional statement or statements unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act, 2013 shall be made in the Notes in addition to the requirements set out in this Schedule.
4. (i) Notes shall contain information in addition to that presented in the Financial Statements and shall provide where required-
   a. narrative description or disaggregation of items recognised in those statements; and
   b. information about items that do not qualify for recognition in those statements.

   (ii) Each item on the face of the Balance Sheet, Statement of Changes in Equity and Statement of Profit and Loss shall be cross-referenced to any related information in the Notes. In preparing the Financial Statements including the Notes, a balance shall be maintained between providing excessive detail that may not assist users of Financial Statements and not providing important information as a result of too much aggregation.

5. Depending upon the Total Income of the company, the figures appearing in the Financial Statements shall be rounded off as below:

Total Income	Rounding off
i. less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof
ii. one hundred crore rupees or more	To the nearest, lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

6. Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statement including Notes except in the case of first Financial Statements laid before the company after incorporation.
7. Financial Statements shall disclose all 'material' items, i,e, the items if they could. individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.
8. For the purpose of this Schedule, the terms used herein shall have the same meanings assigned to them in Indian Accounting Standards.
9. Where any Act or Regulation requires specific disclosure to be made in the standalone financial statement of a company, the said disclosure shall be made in addition to those required under this Schedule.

Note: This Schedule sets out the minimum requirements for disclosure on the face of the Financial Statements, i.e, Balance Sheet, Statement of Changes in Equity for the period, the Statement of profit and Loss for the period (The term 'Statement of Profit and Loss' has the same meaning as Profit and Loss Account) and Notes. Cash flow statement shall be prepared, where applicable, in accordance with the requirement of the relevant Indian Accounting Standard.

Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company's financial position or performance to cater to industry or sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act, 2013 or under the Indian Accounting Standards.

PART I -BALANCE SHEET

Name of the Company....................

Balance Sheet as at ....

(Rs in.........)

	Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
	1	**2**	**3**	**4**
(1)	**ASSETS**			
	Non-current assets			
	a) Property, Plant and Equipment b) Capital work-in-progress c) Investment Property d) Goodwill e) Other Intangible assets f) Intangible assets under development g) Biological Assets other than bearer plants h) Financial Assets i. Investments ii. Trade receivables iii. Loans i) Deferred tax assets (net) j) Other non-current assets			

(2)	Current assets a) Inventories b) Financial Assets i. Investments ii. Trade receivables iii. Cash and cash equivalents iv. Bank balances other than (iii) above v. Loans vi. Others (to be specified) c) Current Tax Assets (Net) d) Other current assets			
	Total Assets			
	EQUITY AND LIABILITIES Equity a) Equity Share capital b) Other Equity			
(1)	LIABILITIES Non-current liabilities a) Financial Liabilities i. Borrowings (ia) Lease liabilities ii. Trade Payables: A. total outstanding dues of micro enterprises and small enterprises; and B. total outstanding dues of creditors other than micro enterprises and small enterprises. (iii) Other financial liabilities (other than those specified in item (b), to be specified)			

	a) Provisions b) Deferred tax liabilities (Net) c) Other non-current liabilities			
(2)	Current liabilities a) Financial Liabilities i. Borrowings (ia) Lease liabilities ii. Trade payables: A. total outstanding dues of micro enterprises and small enterprises; and B. total outstanding dues of creditors other than micro enterprises and small enterprises (iii) Other financial liabilities (other than those specified in item (c) b) Other current liabilities c) Provisions d) Current Tax Liabilities (Net)			
	Total Equity and Liabilities			

see accompanying notes to the financial statements

STATEMENT OF CHANGES IN EQUITY

Name of the Company..............

A. Equity Share Capital

1) Current reporting period

Balance at the beginning of the current reporting period	Changes in Equity Share Capital due to prior period errors	Restated balance at the beginning of the current reporting period	Changes in equity share capital during the current year	Balance at the end of the current reporting period

2) Previous reporting period

Balance at the beginning of the previous reporting period	Changes in Equity Share Capital due to prior period errors	Restated balance at the beginning of the previous reporting period	Changes in equity share capital during the previous year	Balance at the end of the previous reporting period

B. Other Equity

1) Current Reporting Period

	Share application on money pending allotment	Equity component of compound financial instruments	Reserves and Surplus				Debt Instruments through other Comprehensive Income	Equity Instruments through Other Comprehensive Income	Effective portion of Cash Flow Hedges	Revaluation Surplus	Exchange differences on translating the financial statements of a foreign operation	Other items of Other Comprehensive Income (specify nature)	Money received against share capital	Total
			Capital Reserve	Securities Premium	Other Reserves (specify nature)	Retained Earnings								
Balance at the beginning of the current reporting period														
Changes in accounting policy or prior period errors														
Restated balance at the beginning of the current reporting period														
Total comprehensive Income for the current year														
Dividends														
Transfer to retained earnings														
Any other change (to be specified)														
Balance at the end of the current reporting period														

(1) Previous Reporting Period

	Share application on money pending allotment	Equity component of compound financial instruments	Reserves and Surplus				Debt Instruments through other Comprehensive Income	Equity Instruments through Other Comprehensive Income	Effective portion of Cash Flow Hedges	Revaluation Surplus	Exchange differences on translating the financial statements of a foreign operation	Other items of Other Comprehensive Income (specify nature)	Money received against share capital	Total
			Capital Reserve	Securities Premium	Other Reserves (specify nature)	Retained Earnings								
Balance at the beginning of the previous reporting period														
Changes in accounting policy or prior period errors														
Restated balance at the beginning of the previous reporting period														
Total comprehensive Income for the previous year														
Dividends														
Transfer to retained earnings														
Any other change (to be specified)														
Balance at the end of the previous reporting period														

Note: Re-measurement of defined benefit plans and fair value changes relating to own credit risk of financial liabilities designated at fair value through profit or loss shall be recognised as a part of retained earnings with separate disclosure of such items along with the relevant amounts in the Notes or shall be shown as a separate column under Reserves and Surplus.

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

1) An entity shall classify an asset as current when-
   a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
   b) it holds the asset primarily for the purpose of trading;
   c) it expects to realise the asset within twelve months after the reporting period; or
   d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

   An entity shall classify all other assets as non-current.
2) The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents, When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.
3) An entity shall classify a liability as current when-
   a) it expects to settle the liability in its normal operating cycle;
   b) it holds the liability primarily for the purpose of trading;
   c) the liability is due to be settled within twelve months after the reporting period; or
   d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in it settlement by the issue of equity instruments do not affect its classification.

   An entity shall classify all other liabilities as non-current.
4) A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
5) A payable shall be classified as a 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.
6) A company shall disclose the following in the Notes:

A. Non-Current Assets

I. Property, Plant and Equipment

i. Classification shall be given as:
   a) Land
   b) Buildings

c) Plant and Equipment
d) Furniture and Fixtures
e) Vehicles
f) Office equipment
g) Bearer Plants
h) Others (specify nature)

ii. Assets under lease shall be separately specified under each class of assets

iii. A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of Property ,Plant and Equipment) and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

II. Investment Property

A reconciliation of the gross and net carrying amounts of each class of property at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

III. Goodwill

A reconciliation of the gross and net carrying amount of goodwill at the beginning and end of the reporting period showing additions, impairments, disposals and other adjustments.

IV. Other Intangible assets

i. Classification shall be given as:

a) Brands or trademarks
b) Computer software
c) Mastheads and publishing titles
d) Mining rights
e) Copyright, patents, other intellectual property rights, services and operating rights
f) Recipes, formulae, models, designs and prototypes
g) Licenses and franchises
h) Others (specify nature)

ii. A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of intangible assets) and other adjustments and the related amortization and impairment losses or reversals shall be disclosed separately.

V. Biological Assets other than bearer plants

A reconciliation of the carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments shall be disclosed separately.

VI. Investment

i. Investments shall be classified as:

a) Investments in Equity Instruments;
b) Investments in Preference Shares;
c) Investments in Government or trust securities;
d) Investments in debentures or bonds;
e) Investments in Mutual Funds;
f) Investments in partnership firms; or
g) Other investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate that are

i. subsidiaries,
ii. associates,
iii. joint ventures, or
iv. structured entities,

in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). Investment in partnership firms along with names of the firms, their partners, total capital and the shares of each partner shall be disclosed separately.

ii. The following shall also be disclosed:

a) Aggregate amount of quoted investment and market value thereof:
b) Aggregate amount of unquoted investment: and
c) Aggregate amount of impairment in value of investment.

VII. Trade Receivables

i. Trade receivables shall be sub-classified as;

a) Trade Receivables considered good - Secured;

b) Trade Receivables considered good - Unsecured;

c) Trade Receivables which have significant increase in Credit Risk; and

d) Trade Receivables - credit impaired

ii. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

iii. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

iv. For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables ageing schedule (Amount in Rs.)

Particulars	Outstanding for following periods from due date of payment*					
	Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years	Total
(i) Undisputed Trade receivables – considered good						
(ii) Undisputed Trade Receivables – which have significant increase in credit risk						
(iii) Undisputed Trade Receivables – credit impaired						
(iv) Disputed Trade Receivables – considered good						
(v) Disputed Trade Receivables – which have significant increase in credit risk						
(vi) Disputed Trade Receivables – credit impaired						

* similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction. Unbilled dues shall be disclosed separately

VIII. Loans

i. Loans shall be classified as-

a) Loans to related parties (giving details thereof); and

b) Other loans (specify nature).

ii. Loans Receivables shall be sub-classified as:

a) Loans Receivables considered good - Secured;

b) Loans Receivables considered good - Unsecured;

c) Loans Receivables which have significant increase in Credit Risk; and

d) Loans Receivables - credit impaired;

The above shall also be separately sub-classified as-

a) Secured, considered good;

b) Unsecured, considered good; and

c) Doubtful.

iii. Allowance for bad and doubtful loans shall be disclosed under the relevant heads separately.

iv. Loans due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

IX. Other financial assets

i. Security Deposits

ii. Bank deposits with more than 12 months maturity

iii. Others (to be specified)

X. Other non-current asset: Other non-current assets shall be classified as

i. Capital Advances; and

ii. Advances other than capital advances;

1) Advances other than capital advances shall be classified as:

a) Security deposits;

b) Advances to related parties (giving details thereof; and

c) Other advances (specify nature).

2) Advances to directors or other officers of the company or any of them either severally or jointly with any other persons or advances to firms or private companies respectively in which any director is a partner or a director or a member should be separately stated, In case

advances are of the nature of a financial asset as per relevant Ind AS, these are to be disclosed under other financial assets separately.

iii. Others (specify nature).

B. Current Assets

I. Inventories

i. Inventories shall be classified as-

a) Raw materials;

b) Work in-progress;

c) Finished goods;

d) Stock-in-trade (in respect of goods acquired for trading);

e) stores and spares;

f) Loose tools; and

g) Others (specify nature).

ii. Goods-in-transit shall be disclosed under the relevant sub-head of inventories.

iii. Mode of valuation shall be stated.

II. Investment

i. Investments shall be classified as-

a) Investments in Equity Instruments;

b) Investment in Preference Shares;

c) Investment in government or trust securities;

d) Investments in debentures or bonds;

e) Investments in Mutual Funds;

f) Investment in partnership firms; and

g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate that are -

i. subsidiaries,

ii. associates,

iii. joint ventures, or

iv. structured entities,

in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid)

ii. The following shall also be disclosed

a) Aggregate amount of quoted investments and market value thereof;
b) Aggregate amount of unquoted investments;
c) Aggregate amount of impairment in value of investments,

III. Trade Receivables

i. Trade receivables shall be sub-classified as:
a) Trade Receivables considered good - Secured;
b) Trade Receivables considered good - Unsecured;
c) Trade Receivables which have significant increase in Credit Risk; and
d) Trade Receivables - credit impaired.

ii. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

iii. Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

iv. For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables ageing schedule **(Amount in Rs.)**

Particulars	Outstanding for following periods from due date of payment*					
	Less than 6 months	6 Months - 1 year	1-2 years	2-3 years	More than 3 years	Total
(i) Undisputed Trade receivables – considered good						
(ii) Undisputed Trade Receivables – which have significant increase in credit risk						
(iii) Undisputed Trade Receivables – credit impaired						
(iv) Disputed Trade Receivables– considered good						
(v) Disputed Trade Receivables – which have significant increase in credit risk						
(vi) Disputed Trade Receivables – credit impaired						

* similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

IV. Cash and cash equivalents

Cash and cash equivalents shall be classified as-

a) Balances with Banks (of the nature of cash and cash equivalents);

b) Cheques, drafts on hand;

c) Cash on hand; and

d) Others (specify nature).

V. Loans

i. Loans shall be classified as:

a) Loans to related parties (giving details thereof); and

b) others (specify nature).

ii. Loans Receivables shall be sub-classified as:

a) Loans Receivables considered good - Secured;

b) Loans Receivables considered good - Unsecured;

c) Loans Receivables which have significant increase in Credit Risk; and

d) Loans Receivables - credit impaired.

iii. Allowance for bad and doubtful loans shall be disclosed under the relevant heads separately.

iv. Loans due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

VA. Other Financial Assets: This is an all-inclusive heading, which incorporates financial assets that do not fit into any other financial asset categories, such as, Security Deposits.

v. Other current assets (specify nature)

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

Other current assets shall be classified as -

i. Advances other than capital advances

1) Advances other than capital advances shall be classified as:

a) Security Deposits;

b) Advances to related parties (giving details thereof);

c) Other advances (specify nature)

2) Advances to directors or other officers of the company or any of them either severally or jointly with any other persons or advances to firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
a) Earmarked balances with banks (for example for unpaid dividend) shall be separately stated.
b) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
c) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

C. Equity

I. Equity Share Capital

For each class of equity share capital:

a) the number and amount of shares authorised;
b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
c) par value per Share;
d) a reconciliation of the number of shares outstanding at the beginning and at the end of the period;
e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;
f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
g) shares in the company held by each shareholder holding more than five percent. shares specifying the number of shares held;
h) shares reserved for issue under options and contracts or commitments for the sale of shares or disinvestment, including the terms and amounts;
i) for the period of five years immediately preceding the date at which the Balance Sheet is prepared
   - aggregate number and class of shares allotted as fully paid up pursuant to contract without payment being received in cash;
   - aggregate number and class of shares allotted as fully paid up by way of bonus shares; and
   - aggregate number and class of shares bought back;
j) terms of any securities convertible into equity shares issued along with the earliest date of conversion in descending order starting from the farthest such date;
k) calls unpaid (showing aggregate value of calls unpaid by directors and officers);

l) forfeited shares (amount originally paid up).

m) A company shall disclose Shareholding of Promoters* as under:

Shares held by promoters at the end of the year				**% Change during the year*** **
S. No	**Promoter name**	**No. of Shares****	**% of total shares**	
Total				

*Promoter here means promoter as defined in the Companies Act, 2013.

**Details shall be given separately for each class of shares

***Percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.

II. Other Equity

i. 'Other Reserves' shall be classified in the notes as-

a) Capital Redemption Reserve;

b) Debenture Redemption Reserve;

c) Share Options Outstanding Account; and

d) Others- (specify the nature and purpose of each reserve and the amount in respect thereof); (Additions and deductions since last balance sheet to be shown under each of the specified heads)

ii. Retained Earnings represents surplus i.e. balance of the relevant column in the Statement of Changes in Equity;

iii. A reserve specifically represented by earmarked investments shall disclose the fact that it is so represented;

iv. Debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head 'retained earnings'. Similarly, the balance of 'Other Equity', after adjusting negative balance of retained earnings, if any, shall be shown under the head 'Other Equity' even if the resulting figure is in the negative; and

v. Under the sub-head 'Other Equity', disclosure shall be made for the nature and amount of each item.

D. Non-Current Liabilities

I. Borrowings

i. borrowings shall be classified as-

a) Bonds or debentures

b) Term loans

i. from banks

ii. from other Parties

c) Deferred payment liabilities

d) Deposits

e) Loans from related parties

f) Liability component of compound financial instruments

g) Other loans (specify nature);

ii. borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

iii. where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed;

iv. bonds or debentures (along with the rate of interest, and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be, where bonds/debentures are redeemable by installments, the date of maturity for this purpose must be reckoned as the date on which the first installment becomes due;

v. particulars of any redeemed debentures which the company has power to reissue shall be disclosed;

vi. terms of repayment of term loans and other loans shall be stated; and

vii. period and amount of default as on the balance sheet date in repayment of borrowings and interest shall be specified separately in each case.

II. Provisions

The amounts shall be classified as-

a) Provision for employee benefits; and

b) Others (specify nature).

III. Other non-current liabilities

a) Advances; and

b) Others (specify nature).

E. Current Liabilities

I. Borrowings

i. Borrowings shall be classified as-

a) Loans repayable on demand

I. from banks

II. from other parties

b) Loans from related parties

c) Deposits

d) Other loans (specify nature);

ii. borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case;

iii. where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed;

iv. period and amount of default as on the balance sheet date in repayment of borrowings and interest, shall be specified separately in each case;

v. Current maturities of long-term borrowings shall be disclosed separately.

II. Other Financial Liabilities

Other Financial liabilities shall be classified as-

a) Interest accrued;

b) Unpaid dividends;

c) Application money received for allotment of securities to the extent refundable and interest accrued thereon;

d) Unpaid matured deposits and interest accrued thereon;

e) Unpaid matured debentures and interest accrued thereon; and

f) Others (specify nature).

'Long term debt' is a borrowing having a period of more than twelve months at the time of origination.

III. Other current liabilities

The amounts shall be classified as-

a) revenue received in advance;

b) other advances (specify nature); and

c) others (specify nature);

IV. Provisions

The amounts shall be classified as-

i. provision for employee benefits; and

ii. others (specify nature)

F(A) Trade Payables

The following details relating to micro, small and medium enterprises shall be disclosed in the notes:

a) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;

b) the amount of interest paid by the buyer in terms of section 16 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006), along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;

c) the amount of interest due and payable for the period of delay in making payment which has been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006;

d) the amount of interest accrued and remaining unpaid at the end of each accounting year; and

e) the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.

Explanation.- The terms 'appointed day', 'buyer', 'enterprise', 'micro enterprise', 'small enterprise' and 'supplier', shall have the same meaning as assigned to them under clauses (b), (d), (e), (h), (m) and (n) respectively of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.

F(B). For trade payables due for payment, following ageing schedule shall be given:

Trade Payables aging schedule **(Amount in Rs)**

Particulars	**Outstanding for following periods from due date of payment***				
	Less than 1 year	**1-2 years**	**2-3 years**	**More than 3 years**	**Total**
i. MSME					
ii. Others					
iii. Disputed dues – MSME					
iv. Disputed dues - Others					

*Similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction. Unbilled dues shall be disclosed separately.

G. The presentation of liabilities associated with group of assets classified as held for sale and non-current assets classified as held for sale shall be in accordance with the relevant Indian Accounting Standards (Ind ASs)

H. Contingent Liabilities and Commitments (to the extent not provided for)

i. Contingent Liabilities shall be classified as-
   a) claims against the company not acknowledged as debt;
   b) guarantees excluding financial guarantees; and
   c) other money for which the company is contingently liable.

ii. Commitments shall be classified as-
   a) estimated amount of contracts remaining to be executed on capital account and not provided for;
   b) uncalled liability on shares and other investments partly paid; and
   c) other commitments (specify nature).

I. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and title related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on irredeemable preference shares shall also be disclosed separately.

J. Where in respect of an issue of securities made for a specific purpose the whole or part of amount has not been used for the specific purpose at the Balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested.

JA. Where the company has not used the borrowings from banks and financial institutions for the specific purpose for which it was taken at the balance sheet date, the company shall disclose the details of where they have been used.

I. Additional Regulatory Information

i. Title deeds of Immovable Properties not held in name of the Company

The company shall provide the details of all the immovable properties (other than properties where the Company is the lessee and the lease agreements are duly executed in favour of the lessee) whose title deeds are not held in the name of the company in following format and where such immovable property is jointly held with others, details are required to be given to the extent of the company‛s share.

Relevant line item in the Balance sheet	Description of item of property	Gross carrying value	Title deeds held in the name of	Whether title deed holder is a promoter, director or relative# of promoter*/ director or employee of promoter/ director	Property held since which date	Reason for not being held in the name of the company**
PPE -	Land Building	-	-	-	-	**also indicate if in dispute

Investment property -	Land Building					
PPE retired from active use and held for disposal	Land Building					
Others						

#Relative here means relative as defined in the Companies Act, 2013. *Promoter here means promoter as defined in the Companies Act, 2013.

ii. The Company shall disclose as to whether the fair value of investment property (as measured for disclosure purposes in the financial statements) is based on the valuation by a registered valuer as defined under rule 2 of Companies (Registered Valuers and Valuation) Rules, 2017.

iii. Where the Company has revalued its Property, Plant and Equipment (including Right-of- Use Assets), the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of Companies (Registered Valuers and Valuation) Rules, 2017.

iv. Where the company has revalued its intangible assets, the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of Companies (Registered Valuers and Valuation) Rules, 2017.

v. The following disclosures shall be made where Loans or Advances in the nature of loans are granted to promoters, directors, KMPs and the related parties (as defined under Companies Act, 2013), either severally or jointly with any other person, that are:

a) repayable on demand; or
b) without specifying any terms or period of repayment,

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related Parties		

vi. Capital-Work-in Progress (CWIP)

a) For Capital-work-in progress, following ageing schedule shall be given:

CWIP aging schedule

(Amount in Rs.)

CWIP	Amount in CWIP for a period of				Total*
	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Project in progress					
Projects temporarily suspended					

*Total shall tally with CWIP amount in the balance sheet.

b) For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given:**

(Amount in Rs)

CWIP	To be completed in			
	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.

vii. Intangible assets under development:

a) For Intangible assets under development, following ageing schedule shall be given:

Intangible assets under development aging schedule

(Amount in Rs)

Intangible assets under development	Amount in CWIP for a period of				Total*
	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Project in progress					
Projects temporarily suspended					

* Total shall tally with the amount of Intangible assets under development in the balance sheet.

b) For Intangible assets under development, whose completion is overdue or has exceeded its cost compared to its original plan, the following Intangible assets under development completion schedule shall be given:**

(Amountin Rs)

CWIP	To be completed in			
	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

viii. **Details of Benami Property held**

Where any proceeding has been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, the company shall disclose the following:

a) Details of such property,
b) Amount thereof,
c) Details of Beneficiaries,
d) If property is in the books, then reference to the item in the Balance Sheet,
e) If property is not in the books, then the fact shall be stated with reasons,
f) Where there are proceedings against the company under this law as an a better of the transaction or as the transferor then the details shall be provided,
g) Nature of proceedings, status of same and company's view on same.

ix. **where the Company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following:**

a) whether quarterly returns or statements of current assets filed by the Company with banks or financial institutions are in agreement with the books of accounts;
b) if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

x. **Wilful Defaulter***

Where a company is a declared wilful defaulter by any bank or financial Institution or other lender, following details shall be given:

a) Date of declaration as wilful defaulter,
b) Details of defaults (amount and nature of defaults)

* wilful defaulter" here means a person or an issuer who or which is categorized as a wilful defaulter by any bank or financial institution (as defined under the Companies Act, 2013) or consortium thereof, in accordance with the guidelines on wilful defaulters issued by the Reserve Bank of India.

xi. Relationship with Struck off Companies

Where the company has any transactions with companies struck off under section 248 of the Companies Act, 2013 or section 560 of Companies Act, 1956, the Company shall disclose the following details, namely:

Name of Struck off Company	**Nature of transactions with struck off Company**	**Balance Outstanding**	**Relationship with the Struck off company, if any, to be disclosed**
	Investments in securities		
	Receivables		
	Payables		
	Shares held by stuck off company		
	Other outstanding balances (to be specified)		

xii. Registration of charges or satisfaction with Registrar of Companies (ROC)

Where any charges or satisfaction yet to be registered with ROC beyond the statutory period, details and reasons thereof shall be disclosed.

xiii. Compliance with number of layers of companies

Where the company has not complied with the number of layers prescribed under clause (87) of section 2 of the Act read with the Companies (Restriction on number of Layers) Rules, 2017, the name and CIN of the companies beyond the specified layers and the relationship or extent of holding of the company in such downstream companies shall be disclosed.

xiv. Following Ratios to be disclosed:

a) Current Ratio,
b) Debt-Equity Ratio,
c) Debt Service Coverage Ratio,
d) Return on Equity Ratio,
e) Inventory turnover ratio,
f) Trade Receivables turnover ratio,
g) Trade payables turnover ratio,
h) Net capital turnover ratio,
i) Net profit ratio,
j) Return on Capital employed,
k) Return on investment.

The company shall explain the items included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

xv. Compliance with approved Scheme(s) of Arrangements

Where the Scheme of Arrangements has been approved by the Competent Authority in terms of sections 230 to 237 of the Companies Act, 2013, the company shall disclose that the effect of such Scheme of Arrangements have been accounted for in the books of account of the Company in accordance with the Scheme and in accordance with accounting standards�much and any deviation in this regard shall be explained.

xvi. Utilisation of Borrowed funds and share premium:

A. Where company has advanced or loaned or invested funds (either borrowed funds or share premium or any other sources or kind of funds) to any other person(s) or entity(ies), including foreign entities (Intermediaries) with the understanding (whether recorded in writing or otherwise) that the Intermediary shall

(i) directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (Ultimate Beneficiaries) or

(ii) provide any guarantee, security or the like to or on behalf of the Ultimate Beneficiaries; the company shall disclose the following:

I. date and amount of fund advanced or loaned or invested in Intermediaries with complete details of each Intermediary.

II. date and amount of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate Beneficiaries along with complete details of the ultimate beneficiaries.

III. date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries

IV. declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money- Laundering act, 2002 (15 of 2003).

B. Where a company has received any fund from any person(s) or entity(ies), including foreign entities (Funding Party) with the understanding (whether recorded in writing or otherwise) that the company shall

i. directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party (Ultimate Beneficiaries) or

ii. provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries, the company shall disclose the following:

(i) date and amount of fund received from Funding parties with complete details of each Funding party.

(ii) date and amount of fund further advanced or loaned or invested other intermediaries or Ultimate Beneficiaries along with complete details of the other intermediaries or ultimate beneficiaries.

(iii) date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries

(iv) declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money - Laundering act, 2002 (15 of 2003).]

7) When a company applies an accounting policy retrospectively or makes a restatement of items in the financial statements or when it reclassifies items in its financial statements, the company shall attach to the Balance Sheet, a "Balance Sheet" as at the beginning of the earliest comparative period presented.

8) Share application money pending allotment shall be classified into equity or liability in accordance with relevant Indian Accounting Standards. share application money to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable shall be separately shown under 'Other financial liabilities'.

9) Preference shares including premium received on issue, shall be classified and presented as 'Equity' or 'Liability' in accordance with the requirements of the relevant Indian Accounting Standards. Accordingly, the disclosure and presentation requirements in that regard applicable to the relevant class of equity or liability shall be applicable mutatis mutandis to the preference shares. For instance, plain vanilla redeemable preference shares shall be classified and presented under 'non-current liabilities' as 'borrowings' and the disclosure requirements in this regard applicable to such borrowings shall be applicable mutatis mutandis to redeemable preference shares.

10) Compound financial instruments such as convertible debentures, where split into equity and liability components, as per the requirements of the relevant Indian Accounting Standards, shall be classified and presented under the relevant heads in 'Equity' and 'Liabilities'

11) Regulatory Deferral Account Balances shall be presented in the Balance Sheet in accordance with the relevant Indian Accounting Standards.

PART II - STATEMENT OF PROFIT AND LOSS

Name of the Company........................

Statement of Profit and Loss for the period ended...............

	Particulars	Note No.	Figures as at the end of current reporting period	Figures for the previous reporting period
I	Revenue from operations			
II	Other Income			
III	Total Income (I + II)			
IV	EXPENSES Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods, Stock-in -Trade and work-in-progress			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expenses			
	Other expenses			
	Total expenses (IV)			
V	Profit/(loss) before exceptional items and tax (I-IV)			
VI	Exceptional Items			
VII	Profit/ (loss) before exceptions items and tax(V-VI)			
VIII	Tax expense: 1) Current tax 2) Deferred tax			

IX	Profit (Loss) for the period from continuing operations (VII - VIII)			
X	Profit/(loss) from discontinued operations			
XI	Tax expenses of discontinued operations			
XII	Profit/(loss) from Discontinued operations (after tax) (X-XI)			
XIII	Profit/(loss) for the period (IX+XII)			
XIV	Other Comprehensive Income A. (i) Items that will not be reclassified to profit or loss (ii) Income tax relating to items that will not be reclassified to profit or loss B. (i) Items that will be reclassified to profit or loss (ii) Income tax relating to items that will be reclassified to profit or loss			
XV	Total Comprehensive Income for the period (XIII+XIV) Comprising Profit (Loss) and Other comprehensive Income for the period)			
XVI	Earnings per equity share (for continuing operation): 1) Basic 2) Diluted			
XVII	Earnings per equity share (for discontinued operation):			

	1) Basic 2) Diluted			
XVIII	Earning per equity share (for discontinued & continuing operation) 1) Basic 2) Diluted			

see accompanying notes to the financial statements

GENERAL INSTRUCTIONS FOR PREPARING OF STATEMENT OF PROFIT AND LOSS

1) The provisions of this Part shall apply to the income and expenditure account, in like manner as they apply to a Statement of Profit and Loss,
2) The Statement of Profit and Loss shall include:
   i. Profit of loss for the Period;
   ii. Other Comprehensive Income for the period
   The sum of (1) and (2) above is "Total Comprehensive Income"
3) Revenue from operations shall disclose separately in the notes
   a) sale of products (including Excise Duty);
   b) sale of services;
   (ba) Grants or donations received (relevant in case of section 8 companies only); and
   c) other operating revenues.
4) **Finance Costs:** Finance costs shall be classified as-
   a) interest;
   b) dividend on redeemable preference shares;
   c) exchange differences regarded as an adjustment to borrowing costs; and
   d) other borrowing costs (specify nature).
5) Other income: other income shall be classified as-
   a) interest Income;
   b) dividend Income; and
   c) other non-operating income (net of expenses directly attributable to such income)
6) Other Comprehensive Income shall be classified into-
   A. Items that will not be reclassified to profit or loss

i. Changes in revaluation surplus;
ii. Re-measurements of the defined benefit plans;
iii. Equity Instruments through Other Comprehensive Income;
iv. Fair value changes relating to own credit risk of financial liabilities designated at fair value through profit or loss;
v. Share of Other Comprehensive Income in Associates and Joint Ventures, to the extent not to be classified into profit or loss; and
vi. Share of Other Comprehensive Income in Associates and Joint Ventures, to the extent not to be classified into profit or loss; and
vii. Others (specify nature).

B. Items that will be reclassified to profit or loss;

i. Exchange differences in translating the financial statements of a foreign operation;
ii. Debt instruments through Other Comprehensive Income;
iii. The effective portion of gains and loss on hedging instruments in a cash flow hedge;
iv. Share of other comprehensive income in Associates and Joint Ventures, to the extent to be classified into profit or loss; and
v. Others (specify nature)

7) **Additional Information:** A Company shall disclose by way of notes, additional information regarding aggregate expenditure and income on the following items:

a) employee Benefits expense (showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) share based payments to employees, (iv) staff welfare expenses).
b) depreciation and amortisation expense;
c) any item of income or expenditure which exceeds one per cent of the revenue from operations or 10,00,000, whichever is higher, in addition to the consideration of 'materiality ‘as specified in clause 7 of the General Instructions for Preparation of Financial Statements of a Company;
d) interest Income;
e) interest Expense
f) dividend income;
g) net gain or loss on sale of investments;
h) net gain or loss on foreign currency transaction and translation (other than considered as finance cost);

i) payments to the auditor as (a) auditor, (b) for taxation matters, (c) for company law matters, (d) for other services, (e) for reimbursement of expenses;

j) in case of companies covered under section 135, amount of expenditure incurred on corporate social responsibility activities; and

k) details of items of exceptional nature;

l) Undisclosed income

The Company shall give details of transactions unrecorded in the books of accounts that has been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act (such as, search or survey or any other relevant provisions of the Income Tax Act, 1961), unless there is immunity for disclosure under any scheme and shall also state whether the previously unrecorded income and related assets have been properly recorded in the books of account during the year.

m) **Corporate Social Responsibility (CSR):** Where the company covered under section 135 of the Companies Act, the following shall be disclosed with regard to CSR activities:-

i. amount required to be spent by the company during the year,
ii. amount of expenditure incurred,
iii. shortfall at the end of the year,
iv. total of previous years shortfall,
v. reason for shortfall,
vi. nature of CSR activities,
vii. details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
viii. where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year shall be shown separately.

n) Details of Crypto Currency or Virtual Currency

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:-

i. profit or loss on transactions involving Crypto currency or Virtual Currency,
ii. amount of currency held as at the reporting date,
iii. deposits or advances from any person for the purpose of trading or investing in Crypto Currency or virtual currency.

8) Changes in Regulatory Deferral Account Balances shall be presented in the Statement of Profit and Loss in accordance with the relevant Indian Accounting Standards

PART III - GENERAL INSRUCTIONS FOR THE PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

1) Where a company is required to prepare Consolidated Financial Statements, i.e,, consolidated balance sheet, consolidated statement of changes in equity and consolidated statement of profit and loss, the company shall mutatis mutandis follow the requirements of this Schedule as applicable to a company in the preparation of balance sheet, statement of changes in equity and statement of profit and loss .In addition, the consolidated financial statements shall disclose the information as per the requirements specified in the applicable Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules 2015, including the following, namely:

i. Profit or loss attributable to 'non-controlling interest ‛and to ‛owners of the parent' in the statement of profit and loss shall be presented as allocation for the period Further, 'total comprehensive income for the period attributable to 'non-controlling interest' and to 'owners of the parent shall be presented in the statement of profit and loss as allocation for the period. The aforesaid disclosures for 'total comprehensive income shall also be made in the statement of changes in equity. In addition to the disclosure requirements in the Indian Accounting Standards, the aforesaid disclosures shall also be made in respect of 'other comprehensive Income

ii. 'Non-controlling interests' in the Balance Sheet and in the Statement of Changes in Equity, within equity, shall be presented separately from the equity of the 'owners of the parent'.

iii. Investments accounted for using the equity method.

2) In Consolidated Financial Statement, the following to be disclosed by additional information

Name of the entity in the Group	**Net Asset i.e. total assets minus total liabilities**		**Share in profit or loss**		**Share in other comprehensive income**		**Share in total comprehensive income**	
	As % of consolidated net assets	Amount	As % of consolidated profit or loss	Amount	As % of consolidated other comprehensive income	Amount	As % of total comprehensive income	Amount
Parent Subsidiaries Indian 1. 2. 3. Foreign								

1. 2. 3. Non- Controlling Interest in all subsidiaries Associates (Investment as per the equity method) Indian 1. 2. 3. Foreign 1. 2. 3. Joint Venture (Investment as per the equity method) Indian 1. 2. 3. Foreign 1. 2. 3.								
Total								

3) All subsidiaries, associates and joint venture (whether Indian or Foreign) will be covered under consolidated financial statement.
4) An entity shall disclose the list of subsidiaries or associates or joint venture which have been consolidated in the consolidated financial statement along with the reason of not consolidating.

GUIDANCE NOTE ON SCHEDULE III

Corporate Laws & Corporate Governance Committee (CLCGC) of ICAI issued the Guidance Note on Division-II to Schedule III to the Companies Act, 2013 in 2017 and kept on revising the same as per requirements. Latest Guidance Note on the subject is issued in January, 2022. This Guidance Note aims to provide guidance on the amended Division-II to Schedule III to the Companies Act, 2013. It also lays down broad guidelines to deal with practical issues that may arise in the implementation of Division-II to Schedule III to the Companies Act, 2013. Accordingly, wherever required conceptual guidance has been provided in the Guidance Note.

Following are the some of the key guidance stated in guidance note. The following should be read in conjunction with Guidance Note issued on the subject:

1) **Property, Plant and Equipment:** companies should continue to present land and building separately as given in Ind AS Schedule III and such presentation needs to be followed consistently.

   As per Ind AS Schedule III, capital advances/ advances for purchase of capital assets should be included under other non- current assets and hence, should not be included under capital work-in-progress

2) **Non-current Investment:** Under each sub-classification of Investments, there is a requirement to disclose details of investments including names and the nature and extent of the investment in each body corporate which is a subsidiary, associate, joint venture and structured entity. The nature and extent would imply the **number of such instruments held and the face value** of such instrument.

   Ind AS Schedule III requires disclosure of the aggregate amount of quoted investments and market value thereof and the aggregate amount of unquoted investments. The aggregate amount of such investments would include aggregate amount of carrying value of these investments as at the reporting date as included in the financial statements.

   As per Ind AS Schedule III, aggregate amount for impairment in value of investments should be disclosed separately. As per Ind AS 109, the company is required to recognize a loss allowance (i.e. impairment) for expected credit losses on investments measured at amortized cost. **Such loss allowance should be presented as an adjustment to the amortized cost of the investment.**

   As per Ind AS 109, in case of debt investments measured at fair value through other comprehensive income (FVTOCI), a company shall estimate a portion of fair value change, if any, attributable to a change in credit risk of such investment and disclose the same in the profit and loss section of the statement of profit and loss with a corresponding impact in other comprehensive income section.

   The aggregate provision for impairment as per Ind AS 36 in the value of investments may be either presented in totality, where relevant, for all the investments or separately for each class of investments (e.g., 'Investment at amortized cost', 'Investment in debt instruments at FVOCI') disclosed in the financial statements.

A limited liability partnership is a body corporate and not a partnership firm as envisaged under the Partnership Act, 1932. Hence, disclosures pertaining to Investments in partnership firms will not extend to investments in limited liability partnerships. The investments in limited liability partnerships will be disclosed separately under 'other investment'.

Note: Any application money paid towards securities, where security has not been allotted on the date of the Balance Sheet, shall be disclosed as a separate line item under 'other non-current financial assets'. In case the investment is of current investment in nature, such share application money shall be accordingly, disclosed under other current financial assets.

3) **Trade Receivables:** A receivable shall be classified as 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business and the company has a right to an amount of consideration that is unconditional (i.e. if only the passage of time is required before payment of that consideration is due). Hence, amounts due under contractual rights, other than arising out of sale of goods or rendering of services, cannot be included within Trade Receivables. Such items may include dues in respect of insurance claims, sale of Property, Plant and Equipment, contractually reimbursable expenses, etc. Such receivables should be classified as "other financial assets" and each such item should be disclosed nature-wise

The ageing of the trade receivables needs to be determined from the due date of the invoice. Due date is generally considered to be the date on which the payment of an invoice falls due. The due date of an invoice is determined based on terms agreed upon between the buyer and supplier. In case if the due date is neither agreed in writing nor orally, then the ageing related disclosure needs to be prepared from the transaction date.

Schedule III requires split of trade receivables between 'disputed' and 'undisputed'. These terms have not been defined in the Schedule III. A dispute is a matter of facts and circumstances of the case; however, dispute means disagreement between two parties demonstrated by some positive evidence which supports or corroborates the fact of disagreement. In case there are any disputes such fact should also be considered while assessing the credit risk associated with respective party while computing the impairment loss. However, a dispute might not always be an indicator of counterparty's credit risk and vice-versa. Hence, both of these should be evaluated independently for the purpose of making these disclosures.

4) **Other Non-Current Financial Assets –** Ind AS Schedule III does not specify about the presentation of finance lease receivables. However, the guidance note clarifies that he non- current portion of a finance lease receivable shall be presented under 'Other non -current financial assets' while its current portion shall be presented under 'Other current financial assets'.

5) **Current Assets -** As per Ind AS Schedule III, all items of assets and liabilities are to be bifurcated between current and non-current portions. In some cases, the items presented under the "non-current" head of the Balance Sheet may not have a corresponding "current" head under the format given in Ind AS Schedule III. Since Ind AS Schedule III permits the use of additional line items, in such cases the current portion should be classified under the "Current" category of the respective balance as a separate line item and other relevant disclosures should be made.

6) **Cash and Cash Equivalents -** Cash and cash equivalents is not defined in Ind AS Schedule III however, according to Ind AS 7 Statement of Cash Flows, Cash is defined to include cash on hand and demand deposits with banks. Cash Equivalents are defined as short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. As per para 8 of Ind AS 7 "where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn." Although Ind AS 7 permits bank overdrafts to be included as cash and cash equivalent, however for the purpose of presentation in the balance sheet, it is not appropriate to include bank overdraft as a component of cash and cash equivalents unless the offset conditions as given in paragraph 42 of Ind AS 32 are complied with. Bank overdraft, in the balance sheet, should be included as 'borrowings' under Financial Liabilities.

7) **Current Tax Assets -** If amount of tax already paid in respect of current and prior periods exceeds the amount of tax due for those periods (assessment year-wise and not cumulative unless tax laws allow for e.g., say tax laws in the country of overseas subsidiary permits), then such excess tax shall be recognised as an asset. The excess tax paid (presented as current tax assets) may not be expected to be recovered / realised within one year from the balance sheet date and if so, the same shall be presented under non-current assets. An entity should evaluate whether current tax assets meet the definition of current assets or not and should accordingly present the same.

8) **Equity Share Capital -** The accounting definition of 'Equity' is principle based as compared to the legal definition of 'Equity' or 'Share', such that any contract that evidences residual interest in an entity's net asset is termed as 'Equity' irrespective of whether it is legally recognized as a 'Share' or not. Accordingly,

all instruments (including convertible preference shares and convertible debentures) that meet the definition of 'Equity' as per Ind AS 32 in its entirety and when they do not have any component of liability, should be considered as having the nature of 'Equity' for the purpose of Ind AS Schedule III. Such instruments shall be termed as 'Instruments entirely equity in nature'.

9) **Borrowings-** The phrase "term loan" has not been defined in the Schedule III. Term loans normally have a fixed or pre-determined maturity period or a repayment schedule.

   Terms of repayment of term loans and other loans shall be disclosed. The term 'other loans' is used in general sense and should be interpreted to mean all categories listed under the heading 'Non – Current borrowings' as per Ind AS Schedule III. Disclosure of terms of repayment should be made preferably for each loan unless the repayment terms of individual loans within a category are similar, in which case, they may be aggregated.

   Ind AS Schedule III requires presenting 'current maturities of long-term debt' under 'current borrowings'. Long-term debt is specified in Ind AS Schedule III as a borrowing having a period of more than twelve months at the time of origination. The portion of non-current borrowings, which is due for payments within twelve months of the reporting date is required to be classified under "current borrowings" while the balance amount should be classified under non-current borrowings.

10) **Trade Payable -** A payable shall be classified as 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business. Hence, amounts due under contractual obligations or which are statutory payables should not be included within Trade Payables. Such items may include dues payable in respect of statutory obligations like contribution to provident fund or contractual obligations like contractually reimbursable expenses, amounts due towards purchase of capital goods, etc .

11) Due date shall be the date by when a buyer should make payment to the supplier as per terms agreed upon between the buyer and supplier. In case if the due date is neither agreed in writing nor oral, then the disclosure needs to be prepared from the transaction date. Transaction date shall be the date on which the liability is recognised in the books of accounts as per the requirement of applicable standards. A dispute is a matter of facts and circumstances of the case. However, dispute means disagreement between two parties demonstrated by some positive evidence which supports or corroborates the fact of disagreement. Reference is given to the term "Dispute" as defined under the Insolvency and Bankruptcy Code, 2016.

12) **Current Borrowings** - Loans payable on demand should be treated as part of current borrowings. Current borrowings will include all loans payable within a period of 12 months from the date of the loan.

In the case of current borrowings, the period and the amount of defaults existing as at the date of the Balance Sheet should be disclosed (item-wise).

To provide relevant information to the users of the financial statements regarding total amount of liability under the respective category of noncurrent borrowings, Companies shall provide the amount of non-current as well as current portion for each of the respective category of non-current borrowings either by way of a note or a schedule or a cross- reference, as appropriate. This shall be in addition to Ind AS Schedule III requirements for presenting 'current maturities of long-term borrowings' under current borrowings.

13) **Other Current Liabilities** - Trade Deposits and Security Deposits, which do not meet the definition of financial liabilities, should be classified as 'Others' grouped under this head. Others may also include liabilities in the nature of statutory dues such as Withholding taxes, Service Tax, VAT, Excise Duty, Goods and Services Tax (GST), etc.

14) **Contingent Liabilities and Commitments -** A contingent liability in respect of guarantees arises when a company issue guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations. However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance Sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premium, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premium when demanded or to make deferred payments when due. Hence, such performance guarantees and counter guarantees should not be disclosed as contingent liabilities.

15) **Revenue from Operations and other operating income-** Indirect taxes such as Sales tax, Goods and Services tax, etc. are generally collected from the customer on behalf of the government in majority of the cases. However, this may not hold true in all cases and it is possible that a company may be acting as principal rather than as an agent in collecting these taxes. Whether revenue should be presented gross or net of taxes should depend on whether the company is acting as a principal and hence, is responsible for paying tax on its own account or, whether it is acting as an agent i.e. simply collecting and paying tax on behalf of government authorities. If the entity is the principal, then revenue should also be grossed up

for the tax billed to the customer and the tax payable should be shown as an expense. However, in cases, where a company collects such taxes only as an agent, revenue should be presented net of taxes.

The term "other operating revenue" is not defined. This would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities.

16) Exceptional Items - The term 'Exceptional items' is neither defined in Ind AS Schedule III nor in Ind AS. However, Ind AS 1 has reference to such items. Ind AS 1 states that disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense. It indicates circumstances that would give rise to the separate disclosures of items of income and expenses and include:

a) Write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
c) disposals of items of property, plant and equipment;
d) disposals of investments;
e) discontinued operations;
f) litigation settlements; and
g) Other reversals of provisions.

IND AS 1: PRESENTATION OF FINANCIAL STATEMENTS

1. **OBJECTIVE OF IND AS 1:** This standard prescribes the basis for presentation of general-purpose financial statements to ensure comparability:

   a) with the entity's financial statements of previous periods and

   b) with the financial statements of other entities.

   It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

2. APPLICABILITY:

This standard applies to all types of entities including those that present:

(a) consolidated financial statements in accordance with Ind AS 110 'Consolidated Financial Statements'; and

(b) separate financial statements in accordance with Ind AS 27 'Separate Financial Statements'.

This standard **does not apply to** structure and content of condensed **interim** financial statements prepared in accordance with Ind AS 34

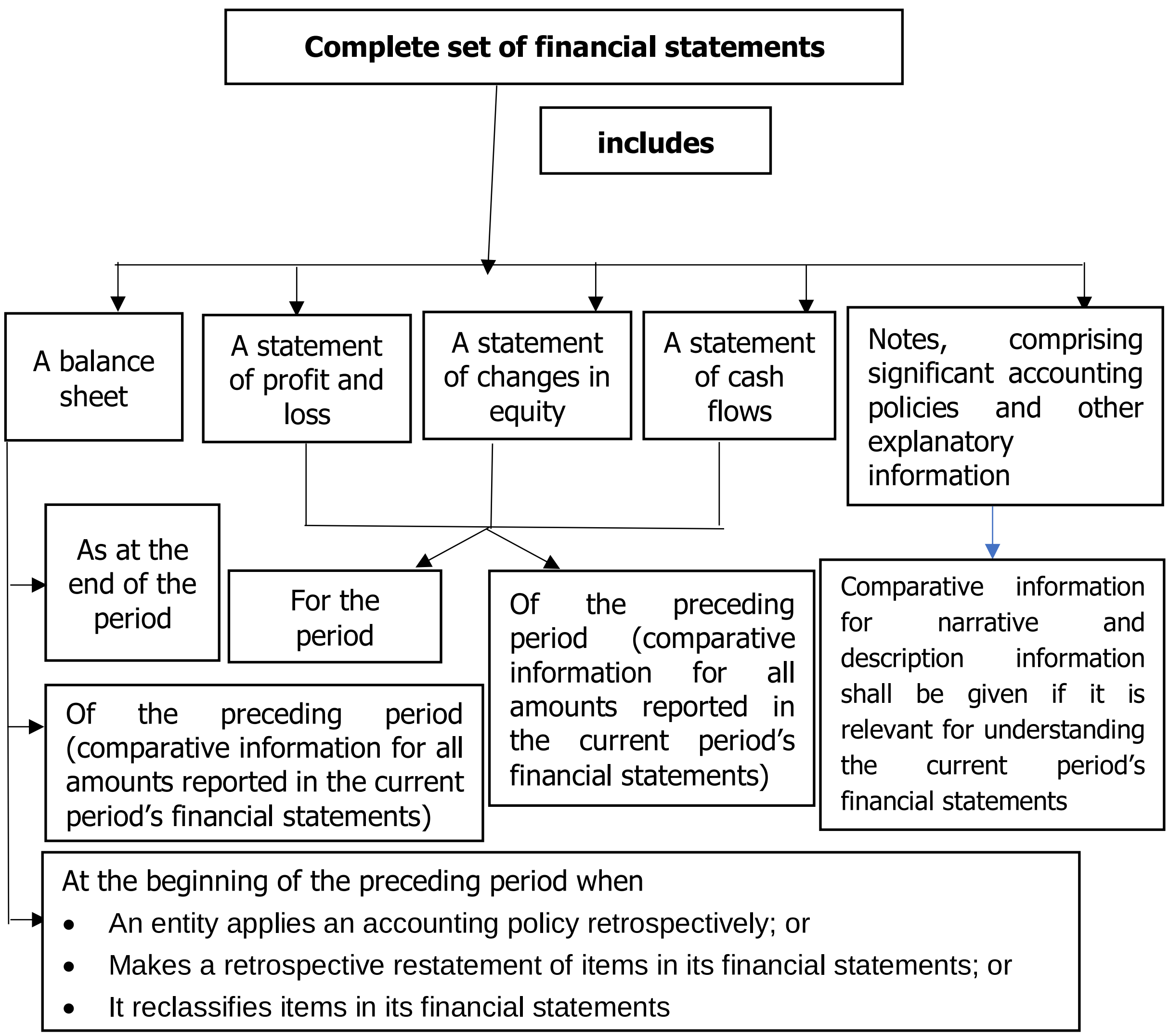
3. **OBJECTIVE OF FINANCIAL STATEMENTS:** The objective of financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions. A complete set of financial statements comprises:

- a balance sheet as at the end of the period;
- a statement of profit and loss for the period;
- statement of changes in equity for the period;
- a statement of cash flows for the period;
- notes, comprising material accounting policy information and other explanatory information;
- comparative information in respect of the preceding period;
- a balance sheet as at the beginning of the preceding period when an entity applies an

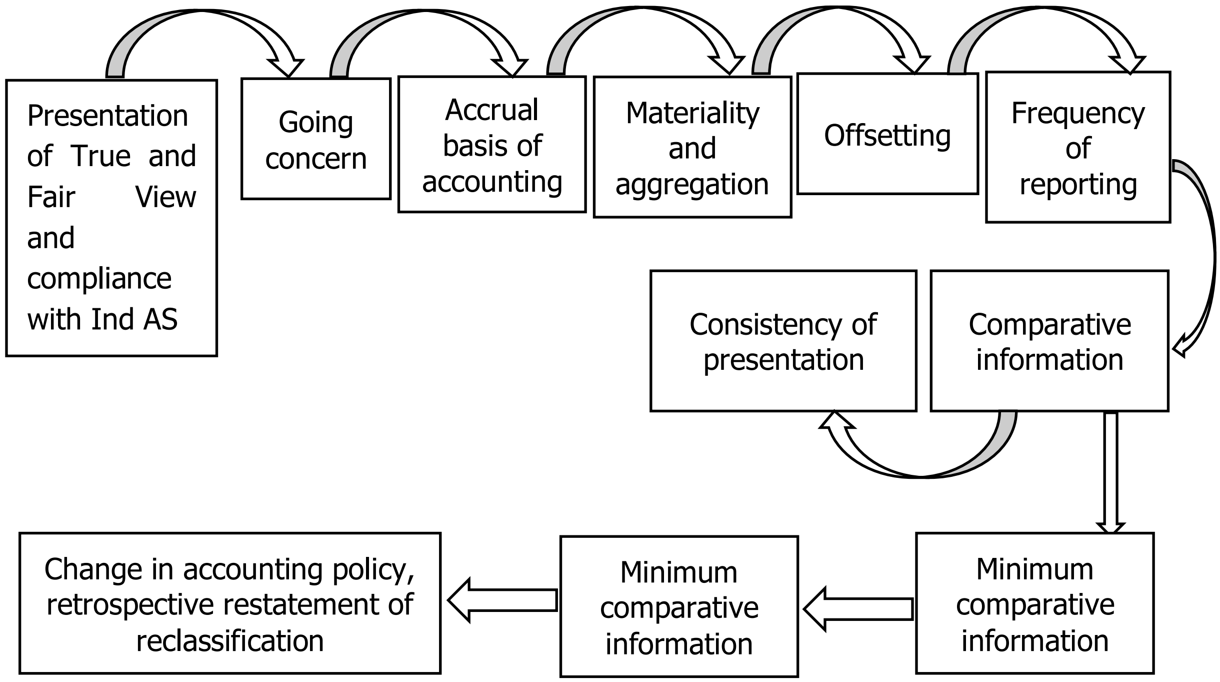
accounting policy retrospectively or makes a retrospective restatements of items in its financial statements, or when it reclassifies items in its financial statements.

An entity shall present a single statement of profit and loss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed directly by the other comprehensive income section.

Many entities also present reports and statements (generally in annual reports) such as financial reviews by management, environmental reports, and value added statements that are outside the financial statements. Such reports and statements that are presented outside the financial statements are outside the scope of Ind AS.



4. **GENERAL FEATURES OF FINANCIAL STATEMENTS:**



i. TRUE AND FAIR PRESENTATION:

Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Conceptual Framework. The application of Ind AS, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.

Such a true and Fair presentation is achieved

a. By Complying with required Ind AS
b. Selection of appropriate accounting polices (Ind AS 8)
c. To present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
d. By Giving appropriate disclosures to Enhance the Understandability of Financial Statements.

EXPLICIT & UNRESERVED STATEMENT:

An entity whose financial statements comply with Ind AS **shall make an explicit and unreserved statement of such compliance** in the notes.

An entity shall not describe financial statements as complying with Ind AS unless they comply with all the requirements of Ind AS. There may be disagreement between the Company and its auditor on the applicability of any Ind AS or any particular requirement of any Ind AS and accordingly auditor may qualify the audit report. Even in such a situation, the financial statements shall be assumed to be Ind AS compliant.

An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.

Departure from Ind AS

In extremely rare circumstances, if the management is of the opinion that compliance with provision of Ind AS would provide a mis leading view of financial statements, the entity may apply alternative accounting treatment but has to give the following disclosures.

a. Ind AS name and number
b. The provision not complied
c. Reasons for non-compliance
d. Alternative treatment adopted by the management
e. Financial effect due to such non compliance on current period & comparatives
f. Disclosure that company has achieved true & fair presentation and complied with all other IND AS.

If deviation not permitted by law:

Entity may have to deviate from Ind AS requirements to achieve fair presentation but legal requirements prohibit such deviation F.S. may not be prepared to give fair presentation due to limitation imposed by law. In such circumstances disclosures to be given to achieve fair presentation

Presentation of True of Fair View and compliance with Ind AS

- Of the financial position
- Of the financial performance
- Of the cash flows of an entity

Presentation of a true and fair view requires an entity to

- To select and apply accounting policies as per Ind AS 8
- To present information, in a manner that provides relevant, reliable, comparable and understandable information
- To provide additional disclosures, if required, to enable users to understand the impact of particular item

When an entity departs from a requirement of an Ind AS (in extremely rare circumstances), it shall disclose

- Management's conclusion that the financial statements present a true and fair view
- Management's compliance with applicable Ind AS, except departure from a particular requirement to present a true and fair view
-
  - The little of the Ind AS departed
  - The nature of the departure
  - The treatment that the Ind AS would require
  - The reason why that treatment would be so misleading; and
  - The treatment adopted
- For each period presented, the financial effect of the departure on each item in the financial statements

Note: An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.

ii. GOING CONCERN:

- In each year the management must assess whether the entity is a going concern or not.
- If entity concludes that it is going concern without any uncertainties then NO DISCLOSURE is necessary.
- If any material uncertainties exist but management establishes that going concern is valid then it has to disclose all such material uncertainties and the counter plan / actions & measures adopted by the management in the notes.
- If the management concludes that the entity is no more a going concern disclose
  - ✓ the fact that entity does not have going concern;
  - ✓ basis of preparation the financial statements; and
  - ✓ the reason why the entity is not regarded as a going concern.
  - ✓ the entity should account for all its assets at net realisable value OR on a liquidation basis but not on the historical cost basis;& The difference between the carrying amount and net realizable value should be taken to P&L a/c.

iii. ACCRUAL:

An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting. [ACCRUAL = Recognising assets, liabilities, incomes and expenses in accordance with IND AS Conceptual framework]

iv. MATERIALITY AND AGGREGATION:

a. Clubbing of items of income / expense is permitted when they have similar nature.
b. Dissimilar items should be presented separately and not to be clubbed unless they are immaterial.
c. Ind AS 1 requires that: Items of Dissimilar nature (e.g. CSR & Donation) Or Items of Similar Nature, Different class (Donation to political & non-political parties) **Should not**

be aggregated to obscure material information being presented/disclosed to users of Financial Statements (except if required by law) i.e Clubbing should not be done if it distorts the understandability of financial statements.

d. **Definition of Materiality:** Transaction or other events and information is material if omitting misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statement make on the basis of those financial statements, which provide financial information about a specific reporting entity.(Amendment)

e. Ind AS 1 also states that company should not combine immaterial information with material information.

f. Disaggregation of information of material items may be given on face of financial statements or in the notes.

NOTE: Information is considered as Obscuring/ misguiding if

i. Its vague & unclear
ii. Scattered across the Financial statements
iii. Clubbing dissimilar items
iv. Similar items inappropriately disaggregated
v. Information is hidden

g. In SPL a Separate disclosure is required for **EXCEPTIONAL ITEMS.** These Include.

a) Profit / Loss on sale of Fixed Assets or long term Investments
b) VRS Compensation
c) Litigation Settlements
d) Penalties Paid
e) Write down of Inventories to NRV
f) Restructuring Provisions
g) Any Abnormal losses

Note: In IND AS there is nothing classified as EXTRA ORDINARY ITEM.

v. OFFSETTING:

- Netting off income & expense or asset & liability while **presenting** financial information.
- An entity shall NOT offset assets and liabilities OR income and expenses, unless required or permitted by an Ind AS.
- Offsetting financial statement items is reasonable only when that reflects the substance of the transaction or other event. It should not lead to 'window dressing'. It should help the user to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows. Eg: reimbursement of expenses on behalf of third parties, setting off insurance claim with loss)
- In case of revenue (sales) in the ordinary course of business - it should present revenue separately and related expenses separately. So that users can analyze the performance during the period.
- If the transactions like sale of fixed assets, investments (non-current assets), foreign exchange gains and losses, it should present the gain or loss i.e. income after deducting the relevant expenses arising from the transaction. These do not generate revenue but are incidental to the main revenue-generating activities.
- When there is material gain on one transaction should not be offset with material loss on another transaction i.e. when foreign exchange gain and foreign exchange losses are material it should be disclosed separately.
- Measuring assets net of valuation allowances- for example, obsolescence allowances on inventory and doubtful debt allowances on receivables- is not offsetting.

vi . FREQUENCY OF REPORTING:

a) An Entity shall present a complete set of FS at least annually.

b) If it presents FS for a longer or Shorter period, it has to **disclose the reason** for the same and also **mention that the Figures in the FS are not entirely comparable.**

vii. COMPARATIVE INFORMATION:

a) The financial statements should be accompanied with at least comparatives for one year.

b) However, entity can also provide additional financial statements or some components thereof for periods preceding one year also. Such additional financial statements provided must also be in compliance with IND AS.

c) Along with the balance Sheet at the end of Current year we will give a Comparative Balance Sheet at the end of Previous year. **The Opening balance Sheet of previous year** is also required to be presented when there is a change in Accounting Policy, Rectification of Error, or when there is a major reclassification of Asset/liability/income/expense which has a material effect on the opening balance sheet of previous year.

When the entity changes the presentation or classification of items in its financial statements, the entity shall reclassify comparative amounts unless reclassification is impracticable.

viii. CONSISTENCY:

Company shall use consistent basis of accounting for similar items or items of similar class. Changes to be made only if

a) It provides better presentation

b) Change in nature of operations

c) Required by any IND AS.

Disclosures are required for changes in accounting policies giving the financial effect.

5. DISCLOSURES:

1. Material Accounting policy information:

(i) Material Accounting policy information (earlier called as significant accounting policies) shall be disclosed in notes. Accounting policy information is considered material when considered together with other information included in entity's financial statements, it can reasonably be expected to influence decisions that the primary users of financial statements.

(ii) Earlier companies had to disclose significant APs used in preparing FS and other policies relevant to understanding of FS which provided more of policies as envisaged in the standards rather than information specific to the entity with respect to selection and application of AP.

Hence now the information about AP would disclose what company is doing rather than just what is required to be ideally done as per IndAS

(iii). Accounting Policy (AP) information that relates to immaterial transactions, other events or conditions is immaterial and need not be disclosed.

(iv). AP information may nevertheless be material because of the nature of the related transactions, other events or conditions, even if the amounts are immaterial.

(v). AP information is expected to be material if users of an entity's FS would need it to understand other material information in the FS. For example, an entity is likely to consider AP information material to its FS if that information relates to material transactions, other events or conditions and:

a) the entity changed its AP during the reporting period and this change resulted in a material change to the information in the FS;
b) the entity chose the AP from one or more options permitted by Ind ASs;
c) the AP was developed in accordance with Ind AS 8 in the absence of an Ind AS that specifically applies;
d) the AP relates to an area for which an entity is required to make significant judgements or assumptions in applying an AP, and the entity discloses those judgements or assumptions
e) the accounting required for them is complex and users of the entity's FS would otherwise not understand those material transactions, other events or conditions—such a situation could arise if an entity applies more than one Ind AS to a class of material transactions.

(vi). Entity shall disclose, along with material AP information or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's APs and that have the most significant effect on the amounts recognised in the FS.

2. ACCOUNTING ESTIMATES:

Disclose any material uncertainty/Estimates involving significant uncertainty to be disclosed providing information on:

a) estimates used
b) sensitivity involved
c) range of possible outcomes
d) basis of selection of estimates

3. CAPITAL MANAGEMENT POLICIES:

An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital

4. OTHER DISCLOSURES

a) Proposed dividend

b) Dividends declared before approval of financial statements but yet to be paid.

c) Arrears of dividend on preference shares.

d) Ind AS 1 requires certain other disclosures, if not disclosed elsewhere in information published with the financial statements:

- ✓ the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office);
- ✓ a description of the nature of the entity's operations and its principal activities;
- ✓ the name of the parent and the ultimate parent of the group; and
- ✓ if it is a limited life entity, information regarding the length of its life.

e) Presentation currency of FS should be included.

OTHER MATTERS:

i. Always distinguish clearly between the Financial Statements and other statements / Reports attached with the FS.

ii. Ind AS 1 requires the Balance Sheet and SPL to consist specified line items. Ind AS 1 does not prescribe any format of FS. The format under schedule III Division II is in compliance with the Requirements of Ind AS 1.

iii. Current, Non-current classification, Meaning of operating cycle given Ind AS 1 is exactly similar to Schedule III.

iv. Ind AS does not specify any rounding off requirements. However Schedule III prescribes Rounding off limits based on Total income. It must be ensured that the rounding off units are consistently applied throughout the financial statements.

v. <u>LOAN – CLASSIFICATION</u>

a) If there is a breach in material provisions in the loan agreement as a result of which the loan becomes repayable on demand, the loan should be classified as current.

b) If After the Balance Sheet date but before approval of FS, the breach is rectified and the bank agreed not be demand repayment, the loan would be classified as Non Current.

c) By the balance Sheet date if the breach is not rectified but the bank has given additional time period for rectification.

   If additional period > 12m – classify the loan as Non current
   If additional time period allowed $\leq$ 12m – classify as current liability

d) When the loan is repayable with next 12m from Balance Sheet date, it will be classified as Current.

However if an Entity Enters into a refinancing arrangement to roll over the Existing loan liability beyond a period of 12m, the loan will be classified as Non Current.
If the entity obtains a new loan either from the same bank or a new bank, without any refinancing arrangement, the existing loan liability will retain its classification as current.

IND AS 37: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

1.OBJECTIVE

The objective of Ind AS 37 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions , contingent liabilities and contingent assets and sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount.

2.SCOPE

Ind AS 37 should be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:

a) those resulting from executory contracts, except where the contract is onerous; and

b) financial instruments (including guarantees) that are within the scope of Ind AS 109,Financial Instruments;

c) those covered by another Standard such as:

(i) **revenue from contracts with customers covered by Ind AS 115**. However, Ind AS 115 contains no specific requirement to address onerous contracts with customers. Hence, Ind AS 37 applies to such cases;

(ii) **income taxes (Ind AS 12, Income Taxes);**

(iii) **leases (Ind AS 116, Leases)**. However, this Standard applies to any lease that becomes onerous before the commencement date of the lease as defined in Ind AS 116. This Standard also applies to short-term leases and leases for which the underlying asset is of low value accounted for in accordance with paragraph 6 of Ind AS 116 and that have become onerous;

(iv) **employee benefits (Ind AS 19, Employee Benefits);** and

(v) **insurance contracts (Ind AS 104, Insurance Contracts)**.

(vi) **Contingent consideration** of an acquirer in a business combination (Ind AS 103, Business Combinations)

3. EXECUTORY CONTRACTS:

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.

For example

a) employee contracts in respect of continuing employment;

b) contracts for future delivery of services such as gas and electricity;

c) obligations to pay local authority charges etc are executory contracts.

4. **PROVISION** is a liability of Uncertain amount or timing.

5. **LIABILITY** is a present obligation as a result of Past Event, the Settlement of which results in outflow of Resources.

6. Obligation is a duty or responsibility. It arises due to

   I. **Legal obligation:** These arise due to binding Contracts, Statutory requirements or other operation of law:

   II. **Constructive Obligation:** These are Created due to Past practices, customs in the business, desire to maintain good relations, or a specific statement by the Entity etc, and which has created a valid expectation for others that entity will discharge the Obligation.

7. An **obligating event** is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

8. **<u>Present Obligation</u>**: an obligation will become a present obligation if based on Evidence available, its EXISTENCE on the Balance Sheet date is Considered Probable. [Probability of Existence Should be > 50%].

9. **<u>Possible Obligation</u>:** an obligation will become a possible obligation if based on Evidence available, its EXISTENCE on the Balance Sheet date is Considered Not Probable. [Probability of Existence Should be < = 50%].

10. <u>RECOGNITION CRITERIA FOR PROVISIONS</u>: Provision can be recognized only when ALL the following three Conditions are Satisfied.

i. There is a present obligation as a result of Past event

ii. It is probable that outflow of economic resources is required to settle the Obligation. [Probability of outflow > 50%]

iii. A reliable Estimate could be made towards the amount of Obligation.

11. CONTINGENT LIABILITY: A Contingent liability is

i. A possible Obligation arising as a result of past Event. The Existence of which will be confirmed by occurrence or non-occurrence of one or more uncertain future Events not wholly within the control of Enterprise. [OR]

ii. A present obligation but could not be recognised Since

a) Outflow resources is not probable (or)

b) A reliable Estimate could not be made.

Contingent Liabilities should not be recognised. **They should be disclosed in notes** unless the possibility of outflow is remote.

12. CONTINGENT ASSET:

i. It is a possible asset arising a result of past Event, the existence of which will be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of Enterprise.

ii. **Contingent Assets should not be recognised** since this may result in the recognition of income that may never be realised.

iii. However, when the Realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

iv. **A contingent asset should be disclosed, where an inflow of economic benefits is probable.**

v. 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.**

13. MEASUREMENT OF OBLIGATION

a) The amount of Obligation should be measured based on the best Estimates Considering Past Experience or reports from Experts.

b) When there are class of obligations, we should measure the obligation using expected value method, considering the probabilities given for each outcome

   Expected value = Σ(Loss amount x Probability)

c) If there is a Single obligation it should be measured on the basis of most likely outcome (Ignore Probabilities)

d) RISK ADJUSTMENT: Risk refers to variability of outcome. Risk adjustment should be made for the amount that would pay in excess of the expected value due to uncertainty attached with the outcome. This risk adjustment usually increases the amount of liability measured.

e) REIMBURSEMENT OF PROVISION: If there is a third party agreeing to reimburse the amount of provision, such reimbursement can be recognized as an Income only when it is virtually certain to be received. If reimbursement is not virtually certain do not recognize it as Income and asset. However, a contingent asset shall be disclosed.

f) DISCOUNTING OF PROVISION:

   While calculating the amount of provision, it should be measured on present value basis if time value of money is material, each year interest cost will be recognised and provision amount will be Increased to the desired Future value. This is called as UNWINDING OF DISCOUNT.

g) The nature & amount of obligation created shall be reviewed at the end of each year for any changes in estimates. Once the amount of the obligation is crystallised and there is no uncertainty associated with an obligation, the liability is no longer a provision. The same should be reclassified as an element within liabilities

14. SPECIAL CASES

A. ONEROUS CONTRACTS

A contract is said to the onerous if the Unavoidable cost of meeting the obligations Exceed the expected benefits from the Contract. The Entity has to recognize a provision for lower of the following.

a. Cost of Executing the Contract (or)
b. Damages Payable for terminating the Contract.

B. No provision should be created for future Expenditure that may be Incurred for which there is no past obligating event provision will not be recognised even if there is legal requirement to incur such expenditure.

C. If an entity is responsible for damage of Environment due to its past actions, it has to create a provision if there a law in place or enactment of such law is virtually certain.

D. If the acquisition of Property plant & Equipment Creates an obligation to Incur decommissioning, restoration cast the entity has to recognize a provision for such cost at its present value by capitalizing it to PPE [IND AS 16 + IND AS 37]

E. Use of Provisions:

a) A provision should be used only for expenditures for which the provision was originally recognised. Repurposing of the provisions is not allowed.

b) Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

F. Joint and Several Obligations:

If the conditions for provisions are satisfied, the entity will recognize a provision to the extent of its state of obligation. If should also disclose a contingent liability to the extent of other parties share.

G. Restructuring: Restructuring is a programme operated by the Management, which materially changes the scope of the Business or changes the manner of Conducting the business.Eg:- Sale / termination of a line of Business, Closure of business in certain areas, relocation of business etc.

i. The decision of Restructuring will result into certain Expenses / costs to be Incurred like Compensation payable to employees, Cost of Terminating Existing lease agreements, damages payable for non-fulfillment of Existing orders etc.
ii. A provision for these costs should be recognised if the recognition criteria satisfied.
iii. In this case the constructive obligation arises only when the Entity has
   a) A detailed formal plan of restructuring identifying the businesses concerned, the locations effected, the no of employees who will be terminated and compensated, estimated expenditure and the timeline of implementation of the plan.
   b) It has raised a valid expectation on these effected parties by announcing a plan to them.

Note: No announcement of Plan – No restructuring provision is required

If Decision to restructure is taken before the Balance Sheet date but it is announced after the Balance Sheet date before approval of accounts. It shall be treated as non adjusting event and hence NO provision has to be created.

iv. No provision should be created for future operating losses.
v. The Entity Shall not recognize any expected Gain on disposal of assets.

15. GENERAL POINTS:

1. This Standard does not cover any provisions relating to assets.
2. O/s Expenses / Accrued Business Expenses are not provisions since there is no uncertainty about amount / timing

16. DISCLOSURE OF PROVISION IN FINANCIAL STATEMENTS

Provision

An entity should disclose for each class of provision:

- The carrying amount at the beginning and end of the period with movements by type including:
  - Additional provisions in the period including increases to existing provisions;
  - Amount used; Amount reversed;

- Increase during the period of any discounted amount arising due to the passage of time or change in rate;
- Comparative information not required.

- A brief description of the nature of the obligation and expected timing of the expenditure;
- An indication of the nature of the uncertainties about the amount or timing of the outflows;
- The amount of any expected reimbursement with details of asset recognition.

Contingent Liabilities

For each class of contingent liability, unless the contingency is remote, discloses:

- A brief description of the nature of the contingency and where practicable;
- The uncertainties that are expected to affect the ultimate outcome of the contingency;
- An estimate of the potential financial effect;
- The possibility of any reimbursement.

Contingent Assets

For each class of contingent asset, when the inflow of economic benefits is probable, discloses:

- A brief description of the nature of the contingency and where practicable;
- An estimate of the potential financial effect.

Prejudicial information

In extremely rare cases, disclosure of some or all of the information required above might seriously prejudice the position of the entity in its negotiations with other parties in respect of the matter for which the provision is made. In such cases the information need not be disclosed, but entities should:

- Recognize a provision;
- Explain the general nature of the provisions; and
- Explain the fact and reasons why that information has not been disclosed;

A brief description of the nature of the contingency and where practicable.

IND AS 23 BORROWING COSTS

1. **Borrowing cost that are directly attributable to acquisition, construction and production of Qualifying asset should be capitalized.** Such Capitalization can be done only when

   i. The asset is capable of yielding future economic benefits and
   ii. The Borrowing cost can be measured reliably.

   Other borrowing costs are recognized as an expense in the period in which they are incurred.

2. **Qualifying Asset**: - A qualifying asset is an asset which necessarily takes substantial period to get ready for its Intended usage or sale. What is substantial period depends on facts and Circumstances of each case. Example of Qualifying asset include buildings under construction, P&M under construction, Intangible asset under development, construction of dams, ships, refineries, Inventory that takes substantial period of time, Tangible fixed assets which takes substantial time for delivery & Installation.

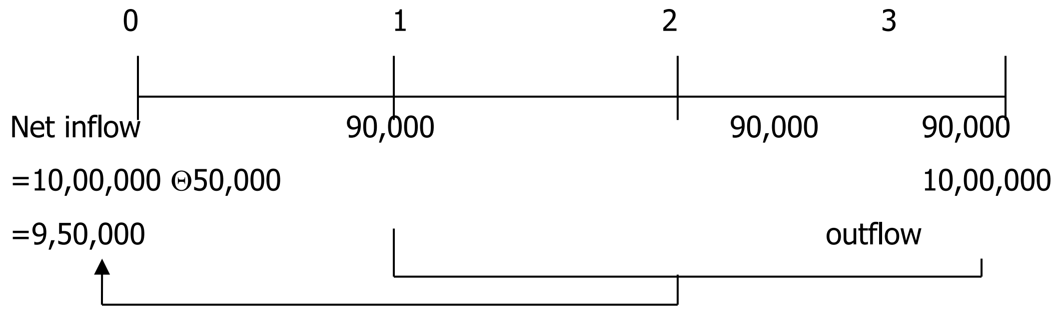
   Financial assets and inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets.

   Assets that are ready of their intended use or sale when acquired are not qualifying assets.

3. **Borrowing Costs**: Borrowing costs are Interest and other costs incurred in relation to borrowing of funds. It includes

   a) Interest Expense calculated using effective interest rate method.
   b) Finance charges in case of Finance lease
   c) Exchange differences on foreign currency borrowing to the extent they are regarded as adjustment to interest costs.

Example 1: A Ltd has made a Borrowing of Rs 10 lacs @ 9% p.a. The loan is to be repaid after three years. A Ltd has paid processing charges of Rs 50,000. Calculate the effective interest Rate. Effective Interest Rate is the interest rate computed considering the net inflow at the time of Borrowing and various outflows for Repayment of borrowing. EIR is to be computed using IRR method. It is that discounting rate which equates the PV of future cash outflows to the net Inflow today.



1st Trial @ 10%

PV of COF's = 90,000 x PVIFA (10%,3) + 10,00,000 x PVIF (10%, 3)

= 90,000 x 2,4868 +10,00,000 x 0.7513

= 9,75,112

2nd trial @ 12%

PV of COF's = 90,000 x PVIFA (12%, 3) + 10,00,000 x PVIF (12%, 3)

= (90,000 x 2.4018) + (10,00,000 x 0.7118)

= 9,27,945

EIR is in between 10% & 12% we have to Interpolate

@ 10% rate → PV of COF's = 975112

@ 12% rate → PV of COF's = 927945

For Δ of 2% → Δ in PV of COF's = 47167

?? ← Desired Δ decrease in PV of COF's

= 975112 – 9,50,000

= 25,112

= $25{,}112 \times \frac{2}{47{,}167}$

= 1.06% Desired change in%

∴ EIR = 10% + 1.06%

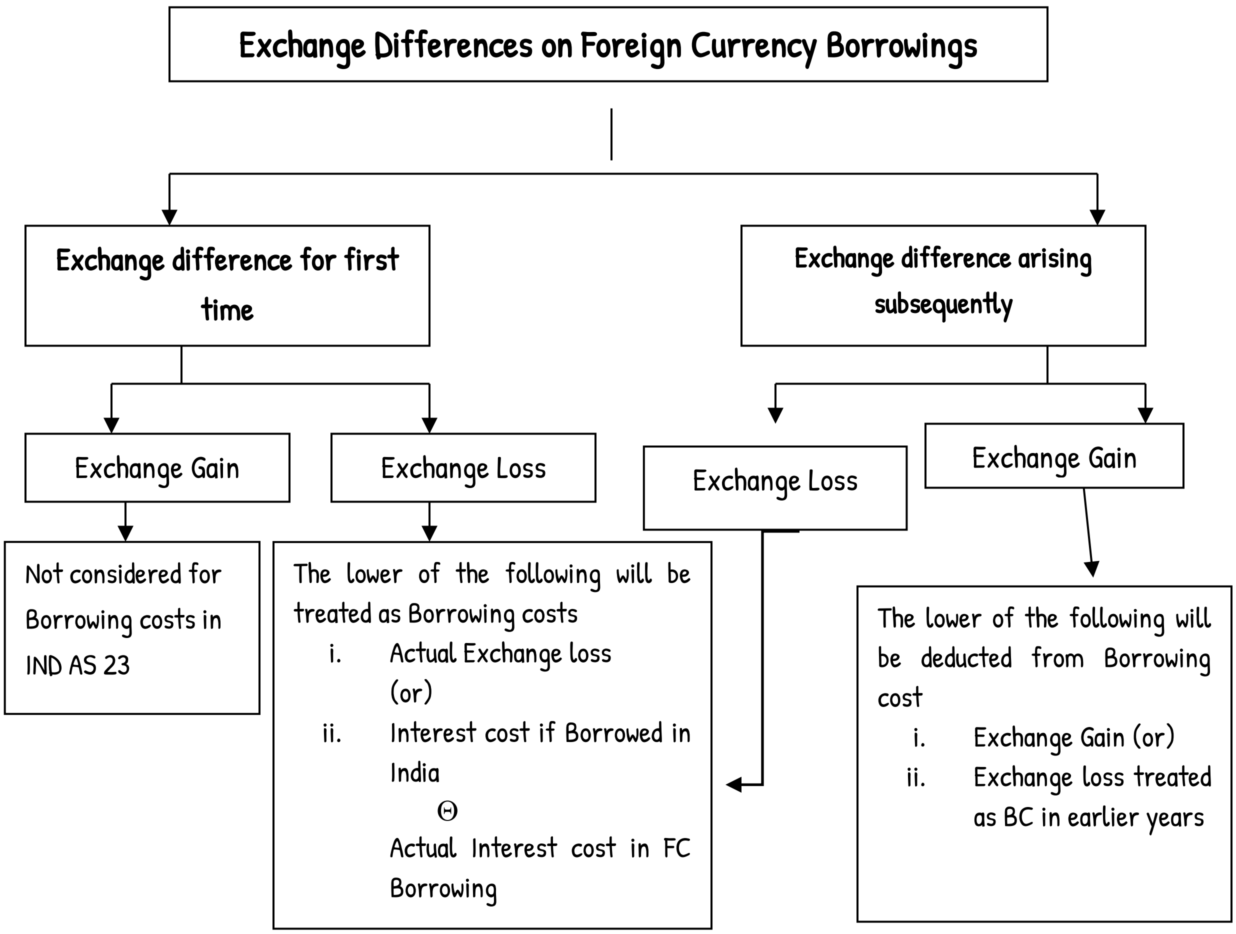
= 11.06%

Loan A/c

To Bank (Processing charges)	50,000	By Bank @ End of 1st year	10,00,000
To Bank	90,000	By Interest Exp [9,50,000 x 11.06%]	105070
To Bal c/d	9,65070		
To Bank	90,000	By Balance b/d	9,65070
To Bal c/d	981807	By Interest Exp	106737
To Bank [90,000 + 10,00,000]	10,90,000	By balance b/d	9,81,807
To Bal c/d	NIL	By Interest Exp [9,81,807 x 11.06%]	108193 (b/fig)

NOTE 1: EXCHANGE DIFFERENCES ON FOREIGN CURRENCY BORROWINGS

Entities make FC borrowings to take the advantage of lower Interest Rates. If such FC borrowing is used for a Qualifying asset, the Borrowing cost will be capitalized. On the FC Borrowings there may be an Exchange loss some portion of this loss will be treated as a Borrowing cost and will be capitalized.



Example 2: A Ltd has taken a Borrowing of 1,00,000$ @ 4% from a US Bank on 01.04.2016. The spot Rate on that date is 1$ = Rs 50. The above loan is used for construction of a plant & Machinery. A Similar loan could be obtained in India @ 10%.

At the end of First year the Exchange Rate was

Case (i): - 1$=Rs 54

Case (ii): - 1$=Rs 51

Calculate the Total Borrowing Cost that can be capitalized.

Example 3:- On 01.04.2016 R Ltd has made a Borrowing of 40,000$ @2% from a US Bank. The Exchange Rate on that date is 1$ = Rs 59. The Borrowing rate in India is 8%. The closing exchange Rate in on 31.03.2017 1$ = Rs 63 and on 31.03.2018 1$ = Rs 61. Calculate the Borrowing cost for the both years 2016-17 & 2017-18.

Example 4:- ABC Ltd has made a Borrowing of Rs 100,00,000 @ 10% repayable after 8 years. The Borrowed amount if used for construction of Qualifying asset.
After 3 years, the company sold a division and out of the proceeds realised it has made a part repayment of the loan to the extent of 30,00,000. It also that to pay pre payment charges of Rs 1,50,000. Can Prepayment charges be treated as Borrowing Cost.

Solution:

Borrowing costs would cover only those Expenses which are Incurred for arrangement of Borrowings. It does not Include cost on settlement / Extinguishment of Borrowings.

COMMENCEMENT OF CAPITALIZATION

An Entity is required to begin the capitalization of Borrowing cost from the commencement date. It is the date when the entity has **first met** all the following three conditions cumulatively.

1) It Incurs Expenditure an Qualifying asset
2) It Incurs Borrowing costs
3) It undertakes activities necessary to prepare the asset for the intended use or sale.

Note 1 : Expenditures on a qualifying asset include:

a) Those expenditures that have resulted in payments of cash
b) transfers of other assets
c) assumption of interest-bearing liabilities

Expenditures are reduced by any progress payments received and grants received in connection with the asset.

Note 2: The activities relating to Qualifying asset includes technical / admin work prior to commencement of physical construction. Eg: Obtaining permits from relevant authorities.

It doesn't include the holding of an asset when no production or development that changes the asset's condition is taking place.

For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

SUSPENSION OF CAPITALISATION

a) Entity is required to suspend capitalization of Borrowing cost during extended periods in which active development is interrupted.
b) However, if there is any temporary delay which is normal and acceptable borrowing cost capitalization need not be suspended.

CESSATION OF CAPITALIZATION

a) Cessation refers to stoppage of capitalization forever. Capitalization should be ceased when **substantially all** the activities necessary to prepare the Qualifying asset for its intended usage / sale are complete.
b) When an Entity completes construction of Qualifying asset in parts and each part is capable of being used while construction continues on the other parts, the Entity can cease capitalization of BC relating to that part which is completed.
c) For a qualifying asset that needs to be complete in its entirety before any part can be used as intended, it would be appropriate to capitalise related borrowing costs until all the activities necessary to prepare the entire asset for its intended use or sale are substantially complete.

SPECIFIC AND GENERAL BORROWINGS

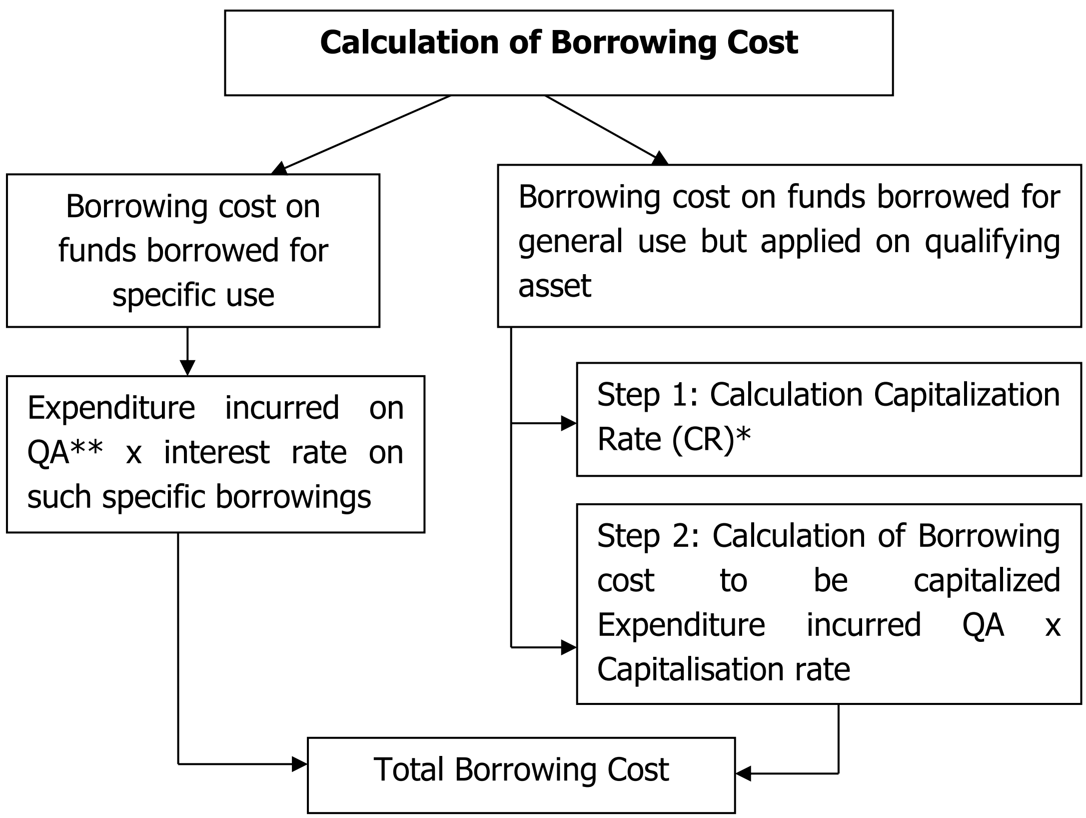
a) When a borrowing is made Exclusively for the purpose of acquisition, production, or construction of a Qualifying asset. It is referred as specific Borrowing.
   BC to be capitalized = **Actual** Borrowing Costs incurred – income on temporary investment of borrowed funds.
b) When Borrowings are made from various sources to be used for various purposes including Qualifying assets, the Borrowings are referred as General Borrowings.
c) In case of General Borrowings identification of Borrowing cost to Qualifying asset is not direct.

d) When the funds are borrowed generally for the purpose of obtaining a qualifying asset, the entity shall **determine the amount of borrowing costs eligible for capitalisation** by applying a **capitalisation rate** to **the expenditures on that qualifying asset**.

e) The capitalisation rate is the weighted average of the borrowing costs applicable to all the general borrowings of the entity that are outstanding during the period.

f) Borrowing costs in respect of specific funds borrowed for the purpose of obtaining a qualifying asset shall be excluded from calculation of capitalisation rate until substantially all the activities necessary to prepare that qualifying asset for its intended use or sale are complete.

g) The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.



$$\text{*CR} = \frac{\text{Weighted average borrowing costs on outstanding borrowings of the entity (excluding specific borrowings cost)}}{\text{Total outstandidng borrowings of the entity during the period (excluding pecific borrowings)}}$$

**QA = Qualifying Asset

Step 1: Calculate weighted average capitalization rate on general Borrowings:

$$= \frac{\text{Total Interest cost on General Borrowings}}{\text{Weighted average General Borrowings outstanding duringthe year}} \times 100$$

Step 2: Calculate the Expenditure Incurred on the Qualifying asset. financed form general Borrowings.

Step 3: Borrowing cost relating to general Borrowings that should be Capitalized = Average Expenditure on Q.A out of General Borrowings ⊗ Capitalization Rate

= Step 2 ⊗ Step 1

EXPENDTURE TO WHICH CAPITALISATION RATE IS APPLIED:

- In determining the borrowing costs to be capitalised, the amount of expenditure on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities.
- Expenditures are reduced by any progress payments received and grants received in connection with the asset (see Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance).
- The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalisation rate is applied in that period.

OTHER RELEVANT CONCEPTS

IMPAIRMENT TESTING

After capitalizing the Borrowing cost to the Qualifying asset, we must ensure that the ultimate carrying amount of Qualifying asset does not Exceed its Recoverable amount or NRV.

If it Exceeds such Recoverable amount or NRV, the Excess amount shall be reduced from the Qualifying asset in accordance with other IND AS.

DIVIDENDS PAYABLE ON SHARES CLASSIFIED AS FINANCIAL LIABILITIES

- An entity might finance its operations in whole or in part by the issue of **preference shares** and in some circumstances these will be **classified as financial liabilities** (as per Ind AS 32). **Dividends payable** on these instruments would **meet the definition of borrowing costs**, subject to the fulfillment of certain conditions.

CAPITALIZING BORROWING COST IN GROUP FINANCIAL STATEMENTS

- There may be a situation when the borrowings are taken by one company and qualifying asset is developed by another company within a group.
- It may be **appropriate to capitalise interest in the group financial statements** on, borrowings that appear in the financial statements of a different group entity from that carrying out the development.
- Based on the underlying principle of Ind AS 23, capitalisation in such circumstances would only be appropriate if the amount capitalised fairly reflected the interest cost of the group on borrowings **from third parties** that could have been avoided if the expenditure on the qualifying asset were not made.
- However, **the entity carrying out the development should not capitalise any interest in its own financial statements** as it has no borrowings.
- If, however, the entity has **intra-group borrowings** then interest on such borrowings may be **capitalization its own financial statements.**

CESSATION OF CAPITALIZATION FOR MATURING INVENTORIES

- For maturing inventories, it is sometimes difficult to determine when the 'period of production' ends, i.e. when inventories are being held for sale as opposed to being held to mature.

Example

Whisky is 'mature' after three years, but goes on improving with age for many more years. Provided that it is consistent with the entity's business model to hole such items so that they mature further, it would seem acceptable to continue to add borrowing costs to the value of such maturing inventories for as long as it can be demonstrated that the particular item of inventory continues to increase in value solely on account of increasing age, rather than because of market fluctuations or inflation.

If this cannot be demonstrated, then the inventories should be regarded as held for sale and no further borrowing costs should be capitalized.

DISCLOSURES

1) The amount of Borrowing cost capitalization during the year
2) The weighted average Capitalization rate on general Borrowings

Example 5 If an asset is acquired in a ready to use condition but such asset can be used in a project along with various others assets which will take substantial period of time to get ready. Can the Readymade asset acquired be treated as a Qualifying asset.

Sol: Any asset which takes substantial period of time to get ready for its Intended use / sale is a Qualifying asset. If the Intention of management is to use this asset along with other assets then this asset should be treated as a Qualifying asset.

Example 6 Can the Advance given for acquisition of a readymade asset can be treated as a Qualifying asset or not.

Sol: If the asset does not take substantial period of time to get ready for its Intended usage, the advance cannot be treated as a Qualifying asset.

However if the advance is given for the asset or will take substantial period of time for Installation. It can be treated as a Qualifying asset.

Example 7 Capital advance Granted to manufacture machine from Borrowed funds. But the manufacturer has not commenced the development of it, can the Borrowing cost on the advance given be capitalized.

Sol: Capitalization of BC can commence only when the work relating to Qualifying asset has Commenced. In the given case since the work is not commenced borrowing cost cannot be capitalized.

IND AS 16: PROPERTY PLANT AND EQUIPMENT

1. The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment.

2. PPE are tangible item of assets held for use in
   i. Production of Goods
   ii. Rendering of Services
   iii. Administrative purpose
   iv. Giving on rentals to others

   AND

   These assets are expected to have a life more than one accounting period.

3. This standard is not applicable to
   i. Biological assets (living plant and animal) except bearer plants.
   ii. Recognition and measurement of exploration and evaluation assets. (IND AS 106)
   iii. Mineral rights, mineral reserves such as oil, natural gases etc.
   iv. PPE held as Classified for sale as per IND AS 105

   Note: Accounting of Investment properties is covered by IND AS 40, However IND AS 16 is relevant for measurement and depreciation aspects.

4. **Bearer Plant:** Bearer plant is a plant that is
   i. Used in the production or supply of agricultural produce &
   ii. It is expected to bear produce for more than 12 months.
   iii. Has a remote chance of being sold other than as incidental scrap sale.

   Note: Annual crops like wheat, etc are not Bearer plants. Trees grown for the purpose of wood are also not bearer plants.

5. Recognition Criteria for PPE:

PPE can be recognized as an asset only when the following conditions are satisfied.

1) It is probable that future economic benefits associated with the asset will flow to the entity (probability > 50%)
2) The Cost can be measured reliably.

Notes:

1) Future Economic benefits means increase in revenue or decrease in cost or both.
2) Future economic benefits can arise directly or indirectly from the assets. Therefore, safety and environment equipment maintained in the business are also recognized as PPE since they provide indirect benefits
3) Major Spare parts and Stand-by Equipment are treated as PPE, if they are expected to be use for more than one accounting period. General Spares of minor value are treated as Inventory and will be transferred to P&L when they are Consumed.

6. INITIAL MEASUREMENT OF PPE

I. WHEN ASSET IS PURCHASED FOR CASH / CREDIT:

Purchase Price	XXX
(+) Non Refundable taxes	XXX
(-) Rebates & discounts	(XXX)
(+) Delivery & Handling charges (Transport, Insurance, loading & Unloading charges)	XXX
(+) Site preparation costs	XXX
(+) Installation Expenses	XXX
(+) Professional & Technical fees Incurred for supervision of Installation	XXX
(+) Trial Run Expenses less Sale proceeds of output in Trial Run	XXX
(+) Borrowing costs if permitted by IND AS 23	XXX
(+) PV of decommissioning, Restoration and other obligations (DROL)	XXX
TOTAL	**XXX**

NOTE 1: DECOMMISSIONING COSTS

The decommissioning / dismantling cost to be incurred on a future date should be capitalized to the cost of the asset on present value basis.

Example A machinery is purchased and installed at a cost of Rs 5,00,000. It has a life of 3 years. after which it must be decommissioned. The estimated cost of decommissioning is Rs 53,240. The discounting rate is 6% p.a. show necessary accounting for all the three years.

WN- 1

1) Estimated cost of decommissioning: 40,000
2) PV of Decommissioning cost = 53240 x PVIF (6%, 3yrs) = 53240 x 0.8396 = 44700

Journal Entries

a) For recognition of PPE

PPE (Machinery) A/c	Dr	5,44,700	
To Bank			5,00,000
To provision for decommissioning			44,700

b) At the end of each year:

Particulars	1		2		3	
i. **For unwinding of discount** Interest cost A/c Dr To Prov. for decomm	2689 [44700 x 6%]		2843 [47362x 6%]		3015 [5022x 6%]	
Cl. Bal of provision	**47382**		**50225**		**53240**	
ii. P&L A/c Dr To Interest cost A/c	2682	2689	2843	2843	3015	3015
iii. **At the end of 3rd year** Prov. for decomm Dr TO Bank		53240 53240				

Note 2: Do not Include following costs as they are not directly attributable costs:

1) Cost of opening new facility [Inauguration expenses]
2) Advertisement & sales promotion expenses
3) Admin and general overheads.
4) Relocation expenses of Employees and facilities during the period of Installation
5) Training costs on employees to Operate the asset
6) Initial operating losses (If PPE is operating @ less than Normal capacity)

Note 3: Do not Deduct the following Incomes from the cost of the asset.

1) Any Rental Income received on letting of Property, before its getting ready for usage.
2) Any Damages received for late delivery of the asset

Note 4: Purchase of asset on deferred Settlement terms.

1) Deferred settlement terms means purchase of an assets @ credit period which is beyond the normal credit period.
2) In these cases the purchase price of the asset includes interest component, which has to be eliminated. The asset should be capitalized at cash price.i.e at the present value.

II. SELF CONSTRUCTED ASSETS & BEARER PLANTS

a) All the actual costs incurred towards material, labor and other related overheads for the **construction activity** shall be capitalized.
b) DO NOT Include any internal / Notional profits
c) Borrowing costs can be capitalized subject to IND AS 23.
d) Do not capitalize abnormal losses during construction
e) Bearer plants are accounted for in the same way as above & references to 'construction' in this Standard should be read as covering activities that are necessary to cultivate the bearer plants before they are in the location and condition necessary to be capable of operating in the manner intended by management.

III. PPE ACQUIRED BY EXCHANGE OF ASSET

When a PPE is acquired by way of an exchange of asset, the asset acquired **shall be recognized at the fair value** provided the following conditions are satisfied.

1) The exchange transaction has commercial substance.
2) The fair value of asset acquired, or asset given up can be determined.

If any of the above the conditions is not satisfied, the incoming asset should be recognized at **book value of asset given up**, after adjusting for any cash Received/ paid and ensure that there is no Gain / loss in the exchange.

COMMERCIAL SUBSTANCE

Commercial substance means the 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 i.e cash flows arising from the new asset acquired should be substantially different from the existing asset given up.

Situation 1: **WHEN THE EXCHANGE HAS A COMMERCIAL SUBSTANCE AND FAIR VALUE CAN BE DETERMINED.**

Assume Existing asset given up is B &
New asset being acquired is A.

Case (i) No cash is Involved

PPE – A	Dr	Fair value	
To PPE – B A/c			Book value

Any difference in the above entry is a Gain / loss transferred to P&L A/c

Case (ii):- If cash is also Involved along with exchange of asset

PPE – A A/c	Dr	Fair value	
Cash A/c	Dr	Cash Received	
To PPE – B A/c			Book value
To Cash A/c			Cash paid

Any Difference in the above entry shall be transferred to P&L A/c.

SITUATION 2: THE TRANSACTION LACKS COMMERCIAL SUBSTANCE OR FAIR VALUE CANNOT BE DETERMINED.

Case (i):- If No cash is Involved

PPE – A A/c	Dr	Book value of PPE - B
To PPE – B A/c		Book value

There will be no difference in the above Entry

Case (ii):- If cash is also involved along with exchange of assets

PPE – A A/c	Dr	[BV of PPE B + Cash paid - Cash Recvd]
Cash A/c	Dr	Cash Received
To PPE – B A/c		Book value
TO Cash A/c		Cash paid

There will be no difference in the above Entry

7. SUBSEQUENT EXPENDITURE INCURRED ON PPE

a) If the cost incurred is capable of yielding incremental future Economic benefits, such cost can be capitalized.
b) Regular maintenance / Servicing costs shall be treated as an expense in P&L A/c.

8. COMPONENT ACCOUNTING

Some items of assets like Aircrafts, ships, power generation facilities, Gas turbines Etc are an assembly of various parts which have different useful lives.

The standard requires that accounting is to be done for each component that has a different useful life.If any existing component is replaced with a new component the cost of new component will be capitalized and any Existing carrying amount of replaced component shall be derecognized .

9. MAJOR OVERHAUL / INSPECTION COSTS

a) Performing major Inspections for any faults in the assets, at regular Intervals may be a pre-condition for usage of assets (Eg: Ships and aircrafts)
b) These major Inspection / overhaul costs has to be capitalized to the cost of PPE. Any unamortized balance of past overhaul costs shall be de-recognized.

10. SUBSEQUENT MEASUREMENT AFTER INITIAL RECOGNITION

a) The Entity has to choose between the following two options

1. Cost model
2. Revaluation Model

b) The choice made by the Entity will become its accounting policy.

c) COST MODEL:

The carrying amount of the asset will be presented as under

Original Cost	xxx
(-) Accumulated Depreciation	(xxx)
(-) Accumulated Impairment loss	(xxx)
Carrying amount	**xxx**

d) REVALUATION MODEL

i. The carrying amount of asset =

Fair value of asset on Previous revaluation	Θ	Subsequent accumulated depreciation	Θ	Subsequent accumulated Impairment loss

ii.

Frequency of Revaluation

If fair value changes are Significant	**If fair Value changes are not significant**
Revalue the asset each year	Revalue the asset for every 3-5 years

The objective is to ensure that there is no significant difference between the carrying amount & the Fair value.

iii. Class of assets:

An Entity can choose to apply either cost model or Revaluation model. However this choice has to be for entire class of the assets. Class of assets means assets having **similar nature & usage.** Eg: land & Building, machineries, Furniture, office Equipment, vehicles, Bearer plants etc. Each class of asset may even have **further sub classes** depending on their nature and usage. For Example the buildings of the enterprise further divided into

a. Buildings for office use
b. Buildings for Industrial use

iv. Presentation of Revaluation

Accounting for Revaluation can be done in any of the Following two alternatives.

Alternative 1:

Increase / Decrease **the original cost of the asset** and **also accumulated depreciation proportionately** to the extent of Increase / Decrease required in the carrying amount

Alternative 2:

Cancel the accumulated depreciation and restate original cost of the asset if required.

Example:

	Existing	Alternative 1	Alternative 2
Original cost	1000	2000	800
(-) Accumulated dep	(600)	(1200)	Nil
Carrying amount To be revalued to 800	**400**	**800**	**800**

Journal entry for Alternative 1 is:

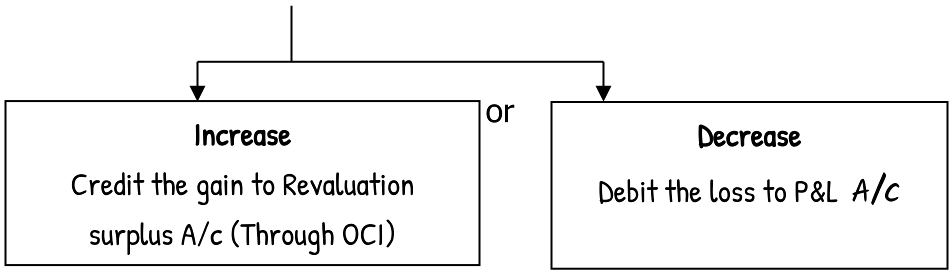
Machinery A/c Dr 1000
To Accumulated depreciation 600
To Revaluation Surplus 400

Journal entry for Alternative 2 is:

Accumulated depreciation 600
To machinery A/c [1000 Θ 800] 200
To Revaluation surplus 400

v. ACCOUNTING TREATMENT OF REVALUATION GAIN / LOSS

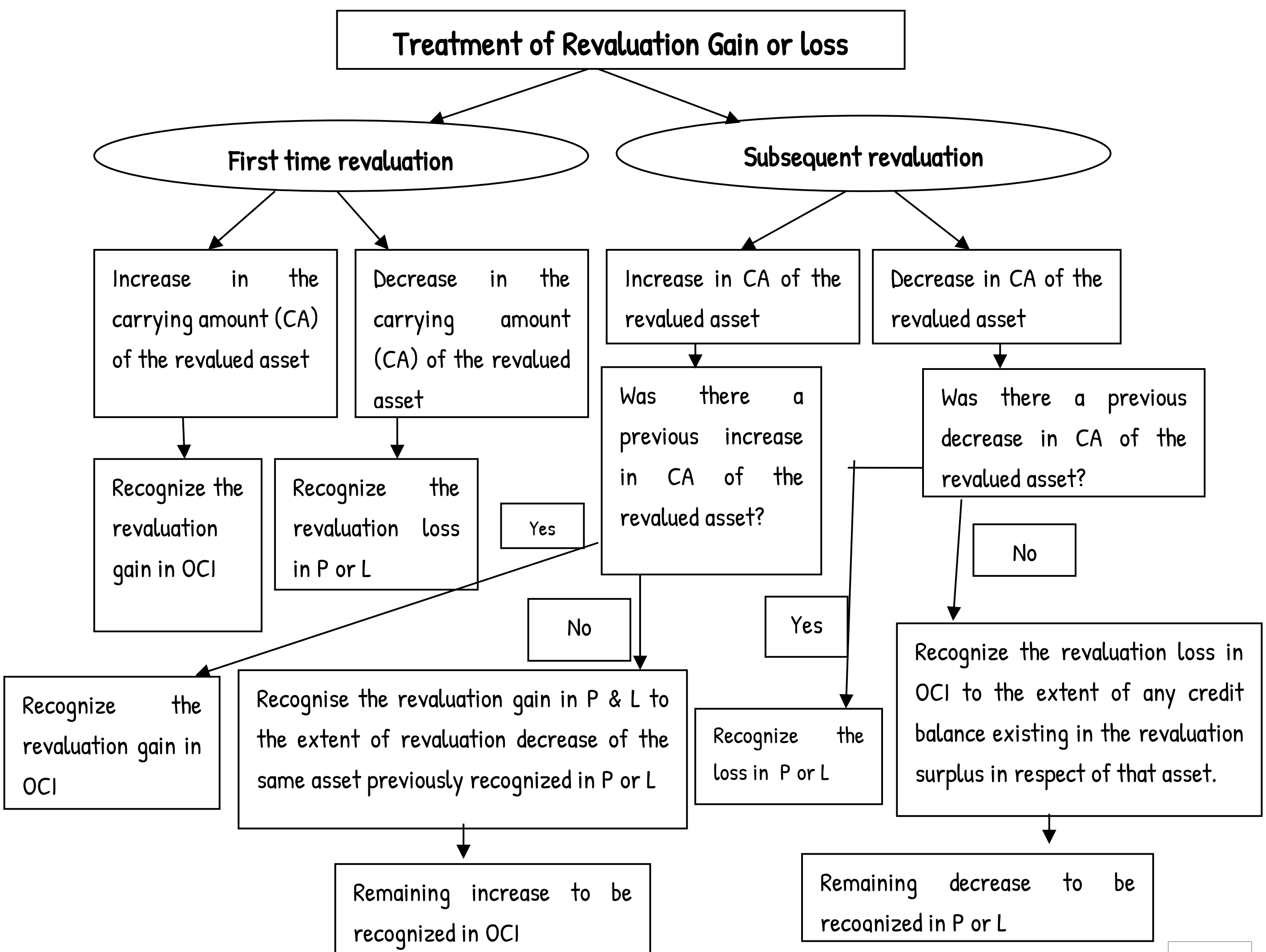
1) First time Revaluation



2) Subsequent Revaluation:

a. Earlier Increase Now Decrease: Adjust the loss against Revaluation Reserve and any further loss to be debited to P&L A/c

b. Earlier decrease, Now Increase: Credit the Gain to P&L A/c to the extent of earlier decrease and any further gain to be credited to Revaluation Reserve.



Utilization of Revaluation Surplus:

Alternative 1: When there is an upward Revaluation there will be an Increased depreciation in P&L A/c. To the Extent of such excess depreciation, a transfer can be made from Revaluation Reserve to Retained Earnings. (This is a adjusted in their Equity don't credit to Statement of Profit and Loss)

Revaluation Surplus A/c Dr
To Retained Earnings

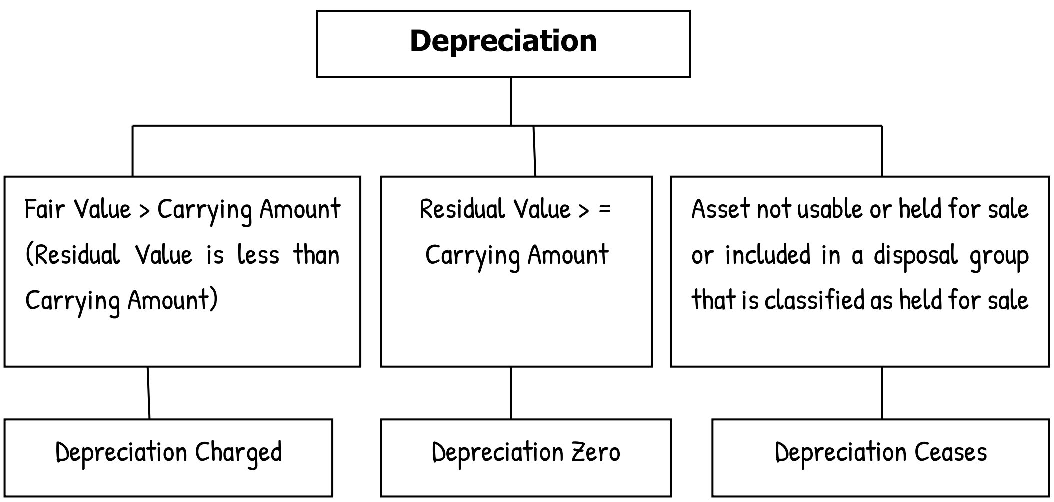
Alternative 2:

The Revaluation Surplus will be maintained as it is till the asset is derecognized on derecognition of asset transfer the entire Revaluation surplus to retained earnings.

11.DEPRECIATION

1) Depreciation is a systematic allocation of a depreciable amount of the PPE over the expected useful life of the asset.
2) Depreciable Amount = Cost of the asset Θ Expected Residual value.
3) The amount of depreciation depends on
   i. Cost of the asset
   ii. Expected useful life of the asst
   iii. Expected Residual value of the asset
   iv. Method of Depreciation
4) The entity should apply a method of depreciation which is in consistence with the future economic benefits that are expected from the asset. There are various methods of depreciation. Most used methods are
   a) Straight line method.
   b) WDV.
   c) Depreciation based on no of units produced.
5) The Entity has to annually review the estimates of useful life, Residual value and method of depreciation.

6) Any change in the Expected useful life or expected residual value or a change in method of depreciation would require a prospective effect. All these changes are treated as changes in ACCOUNTING ESTIMATE.
7) Depreciation will commence when the asset is ready for usage.
8) Depreciation will cease when
   a) When the asset is Derecognized (or)
   b) When the PPE is held for sale in accordance with IND AS 105.
9) There will be no depreciation in a year in the following two situations.
   a) The entity adopts depreciation based on no. of units produced and there is no production in the Current year (or)
   b) The Entity is required to review the residual value of the asset at the end of each year. If on each such assessment, Existing Book Value of asset $\leq$ Expected Residual value $\rightarrow$ NO DEPRECIATION



10) Depreciation is normally recognized as an expense in P&L A/c. However it may be capitalized if this PPE is used in Construction of another PPE.

12. CHANGES IN ESTIMATES FOR DECOMMISSIONING AND RESTORATION COSTS:

1) At the initial recognition of PPE, the Present value of Decommissioning costs will be capitalized as a part of PPE.
2) Subsequently there may be a change in the estimate of these costs to be Incurred resulting into an Increase / decrease of the liability.
3) The accounting treatment of this change in the estimate depends on whether the entity is following cost model or Revaluation model.

CASE (1): - ENTITY FOLLOWS COST MODEL:

a) <u>If there is an Increase in liability</u>

PPE A/c Dr

To Provision for Decommissioning

Note: Due to the above entry the carrying amount of the asset will Increase. If it exceeds the Recoverable amount Impairment loss must be recognised as per IND AS 36.

b) <u>If there is a decrease in liability:</u>

Provision for decommissioning A/c Dr

To PPE A/c

Note:- If the decrease in liability exceeds the book value of the asset, the additional decrease in the liability shall be credited to P&L A/c.

In case of Leased Asset , we shall adjust it to ROU ASSET capitalized as per Ind AS 116.

CASE (2):- ENTITY FOLLOWS REVALUATION MODEL:

The Increase / decrease in the value of liability should not be adjusted to the cost of PPE. Increase in liability is treated as Revaluation loss and decrease in liability is treated as Revaluation Gain.

a) If there is an Increase in Liability:- REVALUATION LOSS

Revaluation Surplus A/c Dr [To the extent available]

P&L A/c Dr [Bal. Fig]

To Provision for decommissioning costs

b) If there is a decrease in Liability REVALUATION GAIN

Provision for decommissioning costs Dr

To P&L A/c [To extent of Revaluation loss debited to P&L earlier]

To Revaluation Surplus A/c [Bal. fig]

13. DERECOGNITION OF PPE

An item of PPE should be derecognized,

a) When it is sold / discarded.

b) When it is estimated that PPE is not capable of Generating any future economic Benefits.

Any Gain / loss on derecognition shall be recognized in P&L A/c. Any existing Revaluation surplus relating to the asset shall be transferred to Retained Earnings.

Derecognition date

The date of disposal of an item of property, plant and equipment is the date the recipient obtains control of that item applying the principles in Ind AS 115 Revenue from contracts with customers, for sales of goods.

14. IMPAIRMENT

- To determine whether an item of PPE is impaired an entity applies Ind AS 36, Impairment of Assets.
- Impairment losses are accounted for accordance with Ind AS 36.

Compensation for impairment

In certain circumstances a third party will compensate an entity for an impairment loss. For example, insurance for fire damage or compensation for compulsory purchase of land for a motorway. Such compensation must be included in profit or loss when it becomes receivable. Recognizing the compensation as deferred income or deducting it from the impairment loss or from the cost of a new asset is not appropriate.

15. DISCLOSURE

a) For each class

- Measurement bases used for determining gross carrying amount
- Depreciation method used.
- Useful lives or the depreciation rates used.
- Gross carrying amount and accumulated depreciation at beginning and end of period. Accumulated impairment losses are aggregated with accumulated depreciation.
- A reconciliation of carrying amount at beginning and end of period showing:

- Additions (i.e., capital expenditure);

- Assets classified as held for sale and other disposals; - Acquisitions through business combinations;
- Increase/decrease resulting from revaluations;
- Impairment losses (i.e., reductions in carrying amount);
- Reversal of impairment losses;
- Depreciation;

b) The financial statements shall also disclose:

- the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
- the amount of expenditures recognized in the carrying amount of an item of property, plant and equipment in the course of its construction;
- the amount of contractual commitments for the acquisition of property, plant and equipment; and
- if it is not disclosed separately in the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

c) Selection of the depreciation method and estimation of the useful life of assets are matters of judgement.

d) In accordance with Ind AS 8 an entity discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods.

IND AS 38: INTANGIBLE ASSETS

1. OBJECTIVE OF IND AS 38 :

The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard.

2. **SCOPE:** This Standard shall be applied to all intangible assets, except:

a) intangible assets that are within the scope of another Standard, for example: Intangible assets held for sale in the ordinary course of business (Ind AS 2), Deferred tax assets (Ind AS 12), Leases of intangibles assets (Ind AS 116) , Goodwill arising in a business combination (Ind AS 103), Non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) (Ind AS 105).

b) financial assets, as defined in Ind AS 32

c) the recognition and measurement of exploration and evaluation assets (see Ind AS 106, Exploration for and Evaluation of Mineral Resources); and

d) expenditure on the development and extraction of minerals, oil, natural gases etc.

3. **An ASSET** is a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.

Control: An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law.

4. **An Intangible asset (ITA) is an identifiable non-monetary asset without any physical substance.**

Identifiability

We have to prove the existence of ITA. An ITA can be Identifiable if

1) It is separable i.e., it could be sold, exchanged or given on rent without disturbing the other assets (or)
2) ITA arises out of legal / contractual rights. (Eg: Non compete fees paid)

Non-Monetary Asset

It means that ITA should not represent a receivable which can be realised in a fixed amount money. i.e., It should not be a monetary asset.

No Physical Substance

ITA does not have any Physical substance. However the Intangible element is contained in a storage device like software on a CD, Digital film storing the movie, patents recorded in legal documentation etc. The cost of this physical substance is usually not material and it will be treated as part of ITA.

5. The following expenses may result into future Economic benefits should not be capitalized
   i. Heavy advertising expenses
   ii. Training costs
   iii. Preliminary Expenses
   iv. Relocation costs
   v. Startup costs

6. RECOGNITION CRITERIA

ITA can be recognised only if the following two conditions are satisfied

i. It is probable that future economic benefits from the ITA will flow to the entity &
ii. Cost can be measured reliably.

7. MEASUREMENT OF INTANGIBLE ASSET:

I. ITA acquired on cash / credit:

Purchase Price	**XXX**
(-) Trade Discount / Rebates	**(XXX)**
(+) Non Refundable taxes	**XXX**
(+) Valuation Expenses	**XXX**
(+) Installation expenses	**XXX**
(+) Any other directly attributable costs	**XXX**

Note: If ITA is acquired on deferred settlement terms, it should be recognised at its cash price / present value.

II. ITA acquired by way of a Government Grant:

The ITA received shall be recognized at fair value in accordance with IND AS 20.

III. **ITA acquired by Exchange of asset:**[Principles same as in IND AS 16]

Record ITA acquired at its fair value if the transaction has a commercial substance.

If there is no commercial substance or fair value of asset acquired / given up cannot be determined, then use the book value of asset given up as the cost of ITA acquired. This may have to be adjusted for any cash paid / cash received.

IV. ITA acquired in a Business Combination

a) ITA acquired in Business combination should be recorded at fair value, in accordance with IND AS 103.
b) ITA can be recognised even though such asset is not recognised by the transferor company provided recognition criteria is met.
c) If the transferor company has any development in process, it can be recognised as ITA in the books of acquirer company at fair value provided recognition criteria is satisfied.

d) Any research work of acquiree entity takenover by the acquirer shall be recognized as ITA @ fair value. If the acquirer entity incurs any further research expenditure then it shall be transferred to P or L.

e) Goodwill as per IND AS 103 = Purchase consideration Θ Fair value of net assets acquired.

8. SELF-GENERATED INTANGIBLE ASSETS:

Self Generated asset like Goodwill, Brands, customer lists, formulas, publishing titles, cannot be recognised as ITA. Since their cost cannot be measured reliably.

9. RESEARCH AND DEVELOPMENT COSTS:

1) Research is original and planned Investigation with an objective of gaining new knowledge, new processes or new production methods.
2) All costs incurred during the Research phase shall be recorded an expense in P&L A/c. This is because it is not probable that future economic benefits will be generated.
3) Development is a phase where successful research findings are applied to create Intangible asset. Entity can capitalize the cost incurred during Development phase if it is able to satisfy all the following six conditions.

a. Technical **F**easibility of creating the Intangible asset. Any costs Incurred before establishing technical feasibility shall be recognised as Expense.
b. **A**bility of the Entity to use/ sell ITA.
c. **I**ntention of the Management of complete the Development
d. Availability of adequate financial and technical **R**esources to complete development.
e. It is probable that future economic benefits can be generated (Existence of active market for the output from ITA).
f. The cost can be measured reliably.

Note 1: The Research Expense will be charged to P&L A/c and would never be capitalized even if Research is successful in future.

Note 2: Similarly if any development Expense is written off to P&L A/c due to non fulfillments of any conditions it can never be capitalized again, even if the conditions are satisfied subsequently.

Note 3: The ITA under development should never exceed its Recoverable amount it is subject to compulsory Impairment testing each year.

Note 4: Do not Include the following costs for capitalization

i. General Admin and selling costs
ii. Staff Training costs
iii. Abnormal losses.

10. SUBSEQUENT EXPENDITURE ON INTANGIBLE ASSET

Further Expenditure can be capitalized only if it results into Incremental future economic benefits, otherwise it is transferred to P&L A/c.

11. SUBSEQUENT MEASUREMENT OF ITA ON EACH BALANCE SHEET DATE

The entity has a choice to follow either cost model or Revaluation model.

All the principles are Similar as IND AS – 16

12. AMORTIZATION OF INTANGIBLE ASSET

a) The Depreciable amount of ITA should be recognized as an expense over the Useful life of the asset. Depreciable amount = Cost of ITA (-) Residual value.

b) The **useful life** of ITA has to be estimated by the management some of the ITA may have life based on contracts. [Non complete fees]. ITA may have finite or Indefinite life's. ITA having Indefinite life will not be amortized but tested for continuous Impairment.

c) Residual Value:

The Residual value of the ITA will be taken as Zero unless there is a third party commitment or there is an active market (as defined in Ind AS 113) for the asset and residual value can be determined by reference to that market & its probable that such a market will exist at the end of useful life.

d) Amortization Method:

ITA should be amortized over its useful life in a pattern which reflects the consumption of future economic benefits arising from the asset. If such a pattern could not be established, adopt straight line method.

Amortization of ITA should commence when the asset is ready for usage. Whenever there is a change in the estimate of useful, of lie or pattern of consumption, it is treated as a change in accounting estimate.

Note: According to IND AS 38, Amortization of ITA based on revenue generated by the asset is considered not appropriate. The revenue generated by an activity that includes the usage of an ITA reflects the factors apart from the consumption of Economic benefits arising from ITA. For example, sales Revenue is effected by Quality of the products, the Inputs considered in manufacturing, selling activities and also the sales price.

However, when it can be demonstrated that the consumption of Economic benefits from ITA, is highly correlated with the revenue of the entity or the ITA itself is expressed as a measure of revenue, the Entity can amortize the ITA on the basis of revenue.

For example, an entity could acquire a concession to explore and extract gold from a gold mine, the expiry of the contract might be based on a fixed amount of total revenue to be generated from the extraction (viz., a contract may allow the extraction of gold reaches Rs 2 billion) and not be based on time or on the amount of gold extracted.

13. **DERECOGNITION OF ITA.** An ITA shall be eliminated from the books of accounts when
    1) It is sold or
    2) The asset is not capable of generating anymore future economic benefits.

Any gain or loss on derecognition will be recognized in PL account.

14. DISCLOSURE

The financial statements should disclose the accounting policies adopted for intangible assets and, in respect of each class of intangible assets:

- Whether useful lives are indefinite or finite and, if finite:
  - Useful life or amortization rate & Amortization method.
  - Gross carrying amount, accumulated amortization and impairment loss at the beginning and at the end of the period.
  - The line item of the statement of profit and loss in which any amortization of intangible assets is included
  - Reconciliation of carrying amount at the beginning and at the end of the period.

Indefinite useful life

Disclose the carrying amount and reasons supporting the assessment of an indefinite useful life.

IND AS 40 INVESTMENT PROPERTIES

1. OBJECTIVE

The objective of this standard is to prescribe the accounting treatment for property (land and/or buildings) held to earn rentals or for capital appreciation (or both) and related disclosure requirements. Ind AS 40 prescribes the cost model for accounting for investment property.

2. SCOPE

1. Ind AS 40 should be applied in the recognition, measurement and disclosure of investment property.
2. This Standard does not apply to:
   a) Biological assets related to agricultural activity (see Ind AS 41 'Agriculture' and Ind AS 16 'property, Plant and Equipment'); and
   b) Mineral rights and mineral reserves such as oil, nature gas and similar non-regenerative resources.

3. DEFINITIONS

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

a. Use in the production or supply of goods or services or for administrative purposes; or
b. Sale in the ordinary course of business.

Property mentioned in (a) above would be covered under Ind AS 16 'property, Plant and Equipment' and property specified in (b) above would be dealt with under Ind AS 2 'Inventories'.

B. Owner – occupied property is property held (by the owner or by the lessee as a right – of –use asset) for use in the production or supply of goods or services or for administrative purposes.

Ind AS 16 'Property, Plant and Equipment' applies to owner-occupied property and Ind AS 116 'Leases' applies to owner – occupied property held by a lessee as a right – of – use asset.

C. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113 'Fair Value Measurement).

D. Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Ind ASs, e.g. Ind AS 102, Share Based Payments.

4. CLASSIFICATION AS INVESTMENT PROPERTIES OR OWNER-OCCUPIED PROPERTY

(a) Investment properties are land, Building or both which are held for earning Income or for capital appreciation purposes. Therefore, an investment property generates cash flows largely independent of the other assets held by an entity. This distinguishes investment property from owner-occupied property. All other properties are referred as owner-occupied properties and they are covered by IND AS 16. Owner Occupied Properties are directly / Indirectly held for use in the business.

Note 1: Land & Building can be obtained through legal ownership or by way of a lease. If the property is obtained on lease, lessee would capitalize it as Right of Use (ROU) Asset & recognize a corresponding lease liability.

Note 2: Land & Building held vacantly for the purpose of capital appreciation or for giving on rent in future is also an investment property (IP)

Even an Investment Property in construction is also classified as IP.

Examples of investment property

The following are examples of investment property:

a. land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.
b. land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)
c. a building owned by the entity (or a right-of-use asset relating to a building held by the entity) and leased out under one or more operating leases.
d. a building that is vacant but is held to be leased out under one or more operating leases.
e. property that is being constructed or developed for future use as investment property.

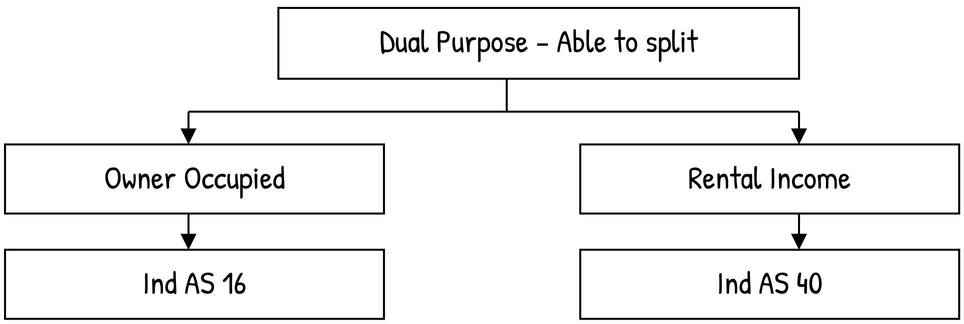
Examples of items which are not investment property

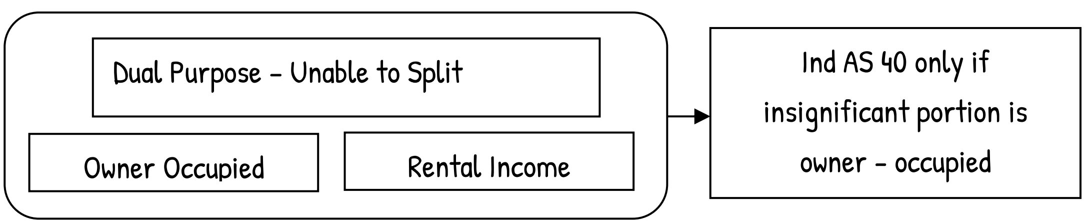
The following are examples of items that are not investment property and are therefore outside the scope of this Standard:

a. property intended for sale in the ordinary course of business or in the process of construction or development for such sale (see Ind AS 2, Inventories), for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale.
b. owner-occupied property (see Ind AS 16 and Ind AS 116), including, (among other things)
    i. property held for future use as owner-occupied property,
    ii. property held for future development and subsequent use as owner-occupied property,
    iii. property occupied by employees (whether or not the employees pay rent at market rates) and
    iv. owner-occupied property awaiting disposal.
c. property leased to another entity under a finance lease.

(b) Property held for more than one purpose

In circumstances when property is held partly for capital appreciation and / or rentals, and partly for production or supply of goods or services or for administrative purposes, the two parts are accounted for separately if they could be sold, or leased out separately under a finance lease, separately. If they could not be sold (or leased out under a finance lease) separately, the property is accounted for as an investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.





(c) ANCILLARY SERVICES

In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole. An example is when the owner of an office building provides security and maintenance services to the lessees who occupy the building.

In other cases, the services provided are significant. For example, if an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property.

(d) Land & Building given on **rent to employees is not IP**, irrespective of how much rent is charged.

(e) If a parent company gives a land and Building on operating lease to subsidiary which is using it for Business activities, the land & Building should be classified as IP in the books of parent company. However, while preparing consolidated FS, such Land & Building is classified as PPE.

Tabular summarization

S.No	Property	Meeting definition of Investment Property	Which Ind AS is Applicable
1.	Owned by a Company and leased out under an Operating Lease	Yes	Ind AS 40
2.	Held as a right – to –use asset and Leased out under an Operating Lease	Yes	Ind AS 40
3.	Held as a right-to-use asset and Leased out under Finance Lease	No	Ind AS 116
4.	Property acquired with a view for development and resale	No	Ind AS 2
5.	Property partly owner occupied and partly leased out under Operating lease	Depends	Ind AS 16 Ind AS 40
6.	Land held for currently undetermined use	Yes	Ind AS 40
7.	Property occupied by Employees paying rent at less than market rate	No	Ind AS 16
8.	Investment Property held for sale	No	Ind AS 105
9.	Existing Investment Property that is being redeveloped for continued use as Investment Property	Yes	Ind AS 40

5. RECOGNITION CRITERIA

IP will be recognized only when the following two conditions are satisfied.

1) It is probable that future economic benefits from the property will flow to the enterprise and
2) Cost can be measured reliably.

6. INITIAL MEASUREMENT:

A. IP should be initially recognized at cost. Cost Includes

Purchase price	xxx
(+) Non-Refundable taxes	xxx
(+) Expenses for obtaining the title	xxx
(+) Any Brokerage / consulting fees etc	xxx
	xxx

Measurement at recognition – general: An owned investment property should be measured initially at its cost. Transaction costs are included in the initial measurement.

Cost Inclusions: 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).

Cost Exclusions: The cost of an investment property is not increased by:

a. start-up costs (unless they are necessary 'to bring the property) to the condition necessary for it to be capable of operating in the manner intended by management),
b. operating losses incurred before the investment property achieves the planned level of occupancy, or
c. abnormal losses

B. When IP is acquired on deferred settlement terms we should exclude the interest from the purchase price and the asset should be recorded at cash price / present value.

C. Day-to-day servicing costs

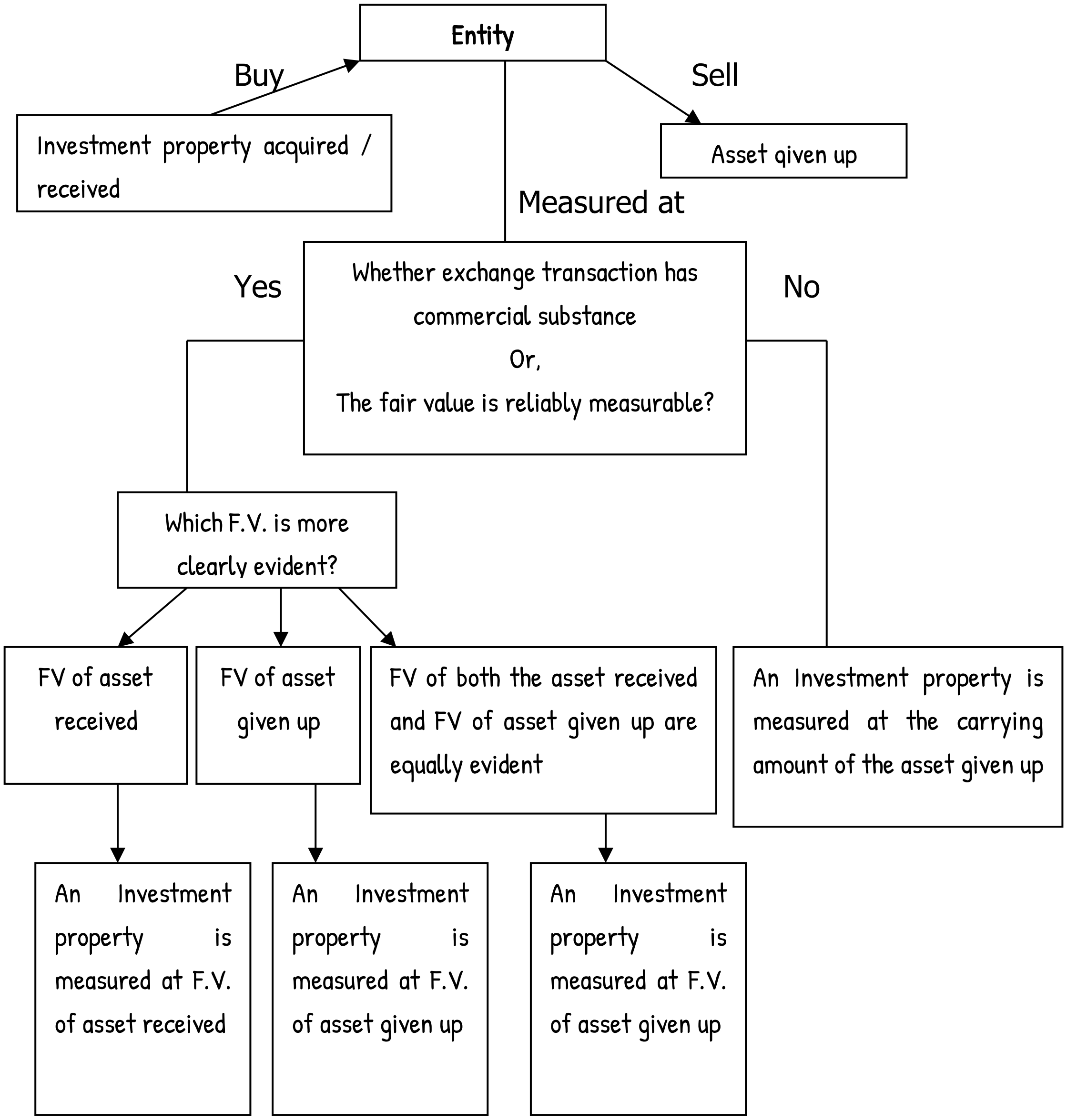
Under the recognition principle set out above, an entity does not recognise in the carrying amount of an investment property the costs of the day-to-day servicing of such a property. Rather, these costs are recognised in the profit or loss as incurred. Costs of day-to-day servicing are primarily the cost of labour and consumables and may include the cost of minor parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the property.

D. Replacement costs

Parts of investment properties may have been acquired through replacement. Under the recognition principle, an entity recognises costs incurred to replace parts of the original property in the carrying amount of investment property if they meet the recognition criteria. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard.

E. Investment property acquired through exchange of another asset

[same principles as discussed in IND AS 16]]



7. SUBSEQUENT MEASUREMENT

a) Investment property should be measured using COST MODEL as given in IND AS 16 i.e., Carrying amount of I.P = original cost Θ accumulated depreciation Θ accumulated Impairment loss

b) Revaluation of Investment properties is not allowed. However, the fair value of IP has to be determined each year & should be disclosed in Notes to accounts.

c) Impairment loss will be recognized if indicators exist.

d) When a IP is held for sale within the next 12m, IND AS 105 is applicable. The property should be now value at FVLCTS (Fair value less cost to sell). No further depreciation should be provided.

8. TRANSFERS/ RECLASSIFICATION: During the life of the property, the entity's intentions on usage of the property may change due to many reasons; i.e. it may use the property for its own use or it may decide to sell the property in the ordinary course of its business, start renting the property which was earlier used in its business, etc.

Such reclassification of an asset should be **made only when there is a change in use, evidenced by:**

- commencement of owner-occupation - i.e. owner occupied the property for its use;
- commencement of development with a view to sale, for a transfer from investment property to inventories;
- end of owner-occupation, for a transfer from owner-occupied property to investment property; or
- commencement of an operating lease to another party, for a transfer from inventories to investment property.

Measurement: 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.

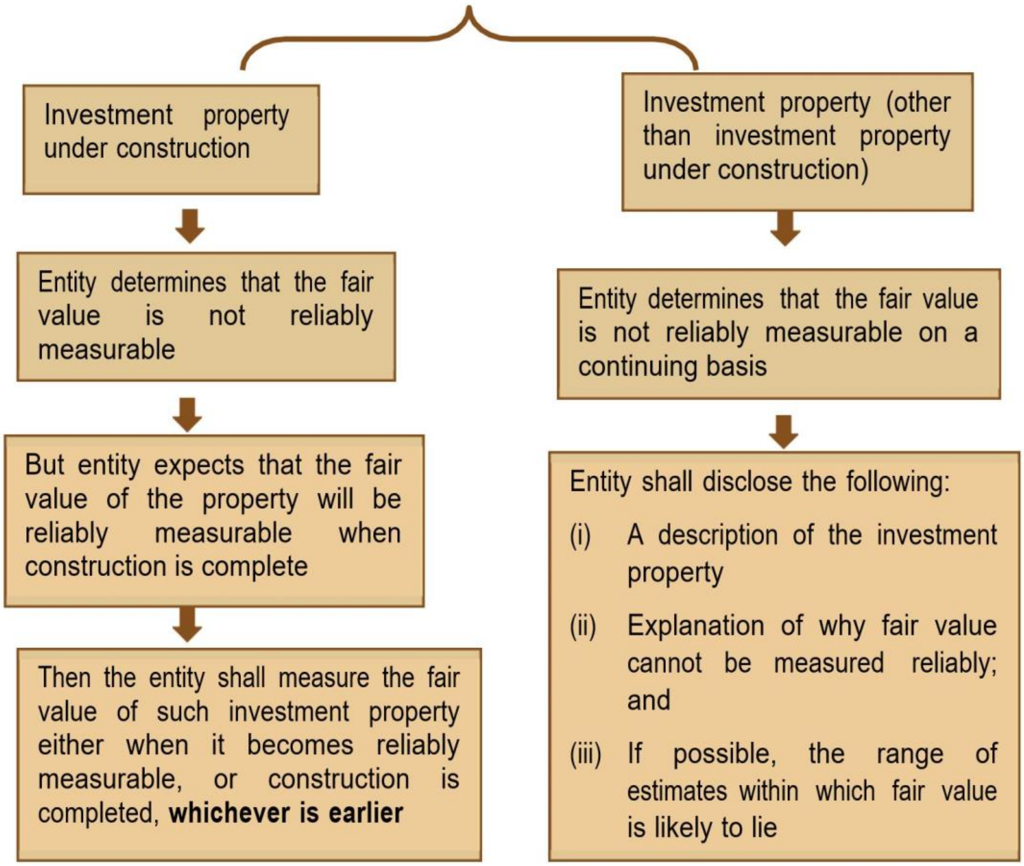
9. FAIR VALUE OF INVESTMENT PROPERTY:

✓ Entities are required to **measure the fair value of investment property, for the purpose of disclosure** even though they are required to follow the cost model. An entity is encouraged, but not required, to measure the fair value of investment property based on a valuation by an independent valuer.

✓ There is a **rebuttable presumption that an entity can reliably measure the fair value** of an investment property on a continuing basis.

- ✓ In exceptional cases, there may be clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the fair value of the property will not be reliably measurable on a continuing basis.

Treatment when Fair Value is not reliably measurable



- ✓ While measuring the fair value of investment property in accordance with Ind AS 113, an entity should ensure that the fair value reflects, among other things, rental income from current leases and other assumptions that market participants would use when pricing investment property under current market conditions.
- ✓ When a lessee measures fair value of an investment property that is held as a right-of-use asset, it shall measure the right-of-use asset, and not the underlying property at fair value.
- ✓ Once an entity becomes able to measure reliably the fair value of an investment property under construction for which the fair value was not previously measured, it should measure the fair value of that property.

- ✓ Once construction of that property is complete, it is presumed that fair value can be measured reliably. If this is not the case, the entity should make the disclosures as mentioned under investment property (other than investment property under construction) above.
- ✓ The presumption that the fair value of investment property under construction can be measured reliably **can be rebutted only on initial recognition**. An entity that has measured the fair value of an item of investment property under construction may not conclude that the fair value of the completed investment property cannot be measured reliably.
- ✓ In the exceptional cases when an entity is compelled, for the reason given above to make the disclosures, it should determine the fair value of all its other investment property, including investment property under construction. In these cases, although an entity may make the disclosures as required for one investment property, the entity should continue to determine the fair value of each of the remaining properties for disclosure as required.
- ✓ **If an entity has previously measured the fair value of an investment property, it shall continue to measure the fair value of that property until disposal** (or until the property becomes owner-occupied property or the entity begins to develop the property for subsequent sale in the ordinary course of business) even if comparable market transactions become less frequent or market prices become less readily available.

10. DERECOGNITION; An investment property shall be derecognized (eliminated from the balance sheet) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.

The disposal of property can be achieved by sale or entering into a finance lease. Gains or losses arising from the retirement or disposal of investment property shall be recognised in the statement of Profit or loss in the period of disposal.

11. DISCLOSURE:

1) Accounting Policy adopted by entity for Investment properties.
2) Any the amounts recognized in profit or loss for:
   - ✓ rental income from investment property;

- ✓ direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period; and
- ✓ direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period.

3) Depreciation provided on IP
4) Reconciliation of carrying amount of the IP at the beginning and end of the period.
5) Fair value of IP and & the extent to which the fair value of investment property (as measured for disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognized and relevant professional qualification. If there has been no such valuation, that fact shall be disclosed.

IND AS 41 AGRICULTURE

1. OBJECTIVE

Ind AS 41 Agriculture sets out the accounting for agricultural activity, the management of the transformation of biological assets (living plants and animals) into agricultural produce (harvested product of the entity's biological assets).

2. SCOPE

This Standard shall be applied to account for the following when they relate to agricultural activity:

(a) biological assets;

(b) agricultural produce at the point of harvest; and

(c) government grants

Ind AS 41 does not apply to:

(i) Land related to agricultural activity

(ii) bearer plants related to agricultural activity. Such bearer plants are covered within the scope of Ind AS 16.However, this Standard applies to the produce on those bearer plants.

(iii) Government grants relating to bearer plants.

(iv) Intangible assets associated with agricultural activity like licenses and rights.They are covered under IND AS 38

(v) Right of use assets arising from lease of land, its covered under IND AS 116.

3. DEFINITIONS

a) **Agricultural activity** refers to the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

The standard states that 'agricultural activity' covers a wide range of activities, e.g. 'raising livestock, forestry, annual or perennial cropping, cultivating orchards and plantations, floriculture, and aquaculture (including fish farming)'.

b) A **Biological asset** is a living animal or plant.

c) **Agricultural produce** is the harvested product from entity's Biological assets. IND AS 41 is applicable to all agricultural produce only at the Point of harvest. Subsequent processing of such agricultural produce is outside the scope of this standard. On the balance sheet date agricultural produce will be valued as Inventory, In accordance with IND AS 2.

d) **Harvest** refers to detachment of produce from the Biological assets or the cessation of Biological assets life process.

e) **Biological transformation** comprises the processes of growth, degeneration, production, and procreation that cause qualitatively of quantitative changes in biological asset.

Biological transformation

Processes (Causing Qualitative of Quantitative changes in a Biological Asset)

Growth	**Degeneration**	**Production**	**Procreation**
An increase in quantity or Improvement in quality of an animal or plant)	A decrease in the quantity or deterioration in quality of an animal or plant	Of agricultural produce such as latex, tea leaf, wool, and milk	Creation of additional living animals or plants

f) **Fair Value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (the definition of Fair value is as given in Ind AS 113, Fair Value measurement)

g) **Costs to sell** are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes.

h) **Bearer plant** ay be defined as a living plant that:

i. is used in the production or supply of agricultural produce;
ii. is expected to bear produce for more than one period; and
iii. has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

For example, tea bushes, grape vines, oil palms and rubber trees, usually meet the definition of a bearer plant and are outside the scope of Ind AS 41 and covered under Ind AS 16. However, produce growing on bearer plant is a biological asset.

The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological assets	Agricultural produce	Products that are the result of processing after harvest
Sheep	Wool	Yarn, carpet
Trees in a timber plantation	Felled Trees	Logs, lumber
Dairy Cattle	Milk	Cheese
Pigs	Carcass	Sausages, cured hams
Cotton plants	Harvested cotton	Thread, clothing
Sugarcane	Harvested cane	Sugar
Tobacco plants	Picked leaves	Cured tobacco
Tea bushes	Picked leaves	Tea
Grape vines	Picked grapes	Wine
Fruit trees	Picked fruit	Processed fruit
Rubber trees	Harvested latex	Rubber products

4. RECOGNITION CRITERIA FOR BIOLOGICAL ASSETS & AGRICULTURAL PRODUCE

Entities are required to recognize a biological asset or agricultural produce when, and only when all the following conditions are met:

a) the entity **controls** the asset as a result of past events;
   Control over biological assets or agricultural produce may be evidenced by legal ownership or rights to control, for example legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning.

b) it is **probable that future economic benefits** associated with the asset will flow to the entity; and
   Future economic benefits are expected to flow to the enterprise from its ownership or control of the asset. The future benefits are normally assessed by measuring the significant physical attributes.

c) the **fair value or cost** of the asset can be measured reliably.

5. MEASUREMENT CRITERIA FOR BIOLOGICAL ASSETS AND AGRICULTURAL PRODUCE

i. Biological assets and agricultural produce are to be initially recognized at fair value less cost to sell. (FVLCTS). In extremely rare circumstances, when the fair value of Biological asset cannot be determined. It should be recorded at cost.

> Initial recognition at COST only When
> a) Quoted market prices are not available and
> b) Alternative fair value measurements determined are clearly unrealizable.
>
> In such a case, it shall **be measured at its costs less any accumulated depreciation and any accumulated impairment losses.**
>
> **Note:-**
>
> Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less costs to sell.

Biological asset A/c Dr FVLCTS
    To bank A/c COST

Note: Any Difference in the above Entry is a **gain / loss to be recognized in P&L A/c**. Any expenses incurred on acquisition of biological asset shall also be recognized in **P&L.**

Initial recognition of agricultural produce

Inventory A/c Dr FVLCTS
    To P&L A/c FVLCTS.

Or

Inventory Ac Dr. FVLCTS
    To Biological Asset

ii. On each Balance sheet date the biological asset has to be remeasured at FVLCTS. And **any gain / loss is recognized in P&L.**

Gain:- Biological asset A/c Dr
    To P&L A/c

Loss: P&L A/c Dr
    To Biological asset

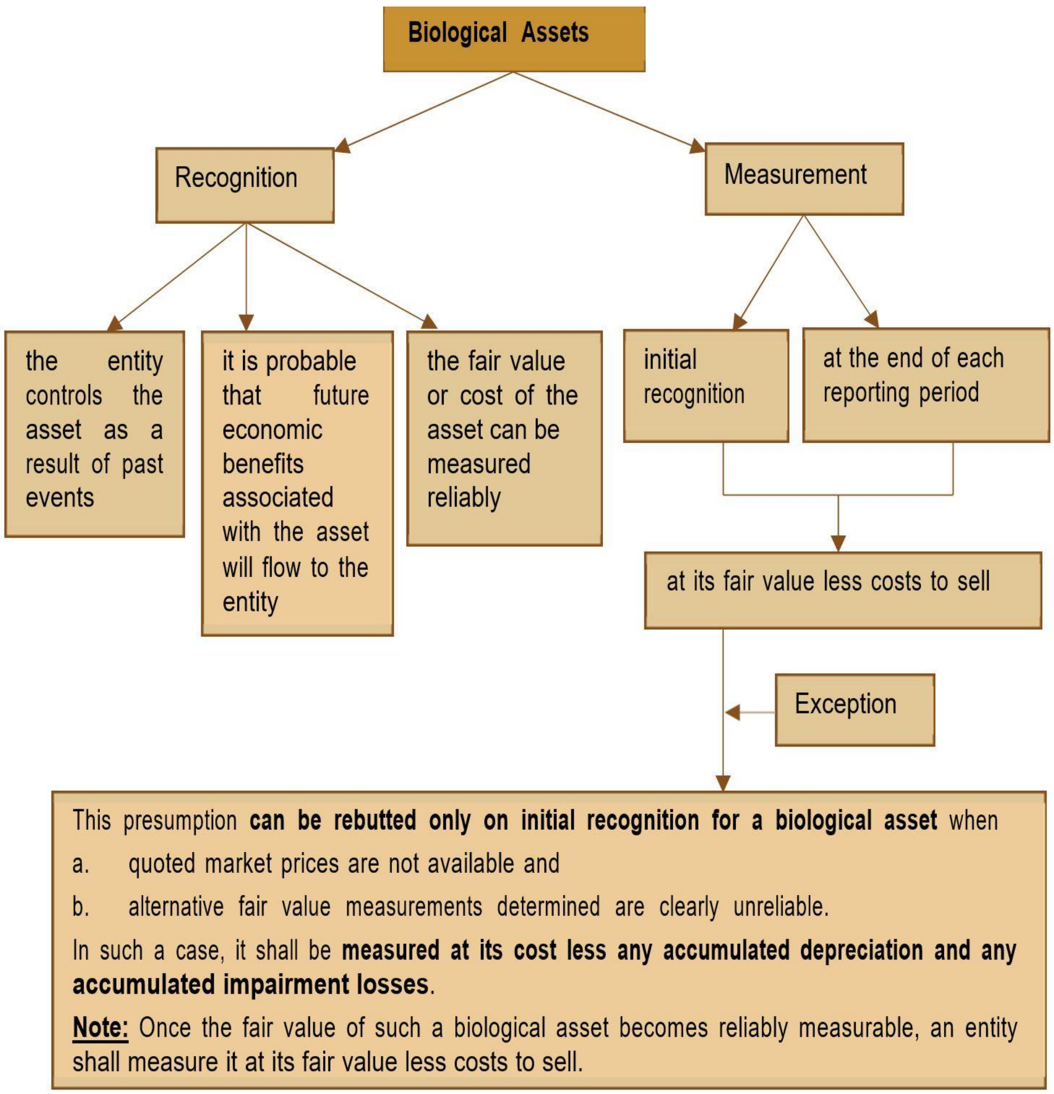
Note: Balance Sheet date of agricultural produce is covered by IND AS 2. It should be valued at lower of cost or NRV. The fair value at which the agricultural produce is initially recognized should be considered as cost.

iii. For any new biological assets created [eg: Calf is born].

Biological asset A/c Dr
To P&L A/c

Note: When Biological asset is re-measured on balance sheet date, the resulting Gain / loss shall be recognized in P&L A/c – In the notes to accounts we have to provide the detail of this Gain / loss as under.

1. Change in the Fair value due to price changes and
2. Change in the fair value due to physical change.



6. GOVERNMENT GRANTS

1) Biological Asset measured at fair value less cost to sell:

a) Unconditional grant:

An unconditional government grant related to a biological asset measured at its fair value less costs to sell shall be recognized in profit or loss when, and only when, the government grant becomes receivable.

b) Conditional grant:

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 recognize the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met.

Terms and conditions of government grants vary. Fr example, a grant may require an entity to farm in a particular location for five years and require the entity to return the entire grant if it farms for a period shorter than five years. In this case, the grant is not recognized in profit or loss until the five years have passed. However, if the terms of the grant allow part of it to be retained according to the time elapsed, the entity recognizes that part in profit or loss as time passes.

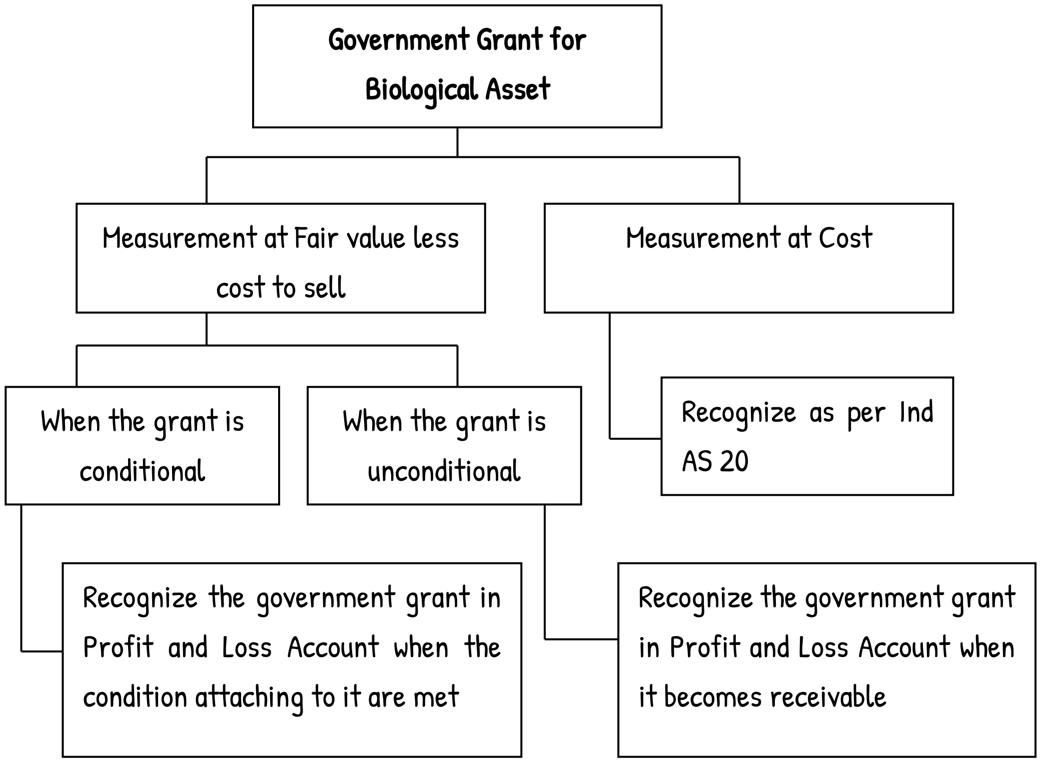
Example 4

Sun Ltd cultivated a huge plot and land. The government offers a grant of Rs 10 crore under the condition that the land is being cultivated for 5 years. If the land will be cultivated for a shorter period, the entity is required to return the entire grant.

Therefore, the government grant will be recognized as a income only after 5 years of cultivation. The situation would be deferent if the returning obligation referred to the years of not cultivating the land is with respect to retention of grant for the period till which the entity has cultivated the land. In this case, the amount of RS 10 crore would be recognized as income proportionately with the time period. Meaning Rs 2 crore per annum.

2) Biological Asset measured at its cost:

If a government grant relates to a Biological Asset measured at its cost less any accumulated depreciation and any accumulated impairment losses i.e. (i.e. inability to measure fair value reliably), Ind AS 20 is applied.



7. DISCLOSURES

1) Description of biological assets and activities.
2) Gains and losses recognised during the period.
3) Reconciliation of changes in biological assets.
4) Additional disclosures when fair value cannot be measured reliably.
5) Details of Government grants.

IND AS 8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES & ERRORS

Ind AS 8 Discusses

Criteria for

- ❖ Selecting accounting policies; &
- ❖ Changes in accounting policies.

Accounting Treatment & Presentation and disclosure of

- ❖ Changes in Accounting estimates;
- ❖ Changes in Accounting policies;
- ❖ Correction of prior period Errors;

The Standard is meant to increase the qualitative characteristics like the relevance, reliability and comparability of an entity's financial statements.

It does not deal with the tax effect of corrections of prior period errors.

A. ACCOUNTING POLICIES

B. Accounting Policies are specific principles, bases, conventions, rules and practices that are applied by the Entity in preparing and presenting financial statements. Examples include

1) Valuation of Inventory using methods like FIFO, weighted average cost, specific identification method etc.
2) Valuation of Investments at FVTPL or FVTOCI
3) Treatment of Foreign Exchange Gains / Losses.

C. Selection of Accounting Policy:

i. If there is any Existing IND AS Covering the transaction, it should be selected as accounting policy.

ii. If there is no specific IND AS Covering the transaction then the Management has to develop an accounting policy based on their best judgement. The objective should be to ensure that FS should **give relevant and reliable** Information to the users.

Objective should be that FS are

Relevant

Relevant for decision making of users.

Reliable

1) They should be free from bias (neutral)
2) Reflect Economic Substance of transaction than legal form.
3) Completeness
4) Prudence.
5) Faithful representation.

Other Considerations the management should see are

a) Any accounting treatment given in IND AS for similar transactions. **[mandatory reference]**

b) Definition criteria for recognition of asset, liability, Income or Expense. **[mandatory reference]**

c) Any Pronouncements of IASB. **[optional reference]**

d) Other / Similar frameworks [Eg: US GAAP]. **[optional reference]**

D. **Consistency**: An Entity shall follow accounting policies consistently for all transactions of Similar nature unless IND AS permits to adopt different accounting policies.Eg:- In IND AS 16 Cost or Revaluation model is a choice that should be applied on entire class of assets. However under Buildings we can follow different accounting policies for office buildings & Factory building, Since it is permitted by IND AS 16.

E. Change in Accounting Policies:

An accounting policy can be changed if either of the following conditions are satisfied.

1) Such a change is required by IND AS (or)
2) The change results into more relevant and reliable presentation of Financial statements.

F. Accounting treatment of change in Accounting policy.

1) The change in accounting policy is accounted using any specific transitional provisions given in IND AS or given in IND AS 101(First time adoption of IND AS)
2) If transitional provisions are not there, then the accounting for change in the policy has to be done **retrospectively**. It means that FS are prepared in such a manner as if the new policy had been from the very beginning. This would lead to restatement of previous year FS.
3) If retrospective effect could not be given from the beginning, it should be given from such date when its practicable. If restatement cannot be identified towards any specific year, it has to be adjusted in the opening Balance of Retained Earnings in current year.
4) If application of Retrospective effect is **impracticable** only prospective effect shall be given.
5) The following are not treated as change in accounting Policy.
   a) Application of an accounting policy on fresh transactions that were not there in the earlier periods
   b) Application of an accounting policy for transactions or event which were immaterial in the previous periods.

Note: For the FIRST TIME when a PPE or Intangible asset are changed from COST Model to Revaluation model, It is a change in accounting policy but retrospective effect is NOT required. Prospective accounting is to be done [given in ind as 16 and ind as 38]

Disclosure for change in Accounting Policy – General points

i. The IND AS which has required the change of Accounting Policy.
ii. Transitional provisions that are applied for accounting.
iii. Details of any Retrospective effect given.
iv. Effect of Policy change on each item in FS and on EPS.
v. Any Reasons if retrospective application was not possible.

G. Disclosure Requirements of change in accounting policy.

As discussed, change in accounting policy takes place either due to change in Ind AS or voluntary change to give better presentation. Disclosure requirements are depending on the reason of change

When accounting policy is changed due to **initial adoption of the Ind AS:**

- ✓ Title of the Ind AS;
- ✓ Changes in accounting policies made in accordance with transitional provisions;
- ✓ Nature of change;
- ✓ Description of transitional provision;
- ✓ Potential effects of the change on future periods;
- ✓ Effect on each line item of the current period and prior periods and on Earnings per share;
- ✓ If retrospective application is impracticable, disclose the circumstances that led to the condition and a description of the change and how the same has been applied.

The above shall be disclosed only in the period of change in policy and need not repeat the same disclosure in future periods.

When accounting policy is changed due to **voluntary adoption of the Ind AS for better presentation:**

- ✓ Nature of change;
- ✓ Reasons for such Change and how does new policy gives more reliable and relevant information;
- ✓ Effect on each line item of the current period and prior periods and on Earnings per share;
- ✓ Amount of adjustments to the prior periods
- ✓ If retrospective application is impracticable the circumstances that led to the condition and a description of the change and how the same has been applied

The above shall be disclosed only in the period of change in policy and need not repeat the same disclosure in future periods.

Where **an Ind AS has been issued** but is **not effective up to the date** of the financial statements the entity shall disclose

- ✓ The above fact;
- ✓ Title of the new Ind AS;
- ✓ Nature of changes going to take place;
- ✓ Date of application of the Ind AS;
- ✓ The date the management estimates to adopt the new Ind AS;
- ✓ The estimated impact of the above mentioned Ind AS on the financial statements of the entity;
- ✓ If the estimated impact of the new Ind AS cannot be reasonably measured a statement to the effect

B. CHANGES IN ACCOUNTING ESTIMATES.

A. Accounting estimates are monetary amounts in financial statements that are **subject to measurement uncertainty**. The term estimate indicates it is an an approximation of a financial item in the absence of précised means of measurement.

B. A change in accounting estimate is an adjustment of carrying amount of Assets or Liability or periodic consumption of benefits from the asset, that **results from new information or subsequent developments.**

Following are general estimations used in preparation of financial statements. Allowance for doubtful debts; Fair value of financial assets or financial liabilities; Inventory obsolescence; Warranty obligations; Useful lives, residual value and method of depreciation i.e. pattern of economic benefits consumption from fixed assets;

C. An entity uses measurement techniques and inputs to develop an accounting estimate. Measurement techniques include estimation techniques (for example, techniques used to measure a loss allowance for expected credit losses applying Ind AS 109) and valuation techniques (for example, techniques used to measure the fair value of an asset or liability applying Ind AS 113).

D. A change in accounting estimate **should not be treated** as a ERROR OR PRIOR PERIOD ITEM.

E. The **effect of change in an accounting estimate**, except to the extent that the change results in change in assets, liabilities or relates to an item of equity, **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.

A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods.

F. To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, **it shall be recognised by adjusting the carrying amount** of the related asset, liability, or equity item in the period of the change.

G. A change in the measurement basis applied is a change in an accounting policy and is not a change in an accounting estimate. Where it is difficult to classify a particular change as a change in accounting policy or a change in accounting estimate the same shall be treated as change in accounting **estimate** and treated accordingly.

H. Disclosure requirements of estimation

An entity shall disclose the following:

1. Nature and amount of change;
2. Effect of the change in current and future periods to the extent practicable;
3. if it is impracticable to assess the effect of change in future periods, the same shall be disclosed.

C. ERRORS

A. **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.

B. 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.

C. TREATMENT OF ERRORS:

Situation 1: Error discovered relates to the comparative prior period presented:

Unless impracticable, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by restating the comparative amounts for the prior period(s) presented in which the error occurred;

Situation 2: Error discovered relates to period before the earliest comparative prior period presented:

If the material error occurred before the earliest prior period presented, an entity shall, unless impracticable, correct the same retrospectively in the first set of financial statements approved for issue after their discovery by restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

D. DISCLOSURE REQUIREMENTS OF PRIOR PERIOD ERROR

The following shall be disclosed in the period the prior period in which errors are rectified:

a) Nature of error;

b) Effect of the error on

✓ Each Financial Statement line item;

✓ Earnings per share (Basic and Diluted) if Ind AS 33 is applicable;

c) Amount of correction on the earliest period presented;

d) If retrospective amendment is impracticable, the circumstance that led to the situation and how the error is corrected.

Example

Cost of plant Purchased on 01.04.2014 is Rs 10,00,000. Depreciation was charged at 10% on SLM basis instead of 12% on WDV basis. The current F.Y. 2017 -18. The Balance on Retained Earnings as on 01.04.2016 is Rs 2,20,000. The following further Information is available relating to profits earned.

Particulars	2014-15	2015-16	2016-17	2017-18
Sales	5,00,000	6,00,000	7,00,000	8,00,000
(-) COGS	(2,00,000)	(2,50,000)	(2,80,000)	(3,00,000)
(-) Depreciation	(1,00,000)	(1,00,000)	(1,00,000)	??
Tax rate	30%	30%	30%	30%

Prepare the Extract of P&L and SOCIE after rectification.

Solution:

Total depreciation that should have been charged as per 12% WDV

2014 - 15	10,00,000 x 12%	=	1,20,000
2015 – 16	1,20,000 x 88%	=	105600
2016 – 17	105600 x 88%	=	92928
2017-18	92928 x 88%	=	81776

However in last 3 years up to 2016-17 depreciation has been charged @ Rs 1,00,000 p.a. 2016-17 is the Previous year, the P&L and B/s of this year will be restated and presented in Comparative column.

In the year 2014-15 & 2015-16, total depreciation that should have been charged = 1,20,000 + 105600 = 2,25,600. However actual depreciation charged is 1,00,000 + 1,00,000 = 2,00,000. Therefore depreciation under charged = 2,25,600 Θ 2,00,000 = 25600. Due to this error the asset is overstated by 25600 and tax expense is over stated by 7680 [25600 x 30%] and R.E has been overstated by 17920 [25600 Θ 7680].Rs 17920 is the effect of mistake that has happened beyond the previous year therefore it will be adjusted in the opening Balance of R.E of P.Y i.e., as on 01.04.2016.

Extract of SPL

Particulars	2017-18 (C.Y)	2016-17 [P.Y → restated]
Sales	8,00,000	7,00,000
(-) COGS	(3,00,000)	(2,80,000)
(-) Depn [as per 12% WDV]	(81,776)	(92,928)
PBT	418224	327072
(-) Tax Expense @ 30%	(125467)	(98122)
PAT	292757	228950

Extract of SOCIE

Particulars	2017-18 (C.Y)	2016-17 [P.Y]
Opening Balance	431030	2,20,000
(-) Rectification of Error	-	(17920)
Restated of balance	431030	202080
(+) Total Comprehensive Income	292757	228950
Closing Balance	723787	431030

IND AS 10 EVENTS OCCURRING AFTER REPORTING DATE

1.OBJECTIVE: The objective of this standard is to prescribe.

1. When an entity should adjust its financial statements for the events after the reporting period.
2. The disclosures that an entity should give about the date when the financial statements were approved for issue and about events after the reporting period.

The standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is no longer appropriate.

We need to understand the sequence of approval of financial statements in case of companies.

Step 1: After the financial year end, Board of Directors (BOD) prepares the financial statements and approves the same;

Step 2: Depending on the management structure of the entity, the approved financial statements are issued either to shareholders or a supervisory board (e.g. Audit committee);

Step 3: Audited financial statements are adopted by the Members of the company in the Annual General Meeting.

2. **Events occurring after Reporting date** are those events, favourable and unfavorable, that occur after the Balance Sheet date and up to the date of approval of 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.

3.Date of approval means the date on which the Board of Directors has finalized the FS of concluded accounting period.

Note: Sometimes after approval of FS by the board a further approval may be required from a supervisory body (Eg: Audit committee) Even in this case date of approval by the board of directors is considered as "date of approval for purpose of this standard.

4. These Events after the reporting date are further classified into
    i. Adjusting Events
    ii. Non Adjusting Events
5. **Adjusting Events**: These are events that provide additional information relating to conditions or Situations that are already Existing on Balance Sheet. These Events will be considered in preparing the FS of the Concluded period and it may lead to change in the carrying amount of Assets / liabilities or it may impact the classification.

Examples of adjusting Events

1) Settlement of Court cases / other Litigations whose conditions were Existing on the reporting date.
2) Bonus payable to Employees based on profits whose conditions were Existing on the reporting date.
3) Decline in the value of assets, if conditions is existing on the Balance Sheet date – Insolvency of debtor, sale price of Inventory
4) Errors / Frauds detected after the Reporting date but have occurred before the reporting Period.

6. **Non Adjusting Events**: Non-adjusting events are those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).These are events other than adjusting events. Material Non adjusting events shall be disclosed in the Notes to accounts & an estimate of its financial effect if practicable.

Examples of Non-Adjusting Events

1. Proposed Dividends
2. Abnormal Losses
3. Decline in the market value of Investments.
4. Changes in tax rates
5. Any Business Combination
6. Discontinued operations
7. Major sale of Assets
8. Forex Gains / losses.

7. GOING CONCERN BECOMING INVALID

a) If an Event occurring after Balance sheet makes the going concern Invalid. It should be treated as an Adjusting Event even though there is no situation / condition on the Balance sheet date

b) Going Concern may become Invalid due to reasons like heavy operating losses, Ban on the products. Intention of the management etc., Deterioration in operating results and financial position after the reporting period.

c) 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. All the assets shall be presented at realizable values and all the liabilities at settlement values.

d) Ind AS 1 specifies required disclosures if:

   (a) the financial statements are not prepared on a going concern basis; or

   (b) management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The events or conditions requiring disclosure may arise after the reporting period.

8. DIVIDEND

If an entity declares dividends to holders of **equity instruments** (Refer note below) after the reporting period, the entity shall not recognize those dividends as a liability at the end of the reporting period.

If dividends are **declared after the reporting period** but before the financial statements are approved for issue, the dividends are **not recognised 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 & Schedule III.**

9. Disclosure Requirements:

a) Name of the approval authority of financial statements.

b) Date of approval of financial statements.

c) Material non adjusting Events

d) Disclosure of Events which are adjusted in financial statements.

10. Distribution of Non cash assets to owners (Appendix to IND AS 10)

1. Sometimes any Entity distributes non cash assets like stock or Investments or PPE as dividends to their Equity shareholders. The Entity may also give a choice Either to receive non cash assets or cash.
2. The Entity should recognize a liability towards dividend payable when dividend is declared. The liability is recognized at
   a) <u>If only non cash assets are to be distributed:-</u>
   Recognize liability @ Fair value of asset to be distributed.
   b) <u>If an option is given to select Non cash assets or cash payment</u>
   Consider the Fair value of each alternative and calculate the Expected value of liability Considering the probabilities of each alternative.
3. On the Reporting date and also on the settlement date the Entity has to remeasure the dividend payable and recognize the Gain / loss directly in Equity (Retained Earnings)
4. On the Settlement date, the Carrying amount of the Non Cash assets has to be restated to its fair value and any Gain / loss shall be transferred in P&L A/c.

Example

A Ltd has declared dividend to the shareholders on 01.03.2016. Dividend can be paid in cash of Rs 5,00,000 or 10,000 units of stock which has a present Fair value of Rs 6,00,000. The probability for cash alternative is 60% and for stock alternative it is 40%. The cost of the stock is Rs 4,00,000.

On 31.03.2016:

The Fair value of stock has increased by Rs 50,000. Probability of cash alternative is re assessed @ 55% and stock alternative as 45%.

On 30.4.2016:

Dividend was distributed, 40% opted for cash and 60% opted for stock. Fair value of stock is Rs 6,80,000. Write the Journal Entries in the books of company.

Solution:

On 01.03.2016 – Declaration of Dividend:

Retained Earnings A/c	Dr	5,40,000	
To Dividend Payable			5,40,000

Cash alternative	=	5,00,000 x 60%	=	3,00,000
Stock alternative	=	6,00,000 x 40%	=	2,40,000
				5,40,000

On 31.03.2016 – Restatement of Dividend Payable:

Retained Earnings	A/c	Dr	27500	
To Dividend Payable				27500
(567,500 – 540,000)				

Cash alternative = 5,00,000 x 55%	=	275000
Stock alternative = 6,50,000 x 45%	=	292500
Fair value of Dividend payable		567500

On 30.04.2016 – Restatement of Dividend Payable on Settlement date.

Retained Earnings	A/c	Dr	40500	
To Dividend payable				40500
[608000 Θ 567500]				

Cash alternative = 5,00,000 x 40%	=	2,00,000
Stock alternative = 6,80,000 x 60%	=	408000
FV of Dividend payable		608000

On 30.04.2016 – Restatement of asset to its Fair value

Stock A/c	Dr	168000	
To P&L A/c			168000

Cost of stock Distributed = 4,00,000 x 60%	=	2,40,000
Fair value of stock distributed = 6,80,000 x 60%	=	408000
Increase in value of stock		168000↑

On 30.04.2016 For Payment of Dividend

Dividend Payable A/c	Dr	608000	
To Bank A/c			2,00,000
To Stock A/c			4,08,000

11. Breach in Covenants of Long Term loan

If there is any breach in the conditions of a long-term loan before the balance sheet date due to which the loan has become repayable on demand, the loan should be classified as a current liability in the Balance Sheet.

However if after the balance Sheet but before approval of Financial statements, the breach is rectified and the lender has agreed not to demand repayment. This rectification is considered as an ADJUSTING EVENT. Due to this the loan to the balance Sheet will be classified as NON CURRENT LIABILITY.

SHARE BASED PAYMENTS [IND AS 102]

1. Share Based payments means the Reporting Entity enters into an agreement with another party under which the Reporting entity receives (Goods / services, Including services from Employees) against payment to be made by issue of Equity or by payment of cash / other assets based on Equity provided vesting conditions are satisfied.

   Note:

   1) The equity to be issued can be of the Reporting entity or of its holding company / subsidiary company.
   2) Equity Instrument may be Equity shares or options to buy Equity shares.

2. Share based payments (SBP) can be equity settled or cash settled or an alternative given to the other party.
3. This standard does not cover the following
   i. Issue of shares to shareholder in the capacity of shareholder.
      Eg: - Bonus shares, Right shares etc.
   ii. Shares issued under business combination
   iii. Contracts which are covered by IND AS 109. (Speculative contracts)
4. **Recognition Entry:**

PPE/Intangible Asset / Expense A/c Dr

To SBP Reserve A/c → SBP Equity settled

To SBP Liability A/c → SBP cash settled

The above entry should be recorded at fair value of goods/services received by the entity or fair value of SBP plan awarded to the counterparty whichever is more clearly evident.

Generally,

In case of services received from employee or any similar services	Consider the fair value of SBP plan issued.
In case of other goods/services	Consider the fair value of such goods/services received unless the fair value of SBP plan is more reliably determinable.

5. **GRANT DATE**: Means a date on which entity and the other party have agreed and approved the terms & conditions of the SBP Arrangement.

6. **MEASUREMENT DATE**: The date at which the fair value of the equity instruments granted is measured for the purposes of this Ind AS. For transactions with employees and others providing similar services, the measurement date is grant date.

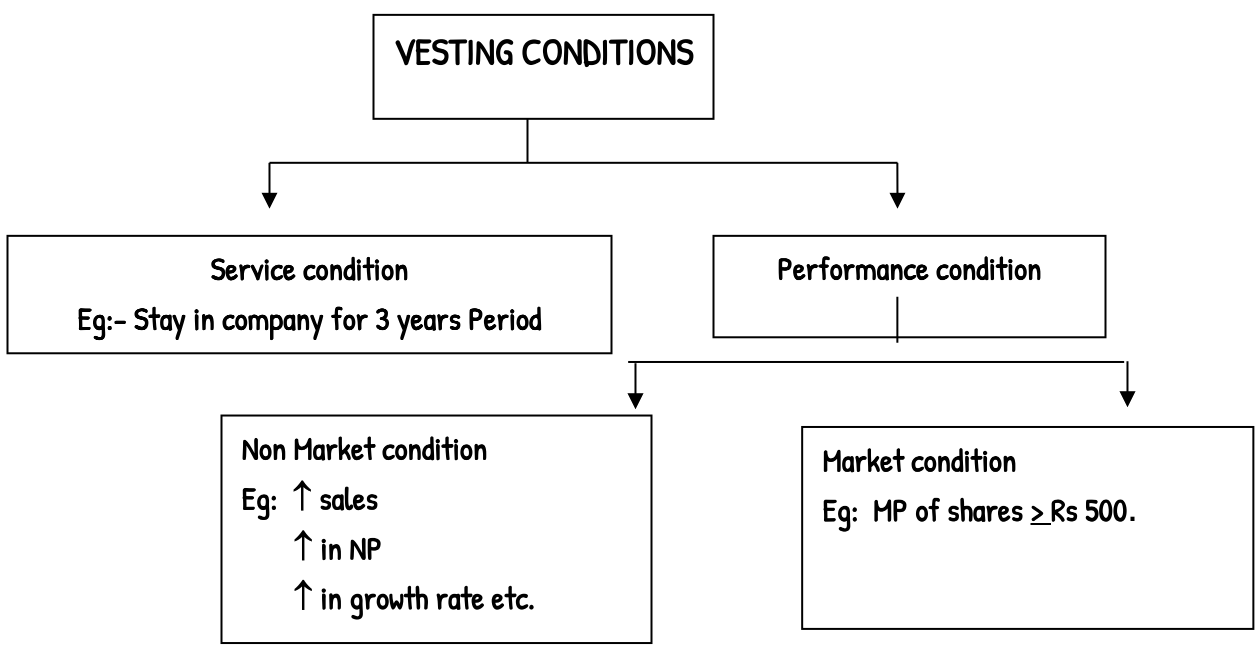
   For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

EMPLOYEE STOCK OPTION SCHEME

1) In ESOPS, Employees will be provided with an option to buy shares of the company at a pre-determined price on a future date. The Employees will get the right to exercise after fulfilling vesting conditions.

2) Vesting Conditions:

These are conditions which have to be fulfilled by the employees in order to become eligible for buying the shares under ESOPS.



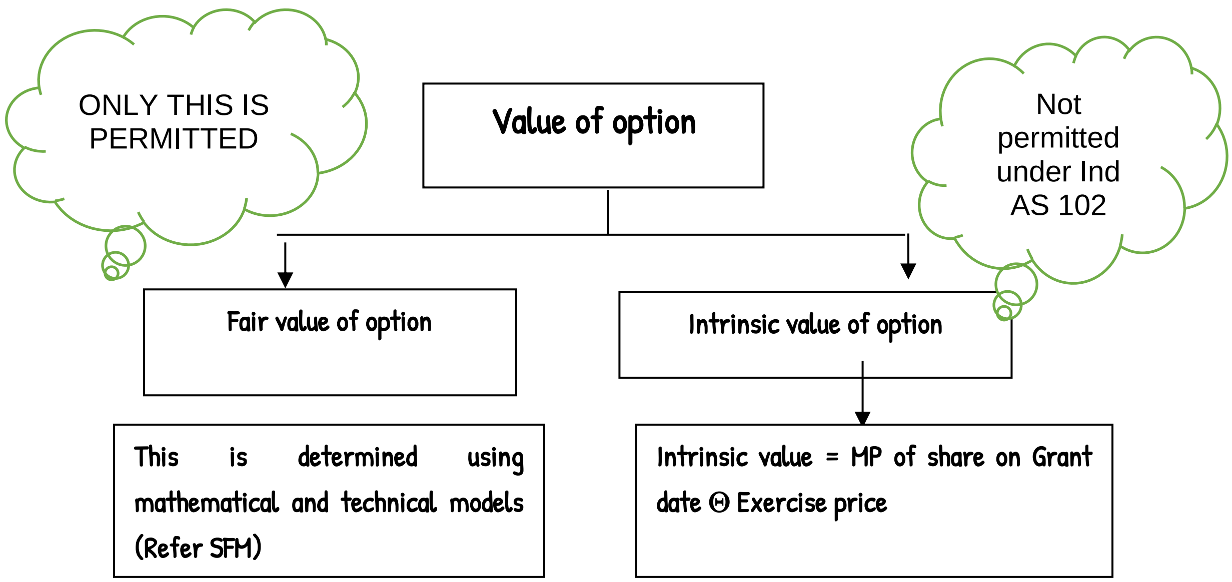
3) If all the vesting conditions are satisfied by the end of vesting period, the employee becomes eligible to buy shares. This is called as options getting vested.

4) Employee has no obligation to buy the shares even if the options are vested. After the vesting date an additional time period is provided where its employee can exercise his options. The option is called as Exercise period. Options not Exercised by the end of exercise period will be lapsed.

5) On Issue of shares to employees the company receives conditions by two forms.

i. Cash – Exercise price

ii. Services during vesting period – value of services is indirectly valued as value of option grant date.



I. Accounting of ESOPS

The option expense has to be recognized each year in P&L A/c throughout the vesting period. Credit will be given to an Equity A/c called as SBP Reserve.

Option Expense each year =

$$\underbrace{\left[\begin{array}{c}\text{NO. of employees expected @end of vesting period X No. of options per employess} \\ \text{x fair value of option } \textbf{on grant date}.\end{array}\right] \times \frac{\text{Expired period}}{\text{Total vesting period}}}_{\text{Desired closing balance of SBP Reserve}}$$

(-)Expenses recognized in earlier years.

Desired closing balance of SBP Reserve

Opening balance of SBP Reserve

Note 1: The factors for computation of option expense like No. of Employees, no of options for employees, fair value of option, total vesting period are to be considered using the latest estimates at the end of each year and therefore can be changed in each period when they are relating to service conditions / Non market performance condition.

Note 2: Calculation of No. Employees to be considered.

- While calculating option expense in the last year of vesting period, we have to consider only the actual no. of employees to whom options are vested. There will be no need to estimates.
- However, while calculating the option expense for the remaining years we have to estimate the No. of employees who are expected to be present at the end of service period.

a) If Rate of Exit (%) is given as average % over the full vesting period, then consider such % for all the years in vesting period. The actual rate of exit in proceeding period should be ignored.

b) If just a rate of exit (%) is given and it is not mentioned that it is an average for the full vesting period then consider such rate of exit for the remaining vesting period.

Journal Entries:

1) **ON Grant – Day** No Entry

2) **During vesting period**

a) For Recognizing option expense

Employee compensation Exp A/c Dr.

To SBP Reserve.

b) Transfer to PL

P&L A/c Dr

To Employee compensation exp.

Note: If option expense is negative, reverse entries will be passed.

3) **After vesting period**

i. If options are exercised:

a) For exercise price received

Bank A/c Dr

To SBP Reserve

b) For Issue of shares

SBP Reserve Dr [Value of option + exercise price] x No of option

To Equity share capital

To Securities Premium

Alternatively,

Bank A/c Dr Exercise Price

SBP Reserve A/c Dr Value of options

To Equity share capital Face value

To Securities premium (Bal. Fig)

ii. If options are lapsed.

SBP Reserve A/c Dr

To Retained Earnings / General Reserve.

TREATMENT OF MARKET CONDITION

Possibility 1: Market condition without any time limit. [Eg: options will vest whenever market price of share exceeds Rs.500]

a) On grant date, the company will estimate a vesting period by which the market condition is expected to be satisfied.

b) Option expense has to be recognised over this estimated vesting period. Any further estimates regarding the vesting period **shall be ignored.**

c) At the end of estimated vesting period, option expense has to be recognised even if market condition is not satisfied.

d) However, if market condition is actually satisfied before the estimated vesting period then there will be a **preponement of option expense**. This is called as acceleration of option expense.

Possibility 2: Market condition with time limit [Eg: options will vest only if market price exceeds Rs.65 by the end of year 3]

a) Here the vesting period is defined in the ESOP contract. Therefore, option expense is to be recognised over this vesting period.

b) If the market condition is not satisfied by the end of vesting period, then options do not vest at all. However, the option expense needs to be recognised as usual. This is because the possibility of market condition not getting satisfied is already considered in determining the fair value of option on grant date. As the options do not vest, the accumulated balance in **SBP Reserve is transferred to Retained earnings.**

Example

No. of Employees covered in ESOPS = 100

No. of options per employee = 60

Fair value of the option = 17

Market price should become Rs 150 is the vesting condition and employee should stay till such period. Expected vesting period on Grant date = 4 years.

At the end year 1:

Employees left 5, expected to leave 12 and MP not estimated to cross Rs 150 within 4 years.

At the end of year 2:

Employees left 3, expected to leave in future is 4, MP will reach the target after 4 years from year 2.

At the End of the year 3:-

Employees left 7, market price has attained the target level of Rs 150 in this year. Hence the options vested.

Calculated option expense each year.

II. MODIFICATION OF ESOP

(I) Modification: It refers to changes in terms and conditions of the plan.

Situation 1: Where modification is unfavorable to the employee.

Ignore such modification for the purpose of accounting continue accounting the ESOP's as per original terms & conditions.

Example of such changes

1) Increase in Exercise price
2) Increase in Vesting period
3) Increase in targets to be achieved

Situation 2: When modification is favorable to the Employee.

1) If subsequent to Grant option the MP of share decreases, it will reduce the amount of benefit that will be derived by the Employee. The company may modify the ESOP plan by reducing the exercise price or by Increasing the no. of options.
2) We have to calculate the Incremental benefit given to the Employee and such Incremental benefit shall be accounted as Incremental option expense, over the remaining vesting period. Apart from this recognition of option expense as per original terms & conditions should normally continue.
3) Incremental benefit to employees due to repricing of options (↓ in Exercise price) = Fair value of option after repricing Θ Fair value of option before repricing

   Incremental benefit to employee due to additional options Granted = No of additional options Granted x Fair value of option on date of modification.

(II) CANCELLATION OF ESOP'S

1) If the company cancels the share based payment plan, it has to immediately account the option expense relating to the remaining vesting period. The is a preponement of option expense also referred as acceleration.

   Employee compensation A/c Dr

   To SBP Reserve

   P&L A/c Dr

   To Employee compensation.

2) If any cash payment is made to the employees it will be accounted as if it is a buy back i.e., by reducing the Reserves / Equity.

   General Reserves / Retained earnings Dr

   To Bank A/c

   Note: If, however the cash paid to the employee is in excess of FAIR VALUE OF OPTION ON CANCELLATION DATE, such excess amount is a loss and it will be debited to P&L A/c.

3) The amount accumulated in SBP Reserve will be transferred to Equity (General Reserve/ Retained Earnings).

STOCK APPRECIATION RIGHTS (SAR) OR CASH SETTLED SHARE-BASED PAYMENT.

1) In SAR the company agrees to pay cash to the employee after the vesting period to the extent of MP over and above the exercise price.

   Cash paid to employee = MP of share on exercise date (-) Exercise price

   This is called as INTRINSIC VALUE of option on EXERCISE DATE

2) Unlike ESOP's, SAR is a liability since the company has an obligation to pay cash.
3) Since SAR is a liability, it has to be remeasured each year considering the Fair value of option at the end of each year.

Journal Entries:

1) For Recognizing option expense

   Employee compensation A/c Dr

   To SBP liability A/c / Provision for SAR

2) Transfer to P&L

   P&L A/c Dr

   To Employee compensation Expense.

3) On payment of cash to employee

   SBP Liability A/c Dr

   To Bank A/c

Note 1: While calculating option expense each year, we have to consider the fair value of option at the end of each year.

Note 2: If any Excess liability is created or SAR is not Exercised such excess liability shall be reversed by transferring to P&L A/c.

Example : Softex Ltd announced SAR on 01.04.07 Each employee is given 100 options an the exercise price is Rs 125. Vesting period is 3 years. SAR is exercisable after 31st March 2010 but before 30 June 2010.

The fair value of SAR was Rs 21 in 2007-08, Rs 23 in 2008-09 and Rs 24 in 2009-10. In 2007-08 the company estimated that 2% of its employees shall leave the company annually. This was revised to 3% in 2008-09. Actually 15 employees left during 2007-08, 10 left in 2008-09. And 8 left in 2009-10. The SAR actually vested in 492 employees. All the options are exercised on 30 June 2010 when the intrinsic value was Rs 25 per share. Calculate the option expense each year.

ESOP'S WITH CASH ALTERNATIVE

The employees will be given a choice to select either cash (SAR) or shares (ESOP's) after the vesting period. This plan will be accounted as under.

Step 1: FV of SAR on grant date = No. of options x Fair value of option without restrictions

Step 2: FV of Equity obligation = No. of options x Fair value of option after considering Restrictions.

Step 3: Equity component = [Step 2 Θ Step 1] only if positive.

Step 4: The No of options in step 1 should be accounted as throughout the vesting period and The Equity component in step 3 if any will be accounted as ESOP's

Step 5: After Vesting date.

Situation 1: Employee Opts for cash

a) Pay cash to employee from SBP Liability A/c and
b) The Balance in SBP Reserve is transferred to Equity (Retained Earnings/ General Reserve)

Situation 2: Employees opts for share

a) The Balance in SBP liability will be transferred to SBP Reserve.
b) From SBP Reserve shares are issued.

SPECULATIVE CONTRACTS

If share Based payment plan is entered with a motive of cash settlement / Gain / loss without actually taking the delivery of Goods / services. The contract becomes a speculative transaction. Such transactions are out of the scope from IND AS 102. They are covered by IND AS 109.

The intention of the parties and the past track record of settlements in similar transactions will provide on evidence in regard.

GROUP SETTLED PLANS

A parent entity and its subsidiaries together are referred as a group. There can be situations where services are received by one Entity in the group but settlement is done by using shares of another entity in the group.

Situation 1:

Services are received by parent co.
+
Shares are to be issued by subsidiary co.

In the books of parent co.	In the Books of subsidiary Co.
Employee compensation A/c Dr To Dividend Income (Subsidiary issuing shares out of their reserves is a kind of dividend distribution]. This Dividend is an Income to parent co.	Retained Earnings/General Reserve Dr To SBP reserve/ equity share capital

Situation 2:

Services are received by Subsidiary Co.
+
Shares are to be issued by parent Co.

In the books of Parent Co.	In the Books of subsidiary Co.
Investment in subsidiary co. Dr To SBP Reserve/ Equity share capital	Employee compensation A/c Dr To capital contribution by parent

FINANCIAL INSTRUMENTS

1) Financial Instruments is covered in following three IND AS

   IND AS 32: Presentation of Financial Instruments (It predominantly deals with classification of Equity and Financial Liability)

   IND AS 109: Recognition and measurement principles

   IND AS 107: Disclosures relating to Financial Instruments

2) Definition of Financial Instruments: It is a contract between two or more parties that gives rise to a Financial asset one Entity and a Financial Liability or Equity Instrument of another Entity. Existence of contract is mandatory. It can be written, oral or Implied.

3) A **FINANCIAL ASSET** is any asset that is

A. Cash;

B. An equity instrument of another entity;

C. A contractual right:

a. to receive cash or another financial asset from another entity; or

b. to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or

D. a contract that will or may be settled in entity's own equity instruments and is:

a. a non-derivative for which the entity is or may be obliged to receive a variable number of entity's own equity instruments; or

b. a derivative that will or may be settled other than by exchange of fixed amount of cash or another financial asset for a fixed number of entity's own equity instruments. For this purpose, entity's own equity instruments do not include puttable financial instruments classified as equity instruments, instruments that impose on the entity an obligation to deliver to another party a pro-rata share of net assets of the entity on liquidation and are classified as equity instruments, or instruments that are themselves contracts for future receipt or delivery of entity's own equity instruments.

4) A **FINANCIAL LIABILITY** is any liability that is;

(a) A contractual obligation:

(i) To deliver cash or other financial asset to another entity; or

(ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity;

or

(b) A contract that **will or may be settled in entity's own equity instruments** and is:

(i) A non-derivative for which the entity is or may be obliged to deliver a variable number of entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

As an exception, following type of instruments that meets the definition of a financial liability may still be classified as an equity instrument if they have certain features and meets specific conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of Ind AS 32.

5. EQUITY INSTRUMENT

1) An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities,
2) An instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met:

a) The instrument includes **no contractual obligation:**

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the issuer.

b) If the instrument **will or may be settled in the issuer's on equity instruments**, it is:

i. a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its on equity instruments; or

ii. a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its on equity instruments.

For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments, Also, for these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's on equity instruments.

A contractual obligation, including one arising from a derivative FI, that will or may result in the future receipt or delivery of the issuer's on equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument.

Identification of financial Asset and Financial Liability

Particulars	Financial Asset (FA) or Financial Liability (FL)
1. Bank Balance	Financial Asset
2. Trade Receivables	Financial Asset
3. Advance given to suppliers	Not a FA, No contractual right to receive cash
4. Bills Receivable	FA
5. Inventory	Not a F
6. Investment in Debentures	FA, since it gives a right to collect inertest & principal cash flows
7. Investment in Equity shares	FA, specifically covered as such in the definition
8. Investment in Convertible debentures	FA, It gives right to receive equity shares which is a FA
9. Prepaid Expenses	Not FA
10. PPE	Not FA
11. Damages receivable in court case	Not FA, since there is no contract
12. Insurance claims receivable	FA, contract exists
13. Creditors, Bills payable	FL, since there is obligation to pay
14. Loans taken, deposits accepted, Debentures issued	FL
15. Provision for tax	Not a FL, since there is legal obligation but not a contractual obligation
16. O/s Interest on loans	FL
17. Financial Guarantee	Guarantees represent a right to collect cash for the lender if the borrower defaults. It also represents a contractual obligation to pay cash for the Guarantor.

6. DERIVATIVES

Derivatives are contract which satisfy all the following conditions.

1. These contracts require zero / a small initial Investment
2. Such contracts are to be settled on a future date.
3. The value of this contract is derived from the value of the underlying

Note:

1. In a derivative contract, there will be a possibility of Gain / loss
2. In a derivative contract, a price is fixed, which will be Instrumental for computing Gain / losses.

I. FORWARD CONTRACT / FUTURE CONTRACTS

a) These are contracts entered to buy / sell the underlying asset in future @ pre-determined rate.

b) A forward contract is an over the counter contract, whereas Futures contract is exchange traded contract.

c) The predetermined rate is called as Forward rate (or) Future's rate.

d) Party who agreed to buy the underlying asset is said to have a LONG position. This party will gain, if MP of underlying asset increases.

e) Party who agreed to sell the underlying asset is said to have a short position. This party will gain, if MP of underlying asset decreases.

f) The value of Forward contract / Futures contract fluctuates on the basis of fluctuation in market price of underlying asset.

g) The parties in the contract can close the contract before the maturity date by Entering into an opposite contract.

Original position	Position to be taken now for closing / squaring up.
LONG POSITION	Now take short position for remaining maturity period
SHORT POSITION	Now take long position for remaining maturity period.

II. OPTIONS CONTRACT

a) In option contract there will be two parties, HOLDER, AND WRITER. HOLDER will have a RIGHT and writer will have an OBLIGATION.

b) On entering into the Contract, Holder pays premium to the writer. Therefore the Holder is called as Buyer of Option and writer is called as Seller of Option.

c) There are two types of options

1. Call Option
2. Put Option

	CALL OPTION	**PUT OPTION**
HOLDER	Right to BUY the underlying asset @ pre-determined price	Right to sell the underlying asset @ pre-determined price
WRITER	Obligation to sell the underlying asset @ predetermined price	Obligation to buy the underlying asset @ pre determined price
Exercised by Holder when	MP> Strike price	MP < Strike price

STATUS OF OPTION:

IN THE MONEY: On comparison with prevailing market price if the option is likely to be exercised, then its ITM.

OUT OF THE MONEY: On comparison with prevailing market price if the option is likely to be lapsed, then its OTM.

AT THE MONEY: IF prevailing market price = strike price of option, its ATM.

Note: If any contract entered today will be settled on a future date and its value depends on the value of underlying asset but has higher initial investment cannot be called as a derivative.

Accounting of derivatives: Derivative can be classified as a

i) Financial Asset or

ii) Financial Liability or

iii) Equity instrument or

iv) may be scoped out of this Standard.

7. CONTRACTS ENTERED ON NON-FINANCIAL ASSETS TO BE EXECUTED IN FUTURE

1. These are contracts entered by the entity to buy/sell non-Financial assets on a future date i..e, Agreement to buy /sell commodities on a future date.
2. If such contracts is entered purely for delivery and used for self-consumption or sale / purchase in the ordinary course of Business, then these contracts are not treated as Financial Instrument.

   Note: However if it can be established that the objective of entering into the contract is for speculation purposes, it is covered as a Financial Instrument.

   Example: Contract entered for the purpose of delivery and selling the commodity in the market immediately for a speculative Gain.
3. If the contract is to be settled only by way of net cash settlement, then they are covered as Financial Instruments.

   Net cash settlement means there will be no delivery of the non financial asset, only the Gain / loss is settled in cash.
4. **If the entity has a choice** as regarding the mode of settlement, [Delivery or net cash] then **we have to check the history of past settlements in similar contracts. If it can be established that the objective is to obtain physical delivery to meet own usage requirements, then exemption under** IND AS 109 is available. Own use exemption to classify a contract with Net settlement option as a non financial instrument applies only when intention is to meet own usage requirement (to give delivery) **both at the time of initial date and subsequently.**

8. CONTRACTS TO BE SETTLED BY ENTITY S OWN EQUITY INSTRUMENTS

WHERE ENTITY HAS TO DELIVER ITS OWN EQUITY	WHERE ENTITY RECEIVES ITS OWN EQUITY.
(a) Fixed to Fixed Test	(d) Buyback
(b) Compound Financial Instruments	(e) Written put option on Own equity
(c) Contingent Settlement provisions.	(f) Treasury shares.

(a) FIXED TO FIXED TEST

1. The contracts which have to be settled by issue of own Equity shares in future will be classified as EQUITY if fixed number of shares are to be issued for a fixed consideration. [Referred as FIXED TO FIXED TEST] Eg: A company issued debentures of Rs 10,00,000 which are convertible into 1,00,000 Equity shares after 5 years.

2. It will not be classified as equity where
   a) Variable no. of Equity Shares are to be issued
      [or]
   b) Fixed no. of equity shares are issued for a variable consideration.

Example 1: X Ltd has issued debentures Rs 10,00,000 which will be converted into Equity shares after 5 years. No. of shares to be issued depends on Fair market value of shares @ 5 years' time. The debentures are not classified as EQUITY. It is a Financial Liability.

Example 2: X Ltd has issued debentures Rs 10,00,000 after 5 years one lakh Equity shares will be issued. The amount of liability reduction after 5 years depends on the Fair value of share @ 5th year. The remaining liability has to be paid in cash.In this case even though the no of shares to be issued is fixed, the consideration for Equity shares is variable. Therefore this debenture is not classified as EQUITY. It is a FINANCIAL LIABILITY.

Notes:

1. If the company increases the no. of shares due to a Bonus issue or a share split, it is not treated as variable, since it is done to protect the interest of instrument holder in comparison with other Equity shareholders. The increase in the number of shares is done to protect the rights of the instrument holders and not their return.
2. No. of Equity Instruments to be granted may be different for different dates in this case the number of Equity Instruments to be issued is not considered as variable since the no. of shares to be issued depends on time which is a certain event.

3. When Conversion ratio depends on targets to be achieved

   If different no. of shares will be issued based on each target achieved, the no. of shares that would be issued will be treated as fixed if the target conditions are independent

   If the target conditions are interdependent on each other Fixed to Fixed test is not met.

Example 3: A call option is written by Entity A, which gives the holder Right to buy Equity shares of Entity A for Rs 100 per share as follows.

a) 1000 shares if Entity A achieves profit of Rs 20 crores in year 1
b) 2000 shares if Entity A achieves profit of Rs 60 crores in year 2
c) 3000 shares if Entity A achieves profit of Rs 100 crores in year 3

Is the Fixed to Fixed Test passed?

In the above case the target conditions are viewed as discrete because the achievement of each target can occur independently of other targets. Since they relate to financial performance in different periods. The arrangement can therefore be considered to be economically equivalent to three separate contracts. The price per share and the no. of shares to be issued is fixed in each of these three discrete periods. Therefore the fixed to fixed test is passed and the call option written will be classified as EQUITY instrument.

Example 4 Entity C writes a call option that gives the buyer a right to buy the Equity shares of Entity C @ Rs 100 per share as follows.

1. 1000 shares if Entity C achieves sales revenue of 20 crores in year 1
2. 2000 shares if Entity C achieves sales revenue of 60 crores in year 1
3. 3000 shares if Entity C achieves sales revenue of 100 crores in year 1

Is the Fixed to Fixed Test passed?

All the three targets are interdependent because the second target cannot be met without meeting the first target and the third target cannot be met unless the first two are met. Therefore this contract is seen as a single instrument when applying the fixed to fixed test. This test is failed because the no. of shares is variable

(b) COMPOUND FINANCIAL INSTRUMENT

It is a financial instrument that has the components of financial liability as well as equity. These types of instruments are accounted by segregating the equity component and the financial liability component on the initial recognition date [Accounting discussed later].

Examples 5

1. Issue of redeemable preference shares with a life of 5 years with discretionary dividend. Here principal amount is FL, discretionary dividend is Equity. Overall, it is CFI.
2. Issue of irredeemable debentures with mandatory dividend. Here principal amount is not repayable so it is equity, mandatory interest creates an obligation therefore it is FL. Overall it is CFI.
3. Convertible or Redeemable Debentures/Pref shares:

   a) **At the option of the holder:** Principal amount is a Financial Liability since the entity has the obligation to pay cash if the holder selects redemption option in cash**.**

   b) At the option of the issuer entity: Principal amount is equity since the company has no obligation to pay cash. However, if in substance the company is going to pay cash only & would not convert into equity shares, then it may classify the principal amount as Financial Liability.

   When a company issues convertible instruments as above, the coupon rate (contracted rate) will be LOWER than the ordinary rate what the investors expect from a Non convertible instrument. It means the company is reducing its interest obligation by introducing the equity conversion feature. This creates an equity component. Therefore convertible instruments with mandatory interest are treated as CFI.

(c) CONTINGENT SETTLEMENT PROVISIONS

In any situation the contracts have to be settled either by issue of own Equity shares or payment in cash and this is dependent on a future uncertain event which is not in the control of any parties the contract is referred as a contingent settlement contract.

These contracts should be accounted as a FL unless all the settlement alternatives result into issue of Equity.

Example 6 X Ltd has issued debentured for 5 years on the following terms

Case (i): Debentures are converted into Equity shares in the ratio of 10:1, if the Fair Market value of share is > 100, otherwise it will be redeemed in cash. This will be classified as FL. Any expectation about future market price of the share is irrelevant for the classification today.

Case (ii):The debentures are converted into 10 equity shares if market price > Rs 100, otherwise it will be converted into 15 shares. Even though the settlement will happen only by issue of shares, the debentures cannot be classified as Equity since the no of equity shares is not fixed.

Case (iii):The debentures will be converted into equity shares @ 5:1 only when the MPS > Rs 100.The debenture issued will be classified as Equity Instrument since there is no possibility of making any cash payment.

(d) ACCOUNTING FOR BUYBACK

Repurchase of Entities own Equity Instruments is called as buy back. The accounting for such buy back is specified in IND AS 32.

If Buy Back is done Immediately.

EQUITY A/c Dr

To Bank A/c (Buy back price)

The face value of shares bought back & cancelled will be debited to Equity share capital A/c and any excess amount paid, i.e., premium on buy back will be debited to other EQUITY.

(e) IF OWN SHARES ARE AGREED TO BE BOUGHT BACK UNDER A PUT OPTION WRITTEN BY THE COMPANY

a. For Premium received under put option

Bank A/c Dr

To Equity

b. By Writing a put option there is an obligation to pay cash in future to the extent of exercise price. Recognize the PV of such exercise price as a FL, by debiting equity.

Equity A/c Dr

To Financial Liability **(PV of Exercise price)**

* This debit should not be given to ESC. Its debited to Reserves i.e., other Equity.

c. At the Exercise date

i. For recognition of Interest Expense on FL.

Interest cost A/c Dr

To Financial Liability.

[after the above Entry, FL A/c will represent the Exercise price]

ii. If put option is Exercised by the holder. (i.e. shares are bought back)

1. Financial liability A/c Dr

   To Bank A/c

   [with the Exercise price]

2. Equity share capital A/c Dr

   To Equity

   [with paid up value of shares bought back]

iii. If put option is lapsed by the holder

(i.e., shares are not bought back)

Financial liability A/c Dr

To Equity A/c

(f) TREASURY SHARES

When a company buys back its own shares in the market, as per companies Act such shares should be destroyed / cancelled within a period of 7 days.

However, in other countries, it is permissible for the companies to hold such shares like an investment. When company holds such shares instead of cancelling them, it is referred as treasury shares. Own shares held by the company as investment cannot be shown as a Financial asset, it is deducted from Equity

a) On Purchase of own shares

Equity A/c Dr Purchase price

To Bank A/c

b) Subsequently when these shares are sold, the sale proceeds are credited to Equity.

Bank A/c Dr Sale price

To Equity

The Profit / loss on sale is directly adjusted in Equity and will not be transferred to P&L A/c.

9.TRANSACTION COSTS

Related to Issue of Equity Instruments

Costs incurred are to be directly adjusted into equity [Eg: Retained earnings]

Related to Fin. Assets (Or) Fin. Liability

Will be covered in Ind AS 109. Depends on method of accounting [ACM / FVTPL / FVTOCI]

Cost incurred for listing of equity shares will be treated as AN EXPENSE IN P or L

Any contract / instrument if classified as equity, it will be measured only at its initial value and there would be no subsequent Re-measurement.

10. INTEREST & DIVIDENDS

On Financial Assets

Recognized as income in P or L

On Financial Liability

Recognized as expense in P or L

On EQUITY instruments

Adjusted directly into EQUITY (Related earnings)

Any **discretionary payments** of interest or dividend made on financial liabilities are also adjusted directly into **EQUITY.**

11. OFFSETTING FINANCIAL ASSET AND FINANCIAL LIABILITY

A Financial asset and Financial liability can be offset for the purpose of presentation if the following two conditions are satisfied.

1. There is a legally enforceable right to net off financial asset and financial liability and
2. The parties intend to settle on a net basis.

12. FOREIGN CURRENCY CONVERTIBLE BONDS

Conversion of FCCB into Equity shares on a future date will be classified today as an equity Instrument, provided the issue price is fixed in any currency. The no of shares to be issued in future on conversion may be variable as it is dependent on the exchange rate on the date of conversion. Even then it will be classified as an equity instrument as per IND AS 32.

Example 6: ABC Ltd has issued FCCB FV 1$ each 5 years FCCB will be converted into "X" of Equity shares which will be issued at Rs 10 per share.

∴ No. of shares that will be issued @ 5 years time = $\frac{1\$ \text{ X exchange rate an date of conversion}}{\text{Rs } 10}$

Note:- However in IAS 32, the above FCCB should be classified as Financial liability and not as Equity since the no of shares to be issued is variable.

The provision in IND AS 32 classifying the above FCCB as Equity is a CARVE OUT from IAS 32.

13. PUTTABLE FINANCIAL INSTRUMENTS [PARA 16A & 16B]

These Financial Instruments contain a contractual obligation for the issuer to purchase / redeem the instrument for cash or another Financial asset on the Exercise of the put. These instruments are normally classified as Financial liability.

However if conditions mentioned in Para 16A & 16B are satisfied, these puttable financial instruments will be treated as Equity Instrument.

Eg: Open ended mutual fund units

Para 16A [Instrument Specific conditions]

1) Puttable financial instruments has got a right to obtain cash which represents their proportionate share of net assets in the entity in the event of liquidation.
   PSNA – Example: NAV on open ended units of MF
2) These instruments should be the most sub ordinate instrument (last priority) in the entity
3) All PFI have identical rights among them selves
4) Apart from the obligation to pay cash on exercise of put option, the entity should have no other obligation to pay cash/issue shares.
5) The total cash flows that are attributable to PFI holders are substantially based on (i) profit or loss (ii) Net Assets (iii) Fair value gains on Net assets.

Para 16B:[Issuer specific conditions]

There should be no other instrument in the entity that has

a. Cash flows based on (5) above &
b. Has the effect of substantially fixing & restricting the return to PFI holders.

14. INSTRUMENTS ENTITLED TO CASH PAYMENT ONLY ON LIQUIDATION [PARA 16C & 16D]

Eg: SPV s formed for a specific purpose; closed ended scheme of MF.

PARA 16C

First 3 conditions of PARA 16A

PARA 16D

Same as PARA 16B

15. EXCLUSIONS FROM IND AS 32 & AS 109

1) Investment in equity of subsidiary, Joint venture or associate [Ind AS 27 Separate financial statements]
2) Rights and obligations under leases to which Ind AS 116 Leases applies.
3) Insurance contracts [Ind AS 104 Insurance contracts]
4) Contractual obligations arising out or warranties which is covered in Ind AS 37 – provisions, contingent Liab, Contingent Assets]
5) Business Combination transactions [Ind AS 103 Business Combination]
6) Loan Commitments unless they become onerous.
7) Financial instruments, contracts and obligations under share-based payment transactions to which Ind AS 102 Share-based Payment applies, except for contracts to buy non-financial items as described below.

RECOGNITION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

I. FINANCIAL ASSET

- Amortized cost
- FVTPL
- FVTOCI

II. FINANCIAL LIABILITY

- Amortized cost
- FVTPL

1. The accounting for FA and FL is based on any of the following three methods.

1. AMORTIZED COST METHOD

a) The initial recognition of FA/FL will be done at fair value including the transaction costs.

b) The Interest Income / Interest Expense will be recognized using effective Interest method.

c) There will be no subsequent revaluation.

2. FAIR VALUE THROUGH PROFIT OR LOSS (FVTPL)

a) The initial recognition will be done at fair value at the transaction costs are directly transferred to P&L A/c.

b) On each balance sheet date, the FA/ FL will be Fair valued and the resulting gain / loss shall be recognized in P&L A/c.

3. FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (FVTOCI)

a) The initial recognition of FA will be done at Fair value including transaction costs

b) If the cash flows from FA are in the nature of Interest and principal, the Interest Income shall be recognized on effective Interest basis.

c) On each balance sheet date the FA is fair valued and the resulting Gain / loss will be recognized in other comprehensive Income separately. The Gain / loss so accumulated in OCI may or may not be re-classified to P&L A/c subsequently.

Example 7: A Ltd has issued 9% debentures of the FV Rs 100 each @ 5% discount. These debentures are redeemable after 3 years @ par value. Show the Accounting in the books of A Ltd applying amortized cost Method.

Example 8: A Ltd has advanced an amount of Rs 1,00,000 to B Ltd on 01.04.2015. It has collected Processing charges of Rs 10,000 on the same day from B Ltd. This loan carries an interest of rate 10%. The loan is repayable after 3 years at a premium of 5%.Show the accounting in the books of A Ltd for all the 3 years using amortized cost method.[EIR = 15.88%]

Example 9 From the above data prepare the loan liability A/c in the Books of B Ltd using Amortized cost method.

Example 10: On 01.05.2016 A Ltd has purchased Investment in shares of X Ltd @ Rs 40,000. The transaction cost paid is Rs 2,000. The fair value of shares on different dates is as under

Date	**Fair value**
31.05.2016	48,000
30.06.2016	45,000
31.07.2016	38,000

Show the accounting of the Investment A/c under

Case (i) FVTPL

Case (ii) FVTOCI

ACCOUNTING FOR INVESTMENT IN EQUITY SHARES

1. Investment in equity Instruments should be initially recognized at Fair value. The transaction cost will be transferred to P&L A/c and subsequently the Investment will be measured using FVTPL.
2. If the Investment in Equity shares is not held for trading Purposes, then the Entity has an option to designate the equity Instrument to be measured using FVTOCI.

   In this case the Gains / Losses on Fair valuation will be transferred to OCI Reserve. Subsequently when the investments are sold, the accumulated balance in OCI reserve **CANNOT BE RECYCLED to P&L A/c**. It will be directly transferred into Retained Earnings.
3. Any dividend Income or Gain / Loss on disposal shall be recognized in P or L A/c.

ACCOUNTING FOR INVESTMENT IN FINANCIAL ASSETS OTHER THAN EQUITY INSTRUMENTS.[Debt Instruments, loan Receivables, loans given to employees, Investment in preference share, Investment in Convertible debentures]

The accounting for these financial assets will depend on the following two tests.

I. BUSINESS MODEL TEST

Here we understand the objective of the entity in holding the Financial Asset. It could be any of the following.

A. **To hold** the FA till its maturity.

B. **To hold** the FA till maturity but the FA may **also be sold.**

C. The objective of holding the FA is **to sell it**.

II. CONTRACTUAL CASH FLOW TEST/ SPPI TEST

D. The FA provides a right to collect cash flows which represent SOLELY PRINCIPAL PAYMENT AND INTEREST **[SPPI].**

METHOD TO BE APPLIED

1. **USE AMORTIZED COST METHOD** when **(A) + (D)** are satisfied.
2. **USE FVTOCI** if **(B) + (D**) are satisfied.

[Int Income to be recognized on effective interest basis as incase of Amortized cost method. The accumulated Gains / Losses in OCI can be RECYCLED to P&L A/c on disposal]

3. **Use FVTPL**: In any other case

Notes:

1. If the Entity has sold FA, before its maturity in a stress case Scenario [For requirement of Funds]. It does not Contradict the objective of the Entity to held the FA till its maturity.
2. If the Entity has sold FA, before its maturity since the risk in investee has increased beyond acceptable levels, does not contradict the objective of holding till maturity.
3. If the entity has sold insignificant portion of FA to check the liquidity of the FA.
4. The cash flows arising from FA should be in the nature of Interest and principal to meet the CFT test. If the FA involves rights of conversion into Equity shares then CCFT is not passed.
5. Interest is the consideration which should represent time value of money plus an additional return covering the credit risk. The Interest rate may be linked to Inflation rate also. Interest rate may be fixed or floating or both.
6. If the cash flows arising from FA are linked to the profits of the Borrower then such cash flows does not represent SPPI.
7. An Entity can hold different Financial assets with different objectives.
   Eg:- Loans given to employees → objective is to hold till maturity
   Investment in bonds → objective is to sell
8. If the loan is held with the objective of sale to subsidiary & the subsidiary has an objective to realise cash flows from the FA transferred, while preparing CFS it should be considered as if the group has as objective to collect cash till its maturity and not to sell it.

SPECIAL CASES

I. STAFF LOANS

1. Sometimes the Entities provide loans to its Employees without Interest or at concessional rate of Interest. These loans given to Employees are usually classified under amortized cost method.
2. The initial recognition of the staff loan shall be made at Fair value of loan given, which is equal to the PV of Future cash flows receivable from employees, Discounted @ market Interest Rate.

3. The difference between the actual amount given and the Fair value loan will be accounted as expense in P&L A/c immediately, if there are no further conditions to be satisfied.If any conditions are to be met by the Employees, this difference will be accounted as a prepaid expense and it will be amortized to P&L A/c over the period of loan.

Journal Entries

Staff loan A/c Dr	(Fair value)	
Staff cost A/c / prepaid staff cost A/c		(Bal. fig)
To Bank A/c		(Amount Advanced)

Staff loan A/c will be accounted using amortized cost method recognizing interest income at market Interest rate.

Example 11

A Ltd has given Rs 1,00,000 loan to its Employee @ Int Rate of 2%, the loan will be repaid after 3 years the market interest Rate is 10% p.a. Show the accounting in the books of A Ltd.

II. SECURITY DEPOSIT

1. When the Entity gives any security deposits under any contract on under a rental agreement, the deposits will be refunded after the specified contract Period. These security deposits are financial assets and will be accounted using amortized cost method. These deposits may or may not offer Interest Income.
2. The security deposit will be initially recognized at fair value, which is the PV of future cash inflows discounted @ market Interest Rate.
3. Any difference between the actual amount given and the fair value of deposit will be accounted as a asset or expense whichever is appropriate.

Note: Accounting for Prepayment

In case of staff loans or security deposits which are recognized as financial assets, if there is any prepayment, then the value of the FA (loan given) should be restated and it should represent the PV of remaining cash flows discounted @ original Interest Rate. Any difference between the book value of the loan & the Restated Fair value of the loan will be adjusted against the balance in prepaid expense A/c to the extent available and any further difference adjusted in P&L A/c.

III. LOANS WITHIN THE GROUP

Loan between group companies: These loans are of **three types:**

A. Loan is Repayable on demand: Fair value is equal to cash consideration given and recognized as financial asset and liability, for lender and borrower respectively.

B. Loan is given for a specified period:

Step 1: Calculate Fair Value of loan by using Market rate of Interest.

Step 2: Calculate difference between consideration paid and fair value of loan which shall be recorded as follows:

Case 1: If Lender company is Parent Co.: Such difference shall be recorded

- In the books of Parent Company: as investment in Subsidiary Company

And

- In the books of subsidiary company: as on equity contribution by parent co.

Case II: if Lender company is Subsidiary Co,: Such difference shall be recorded

- In the books of Parent Company: Dividend income

And

- In the books of subsidiary company: Dividend distribution

C. Loan repayable when funds are available: Such loan either can be interest free loan or loan at a lower rate, same accounting treatment as discussed in above point 2, but for the purpose of calculation of fair value the entity needs to estimate the repayment date and determine its measurement accordingly.

Note: The above treatment is for standalone financial statement, In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

IV. Investment in Perpetual Bonds

These instruments do not have any redemption but they pay interest cash flows for indefinite period. Any Investment in such Instruments will be initially recognized at fair value which is Fair value of Perpetual Investment $= \frac{\text{Interest cash flow}}{\text{Market Int rate}}$

V. Demand Deposit

Since the Deposit is recoverable on demand, It will be accounted at **the transaction value**, there is no need to apply amortized cost method.

VI. Trade Receivables:

Debtors and other receivables are initially recorded at the transaction value. However if Extended credit period is provided, then amortised cost Method will be applicable.

Example 12

A Ltd sold goods for Rs 50,000 to B Ltd on 2 years credit. The normal credit period offered is only 30 days and sale would have been at 40,000. Show the accounting in the books of A Ltd.

VII. Regular way purchase / sale of Financial Asset [Applies where securities transactions are regulated by an exchange having a customary period between trade and settlement date]

1. Trade date refers to the date of transaction and settlement date refers to the date on which delivery of asset is obtained and settlement is done.
   Normally, the settlement in cash will be done at the rate prevailing on transaction date. If the difference between transaction day price and settlement date price is to be recovered / paid in cash, then the contract will be accounted as a Derivative instrument till the settlement date.
2. The standard has given an option to do the accounting either on the trade date or the settlement date as per the policy of the Entity.

Example 13 X ltd has purchased on investment in bonds Rs 100 on 30.03. on 31.03, the FV of these bonds is 101.The above transaction was settled on 01.04, and the FV on that date is Rs 103. Show the accounting in the Books of X Ltd assuming trade date accounting and settlement date accounting.

IMPAIRMENT OF FINANCIAL ASSET / LOSS ALLOWANCE ONFINANCIAL ASSET

1. Financial assets which are carried at FVTPL need not be tested for any Impairment as they are already reflecting the fair value and any loss has already been recognized in PL A/c.
2. Impairment Loss Allowance is required for Financial assets which measured at amortized cost method (or) FVTOCI.
3. The impairment loss (Expected credit loss) ill be determined by the entity based on their past experiences in realization of cashflows and assessment about future.

Calculation of loss allowance [most followed method]

Step 1: Calculate the Expected Cash inflows from the FA, that will not be received as per the estimates of the company

Step 2: Calculate PV of such expected cash inflows which are not likely to be received. Use original effective Interest Rate.

Step 3: To calculate the loss Allowance,
We have to multiply the value in step 2, with the probability of default

It can be either of the following

a) **12m Expected credit loss** =Probability of default in next 12m x PV of loss calculated in step 2

[Or]

b) Life time expected credit loss = Probability of default over the life of Financial Asset x PV of loss calculated in step 2

Notes:

1. 12m ECL represents the loss calculated over the life of the Financial asset by considering the probability of default in the next 12m.
2. If we consider the probability of default during the life time of the FA, the loss computed is called as lifetime ECL.

3. When to create 12m ECL & when to create Lifetime ECL?

FINANCIAL ASSET	ECL TO BE CREATED
a) For Trade receivables	**Apply Life time ECL**
b) For Lease receivables	**Lessor has a choice to apply Lifetime ECL or 12m ECL**
c) Financial Assets that are **credit impaired at acquisition**	**Apply Life time ECL**
d) Financial assets whose credit risk has **increased significantly** on the reporting date, compared to the date of acquisition.	**Apply Life time ECL**
e) Any Financial asset where the amount is **outstanding beyond 30 days** from due date, the standard makes a rebuttable assumption that it is credit impaired.	**Apply Life time ECL**
f) In any other case.	**12m ECL**

Accounting treatment of loss allowance

If FA carried @ Amortized cost method

P&L A/c Dr
To Loss allowance
[Shown as reduction from FA]

If FA carried @ FVTOCI

P&L A/c Dr
To OCI Reserve

Recognition of Interest Income

1. Financial assets measured under Amortized cost method / FVTOCI method, we apply effective Interest method to recognize the Interest Income.
2. Even if a allowance is created, the effective Interest Rate shall continued to be applied on the gross amount of FA, without reducing the loss allowance.
3. Effective Interest Rate will be applied on the net amount after considering loss allowance only when there is an actual default.

OTHER APPROACHES FOR ESTIMATING IMPAIRMENT LOSS: Apart from the above ECL method the following methods are also followed

1) **PROBABILITY DEFAULT APPROACH**: In this method based on past experience we assign probabilities to various outcomes of losses and calculate the expected credit loss.
2) **PROVISION MATRIX:** This approach is usually followed for debtors where provision rate is assigned based on the outstanding periods.

IMPAIRMENT LOSS ON LOAN COMMITMENTS

a) If no loss is foreseen, then no accounting is done for loan commitments as they are executory in nature.
b) If a loss is expected then measure the commitment at fair value & recognise the loss in P or L.

DERECOGNITION OF FINANCIAL ASSET

1. Derecognition refers to removing a financial asset from the books.
2. An entity can derecognize FA if the right to collect cash flows have expired.
3. Financial asset should also be derecognized if the entity transfers the right to collect cash flows to another party along with substantial risks and rewards.
4. Sometimes the Entity may retain the right to collect the cash flows from the financial asset but it creates an obligation to pay such cash flows to another party. In this case also FA shall be derecognized.
5. To entity should not retain any control on the financial asset. If it retains any control then FA should not be derecognized.
6. The right to collect the cash flows from the FA may represent total cash flows or specific identified cash flows from the FA or a portion of specific cash flows from the specific FA. Even partial derecognition oof FA is also possible.
7. Any gain or loss on derecognition shall be transferred to P or L.
8. In cases where transfer of FA is made for a consideration but risks and rewards are not transferred, the FA shall not be derecognized. Any amount received shall be treated as a financial liability.

Journal Entries in case of Derecognition of Specified / proportionate cash flows

Step 1:- Determine the fair value of transferred strip of cash flows and retained strip of cash flows. Consider the market Interest rate for computing the fair value

Step 2:- Allocate the Book value of FA to transferred strip and retained strip in the ratio of Fair values computed in step 1 above

Transferred strip A/c Dr } allocated in the ratio of fair value
Retained strip A/c Dr }
To Financial asset Book value

Step 3:- For receipt of consideration

Bank A/c Dr
To Transferred strip
(Any Difference is recognized in P&L A/c immediately)

DERECOGNITION WITH CONTINUING INVOLVEMENT

1. The Entity may transfer the right to receive cash flows from the FA to another party but may provide a Guarantee to some extent for the risk of bad debts. This is referred as Derecognition with continuing Involvement.
2. The entity shall recognize a continuing involvement FA and also recognize a FL towards Guarantee given.
3. The fair value of Guarantee given is also recognized as a liability by debiting the P&L A/c. This fair value of Guarantee given represents the expected loss to be suffered due to bad debts.

Example 15 A Ltd has trade receivables worth Rs 10,00,000. It has sold the right to receive cash flows to a factor X Ltd., for a lumpsum consideration of Rs 9,00, 000.Show the accounting in the books of A Ltd. in the following cases.

Case (i)The transfer to X ltd is on non-recourse basis i.e., risk of bad debts is transferred.

Case (ii)The transfer to X Ltd., is on recourse basis i.e., risk of bad debts is not transferred to X ltd., (Retained by A Ltd).

Case (iii)A Ltd has transferred the right to collect all the trade receivables and also has given guarantee to the factor to the extent of Rs 2,00,000. The fair value of guarantee given is Rs 30,000.

Repurchase Agreements: Any sale and repurchase agreements of FA do not Qualify for Derecognition as they effectively amount into financing transaction. Therefore the FA continues to remain in the books and the amount received will be accounted as a liability.However if the repurchase agreement is entered to buy back the FA at a future date at the Fair value prevailing at that date then this transaction involves transfer of risks and rewards to the other party and therefore Qualifies for Derecognition.

Interest Rate swaps: If an entity enters into an Interest rate swap for converting fixed interest to floating basis on floating Interest into fixed basis will involve exchange of interest and also transfer of cash flows.This will not be treated as satisfying the Derecognition criteria.

Transfer of FA to Trust / SPV: In securitization transactions, loan receivables are transferred to a trust / SPV created for this purpose. This transfer to trust / SPV qualifies for Derecognition provided the transfer is made on non-recourse basis.

Options related to transfer of FA

Case (i): - When put option is given to the buyer of FA.

- If put option is DEEPLY in the money
  - Do not derecognize
- In any other case
  - Derecognize the asset

Case (ii): - When a call option is existing with the seller of FA

- If call option is DEEPLY in the money
  - Do not derecognize
- In any other case
  - Derecognize

IN THE MONEY: Option likely to be exercised. OUT OF THE MONEY:Option likely to be lapsed.

RECLASSIFICATION OF FINANCIAL ASSETS

a) A financial asset can be measured either at ACM or FVTPL or FVTOCI in accordance with the guidance given in the standard based on the Business Model test and the contractual cash flow test.

b) When there is a change in Business model, then financial asset can be reclassified from one method to another method. However the reclassification accounting is to be applied form the **BEGINNING OF NEXT YEAR.**

There are 6 possibilities in reclassification of financial asset

Case (i)ACM to FVTOCI

a) Fair value the financial asset at the beginning of next year and the resulting gain / loss transferred to OCI reserve.

b) Interest income will continued to be recognized at original EIR.

Case (ii): ACM to FVTPL:

a) Fair value the financial asset and the gain / loss will e transferred to P or L

b) Interest income received / receivable as per the contract is directly recognized in P or L. EIR SHOULD NOT BE APPLIED.

Case (iii): FVTPL to FVTOCI:

a) No further fair valuation is required as the FA already appears at fair value.

b) The fair value at the beginning of next year is taken as the base to measure EIR based on future REMAINING CASH FLOWS

Case (iv): FVTPL to ACM: Same as case iii above. However, there will be no fair valuation at the end of each year.

Case (v): FVTOCI to FVTPL:

a) No fair valuation is necessary; b)EIR should not be applied; c)The accumulated gain / loss in OCI reserve shall be recycled to P or L.

Case (vi): FVTOCI to FVTPL:

The accumulated balance of Gain / Loss in OCI reserve shall be adjusted against the carrying amount of the financial asset. The FA will not appear at an amount which represents the carrying amount is ACM was followed from the very beginning.

Example 16 A Ltd. Has purchased 10% debentures of face value Rs 10,000 which are issued at 20% discount and or redeemable after 4 years at par value original EIR in the FA is 17.3%.During year 2, there is a change in the business model of the entity.

The fair value of the financial asset is as follows

@ end of year 1	-	Rs 8500
@ end of year 2	-	Rs 9500 [@ beginning of y3]

Show the accounting for reclassification in all the 6 possible cases.

RECOGNITION AND MEASUREMENT OF FINANCIAL LIABILITY

1. Generally all the Financial liabilities are to be accounted using **AMORTIZED COST METHOD.** The initial recognition will be done at fair value net off transaction cost. FL which are payable on demand or has insignificant time value of money are recorded at TRANSACTION VALUE.

2. However some financial liabilities will be measured at FVTPL. (discussed later)

Example 17 B Ltd has issued 10% debentures of FV Rs 1,00,000 redeemable after 3 years. The initial issue expenses is Rs 5000. Show the accounting in the books of B Ltd if the effective interest rate is 12.1%.

Example 18 A Ltd has issued zero coupon bonds for Rs 7,00,000 which will be redeemed after years at their nominal of Rs 10,00,000.

The initial expenses incurred for issuing the bonds is Rs 20,000. Show the accounting in the books of A Ltd.

COMPOUND FINANCIAL INSTRUMENTS:

These are instruments which have the characteristics of financial liability and also equity. Convertible debentures, convertible preference shares usually fall into this category.

I. Initial recognition

Step 1: Determine fair value of FL = Present value of undeniable future cash outflows discounted at market Interest rate

Step 2: Fair value equity = Amount raised on issue – Fair value of FL (Step 1)

Step 3:

Bank Dr		Amt raised on issue
To CFI -FL	Step (1) Amt	
To CFI -Equity	Step (2) Amt	

II. Transaction costs:

Split the transaction cost incurred towards F.L. & Equity in the ratio of step (1): step (2)

Transaction Cost

Related to FL
- Adjusted into the Financial Liability A/c
- New EIR has to be determined based on the adjusted carrying amount of FL & Future Cash outflows.

Related to Equity
- Adjusted into Equity

III. On settlement date:

a) Settle the CFI either by issue of equity shares or payment in cash.

b) Sometimes, reclassification may be required.

Reclassification

From FL to Equity
Eg: Holder opted for conversion

Transfer the CFI–FL to CFI – Equity @ it's carrying amount

(Or)

From Equity to FL
Eg: Company decided to redeem in cash

Transfer the CFI–equity to CFI–FL @ the payable amount & any difference to be adjusted in retained earnings

IV. Early redemption of CFI

a) Split the buyback price of CFI into equity & liability components considering the market interest rate on the date of buyback
b) Compare the buyback price of equity and liability components with their respective carrying amounts.
c) The gain / loss on buyback relating to FL will be recognized in P or L
The Gain / loss in relation to equity component is adjusted into equity [Retained earnings].

Example 19

JIO Ltd has issued 10% debenture of Rs 25000, redeemable or convertible after 4 years at par. The market int rate on similar debentures without conversion feature is 14% debentures will be converted into equity shares having a face value of Rs 10,000.

Show the accounting in following cases.

Case (i) The option to convert / redeem is with the holder

Case (ii) The Option to convert / redeem is with the entity

Example 20

On 01.04.2015 sigma Ltd has issued 6% convertible debentures at face value of Rs 100 each. These debentures are redeemable at a premium of 10% on 31.03.2019 (or) These may be converted into ordinary shares at the option of holder. The Interest rate for similar debentures without conversion rights is 10%. Being a compound Financial instrument, you are required to separate equity and debt potion on 01.04.2015.

On 01.04.2015 the Fair value of equity component is Rs 185400 calculate the fair value of liability. The PV factors @ 10% interest for next four years are 0.91, 0.83, 0.75, 0.68.

Example 21

On 01.01.2000 Entity has issued a 7% convertible debenture with a face value of Rs 1000. Maturity on 31.12.2008. The debenture are convertible into ordinary shares of the entity at a conversion price of Rs 50 per share. Interest is payable yearly inc ash. At the date of issue the entity could have issued a non convertible debt at an interest rate of 10%.

On 01.01.2005 the convertible debenture has a fair value of Rs 1450. The Entity made on offer to the holder of debenture to repurchase the debenture for Rs 1450 to which the holder accepts. On the date of Repurchase the company could have issued a non convertible debenture with 4 years life at a coupon rate of 6%.

Show the accounting for Initial recognition and also on the date of early redemption.

DERECOGNITION OF FINANCIAL LIABILITIES:

FL should be derecognized when it is paid or when the entity is legally released from the primary responsibility towards FL any Gain / loss on Derecognition of FL shall be recognized in P&L A/c.

Example 22

X Ltd has taken a loan of Rs 500 lacs from a bank which is repayable after 10 years. After 4 years, the company wanted to prepay 60% of the loan. Prepayment penalty is 2% show the accounting for prepayment of loan.

Loan	A/c	Dr	300 [500 lacs x 60%]	
P&L	A/c	Dr	6	-
To Bank A/c				306 → [300 ⊕ 2%]

RESTRUCTURING OF DEBT / CORPORATE DEBT RESTRUCTURING

1. It is a situation where the terms of the original loan agreement are altered like the Interest Rate, Installment Amount, Period of loan No. of installment, Reduction in principal amount etc.
2. When there is a restructuring of debt arrangement we have to determine, whether such restructuring is modification or substantial modification.

Step 1: Calculation

PV of Revised cash flows @ ORIGINAL EFFECTIVE INTEREST RATE	**xxx**
(+) Modification / legal Expenses	**xxx**
(A)	**xxx**

Step 2: Is amount computed in **A** Θ Carrying amount of loan **[B]** $\geq$ 10% of (B) ??

YES

It is referred as substantial modification

Extinguishment Accounting applies

NO

It is referred as modification

IND AS 109is silent However, ICAI has suggested 2 alternative treatments

Extinguishment Accounting:

1. Derecognize the existing FL
2. Recognize new financial liability at PV of future cash outflows discounted @ current market /interest Rate.
3. Any legal charges / modification expenses incurred will be transferred to P&L A/c.
4. Any difference arising as a result of above shall be recognized as Gain / loss in P&L A/c.

Modification Accounting:

ICAI has suggested the following two alternative accounting treatments.

Alternative 1:

1. The legal / Modification expenses are transferred to P&L A/c.
2. Restate the carrying amount of FL to the present value of revised cash outflows discounted @ ORIGINAL EFFECTIVE INTEREST RATE.
3. Any Gain / loss on restatement shall be transferred to P&L A/c.

Alternative 2:

1. Adjust the legal / modification expenses into the carrying amount of FL.
2. Now calculate a revised effective Interest rate based on the adjusted carrying amount and revised cash flows in future.

DERECOGNITION OF FL BY ISSUE OF EQUITY.

1. As a part of settlement equity shares may be issued to settle the financial liability either in full or in part.
2. The financial liability will be derecognized and equity issued will be recognized @ fair value. Any difference is gain / loss transferred to P&L.

Loan A/c Dr	Settled amount
To Equity	[Fair value]

Example 23

Z Ltd has an o/s loan of Rs 90 crores to a bank and its effective interest rate is 10%. Owing to financial difficulties the company is unable to service the debt and approaches the bank for a settlement. The bank has offered the following terms

a) 2/3rd of the original liability will be converted into equity shares in Z Ltd. The fair value of equity shares to be issued by Z Ltd is Rs 56 crores.

b) For the remaining 1/3rd of the liability the bank agrees to certain moratorium period and also reduce the interest rate in the initial periods. The PV of revised cash flows according to original effective interest rate is Rs 25 crs. The PV of these cash flows @ today's market interest rate is Rs 28 crores.Show the accounting in the books of Z Ltd

Solution: Existing loan Rs 90 cr

Loan settled by issue of shares = 2/3 (90) = 60Cr

Loan A/c Dr	60	
To Equity		56
To P&L		4

Carrying amount of Remaining part of loan = 30cr

There is a modification PV of revised COFS @ Original EIR = 25Cr

Difference between 25cr and carrying amount of 30Cr is Rs 5 cr

This is 16.67% of carrying amount

It's substantial modification Derecognize existing FL & recognize New FL

FL – Existing loan Dr	30 cr	
To FL New loan		28
To P&L		2

FINANCIAL LIABILITIES MEASURED USING FVTPL

Normally all financial liabilities are accounted under ACM except in the following cases where they are accounted FVTPL.

I.When financial liabilities are held for the purpose of being traded.

EXAMPLE 24 The market price of SBI share is Rs 300 on 01.03.2019. Mr. A has borrowed 1000 SBI shares from the broker and sold them immediately in the market. The borrowing is for a period of 2 months. On 31.03.2019 the market price of SBI share is Rs 290. On 30.04.2019, Mr. A has bought the shares @ Rs 315 per share. Show the accounting of the short sale – transaction in the books of Mr. A

Solution: **01.03.2019:**

Bank A/c	Dr	300000	-
To Fin liab – short sale			-300000
[1000 sh x Rs 300 / sh]			

On 31.03.2019: **Fair valuation of financial liability under FVTPL method:-**

To buy 1000 shares outflow would be

= Rs 290 x 1000 sh = Rs 290000

∴ Restate the financial liability from Rs 300000 to Rs 290000.

Fin liab – short sale A/c -	Dr	10000	-	
To P or L			-	10000

On 30.04.2019: **Settlement date:-**

Mr. A could buy the shares @ Rs 315 per share

Fin.liab – short sale A/c -	Dr	290000	-	
P or L A/c	Dr	25000	-	
To Bank			-	315000

II. Contingent consideration payable in a business combination transaction shall be measured using FVTPL

III. Financial guarantee given under de-recognition of financial asset with continuing involvement will be measured using FVTPL.

IV. Financial Liabilities are measured at FVTPL to avoid an accounting mismatch.

Example 25 An entity has a portfolio of financial assets yielding fixed rate of interest and it also has FINANCIAL Liabilities (FL) with fixed interest payments. The entity manages the FA & FL on GROUP basis i.e., they are treated as a single portfolio.

Normally, FL is measured using ACM. If FA is also measured under ACM, then there will be no fair valuation for the FA or FL. Hence accounting mis match does not arise.

However, if the FA is measured at fair value (FVTPL / FVTOCL] the gain / Loss on FA will be accounted. However, the corresponding loss / gain relating to FL will not be accounted as it is measured using ACM. This creates an accounting mis-match.

To avoid this mis-match, Ind AS – 109 suggests that both FA & FL should be measured at FVTPL.

Note: When the liability value changes due change in required return of the investors, it will result into a gain / loss which is recognized directly in P or L.

However, if there is a gain due to decrease in the value of financial liability which is caused by an increase in entity's own credit risk, then such gain will be recognized in P & L – OCI reserve and not in P or L & it is Non – re-classifiable .

Example 26 X Ltd. Has taken a loan of Rs 10,000 @ 15% p.a. for 5 yrs. This is a loan which is to be measured under FVTPL to avoid an accounting mismatch. Measure the fair value of Financial liability at the end of 1st year in the following cases

i. The required return from the company has gone up by 3% and this increase in the required return is due to increase in the market interest rates.
ii. The required return from the company has gone up by 3% out of which 1% is due to increase in market interest rate and the remaining 2% increase is due to increase in entity's own credit risk.

TREATMENT OF FINANCIAL GUARANTEE:

A. In the books who obtained Guarantee/Beneficiary books: Ind AS 109 provides principles for accounting by the issuer of the guarantee. However, it does not specifically address the accounting for financial guarantees by the beneficiary. In an arm s length transaction between unrelated parties, the beneficiary of the financial guarantee would recognise the guarantee fee or premium paid as an expense.

   In case, financial guarantee is an integral part of the arrangement then it should be taken into account in determining the EIR for the FA/FL.

B. In the books who receive guarantee Amount:

   Initial recognition: Should be measured on initial recognition at its fair value and recognized as a liability **(as 'unearned financial guarantee commission), which is likely to equal the premium received, unless there is evidence to the contrary.**

   i. Subsequently recognition: at higher of two

      1) Impairment loss under Ind AS 109

         Or

      2) The amount initial recognized less income recorded under IND AS 115.

   *Subsequently guarantee amount shall be recognized as income over the period. In case loss allowance is more than balance of unamortized guarantee amount then such loss allowance shall be recognized as liability.

   Sometimes financial guarantee is given between group companies in that case treatment be as follows.

- If fee of guarantee is at arm length price treatment will be same as discussed.
- If less fee or nil fee is charged then any difference between fee charged in market and fee paid by company shall be considered as Investment or dividend respectively
- Necessary disclosure of IND AS 24 is also required.
- No treatment in CFS.

ACCOUNTING FOR DERIVATIVES

A Derivative is a contract which has all the following features.

1. It has no/less initial investment
2. Its value is based on the value of its underlying
3. This contract is to be settled on a future date

Note:

1. The underlying in the contract can be anything whose value fluctuates. It could be a financial instrument like equity shares or non-financial asset like commodities. Even Index, interest rates can also be used as underlying assets.
2. The derivative contract in future will be settled either by way of net cash settlement or by delivery of the underlying asset.

   However if the delivery is of non Financial asset, it is outside the scope of this standard.

3. Most found derivative instruments are
   i. Forward contract.
   ii. Options contract
   iii. Interest rate swaps

   In all the above instruments there will be no initial investment Except in case of options. In options initial investment will be the premium amount. However it is not a substantial investment.

4. All derivative contracts have to be measured using FVTPL. The standard does not make any difference whether the derivative contract is entered in an exchange or in over-the-counter contract.

Example 27 Today's spot rate is 1$ = Rs 62 on 01.01.2018.

X Ltd has entered into a forward contract to buy 10,000$ @ 1$ = Rs 60 on 30.06.2018 i.e., after 6m. Spot rate on 31.3.2018 1$ = Rs 60. On 31.03.2018, 3m forward rate is 1$ = Rs 63.5.

On 30.06 2018, spot rate is 1$ = Rs 65. Show the accounting for forward contract in the books of X Ltd.

JOURNAL ENTRIES FOR DERIVATIVE CONTRACTS

1. On Entering into derivative contract
   No Entry [∵ No Investment]

2. On each Balance sheet date, we have to ascertain the fair value of derivative and recognize gain / loss in P&L

   Derivative Asset A/c Dr
   To P&L A/c
   [Gain]
   [OR]
   P&L A/c Dr
   To Derivative liability
   [For loss]

3. On the settlement date, determine the total gain / loss in the derivative contract. Recognize the remaining Gain / loss

   Derivative Asset A/c Dr
   To P&L A//c
   [For Gain]

   [OR]

   P&L A/c Dr
   To Derivative liability
   [For loss]

   [OR]

   P&L A/c Dr
   To Derivative Asset
   [For loss]

   [OR]

   Derivative liability A/c Dr
   To P&L A/c
   [For Gain]

Example 28

A Ltd has purchased a call option from B Ltd @ premium of Rs 12. The share having an exercise price of Rs 90. The above transaction took place on 01.02.2018 and the Exercise date is 30.04.2018. On 31.03.2018 Fair value of call option = Rs 19.

On 30.04.2018 the market price of the share is Rs 125. Show the accounting in the books of A Ltd and B Ltd.

Entries for Accounting of options

In the books of Holder	In the Books of writer
1. For option premium paid Derivative FA A/c Dr To Bank A/c 2. On balance sheet, fair value the option and Recognize Gain / loss i. If fair value of option increases – Gain Derivative Asset (gain) To P&L ii. If fair value of option Decreases – loss P&L A/c Dr To Derivative Asset 3. On the settlement date recognize the Balance Gain / loss Derivative Asset (gain) To P&L [OR] P&L A/c Dr (Loss) To Derivative Asset 4. If option is exercised, cash will be received Bank A/c Dr To Derivative Asset A/c	1) For option premium received Bank A/c Dr To Derivative FL A/c 2) On balance sheet, fair value the option and Recognize Gain / loss a. If fair of option Increases – loss P&L A/c Dr To Derivative liability A/c b. If Fair value of option Decreases – gain Derivative liability A/c Dr To P&L A/c 3) On Settlement date recognize the balance gain / loss Derivative liability A/c Dr To P&L [OR] P&L A/c Dr To Derivative liability 4) If option is exercised by the holder, cash will be paid Derivative liability A/c Dr To Bank A/c

Example 29

Z Ltd has taken up a long position in 3m ITC Futures at Rs 265 on 01.02.2018. On 31.03.2018, the spot price of ITC share is Rs 270 and one month Futures price is Rs 275.On 30.04.2018, the settlement date, Market price of ITC share is

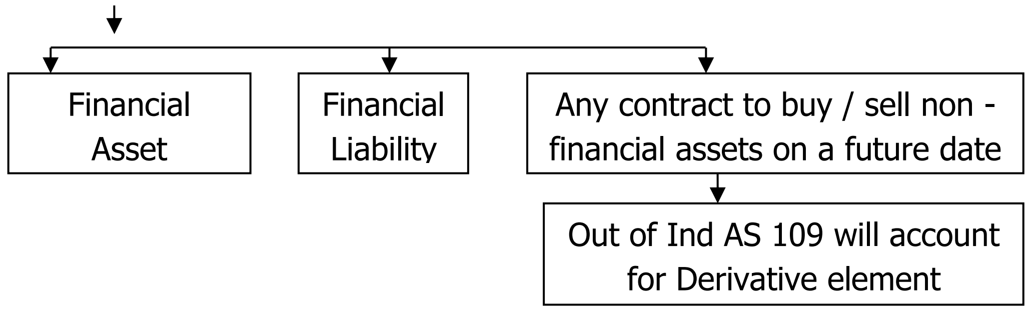
Case (i):- Market Price = Rs 278

Case (ii):- Market price = Rs260.

ACCOUNTING FOR EMBEDDED DERIVATIVES

Whenever a derivative component is attached with a Financial asset / Financial liability or attached with any contract to be executed in future, is referred as a Embedded Derivative.

1) HOST CONTRACT + Derivative element = Embedded derivative contract



2) Examples

Eg (1):- Investment in a convertible bond / preference share the fluctuation in market price of the share will also have an impact on the price of the bond. This creates a derivative element in the financial asset.

Eg (2):- X Ltd., has raised a loan of Rs 10,00,000. The interest on this loan is payable based on the profits of X ltd. As the profit fluctuates, the interest payable on the loan also fluctuates. This creates a derivative element in the financial liability.

Eg (3):- A Ltd., (Indian Company) has made an agreement to sell goods to B ltd. (USA company) after 6M for $ 100,000. The fluctuation in the $ rate creates a derivative element to A Ltd.,

Eg (4):- A Ltd (Indian Company) has made an agreement to sell goods to B Ltd., (Indian company) after 6M for $ 100,000

Eg (5):- X Ltd., took a loan from ICICI bank @ 13.5% p.a with an option to prepay the loan any time in the next 5 years. The normal market interest rate without the prepayment option is 12% p.a.

3) The derivative element included in the host contract must be separated and should be accounted using FVTPL method. The host contract will be accounted in accordance with other provisions of the standard.

4) The host contract could be a financial asset or financial liability or a contract to buy / sell non – financial assets on a future date. For the host contract, the accounting principles are discussed earlier.
5) In the following cases, separation of derivative from the host contract is not required.
    a) If the host contract is accounted FA OR FL under FVTPL
    b) If the host contract is a financial asset [Eg 1 (because once derivative element is included, CCFT test is not satisfied → Host contract is accounted under FVTPL
    c) The inclusion of derivative element is very natural & acceptable i.e., the host contract and the derivative element are closely related. [Unavoidable] (Eg. 3)
    d) The gain / loss from the derivative element is not substantial. [This is management's judgement].
    e) The fair value of derivative element cannot be determined. [Impracticality]

Closely Related: The Derivative component is considered as closely related if the presence of such component is Routine and acceptable and it is not Expected to result in substantial Gain / loss. In this case we will not separate the derivative component form the host contract.If we can establish that the derivative component is included with an intention to make gains other than which are normally acceptable as per the nature of host contract then it is considered as not closely related and therefore contract will be separated.

Fixed Rate loan with Prepayment option:

1. When a company takes a loan at fixed Interest Rate, it is considered as a non derivative since the cash flows are fixed. However due to changes in the market interest rate, the loan taken by the company may have a carrying amount which is higher or lower than the fair value of the loan.This creates a element of Derivative in a fixed rate loan. At the time of taking the Borrowing, the company may have an option to prepay the loan any time before the maturity. With this option the interest rate Quoted by the bank will be slightly higher.
2. Whether this prepayment option is closely related to the borrowing or not has to be determined by the management by comparing the closing balance of the loan with Exercise price for prepayment.
   If the difference is within an acceptable range, then the prepayment option is considered as closely related and therefore the derivative need not be separated.

HEDGE ACCOUNTING

i. An Entity is exposed to various kinds of risks due to fluctuations in prices, Exchange rate, Interest rate etc. Hedging refers to action taken by the entity to protect itself from various risks arising due to fluctuation in prices (or) exchange rates (or) interest rates.

ii. For doing hedging the entity usually enters into a derivative contract like forward (or) futures (or) options (or) swaps. This derivative instrument is referred as hedge instrument.

iii. The item which is being hedged is referred as hedged item. Hedged item can be
   - Recognized assets / liabilities
   - Contracts to buy (or) sell non financial assets at a future date
   - Highly probable forecasted transactions.

iv. The hedge accounting given under the standard is purely optional. If the entity wants to apply hedge accounting, the following two conditions must be satisfied.
   - The entity should have a formal documented policy for hedging and
   - There should be a economic relation between hedged item and hedged instrument.

v. In hedge accounting there are two types of hedge
   - Fair value hedge
   - Cash flow hedge

Accounting under Fair value Hedge:

This type of hedge is used to protect the risks arising from changes in fair value.

The gain (or) loss arising due to change in fair value of hedge item shall be recognized in P (or) L even if the hedged item is basically accounted using FVTOCI. This is because the hedge instrument [Derivative] will be accounted @ FVTPL and therefore there will be matching of gains / losses in the hedge instrument & hedged item.

Exception:

If the hedged item is investment in equity share measured at FVTOCI then the fair value gains (or) losses will continued to be recognized in OCI section. However, the gain / loss in the hedge instrument [derivative contract] shall also be recognized in OCI.

Example 30; A Ltd has purchased an investment on 01.04.18 for Rs 100. To cover the risks arising due to fair value fluctuations, the co. has entered into a forward contract to sell the investment at the end of Yr 1 for Rs 100. This forward contract will be settled in cost representing the gain / loss.

At the end of yr 1, Fair value of investment is reduced to Rs 90.

Show the accounting for fair value hedge in the Books of A Ltd in the following cases.

CASE 1: It is an investment in bonds measured at FVTOCI.

CASE 2: It is an investment in equity shares measure at FVTOCI.

CASE 3: It is an investment in equity shares measured at FVTPL.

ACCOUNTING FOR CASH FLOW HEDGE:

Cash flow hedge:

This accounting is adopted when the entity covers the risk arising due to variability in cash flows.

The Gain / Loss in the hedge instrument will be recognized in OCI section in a separate reserve called as cash flow hedge reserve(CFHR)

When the actual transaction occurs in future resulting in cash flow then the accumulated gain / loss in cash flow hedge reserve will be recycled to P (or) L.

If the future transaction involving cash flow results into an asset then the accumulated gain / loss in CFHR will be adjusted into the asset account & not recycled to P (or) L.

Cash flow hedge is generally applied for highly probable forecasted transactions.

IND AS 24 RELATED PARTY DISCLOSURES

1. OBJECTIVE

Related party relationships are a normal feature of commerce and business. Entities frequently carry on their business activities through its subsidiaries, joint ventures, associates etc. In general, users presume that the transactions in financial statements are presented on an "arm 's length" basis. However, the presumption may NOT be valid in case of the transactions between the related parties as the terms and conditions of related parties generally different from unrelated parties.

Sometimes related parties may not charge anything for their services like interest free loans, free management services etc. Hence the related party relationship will have an effect on the financial position (BS) and operating results (P&L) of the entity.

2. SCOPE OF IND AS 24

This standard is applicable to the consolidated **& separate** financial statements of a parent or investors with joint control/significant influence over an investee - who prepared financial statements under Ind AS 110, Ind AS 27. It is applicable to individual financial statements.
This Standard shall be applied in:

- ✓ identifying related party relationships and transactions;
- ✓ identifying outstanding balances, including commitments, between an entity and its related parties;
- ✓ identifying the circumstances in which disclosure of the items in (a) and (b) is required; and
- ✓ determining the disclosures to be made about those items.

3. This standard requires to give appropriate disclosures, we need not comment on whether the transaction has been established at fair price or not.

4. The related party relationships are predominantly based on Control, Joint control and Significant Influence.

CONTROL – **Power to direct the operating and financial policies**, achieved when Voting power > 50%

SIGNIFICANT INFLUENCE – **Ability to participate in operating and Financial polices** of other Entity achieved when VP $\leq$ 50%.

JOINT CONTROL: Two or more parties jointly control another entity. Agreement should be there requiring consent of all parties.

Note: Above definitions are not complete. Actual definitions covered in Consolidation chapter.

5. A related party is a Person or Entity that is related to the Reporting Enterprise. Related parties are identified in paragraph 9 of the standard. **A related party can be a person, an entity, or an unincorporated business.**

Related parties (**Para 9)**

Persons (Individual) | Entities

a) A **person** or a close member of that person's family is related to reporting Entity is that person

   i. Has **control or Joint control** of the Reporting Entity

   ii. Has **significant Influence** over the reporting entity

   iii. Is a **key managerial Personnel (KMP)** of the Reporting Entity or its Parent Entity.

b) 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 i.e. associate or joint venture of co-subsidiary);

iii. Both entities are joint ventures of the same third party;

iv. One entity is a joint venture of a third entity and the other entity is an associate of the third entity;

v. The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

vi. The entity is controlled or jointly controlled by a person identified in (a).

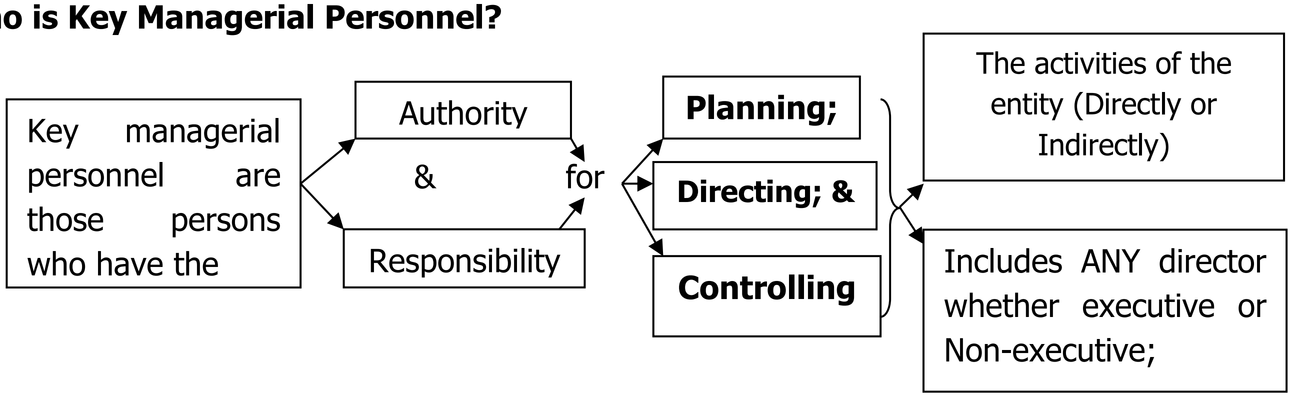
vii. A person identified in (a) (i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

viii. The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

Notes

a) Subsidiary of associate and subsidiary Joint venture are related parties to the reporting Entity.

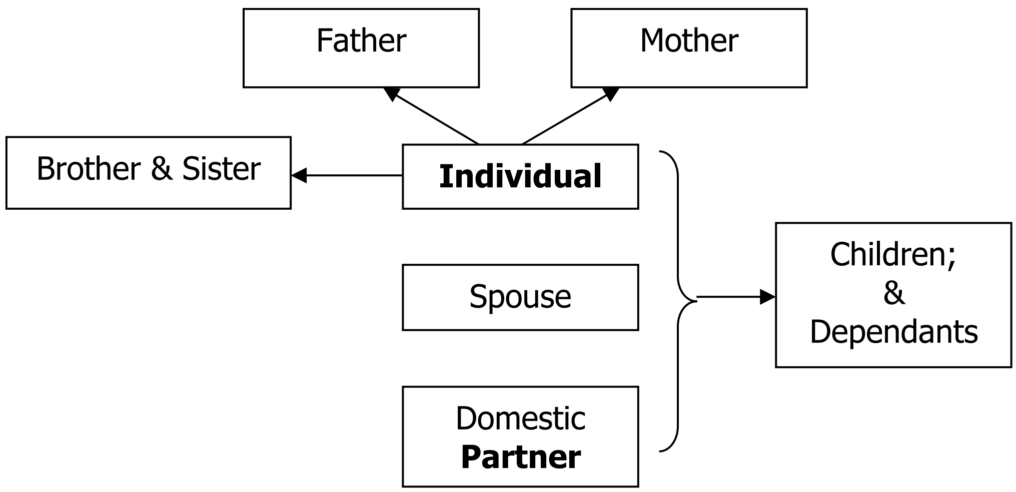
b) Who is Key Managerial Personnel?



Example of key managerial personnel are Managing director, wholetime director, chief executive officer, and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

c) **Close member of the family :** It covers persons who are family members who may be expected to influence or be influenced by that person in the dealings with the entity and includes:

1) Father, Mother, Brother, Sister
2) Spouse / Domestic partner.
3) Children of Individual / spouse/ domestic partner
4) Any dependent of that person or that persons spouse or domestic person.



6. RELATED PARTY TRANSACTION [RPT]

1) A related party transaction means transfer of resources / obligations between the related parties regardless of whether or not a price is charged.

2) This standard requires disclosures for related party transactions. All the transactions that took place during the period when related party relationship was existing have to be disclosed. Existence of Relationship on the balance Sheet date is not required.

3) Examples of related party transactions which require disclosure are as under:

- Purchase or sale of goods (finished or unfinished)
- Purchase or sale of property and other assets
- Rendering or receiving of services
- Leasing or hire purchase arrangements
- Transfer of research and development

- Transfer under license agreements
- Finance (including loan and equity contributions)
- Guarantees and collaterals
- Commitments to do something including executory contracts (recognized and unrecognized)
- Settled of liability on behalf of the entity or by the entity on behalf of that related party
- Management contracts including for deputation of employees.

7. WHO ARE NOT RELATED PARTIES?

1) Two Entities are not related parties because they have a common director / KMP (or) because the KMP in one entity has significant Influence on the other Entity.

2) Co-Venturers are not related parties. Co associates are not related properties.

3) Trade Unions, providers of finance, public, utilities, Government departments / agencies are not related parties to the Entity.

4) A customer, supplier, distributor, or an agent with whom the Entity transaction significant volume of business is not a related party by virtue of their economic dependence.

8. DISCLOSURES

Category 1: The following disclosures of relationships, if exist, must be made irrespective of the fact whether there have been related party transactions by the entity:

a) Under this an entity is required to **disclose the name of its parent** and, **if different, the ultimate controlling party**. It may be noted that the ultimate controlling party may be a person.

b) If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

c) The disclosure of relationship between a parent and its subsidiary (reporting entity) is important because the existence of control relationship may prevent the reporting entity from being independent in making its financial and operating decisions. The disclosure of the name of the related party and the nature of the related party relationship where control exists may sometimes be at least as relevant in appraising an entity's prospects as are the operating results and the financial position presented in its financial statements. Such a related party may establish the entity's credit standing, determine the source and price of its raw materials, and determine to whom and at what price the product is sold.

Category 2

In this category the following two disclosures are required

a) **Compensation to KMP** The Entity has to disclose all the amounts that are paid to KMP under the following categories.

i. Short Term Employee benefits ; ii. Long term Employee benefits ; iii. Post Employment Employee benefits; iv. Termination benefits; v. Share based payments

Any compensation paid to an Entity providing KMP services shall be disclosed. However, the Remuneration paid by such KMP Entity to its Employees, who have managed Reporting Enterprise, need not be disclosed.

b) Following **Disclosures are required**, at minimum, **when there are related party transactions**

1) **Name** of the related party;
2) A description of the **relationship**;
3) A description of the **nature** of transactions;
4) An **amount** of transactions;
5) An amount of **outstanding balances**, including commitments;
   - ✓ their terms and conditions, including whether they are **secured,** and the nature of the consideration to be provided in settlement; and
   - ✓ details of any **guarantees** given or received;
6) **Provisions for doubtful debts** related to the amount of outstanding balances; and
7) The expense recognised during the period in respect of **bad or doubtful debts** due from related parties.

8.EXEMPTIONS FROM RELATED PARTY DISCLOSURES:

In the following cases Related party disclosures are not required to be given

i. If disclosure required by IND AS 24 conflicts with **duties of confidentiality** imposed by statute or any regulatory authority.

ii. Disclosures need not be given in respect of **Intercompany transactions** between parent and subsidiary, while preparing CFS.

iii. **Exemption for Government related Entities.**

Disclosure need not be given for transactions with

a) Government that has control / Joint control / Significant Influence on the Reporting Enterprise (or)

b) Another Entity that is a related party because Government has control on Joint control or Significant Influence on the other Entity and on reporting Entity.

However, the following disclosures are to be given

a) Name of Government

b) Name of Relationship

c) Any Significant Transactions

Illustration of disclosures requirements:

	Particulars	Holding Company	Subsidiaries	Fellow Subsidiaries	Associates	Key management personnel (KMP)	Relatives of KMP	Total
1.	Purchases of goods (finished or unfinished)							
2.	Sale of goods (finished or unfinished)							
3.	Purchase of Property & other assets							
4.	Sale of Property & other assets							
5.	Rendering of services							
6.	Receiving of services							
7.	Transfer under license agreements							
8.	Leasing or hire purchase arrangements							
9.	Transfer of research and development							
10.	Licence agreements Finance (including loans and equity contributions in cash or in kind)							
11.	Guarantees and collaterals							
12.	Management contracts Including for deputation of employees							

Names of related parties and description of relationship:

1. Holding Company — A Ltd.
2. Subsidiaries — B Ltd. and C (P.) Ltd.
3. Fellow Subsidiaries — D Ltd. and Q Ltd.
4. Associates. — X Ltd., Y Ltd. and Z (P.) Ltd.
5. Key Management Personnel — Mr. Y and Mr. Z
6. Relatives of Key Management Personnel — Mrs. Y (wife of Mr. Y), Mr. F (father of Mr. Z)

IND AS 108 OPERATING SEGMENTS

1) **Core Principle**

An Entity shall disclose information to enable users of its financial statements (FS) to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates.

2) Accordingly, additional information will be given relating to business activities / geographical locations in which the entity operates. It helps users of FS to
   i. Better understand the Entity's performance.
   ii. Better assess its prospects.
   iii. Make more informed judgements about the Entity as a whole.

3) This standard is a disclosure standard and it is mandatory for all the Entities for whom IND AS is applicable. No relaxations are given for any Entities.
4) If an Entity prepares separate FS and also Consolidated FS, IND AS 108 has to be applied for CFS. For Separate FS application of this standard is optional.

5) Steps in IND AS 108

   Step 1: Identifying chief operating decision maker (CODM)

   Step 2: Identifying operating segments

   Step 3: Identifying Reportable Segments

   Step 4: Disclosures to be given

Step 1:Identifying chief operating decision maker (CODM)

It is a person / function who reviews the performance of each segment and allocates resources to the segment.

The term 'chief operating decision maker' (CODM) identifies a function, not necessarily a manager with a specific title. That function is to allocate resources to and assess the performance of the operating segments of an entity. Often the CODM of an entity is its chief executive officer or chief operating officer but, for example, it may be a group of executive directors or others.

Step 2: Operating Segments

To become a operating segment, all the following **three** conditions should be satisfied.

1) It is a component of the entity which is engaged in business activities and it may generate revenue and incur expenses.

   Note: Startup operations can also be categorized as operating segments even though it has not yet started earning.
2) Its operating results are reviewed by CODM regularly.
3) Discrete (Separate) Financial information is available.

Note: If any of the above three conditions are not satisfied it is not operating segment.

Note: Operating Segments can be identified on the basis of its products / services or on the basis of its geographical location.

Note: Two Entity Involved in selling similar products may identify operating segments differently.

One Entity – PRODUCT wise

One Entity – GEOGRAPHICAL AREA wise

Note: If CODM focuses on area wise information and also product wise information, the management has to apply judgement and decide the operating segments on the basis of either products or areas, whichever will satisfy the core principle.

Step 3: IDENTIFYING REPORTABLE SEGMENTS

a) <u>Aggregation before Identification of Reporting Segments</u>

It means clubbing of segments before they are identified as Reportable or not. This step of aggregation is purely optional.

Aggregation of segments can be done if the segments have SIMILAR ECONOMIC CHARACTERSTICS. Eg: Similar Gross margin, similar growth ratios etc.

Apart from this, the following 5 conditions should be satisfied

The following shown be similar between operating segments

1) Nature of Products / services
2) Nature of Production process
3) Type of customers
4) Method of distribution
5) Regulatory Environment in which segments operate

b) 10% THRESHOLD LIMITS

After identifying various operating segments, quantitative thresholds should be tested to check whether it is a reportable segment or not;

An operating segment should be reported in financial statements only when it **satisfies ANY ONE** of the following conditions

1. **Segment REVENUE Criteria:**

SEGMENT REVENUE (External + Inter segment transfers) > 10 % TOTAL REVENUE of ALL segments (External + Inter segment transfers);

2. **Reported segment PROFIT OR LOSS Criteria:**

Reported profit or loss of the segment $\geq$ 10 % of

a) the aggregate of only segment profits; or
b) the aggregate of only segment losses;

Whichever is **HIGHER**

(In absolute numbers, don't consider the sign; whether negative or positive)

3. **Segment ASSETS Criteria**

SEGMENT ASSETS $\geq$ 10% TOTAL ASSETS of ALL segments;

c) Management choice:

Even if a particular operating segment does not satisfy any of the 10% criteria, Management can identify that segment as Reportable segment.

d) 75% Test

We should Ensure that the External Revenue of all the Reportable segments identified should be at least equal to 75% of total enterprise revenue. If 75% test is not met, then we have to add more segments as Reportable segments to met the 75% test.

e) Aggregation Again

Among the unrepeatable segments if majority of the 5 conditions specified for aggregation are satisfied, then these segments can be clubbed and again tested or 10% criteria.

f) Reportable Segment in the Previous year

If an operating segment qualified as Reportable segment in the previous year but does not qualify to be a Reportable segment in the current year, it should be continued as a reportable segment even in the current year if the management believes that such disclosure is of continuing significance.

Notes:

1) If a segment is identified as Reportable segment in the current year due to 10% criteria, relevant comparative information of the previous year should also be presented unless it is impracticable.
2) There may be a practical limit to the number of reportable segment for which entity provides separate disclosures, beyond which it may become too detailed once the no of reportable segments reaches to 10, the Entity should consider whether the practical limit is reached.

DISCLOSURES

I. Segment Disclosures

a) General Information

- Factors which are used to identify the entity's reportable segments including basis of organization (whether management has chosen to divide them based on product or on the geographical basis, regulatory environments, how the segments are aggregated, etc.)
- Judgement used by the management is the aggregation criteria - a brief description of the operating segments aggregated and describe the similar economic characteristics of those;
- Types of products and services from which each reportable segment gets its revenue.

b) Information about profit or loss, assets and liabilities

✓ An entity shall report a measure of profit or loss for each reportable segment. (i.e. how the profit or loss is derived)

✓ Segment assets and liabilities information should be disclosed only when it is regularly provided to CODM. (It means, segment assets and liabilities need not be given if not reviewed by CODM - in such case, the fact should be disclosed)

The following information should be disclosed , if they are included in the measurement of segment profit or loss which is reviewed by CODM or it is provided to CODM whether or not same is included in reportable segment profit or loss; (It means, if any of the following information is not provided to CODM, it need not be disclosed)

- Revenues from external customers;
- Inter segment transactions;
- Interest revenue & expense;
- Depreciation and amortization expense;
- Material items of income and expense disclosed separately in financial statements;
- The entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;
- Income tax expense or income;
- Material non-cash items other than depreciation and amortization
- Additions to Non-current assets other than financial instruments, Deferred tax asset and rights arising under insurance contracts and net defined benefit assets;

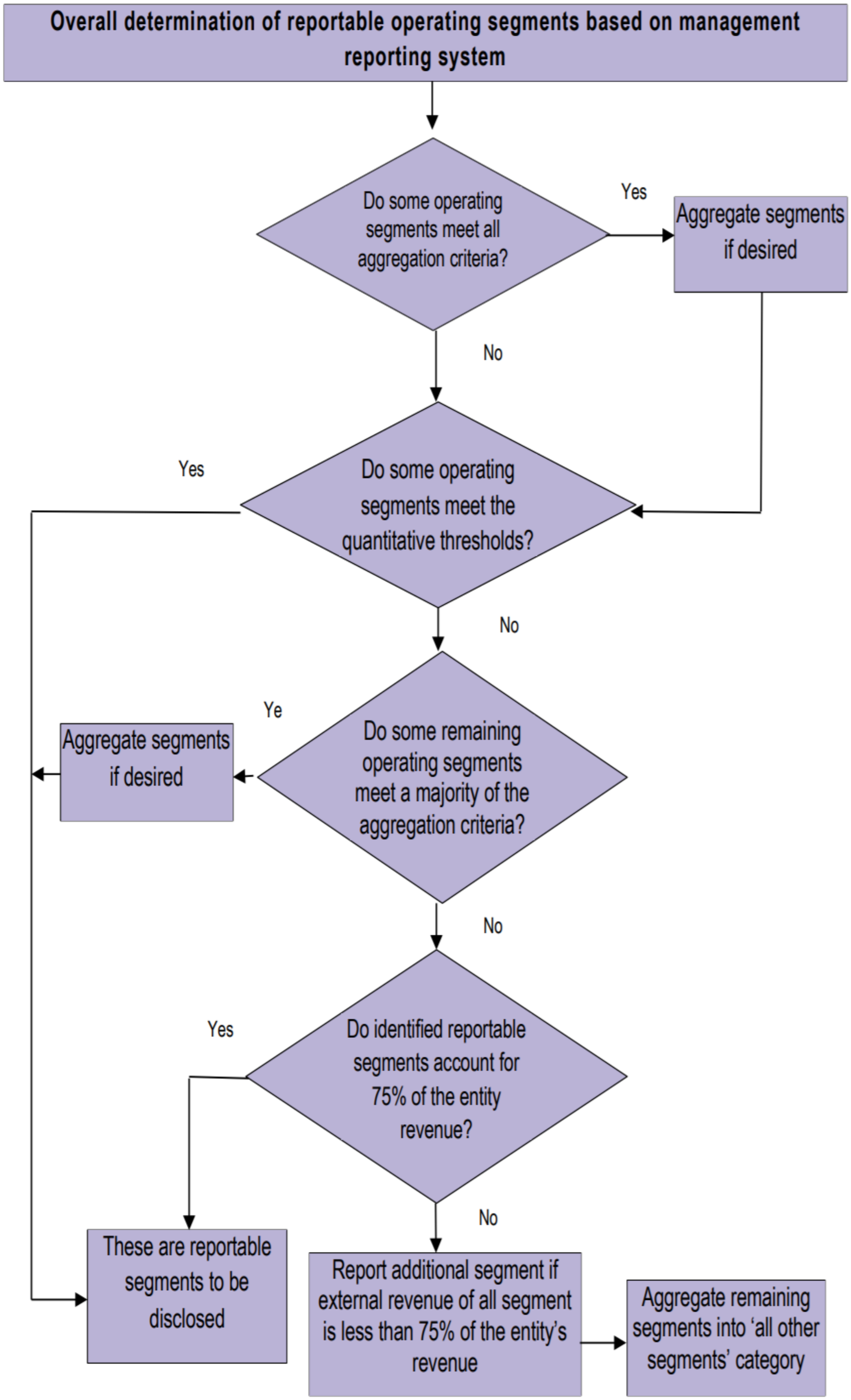
c) Reconciliation:

We have to present one adjustment column to reconcile the segment assets, liabilities, revenue, profit /loss to match with the amounts presented in FS.

II. Entity wide Disclosures

These disclosures are to be given by all the Entities Even if the Entire entity is representing a single segment.

1) External Revenue from each product / service & how much is revenue from India and outside India.
2) Segment assets have to be disclosed as to how much in India & outside India
3) If External sales to a customer is $\geq$ 10% of entity Revenue, the following have to be disclosed
    a) Amount of sales made to such customer
    b) The segment in which such sales re Included [Identity is not required to be disclosed]


Overall determination of reportable operating segments based on management reporting system
Do some operating segments meet all aggregation criteria?
Yes
Aggregate segments if desired
No
Do some operating segments meet the quantitative thresholds?
Yes
No
Do some remaining operating segments meet a majority of the aggregation criteria?
Ye
Aggregate segments if desired
No
Do identified reportable segments account for 75% of the entity revenue?
Yes
No
These are reportable segments to be disclosed
Report additional segment if external revenue of all segment is less than 75% of the entity's revenue
Aggregate remaining segments into 'all other segments' category

IND AS 19 EMPLOYEE BENEFITS

- The objective of this standard is to ensure that employee benefits are recognized as an expense in the period in which services are received by entity & to recognize a liability if employee benefits are unpaid.
- Employee benefits include benefits given in cash or kind to employee, to employee's spouse or other dependant's of the employee.
- All types of employees are covered – full time, part time, permanent, temporary, Casual employees and even managerial personnel.
- This standard is not applicable for accounting of share based payments.
- The employee benefits are divided into following 4 categories:
  1. **Short term employee benefits**
  2. **Long term employee benefits**
  3. **Termination benefits**
  4. **Post employment employee benefits**

ACCOUNTING FOR SHORT TERM EMPLOYEE BENEFITS [STEB]

- STEB are the benefits which are expected to be settled wholly within 12m from the end of the period in which services are rendered.

  Example: Salary, general allowances & Perquisites, Bonuses, short term compensated absences etc.
- **The entity should recognize all STEB as an expense in P&L a/c in the year in which the services are received.**
- This expense should be recognized on undiscounted basis.

JOURNAL ENTRIES

a. For recognizing the expense

   Employee Benefits exp a/c Dr

   To Bank / Employee benefit payable

b. For subsequently discharging the liability

   Employee benefit payable a/c Dr

   To bank

c. For transfer to PL Account.
   P&L a/c
      To Employee benefit exp.

NOTE: In case of profit sharing plans with employees, the accounting would be done as mentioned above provided the obligation to pay such bonus should exist on the balance sheet date.

Accounting for Short Term Compensated Absences (PAID LEAVES)

The leaves which are not utilized by employees fully in the current year may be allowed to be carried forward to next year. These are called accumulated leaves or short term compensated absences.

The accounting treatment of these leaves depends on whether they are vested leaves or unvested leaves

VESTED LEAVES:

The employee has an option either to choose cash or to take additional leave.

The entity should recognize provision for the full amount of leaves**. Recognize** expense & liability **for ALL employees** for **ALL leave days** accumulated.

[All employees x acc leave days x salary per day]

UNVESTED LEAVES:

Here the employee cannot claim cash. He is eligible only for additional leaves.

The entity should recognize provision based on leaves **expected to be utilized** by the employees

[Expected no of employees x expected no of leaves to be utilized x salary per day]

Example Mr. A works for X Ltd for a salary of Rs 25,000 p.m, each month has 25 working days and 5 holidays.In the month of March Mr. A has utilized only a leave of 2 days

X Ltd has the policy of offering vested leaves to the employees which will be utilized within next 1 year.

Show the accounting treatment in the books of X Ltd for March & April assuming that salary per day Rs 1,000.

Sol:

For March month salary paid Salary a/c Dr To Bank	 25000 -	 - 25000
For making provision for leave salary Salary a/c Dr To provision for Leave salary (3 days x Rs 1000)	 3000 -	 - 3000
For transfer to P&L P&L a/c Dr To Salary a/c	 28000 -	 - 28000

<u>ACCOUNTING IN THE MONTH OF APRIL</u>

Situation – 1 Employee claimed Cash	**Situation – 2 Employee took additional leave of 3 days**
No of days worked = 25 days • For April month salary paid Salary a/c Dr 25000 To Bank 25000	**No of days worked = 25 – 3 = 22** • For April month salary Salary a/c Dr 25000 - To Bank - 25000
• For leave salary paid in cash Provision for leave sal a/c 3000 To bank a/c 3000	• For reversal of provision created earlier Prov for leave sal a/c 3000 To salary 3000
• Transfer to P&L P&L a/c Dr 25000 To Salary 25000	• Transfer to P&L P&L a/c Dr 22000 To Salary 22000

<u>NOTE:</u>

In all cases, we can observe that the expense recognized in P&L proportional to the no of days worked by employee.

Considering the data given in above example, show the accounting treatment if the leaves are unvested leaves. The Company expects Mr. A will utilize only 2 days leave.

No. of days worked 25 + 3 = 28 days

March Salary Paid Salary a/c To bank	Dr	 25000 -	 - 25000

For creating provision for expected no of leaves to be utilized Salary a/c To provision for Leave salary (2 days x 1000)	 Dr	 2000 -	 - 2000
Transfer to P&L P&L a/c To Salary	 Dr	 27000 -	 - 27000
In the month of April Apr. Sal paid Salary a/c To bank	 Dr	 25000 -	 25000
For reversal of provision Pro. For leave Sal a/c To Salary	 Dr	 2000 -	 - 2000
Transfer to P&L P&L a/c To Salary	 Dr	 23000 -	 - 23000

The net expense in the month of April is Rs 23,000.

a. If the employee has taken leave for 2 days as expected no of days worked = 25 -2 = 23 days. Therefore the net exp of Rs 23,000 matches proportionality with no of days worked.

b. If the employee has taken 3 day leave in the month of April, the no of days world = 25-3 = 22 days but the net – expense for the April month is Rs 23000. The additional cost of Rs 1000 is arising due to a change in accounting estimate.

PROFIT SHARING PLANS & BONUS

a) Expense has to be recognized for any bonus/ profit sharing plans in the year in which services are received even if such an amount is finalized after the reporting date but before approval of financial statements.

b) However to recognize the expense as mentioned above, the entity must have a **legal or constructive obligation** to pay bonus on the BS date & **a reliable estimate** could be made towards the amount of obligation.

ACCOUNTING FOR POST EMPLOYEMENT EMPLOYEE BENEFITS (PEEB) AND OTHER LONG TERM EMPLOYEE BENEFITS

- PEEB are the benefits which are payable at the end of service period.
  Example: provident fund, pension, Gratuity, Post employment medical care etc.
- Other long term employee benefits are the benefits which are not STEB and are payable during the service period of the employee.
  Eg: Sabbatical leave, Long term disability benefit. Jubilee benefits like special bonus, foreign travel, funding for further education etc.
- The accounting for the above two categories of employee benefits will be same.
- Accounting for these employee benefits will depend on whether they are classified as
  1. Defined Contribution Plan **or**
  2. Defined Benefit Plan

1) **Defined Contribution Plan**: In the plan, the obligation of employer is limited to the extent of making fixed or known contribution to a specified fund. The benefits will be paid to employee from that specified fund. will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

2) **Defined Benefit Plan:** It will be the responsibility of the employer to provide the specified amt of benefit to the employee. In these plans, the actuarial risk and the investment risk are borne by the employer only.

- ✓ **ACTUARIAL RISK:** It is a gain / loss that arises due to changes in estimates.
- ✓ **INVESTMENT RISK:** It is a possibility that the funds accumulated will not be sufficient to meet the cost of employee benefits.

- **ACCOUNTING FOR DEFINED BENEFIT PLAN:**

Defined Benefit plan has to be accounted by entity using projected unit credit method (PUCM)

Mr. A is employed at a monthly salary of Rs 80,000 at X Ltd. His salary is expected to increase at the rate of 10% p.a. starting from year – 2.

Mr. A is eligible for a bonus of one month salary for each year of service rendered, at the end of year – 5. Such bonus is to be computed on the basis of last drawn salary.

Show the accounting in the books of X Ltd assuming a discounting rate of 12% p.a.

Step – 1 Projected benefit

Step – 2: Allocated Cost p.a. $= \frac{\text{Projected benefits}}{\text{No.of years}} =$

Step – 3: Calculation of Current service Cost

Yr	Allocated cost p.a	P.V @ 12%	Current Service Cost
1			
2			
3			
4			
5			

Current service cost represents the expense i.e to the recognized in each year towards amt payable for service rendering by employee. Since this is not paid immediately, interest gets accrued in each year.

Step – 4 Create a liability sheet

Particulars	1	2	3	4	5
Opening bal of obligation					
(+) Current service cost					
(+) Int cost @ 12% on opening balance					
Closing bal					

Step – 5 Journal Entries

Particulars		1	2	3	4	5
Current Ser. Cost a/c Int cost a/c To PV of def benefit obligation	Dr Dr					
(Being Exp recognized)						
P&L a/c To current Service cost To Interest cost	Dr					
(Being Exp. Transferred to P&L a/c)						
P.V of def benefit obligation To Bank	Dr					
(Being Payment made)						

Example:

Consider the data given in the above example and show accounting entries at the end of year – 3, 4 and 5 assuming that the salary eascalation rate is 15% p.a. in year 4 and year – 5

Step – 1 Calculation of projected benefit

Salary @ end of year 3 80,000 $(1+0.10)^2$ = 96,800

@ end of year 5 96800 $(1+0.15)^2$ = 128018

Projected benefit 5-year x 1m x 128018 = 6,40,090

Step -2 Allocated Cost p.a = $\frac{640090}{50}$ = 1,28018

Step – 3 Current Service Cost

Year	Allocated Cost	PVF @ 12%	C&C
1	128018	0.6355	81355
2	128018	0.7118	91123
3	128018	0.7972	1,02,056
4	128018	0.8929	1,14,307
5	128018	1	1,28,018

Step – 4 Liability Sheet

Particulars	1	2	3	4	5
Open bal of Obligation	NIL	81355	182241	3,06,166	457,213
(+) Curr serv cost	81355	91123	102056	1,14,307	1,28,018
(+) Int Cost @ 12%	-	9763	21869	36,740	54859
Closing bal	81355	182241	3,06,166	4,57,213	6,40,090

The Co. has already done the accounting for year – 1 and year – 2 as per old liability sheet. The opening bal of PVDBO (present Value of defined Benefit Obligation in year 3 is 166739. However as per the latest liability sheet, the op.bal should be Rs 182241. This increase in liability is due to change in estimate. This is defined as actuarial loss and it is recognized in P&L a/c

Actuarial loss a/c	Dr	15,502	-
To PV of defined benefit obligation (182,241 – 1,66,739)		-	15,502

Actuarial loss is also called as remeasurement loss. The treatment of remeasurement gain/loss depends on whether it is a LTEB or PEEB. If the remeasurement gain or loss relates to LTEB (as in above example) it shall be recognised in P or L. If the actuarial gain/loss relates to PEEB, it should be recognised in OCI Section not to be recycled.

Journal entries for defined benefit obligation

1. **For recognizing exp each year**

   Current Service Cost Dr

   Int Cost Dr

   To PV of DBO

2. **For recognizing any actuarial gain or loss**

   Actuarial loss (or) PV of DBO

   To PV of DBO To Actuarial gain

3. **For transfer to P&L a/c**

   P or L a/c Dr
   To Int Cost
   To Current service cost

   P or L / OCI Dr.
   To actuarial loss

4. **For payment of benefits**

   PVDBO a/c Dr

   To bank

PLAN ASSETS

- To meet the obligation under defined benefit plan, the employer may accumulate funds each year. These funds are invested in shares securities, contribution to insurance plans are just maintained in a separate bank a/c. These assets collectively are referred as plan assets. How much contribution has to be made in plan assets depends on expected return from plan assets.
- When benefits are payable to employees, plan assets are liquidated / sold and amount is realized.

a. For Investment made / Contribution to plan assets

Plan asset a/c Dr

To Bank a/c

b. For recognizing expected return on plan assets

Plan asset a/c Dr

To Expected return

c. At the end of each year the plan assets are fair valued. This will result into a gain/loss. This is referred as actuarial gain or loss [remeasurement gain/loss]

1) Actuarial loss a/c Dr

To Plan assets

2) Plan assets a/c Dr

To actuarial gain

d. For transfer to P&L a/c

Expected return a/c Dr

To P&L a/c

e. When amt is withdrawn from plan assets

Bank a/c Dr

To Plan asset

If defined benefit plan is related to LTEB, the actuarial gain or loss[remeasurement gain or loss] is recognised in P or L and if the defined benefit plan is related to PEEB then the actuarial gain or loss[remeasurement gain or loss] is recognised in OCI section.

NOTE

1. Expected return is an estimated return from plan assets and it includes the following

Interest and dividend income	%
(+) Realized and unrealized gain on plan assets	%
(-) Cost of administration of plan assets expected return =	- %
Expected return	**%**

Actual return on plan asset = Expected return – Actuarial loss

OR

Expected Return + Actuarial gain

If the question doesn't provide expected return % then consider the discounting rate that is used for measuring PVDBO as expected return.

MODIFICATION OF DEFINED BENEFIT PLAN

- If the employer changes any terms of the existing defined benefit plan, due to which there is an increase in amount of obligation, the change is referred as modification.
- The increase in the liability due to the modification will be accounted as past – service cost

Treatment of Modification

PAST SERVICE COST (PSC)

- Represents the incremental liability towards the employees as a result of modification.

  Past service cost a/c Dr

  To PVDBO

- Past service cost is to be recognized in P&L immediately

  P&L a/c Dr

  To PSC

Example

X Ltd operates a gratuity plan for its 1000 employees where it has agreed to pay 1.5months salary for each year of service rendered, payable at the time of retirement. In be eligible under this plan, the employee should have completed a service of minimum 5 years.

During the current year, the Company has increased the benefit to the employees to pay 2m salary instead of 1.5m as originally planned.Due to this modification, the increase in the liability as on today is Rs 2500 lacs. Out of this Rs 2000 lacs related to 800 employees who has already completed 5 years of service. Entire Rs 2500 lacs will be accounted as past service cost:

PSC a/c	Dr	2500 lacs	-
To PVDBDO		-	2500 lacs
P&L a/c	Dr	2500 lacs	-
To PSC		-	2500 lacs

CURTAILMENT OF DEFINED BENEFIT PLAN

- Curtailment refers to reduction in the employee benefits payable. The employer may reduce the benefits due to reasons like discontinuance of segment, continuous losses or takeover of business etc.
- On curtailment of benefit, the liability existing shall be reduced

Journal Entry for reduction in Liability

PVDBO a/c Dr

To P&L a/c

PRESENTATION IN BALANCE SHEET:

The liability (PVDBO) and asset (PLAN ASSETS) have to be presented on a NET BASIS.

If PVDBO > PA; we will have a NET LIABILITY [referred as Net deficit]

If PA > PVDBO; we will have a NET ASSET [referred as Surplus]

We have to ensure that Net Asset does not exceed the ceiling limit (similar to Recoverable amount). If it exceeds, such excess

ACCOUNTING FOR DEFINED CONTRIBUTION PLAN

- The contribution to be made in each year should be recognized as an expense in P&L a/c. If the contribution is unpaid, liability should be created.
- If the contribution relating to current year is payable beyond 12m from the balance sheet date, the expense & Liability should be recognized on present value basis Eg: PF contribution.

Example

Basic Salary for the month of Apr – 2014 in a Company for all its employees is Rs 15 lacs. Employees contribution towards PF is 12% and similar contribution is to be made by the employee. The Co. has paid the salary at the end of April and it paid Rs 3,10,000 towards PF Contribution on 30.04.2014. Write Journal entries for salary Exp recognized

Salary a/c	Dr	16,80,000	-
To bank (15L-12%)		-	13,20,000
To PF Payable		-	3,60,000
PF Payable a/c	Dr	3,10,000	-
To Bank		-	3,10,000

ACCOUNTING FOR TERMINATION BENEFITS

- There are benefits payable when employment is terminated before the original service period. Eg: VRS Compensation paid, Retrenchment Compensation paid
- The termination benefits are to be recognized in P&L a/c when the obligation arises (Ind AS 37 criteria will apply)
- If the benefit is payable beyond 1 year from the b/s date, the expense and liability shall be recognized on PV basis

Example X Ltd has announced a VRS scheme during PY- 2017-18 which was accepted by the employees. As per the agreement with the employee a total VRS Compensation of Rs 2000 lacs is payable out of which Rs 1500 lacs is payable immediately & the bal 500 lacs is payable on 31.03.2020. The discounting rate is 10% p.a. Show the accounting in the books of X Ltd. Total VRS Compensation = 2000 lacs

1500 lacs Payable immediately	500 lacs payable on 31.03.2020 i.e after 2 years
+	PV = 500 lacs x PVIF (10%)
Recognized expense	= 500 x 0.8264 = 413.20
	Recognized as expense

on 31.03.2018

VRS Compensation a/c	Dr	1913.20	-
To Bank		-	1500
To VRS Payable		-	413.20

31.03.2019 → Recognition of Int Cost / Unwinding of discount

Int Cost a/c	Dr	41.32	-
To VRS payable (413.20 x 10%)			41.32

31.03.2020

Int Cost a/c	Dr	45.48	-
To VRS payable [(413.20 + 10%)-500]		-	45.48
VRS payable		500	
To Bank			500

CONSOLIDATED FINANCIAL STATEMENTS

1. Parent is an entity that controls one or more entities & Subsidiary is an entity that is controlled by another entity. A parent & its subsidiaries are called as a group.

2. As per Ind AS 110, an entity that is a parent should prepare consolidated financial statements.

3. Consolidated financial statements are the financial statements of a group in which assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

4. Sec 129 (3) of Companies Act requires Where a company has one or more subsidiaries, it shall, in addition to financial statements, prepare a consolidated financial statement of the company and all its subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statements.

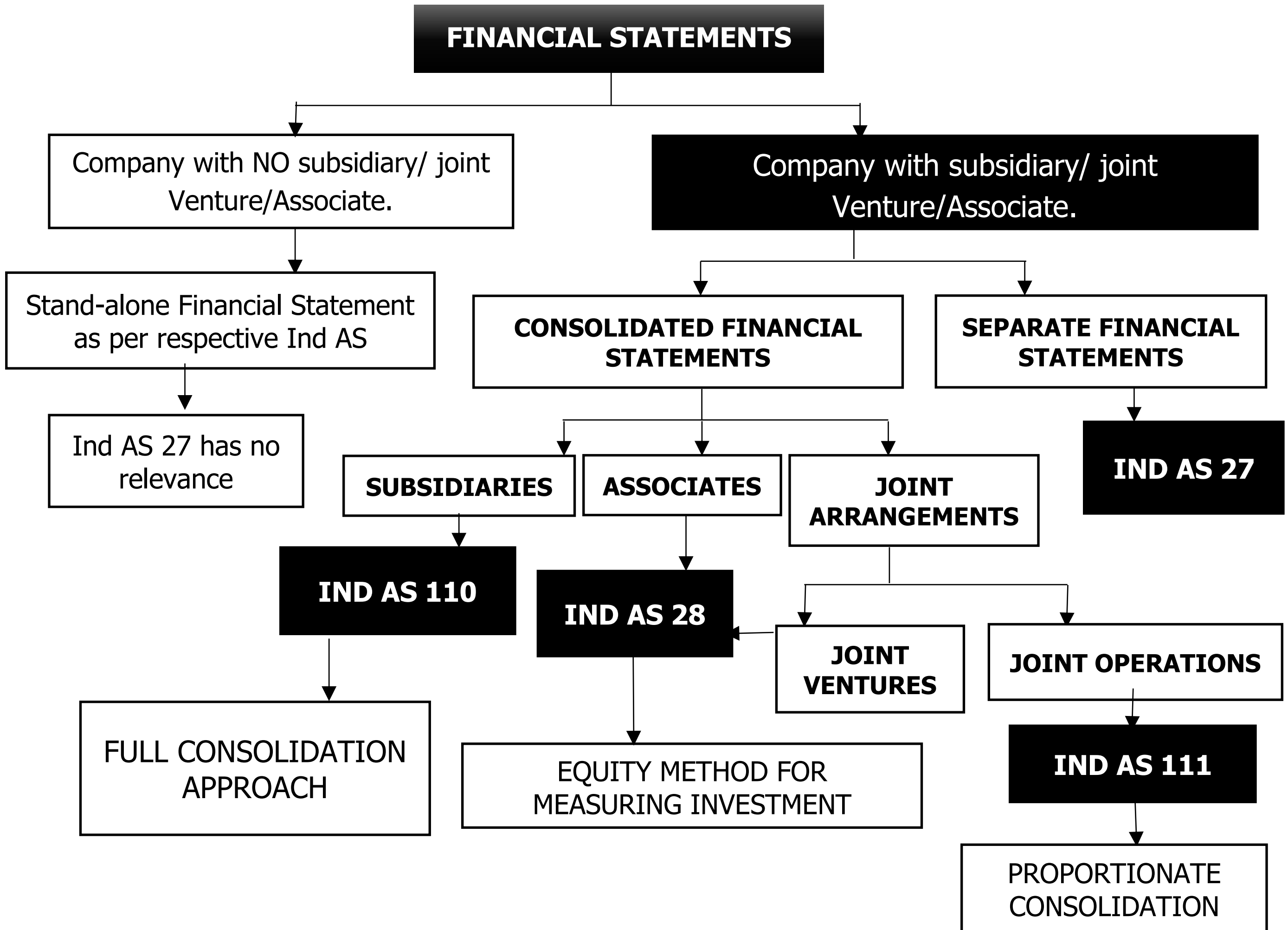
Explanation: For the purpose of this sub–section, the word 'subsidiary' shall include associate and joint venture.

5. **Ind AS 110,** 'Consolidated Financial Statements' and Division II of Schedule III to the Companies Act, 2013 should be applied in the preparation and presentation of consolidated financial statements which includes:

a) Consolidated Balance Sheet;
b) Consolidated Statement of Profit and Loss;
c) Consolidated Statement of Changes in Equity;
d) Consolidated Cash Flow Statement;
e) Consolidated Notes to the Financial Statements.

When a company is required to prepare Consolidated Financial Statements, the company shall follow the requirements of Schedule III to the Companies Act, 2013. In addition, the company shall disclose additional information as required by **Ind AS 27** and **Ind AS 112**

6. IND-AS APPLICABLE FOR VARIOUS FINANCIAL STATEMENTS



7. EXEMPTION FROM CONSOLIDATION

In the following cases consolidation is Not required

a) Exemption from consolidation is available to an **intermediate parent entity** if all the following conditions are satisfied

   i. The entity (intermediate parent) has informed all its owners and they do not object for the entity not preparing CFS.

   ii. The equity or debt instruments of the entity are not traded in any public market, inside / outside India.

   iii. The entity has not filed nor in the process of filing its financial statements on a stock exchange (or) any similar organization.

   iv. The entity's ultimate (or) any intermediate parent produces Consolidated financial statements as for Ind As 110 available for public use.

b) An entity which is set up to handle **Post-employment benefits** (or) Long Term employee benefits is not be consolidated.

c) **Investment entity** which measures all its investments in subsidiaries @ FVTPL.

CONTROL EVALUATION

Investor needs to determine whether it controls the investee or not. If control exists, then

investor = Parent entity

investor = subsidiary

There is control only if the investor has ALL of the following elements:

I
Power over the investee

II
Exposure, or rights to variable returns from investee

III
Ability to use the power to effect the variable returns from investee

CONTROL

I.POWER OVER INVESTEE

An investor will have power over investee if it has 3 elements:

- Existing **rights** that give
- Current **ability**
- To direct the **relevant activities** of investee

Relevant activities

These are activities of investee which significantly affect the investee's returns.

Eg: - Operating & financial activities like

- Sale & purchase of goods
- Capital expenditure decisions
- Managing financial assets
- Determining funding structure
- Appointment, termination & remuneration of KMP's

Current ability

- An investor would have current ability to direct relevant activities if that investor were able to make decisions at the time, those decisions need to be taken.
- Current ability is not limited to being able to act today.
- For entities where majority of activities are predetermined, we have to check whether investor has ability to direct when any exceptional circumstances arise.

Rights that give power to investor

The rights of the investor shall be evaluated to identify

a) Whether they are Substantive rights (or) protective rights

b) Substantive rights relate to the relevant activities of investee and are capable of giving power over investee. Protective rights are to be ignored in assessing power.

While evaluating the substantive rights, we must consider the following:

i. Whether there are any barriers that prevent the holder from exercising rights.

Eg:- High exercise price; Less time available to act; inactivity to obtain information required to act; legal restrictions, operational Barriers,

ii. In situations where agreement of more than one party is required to exercise the rights we have to check whether a proper mechanism is in place to execute the exercise of rights. If there is no such mechanism, then rights are not substantive.

iii. Whether the party that holds the rights would benefit from exercise of those rights would benefit from exercise of those rights.

c) Protective rights are rights to protect the party in exceptional situations. Such rights would not give power over investee.

Eg: Rights exercisable only in event of fraud;
rights of Lender to appoint nominee director;
rights of lender to seize assets in event of default;
rights of minority shares to approve / block decisions relating to capex beyond a specified limit.

d) The rights available with franchisor over the franchisee are generally to protect their brand / license. Usually, such rights are only protective rights if
   - Franchisor's rights doesn't give it ability to direct relevant activities of franchisee
   - Other parties have such ability
   - Franchisor's rights do not effect the ability of other parties
   - Franchisee operated on its own account

e) Power with majority voting rights:

Investor holding majority of voting rights will have power over investee if:

Relevant activities are directed by holder of majority voting rights

(or)

Relevant activities are directed by a governing body & majority members of such body is to be appointed by holder of major voting rights

f) Power without majority voting rights

Even if investor has less than majority voting rights, he can still have power over investee through

1) Contractual arrangement with other vote holders.
2) Rights from other contractual arrangements with the investee.
3) The investor voting rights are sufficient to give him power as the remaining voting rights are held by widespread shareholders who are not related. ∴ It is not likely that all the remaining shareholders will combine & outvote the investor.
4) Potential voting rights like call options, convertible instruments etc. These should be considered only if exercise of such rights is substantive.

g) Power without voting rights Consider the following factors

Purpose and design of investee & the involvement to investor in the design of investee

Contractual arrangements

Special relation between investor & investee
- Evidence of power

  (or)
- Indications of power

  (or)
- Incentive to have power

II. EXPOSURE, OR RIGHTS, TO VARIABLE RETURNS FROM INVESTEE

a) Variable returns are returns that are not fixed & have the potential to vary as a result of performance of investee.

b) Variable returns can be +ve or –ve or both

c) Examples of return:

- Dividends, interest from investee
- Remuneration for servicing the investee, fees or exposure from providing credit / liquidity support
- Any other residual returns

III. LINK BETWEEN POWER & RETURNS

In order to establish control, the investor should have the ability to use its power to affect the returns from investee We have to check whether the decision maker with power is a principal (or) an agent. Decision maker who is an agent of other party or parties cannot be said to have control. We can identify whether decision maker is a principal (or) agent based on following factors:

i. Scope of Decision-making authority

Scope of decision maker is evaluated by considering:

(a) Activities that are permitted as per agreement

and

(b) The discretion that the decision maker has while making decisions.

ii. Removal rights by other Parties

- If a single party holds substantive right to removal of decision maker, without cause then decision maker is an AGENT.
- If more than one party is required to exercise such rights together, then it is not conclusive
- If a greater number of parties are required to remove the decision maker, the less likely that he is an agent.

iii. Remuneration from investee

Decision maker is principal	$\xleftarrow{\text{HIGHER}}$	Magnitude & variability of remuneration in relation returns expected from activities of investee	$\xrightarrow{\text{LOWER}}$	Decision maker is an Agent

iv. Exposure to variable returns from other interests in investee

Other interests in investee	=	Investment in equity / debt of investee (or) providing credit enhancement / liquidity support to investee

Decision maker is principal	$\xleftarrow{\text{HIGHER}}$	Magnitude & variability of returns to decision maker in form of remuneration & other interest's w.r.t returns of investee from its activities	$\xrightarrow{\text{LOWER}}$	Decision maker is an Agent

Note:(For Examination proposes) A fund manager might consider that a 20% investment is sufficient to conclude that it control the fund.

INVESTMENT ENTITIES

1) A parent shall determine whether it is an investment entity. It is an investment entity if all the following conditions are satisfied:
    a) Obtains funds from one or more investor to provide investment management services
    b) Commits to investors that it's business purposes is to invest funds solely for returns from capital appreciation (or) investment income (or) both.
    c) Measures & evaluates performance of substantially all of its investment at fair value.
2) An investment entity may also provide investment related services like advisory services, investment support etc. to its investors.
3) An investment entity may also participate in investment related activities of their investees; however, it should not represent a separate substantial business activity (or) separate substantial source of income. Eg of such activities:
    - Providing mgt & strategic advices and
    - Providing financial support (or) guarantee etc
4) Investment entity does not plan to hold investments indefinitely. It only holds for limited periods. For investments like equity or perpetual bonds (or) non-financial assets which have indefinite life, the entity must have an **EXIT POLICY.**
5) Earnings shall be only in the form of capital appreciation (or) investment income (or) both. An entity is not an investment entity if the entity (or) another member of entity's group, has the objective of obtaining other benefits from entity's investments, which are not available to other unrelated parties.
6) **An investment entity shall not consolidate its subsidiaries** or apply Ind AS 103. And it shall **measure the investments in subsidiary at FVTPL as per Ind As 109.**

    However, If investment has a subsidiary which is providing investment related services, then investment entity has to consolidate such subsidiary.

    No exemption from consolidation to the parent of investment entity. Such parent has to consolidate all its subsidiaries (provided the parent itself is not an investment entity).

CONSOLIDATION OF SUBSIDIARY PROCEDURES

1. CONSOLIDATION PROCESS UNDER IND AS 110 FOR SUBSIDIARY

A. Consolidation of an investee shall begin from the **date when the investor obtains control** [**date of acquisition** as per IND AS 103] of the investee and cease when the investor loses control of the investee.

B. Consolidated financial statements:

- combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
- offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion `X` of equity of each subsidiary (**Ind AS 103 'Business Combination' explains how to account for any related goodwill**).
- eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full).

C. Ind AS 12, Income Taxes, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

2. CALCULATION OF GOODWILL / CAPITAL RESERVE IN BUSINESS COMBINATION / CONSOLIDATION [IND AS 103]

Purchase Consideration for current acquisition of a Business Combination Transaction	xxx
(+) Fair Value of shares acquired before the date of control	xxx
(+) Non-controlling Interest on date of acquisition (Measurement either at **Fair Value** on acquisition date (or) **proportionate share of net assets** on acquisition date)	xxx
(-) Fair Value of identifiable net assets on acquisition date	(xxx)
Goodwill / (Capital Reserve)	xxx

3. NON-CONTROLLING INTEREST (NCI)

a) NCI is calculated if the equity interest in the other entity is not 100%. NCI is first calculated on the date of acquisition and subsequently adjusted for post control events.

b) NCI represents the portion of equity which is not owned by the parent entity. NCI on the date of acquisition is computed in any of the following 2 methods.

- Fair Value method or
- Proportionate share of net Assets [PSNA]

Ind AS allows both the options. If NCI is computed using FV method, it is called as **Full Goodwill method**. If NCI is computed using proportional share of NA, it is referred as **Partial Goodwill method.**

Note 1. Usually the question specifies the FV of NCI, if it is not given apply PSNA method.

Note 2. Any other Equity item (Eg: Preference share capital) of subsidiary to the extent not owned by parent entity is also to be included in computation of NCI.

NON-CONTROLLING INTEREST ON THE DATE OF CONSOLIDATION

1. On the date of acquisition of Control, NCI can be valued either on FV basis or on PSNA

2. Subsequently, any share of post-acquisition profits / Losses is also adjusted into NCI as determined and this adjusted NCI will be reported in CBS

NCI should NOT BE Fair valued on each Balance Sheet date

NCI on acquisition date	Xxx
± share of post acquisition profit/Loss	Xxx
NCI for CBS	Xxx

NOTE: **NCI can be even NEGATIVE if the subsidiary suffers losses.**

4. BASIC STEPS FOR PREPARATION OF CONSOLIDATED BALANCE SHEET

STEP 1: STATEMENT OF NET ASSETS OF SUBSIDIARY.

Particulars	Opening Balance (On the DOA)	Changes	Closing Balance (ON DOC)
Equity Share Capital	XXX	XXX	XXX
Other Equity (Including Retained earnings)	XXX (**Pre -acquisition profit**)	XXX **(Post acquisition profit)**	XXX
(±) Time Adjustment	XXX	XXX	XXX
(±) Fair Value Adjustments	XXX	XXX	XXX
Total	**XXX**	**XXX**	**XXX**

TO BE USED IN COMPUTATION OF GW IN STEP 2

SHALL BE ALLOCATED INTO PARENT & NCI IN THE RATIO OF ITS HOLDING

STEP 2: COMPUTATION OF GOODWILL/ BARGAIN PURCHASE GAIN

Purchase Consideration for current acquisition of a Business Combination Transaction	**xxx**
(+) Fair Value of shares acquired earlier than the date of control	**xxx**
(+) Non-controlling Interest on date of acquisition (Measurement either at a Fair Value on acquisition date (or) proportionate share of net assets on acquisition date)	**xxx**
(-) Fair Value of identifiable net assets on acquisition date	**(xxx)**
Goodwill / (Bargain purchase gain)	**xxx**
Less: Impairment loss if any, on GW	**(xxx)**
Goodwill for CBS	**xxx**

STEP 3 : NCI FOR CONSOLIDATED BALANCE SHEET

NCI ON DATE OF ACQUISITION as computed in step 2	xxxx
ADD: NCI 'S Share of Post acquisition profit in Subsidiary	xxxx
Less: Share of Impairment loss in GW **[ONLY FOR FULL GW]**	(xxx)
NCI for Consolidated Balance sheet	**XXX**

STEP 4 OTHER EQUITY FOR CBS

Other equity in of parent entity on date of consolidation	xxxx
add: Parent's share of post-acquisition profits in subsidiary	xxx
less: parents share of impairment loss in goodwill	(xxx)
Other equity for Consolidated Balance Sheet	**XXX**

For the above steps, further adjustments may have to be carried out.

5. REVALUATION OF ASSETS

a. While considering the net assets of the subsidiary for Computation of Goodwill / capital reserve, the carrying amount of net assets may be different from the Fair value on the date of such acquisition.

b. For computing GW/CR, we have to consider only the FV of net assets. Due to this there may be a Revaluation Profit or Loss. This is Pre acquisition Profit or loss.

c. Due to increase / decrease in the value of Assets, effect has to be given even on the depreciation during the post-acquisition period. Additional depreciation may have to provided or depreciation may have to be reversed.

   Additional Depreciation or Reversal Depreciation

   = Depreciation on Fair value of asset from DOA till DOC (-) Actual depreciation charged by subsidiary during the post-acquisition period.

   Shortcut method: = Revaluation Profit or Loss x Rate of depreciation.

   DON'T USE SHORTCUT if acquisition takes place during the year.

d. If there is an increase in the value of stock and such stock is still unsold on the date of consolidation, Apart from recognizing revaluation profit, we shall also update the inventory in CBS. If such stock is sold after DOA and before consolidation date, the post-acquisition profit of the subsidiary has to be reduced to the extent of revaluation profit.

6. IMPAIRMENT OF GOODWILL

If goodwill arising on Consolidation is required to the impaired then

1) Calculate impairment loss & 2) Allocate such loss to **parent** or **parent & NCI**

Journal entry in CFS

Case – 1 In case of **FULL GOODWILL** (NCI determined using FV on DOA)

P&L of parent a/c	Dr
NCI a/c	Dr
To Goodwill	

Case – 2 In case of **PARTIAL GOODWILL** (NCI determined using PSNA)

P&L of parent a/c	Dr
To Goodwill	

7. ELIMINATION OF CONTRA ITEMS WITHIN THE GROUP

1) We should eliminate Receivables / Payables within the group (Inter co debtors, Creditors, Loans given / taken etc). if any gain or losses arises on cancellation of Investment in debentures & Debenture liability, such loss/ gain to be recognised in P or L.
2) Sometimes the receivable & payable amount may not match due to cash/ cheque in transit. In such case, eliminate the inter co recievable & payable at their respective carrying amounts & recognise cash/ cheque in transit in CBS.
3) Eliminate Incomes and expenses while preparing Consolidated PL A/c. (Interest Income / Expense, Dividend paid / received, Inter Co sales / Purchases)
4) We should eliminate Receipts and payments while, preparing Consolidated Cash flow Statements)

8. TIME ADJUSTMENT OF PROFITS

Sometimes Date of acquisition of shares in Subsidiary can be during the year & not at the beginning of the year. When the question provides balance of reserves at the beginning of year and not on the date of acquisition then certain portion of current period profit must be re-classified as pre-acquisition profits.

Step – 1 Calculate the changes column in retained earnings in the statement of net assets

Step – 2 Add back appropriations (Dividend) & uneven expenses or incomes

Step – 3 Calculate the profit relating to pre-acquisition period assuming that the profits are earned evenly.

Step -4 Give the effect of uneven expenses / Incomes in the appropriate period.

9. TREATMENT OF DIVIDEND RECEIVED FROM SUBSIDIARY

In separate financial statements, any dividend received from the subsidiary will be recognized as income in P or L. It does not matter whether dividend is declared from Pre acquisition profits or post-acquisition profits.

In the process of consolidation, the treatment is as under:

DIVIDEND DECLARED BY SUBSIDIARY FROM POST ACQUISITION PROFITS.

Alternative 1: DO NOTHING Ignore dividend adjustment in the steps in consolidation process.

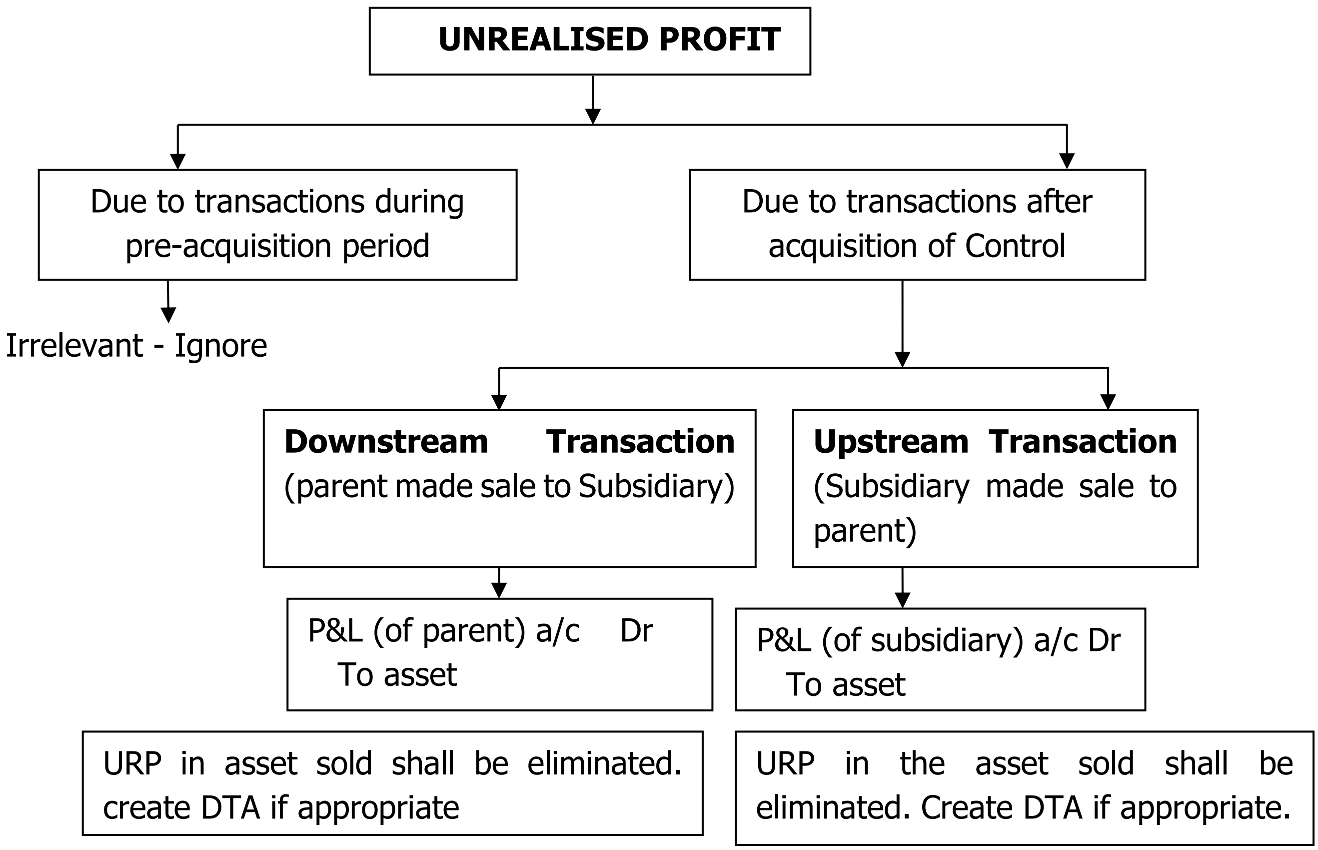
Alternative 2: Same as

DIVIDEND DECLARED BY SUBSIDIARY FROM PRE-ACQUISITION PROFITS.

a. Add the dividend declared by subsidiary to the changes column in step 1 in order to obtain the correct post-acquisition profit.
b. While computing NCI for CBS [Step 3], deduct the dividend received by NCI from the subsidiary.
c. While computing other equity for CBS [Step 4] deduct the amount of dividend received by the parent from the subsidiary company.

10. UNREALISED PROFIT IN TRANSACTIONS BETWEEN PARENT & SUBSIDIARY

If due to any sale / purchase transactions between parent & subsidiary any profit recognised will be an unrealized profit if such asset still exists on the date of consolidation with the group.



URP in stock = Amount of Stock in CBS x % of profit

URP in Fixed Asset = Value of asset x % of profit, Net of depreciation provided.

11. PREPARATION OF CONSOLDATED P&L

1. All incomes and expenses of parent and its subsidiaries should be combined on line-by-line basis. Subsidiary Company incomes & expenses should be considered only from the date of acquisition
2. Any incomes and expenses for intercompany transactions shall be eliminated.
3. Any unrealized profit in the closing stock will be adjusted into COGS. Add URP to the combined COGS.
4. Any impairment loss on goodwill or additional depreciation due to revaluation has to be provided in Consolidated P&L
5. Any dividend paid by subsidiary Company during the year, would be recognised as income in the P&L of parent. This has to be cancelled.
6. From the Consolidated P&L, profit belonging to NCI and the parent should be separately shown.
7. Amount of profit attributable to NCI shall be calculated separately based on the profits of subsidiary. In consolidated P&L this calculated amount of profit will be allocated to NCI and the remaining profit is attributable to the parent.

12. CHANGES IN INVESTMENTS ON POST AQUSITION DATE WITHOUT EFFECTING CONTROL

ACCOUTNING IN CFS

These transactions of purchase / sale which doesn't effect control are in substance considered as changes in NCI. It means purchase of further investment in subsidiary is seen as **acquisition of NCI.** Similarly, sale of shares in subsidiary is seen as **sale of NCI**

JOURNAL ENTRIES IN CFS

For purchase of further Investment in Subsidiary

NCI a/c Dr Prorata share of NCI

To Bank Purchase Price.

Note: Any difference in above entry is recognized as **gain or loss in R&S** for CBS / SOCE

For sale of Investment in subsidiary

Bank a/c Dr

To NCI

Note: Any difference in above entry is recognized as **gain or loss in R&S** for CBS / SOCE

ACCOUNTING IN SFS OF PARENT

On purchase of additional Investment

Investment a/c Dr
To Bank

On Sale of Investment

Bank a/c Dr
To Investment

13. LOSS OF CONTROL

1. The parent entity may lose control due to sale of shares or due to any other reason. [Subsidiary issued shares to others]
2. On Loss of Control, the BV of net assets and NCI and goodwill shall be derecognized. Any gain / Loss shall be recognised in Profit or Loss.

On Sale of Complete Investments

Bank a/c	Dr	Sale proceeds
NCI a/c	Dr	BV
To Net assets of Subsidiary		BV
To Goodwill		BV

Any difference in the above entry is a gain / loss to be recognised in P or L

On Sale of Partial Investments

Bank a/c	Dr	Sale proceeds
NCI a/c	Dr	BV
Investment Retained**	Dr	
To Net assets of subsidiary		BV
To Goodwill		BV

Any difference is gain / loss and it is adjusted in P or L.

**The investment retained should be recognized at Fair value. However if fair value is not given, we can adopt proportionate share of NA in the subsidiary for the proportion of investment retained.

14. UNIFORM ACCOUNTING POLICIES:

A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

If a member of the group uses accounting policies other than those adopted in the consolidated Financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

15. REPORTING DATES

The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date.

When the end of the reporting period of the parent is different from that of a subsidiary (e.g. parent's financial year ends on 31 March 20X1 but the subsidiary's financial year ends on 31 December 20X0), the subsidiary prepares, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.

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

The length of the reporting periods and any difference between the dates of the financial statements shall be the same from period to period. This means that if the financial statements of a subsidiary used for consolidation in previous periods were ending on different dates than that of the parent whereas the financial statements used for current period end on the same date as that of the parent then the comparatives for previous period should be restated to have comparison of equivalent periods

16.CHAIN-HOLDING UNDER CONSOLIDATION

Meaning: A parent co, can establish control over subsidiary directly or indirectly. Chain-holding refers to situations wherein a parent is controlling a subsidiary indirectly. This may happen in number of ways, for example, parent company (P Ltd) holding controlling interest in a subsidiary (S1 Ltd.), which in turn is holding a controlling interest in another company (S2 Ltd). In this case, P Ltd, is having an indirect control over S2 Ltd, through its direct subsidiary S1 Ltd.

Situation I: INDIRECT HOLDINGS in Sub-subsidiaries

Parent P→80% →Subsidiary S1 → 60% → Sub-Subsidiary (S2)

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

Analysis:

1. P owns 80% of 60% = 48% of S2
2. The NCI of P in S1 =20% and in S2= 100%-48%=52%.

Situation II: Direct holdings in sub-subsidiaries:

Parent P → 80% →Subsidiary S1 → Sub-Subsidiary 52 →75%

Parent P → 10% Subsidiary S2

In this case, S2 is a sub-subsidiary of P with additional shares held directly by P.

Analysis:

1. P owns 80% of 75% = 60% of S2
2. P owns 10% of S2, so ultimate holding in S2 is 70%
3. The NCI of P in S1 = 20% and in S2= 100%-70%=30%.

Consolidation procedure is same as discussed earlier except **3 CHANGES**

CHANGE 1: Find out NCI of all subsidiaries **from point view of ultimate Parent co.**

CHANGE 2 & CHANGE 3: Goodwill/Gain on Bargain Purchase, NCI, retained earnings shall be calculated as usual **except THE FOLLOWING 2 adjustments** in investment by middle subsidiary and NCI of middle subsidiary. Such adjustment shall be done as follows:

In computing GW/CR of **last Subsidiary, Do not consider the total investment** made by middle subsidiary. Instead consider the parent's share of such investment.

i.e **Cost of investment made by S1 in S2 x % of holding in S1 held by P.** Therefore, out of the total investment of S1 in S2, the above identified portion is only cancelled while calculating GW/CR. The remaining balance of such investment is not cancelled and normally it comes to Consolidated Balance sheet. However, as this remaining uncancelled ASSET represents the Share of investment in S2 belonging to **NCI in S1,** it will be presented as a **REDUCTION from NCI in S1.**

IND AS 28 INVESTMENT IN ASSOCIATES & JOINT VENTURES

An associate is an entity over which the investor has significant influence. Hence, to assess whether an investee is an associate or not, an entity needs to understand the term 'significant influence.'

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. The following concepts are related to assessment of significant influence:

1. PRESUMPTION OF SIGNIFICANT INFLUENCE

Voting power ≥ 20% but not exceeding 50%	→	results in significant influence unless demonstrated otherwise
Voting power ≥ 20%	→	does not result in significant in influence unless demonstrated otherwise

It should be noted that a substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

2. JUDGEMENT REQUIRED IN ASSESSMENT OF SIGNIFICANT INFLUENCE

In For making judgement about existence of significant influence, the investor shall consider following factors which generally demonstrate the existence of significant influence:

a) representation on the board of directors or equivalent governing body of the investee

b) participation in policy-making processes, including participation in decisions about dividends or other distributions

c) material transactions between the entity and its investee

d) interchange of managerial personnel

e) provision of essential technical information

3. POTENTIAL VOTING RIGHTS IN ASSESEMENT OF SIGNIFICANT INFLUENCE

An entity may own potential voting rights such as share warrants, share call options, convertible instruments, or other similar instruments that can give the entity additional voting power or reduce another party's voting power over the investee.

Potential voting rights that are currently exercisable are considered when assessing whether an entity has significant influence. Potential voting rights that are currently not exercisable are not considered for the assessment.

4. EQUITY METHOD

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

An investor is required to account its investments in associates and joint ventures as per equity method. Under the equity method of accounting, an investor shall pass following entries at various stages of investment:

1) Analyse profits of associate into Pre & Post Acquisition profits.
2) An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture On acquisition of the investment, an entity shall identify the goodwill or capital reserve.

Goodwill

Any excess of the cost of the investment over the entity's share of the net fair value of the investee's identifiable assets and liabilities is treated as goodwill. Goodwill is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.

Capital reserve

Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is treated as capital reserve. It is recorded directly in equity.

3) Initial entry to record investment done in associate or joint venture at cost
4) Recording of **investor's share in the profit or loss** of the associate or joint venture after the date of acquisition

   Recording of **investor's share in the other comprehensive income** of the associate or joint venture <u>after the date of acquisition.</u>

Invst in shares of Associate Dr.

To P or L	Our share of post acq'n profit in P or L of Associate
To OCI	Our share of post acq'n profit in OCI of Associate
To Equity	Our share of post acq'n profit in Equity of Associate

5) DO NOT CANCEL any INTER Co. Receivables & Payables
6) Eliminate unrealized profit in Inter Co. transactions only to the extent of INVESTOR's Share.
7) Dividends received from an investee is reduced from Investment.

JOURNAL ENTRIES IN SFS – IND AS 27	**JOURNAL ENTRIES IN CFS – IND AS 28**
FOR PURCHASE OF INVESTMENT	
Investment in Associate Dr xxx To Bank xxx	Investment in Associate Dr xxx To Bank xxx
FOR APPLYING EQUITY METHOD	
NOT APPLICABLE	Invst in shares of Associate Dr. To P or L To OCI To Equity
FOR RECEIPT OF DIVIDEND	
Bank Dr. To Dividend (P or L)	Bank Dr. To Investment in Associate
FOR ELIMINATING URP IN UPSTREAM TRANSACTION	
NOT APPLICABLE	P or L (Consol) Dr. To Asset [Investor's share of URP]
FOR ELIMINATING URP IN DOWNSTREAM TRANSACTION	
NOT APPLICABLE	P or L (Consol) Dr. To Invst in Associate [Investor's share of URP]
FOR IMPAIRMENT OF INVESTMENT	
	P or L (Consol) Dr. To Invst in Associate

5.EXEMPTIONS FROM EQUITY METHOD

EXEMPTION 1

an entity need not apply equity method if the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in paragraph 4(a) of Ind AS 110.

EXEMPTION 2

When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at **fair value through profit or loss**

EXEMPTION 3

When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at **fair value through profit or loss** in accordance with Ind AS 109.

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

6. SHARING OF ASSOCIATE'S LOSSES IN EQUITY METHOD AGAINST "OTHER INTERESTS" IN ASSOCIATE

1) The investment in associate includes:
    a) Invst in equity shares
    b) Invst in pref shares
    c) Loan receivables

    There are "other interests" they are considered here only if settlement terms are not planned.
2) While applying equity method, our share of post-acquisition losses in Associate are deducted against "Invst in Equity shares". After completely writing off the "Invest in Equity shares", any further loss is adjusted towards:
    I. Invst in pref shares
    &
    II. Loan Receivables

    (in the same order)

However the loss allocated to these "other interests" cannot exceed their carrying amounts as per "Separate financial statements"

3) Subsequently, if associate makes profits, then our share of Associate's profit shall be first used to recover the losses allocated towards.

I. Loan Receivables & II. Invst in pref. shares (in the same order)

The balance profit remaining, if any is to be added to "Invst in Equity shares".

7. DIFFERENT REPORTING PERIODS OF THE ENTITY AND ITS ASSOCIATE OR JOINT VENTURE

To apply equity method of accounting, an entity shall use the **most recent available financial statements** of the associate or joint venture.

When the end date of the reporting period of the entity and that of the associate or joint venture is different then associate or joint venture shall prepare financial statements as of the period end date of the entity for the purpose of doing equity method accounting by the entity.

If it is impracticable for the associate or joint venture to prepare financial statements as of the period end date of the entity then the entity can use the financial statements of associate or joint venture ending on different date subject to giving effect of significant transactions or events occurring in between the gap period.

In no case, the difference between the end date of the reporting period of associate or joint venture and end date of reporting period of the entity **can exceed 3 months.**

8. UNIFORM ACCOUNTING POLICIES

When using the financial statements of an associate or joint venture for doing equity method accounting, the accounting policies (for like transaction and events in similar circumstances) as used by associate or joint venture in preparing their financial statements should be same as the policies used by the entity in preparing its financial statements.

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

Exception 1

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

Exception 2

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

9. IMPAIRMENT LOSSES

After doing accounting as per equity method explained above, an entity shall determine whether there is objective evidence that the entity's net investment in an associate or a joint venture is impaired. The objective evidence of impairment can arise because of:

1. Significant financial difficulty of the associate or joint venture.
2. Breach of contract, such as a default in payments by the associate or joint venture.
3. It becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganization.
4. Disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture.
5. Adverse effect in the environment (technological, market, economic or legal) in which associate or joint venture operates.
6. Significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

Impairment loss is excess of CARRYING AMOUNT over the RECOVERABLE AMOUNT. Recoverable amount is higher of FVLCTS or Value in Use.

Determining value in use

Impairment loss is provided by comparing the recoverable amount (higher of value in use and fair value less costs to sell) with the carrying amount of the investment.

For above purpose, an entity can determine the value in use in either of the following ways:

Method 1: Values in use shall include entity's share in the present value of estimated future cash flows expected to be generated by the associate or joint venture, including:

(i) cash flows from the operations of the associate or joint venture and

(ii) proceeds from the ultimate disposal of the investment

Method 2: Value in use shall include the present value of estimated future cash flows expected to arise from:

(i) dividends to be received and

(ii) proceeds from the ultimate disposal of the investment.

10. DISCONTINUANCE OF EQUITY METHOD

An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture. The accounting consequences when an investment ceases to be an associate or a joint venture are explained below.

Investment becomes a subsidiary

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

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

Retained interest in the former associate or joint venture that is a financial asset shall be measured at fair value. The entity shall recognise in profit or loss any difference between:

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

11. CLASSIFICATION OF INVEST IN ASSOCIATE OR JOINT VENTURE AS HELD FOR SALE

An entity shall apply Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale.

IND AS – III JOINT ARRANGEMENTS

1) Joint Arrangement (JA) is an arrangement in which 2 or more parties have Joint control.
2) To be a Joint Arrangement, following 2 characteristics are to be present:

1) The parties are to be bound by contractual arrangement	2) The contractual arrangement gives joint control to 2 or more parties in the arrangement.

3) Joint control exists only when unanimous consent of 2 or more parties is required.
4) “Unanimous consent” clause can be mentioned explicitly (or) may be implied in the arrangement.
5) Among the parties in the arrangement, if more than one combination of parties is capable of taking decisions, then it is a joint arrangement only when the contractual arrangement specifies & identifies the combination of parties whose unanimous consent is required.
6) Unanimous consent of parties is required for decision making on RELAVANAT ACTIVITES. i.e. activities which significantly affect the returns.
7) Joint Arrangement can be further classified as
    1. JOINT OPERATION (OR)
    2. JOINT VENTURE
8) In a JOINT OPERATION [JO], the parties have rights to assets and obligation towards liabilities of arrangement. The parties are called as JOINT OPERATORS
9) In a JOINT VENTURE [JV], the parties have right on NET ASSETS of the arrangement. The parties are called as JOINT VENTURERS.

10) **How to identify JO (or) JV??**

Is the Joint Arrangement structured as a separate Entity??

NO	YES
JA is a JOINT OPERATION	JA can be a JOINT VENTURE (or) JOINT OPERATION. FURTHER evaluation required.

Further Evaluation when a separate entity is created

1. **Legal form of separate entity** → Does the legal form provide the parties right to assets & obligation to liabilities??
   - **Yes** → Joint Operation
   - **No** ↓

2. **Terms of contractual arrangement** → Does the form of arrangement provide the parties with right to assets & obligation to liabilities??
   - **Yes** → Joint Operation
   - **No** ↓

3. **Other facts & circumstances** → Is the arrangement designed in a manner that
   i. It's activities primarily aim in providing the output to the parties
   and
   ii. The entity depends on the parties for settlement of its liabilities, on continuous basis
   - **Yes** → Joint Operation
   - **No** ↓

It is a JOINT VENTURE

11) ACCOUNTING OF JOINT VENTURE

- In SFS of venturers → Apply **Ind AS 27** & measure the investment @ (i) **COST** (ii) **FAIR VALUE**
- In CFS of venturers → Apply **Ind AS 28 Equity method** for the investment in Joint Venture.

12) ACCOUNTING OF JOINT OPERATION

Each Joint operator will account for it’s share of Assets, liabilities, incomes & expenses of the Joint Operation.

When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in Ind AS 103, it shall apply, to the extent of its share in the joint operation, all the requirements of business combinations accounting as per Ind AS 103.

Sale of Assets or Contribution by operator to Joint operation:

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

Purchases of assets from a joint operation:

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

IND – 27 SEPARATE FINANCIAL STATEMENTS

1) Entity Having Investments in subsidiary / Associate / Joint Venture have to prepare separate financial statements (SFS) as for companies Act, apart from preparing consolidated financial statements unless exempted from consolidation. On such separate financial statements, Ind AS 27 is to be applied.
2) Entities which claim exemption from consolidation, will prepare "SFS" as their only financial statements.
3) As per Ind AS 27, the Parent / Investor / Venturer entity can measure the investment in Subsidiary / Associate / Joint Venture using
   a) COST
      (or)
   b) FAIR VALUE as per Ind AS 109 (i.e. FVTPL (or) FVTOCI)

   The choice of COST (or) fair value is to be applied for each category of investments. However, an investment entity claiming exemption from consolidation under Ind AS 110 (or) Ind AS 28 shall measure the investments in SFS @ FVTPL

4) <u>CHANGE IN STATUS FROM INVESTMENT ENTITY TO NON – INVESTMENT ENTITY</u>

Investment entity earlier would have applied FVTPL. However, hereafter they have the choice of

(i) COST $[\text{deemed COST} = \text{fair value of invst on date of change in status}]$

(or)

(ii) FAIR VALUE as per Ind AS 109.

5) <u>CHANGE IN STATUS FROM NON-INVESTMENT ENTITY TO INVESTMENT ENTITY</u>

The Entity earlier would have applied either COST (or) fair value but here after it must apply only FVTPL.

<u>Possibility 1:</u> **<u>Invst measured @ COST</u>**

Now fair value the Invst & gain/loss t/d to P or L

<u>Possibility 2:</u> **<u>Invst measured @ FVTOCI</u>**

Now fair value the Invst & gain/loss t/d to P or L.

Accumulated gain / loss in OCI – Reserve is recycled to P or L

Possibility 3: **Invst measured @ FVTPL**

Continue applying FVTPL

6) Any dividend from Subsidiary / JV / Associate is recognized as Income in P or L when right to receive dividend is established.

7) RE-ORGANISATION IN GROUP STRUCTURE

When there is a Re organisation in the group in such as

a) A New parent gets created, Ind AS 27 gives guidance on calculating the COST of investment in books of New parent.
b) If the New parent co elects to measure the invst in old parent @ COST then,
   COST = Proportionate share of EQUITY (ESC + other Equity) in Sep. Fin. Statements of Old parent entity.
c) To apply the above methodology, the following conditions are to be satisfied:
   i. New parent obtains control old parent by issuing equity shares to owners of old parent.
   ii. The owners in New Parent shall be same as owners in old parent with same absolute & relative interest in Net assets.
   iii. Assets & liabilities of group should be same before & after re organisation

IND AS 36 - IMPAIRMENT OF ASSETS

1. Impairment means reduction in the value of the asset. The decline is due to either internal or external reasons.
2. The objective of the standard is to ensure that the carrying amount of the assets does not exceed its actual worth.
3. This standard is not applicable for the following assets
    i. Inventories
    ii. Trade Receivables
    iii. Agricultural assets under IND AS 41
    iv. Deferred Tax asset (covered by IND AS 12)
    v. Other Financial assets

    (This standard is mainly applicable for PPE, CWIP, Investment property, Intangible assets, Intangible assets under development and Goodwill, investment in shares of subsidiary/associate/joint venture)
4. If the Entity holds an asset for sale or distribution they should not be impaired under this standard (Ind AS 105 applies)
5. How to calculate Impairment loss

    Impairment loss = Carrying amount - Recoverable amount

Carrying Amount (CA) =	Original cost of asset	xxxx
	(-) Accumulated depreciation	(xxx)
	(-) Accumulated loss (Impairment)	(xxx)
	CA	xxx

    RECOVERABLE AMOUNT is higher of
    i. Fair value less cost of disposal (FVLCTS) (or)
    ii. Value in use

6. Fair value is a price at which an asset can be sold between two market participants in a arms length transaction. Cost to sell / disposal includes incidental expenses for sale like commission, stamp duty or any other legal costs.

7. Value in use is an Entity specific value. It is the present value of future cash inflows arising from the continuing use of the asset and its terminal value.
8. If the Recoverable amount is higher than the carrying amount then there is no impairment loss.
9. **Accounting treatment of Impairment loss**

   Impairment loss shall be recognized in P/L A/c. If the asset has any revaluation surplus it can used to absorb the revaluation loss

   a) Revaluation surplus A/c (OCI) Dr
      P/L A/c Dr (bal. fig)
      To Provision for Impairment loss

   b) After providing impairment loss the carrying amount of the asset will be revised and this will lead to change in the amount of depreciation in the future years.

      Future depreciation (if SLM) = $\frac{\text{Revised CA after,Impairment loss } \Theta \text{ Estimated scrap value}}{\text{Remaining useful life}}$

   c) Impairment loss is not an admissible expense under Income Tax Act. Therefore, there will be an effect on deferred taxes. It results in DTA. (Covered in IND AS 12)

10. **Do we need to compute both FVLCTS and VALUE IN USE?**

    Value in use and FVLCTS are not always necessary to be computed. Some of the situations are
    a) When either of them is computed and such amount is higher than the carrying amount.
    b) We have a reason to believe that FVLCTS is almost equal to ($\simeq$) value in use (This happens when the entity does not have the intention to the use asset but only to sell it)
       In this case value in use need not be calculated.
    c) When fair value of the asset/ VIU cannot be determined.

11. **HOW TO CALCULATE VALUE IN USE?**

    a) Value in use calculation needs
       Expected cash flows and
       Discounting rate.
    b) Estimated cash flows of the future should consider expected cash inflows less expected cash outflows. These cash flows should be based on most recent budgets of the entity.

c) Normally cash flows should be projected for a period not exceeding 5 years, unless a higher period can be justified.
d) While projecting the cash flows we can use a constant growth rate or a declining growth rate which is in line with the Industry standards.
e) The cash flows from the asset should be estimated in its current existing conditions.
f) CFs from existing condition of the asset to be considered. Any improvements in CFs expected due to future plans / anticipated improvement in the asset or Restructuring should be ignored, unless entity is committed to it.
g) If the cash flows are in foreign currency discount those cash flows using a foreign currency discounting rate and determine the value in use. This value in use will be converted into functional currency using the spot rate.
h) The cashflows projected should be net cashflows after deducting the outflows necessary for generating the cashinflows.

Discount Rate:
1. Pre tax rate to be taken.
2. Rate of return on such investment, which could be

   <u>1st preference:</u>

   CAPM based Rate of Return

   $R_f + B \times (R_m - R_f)$

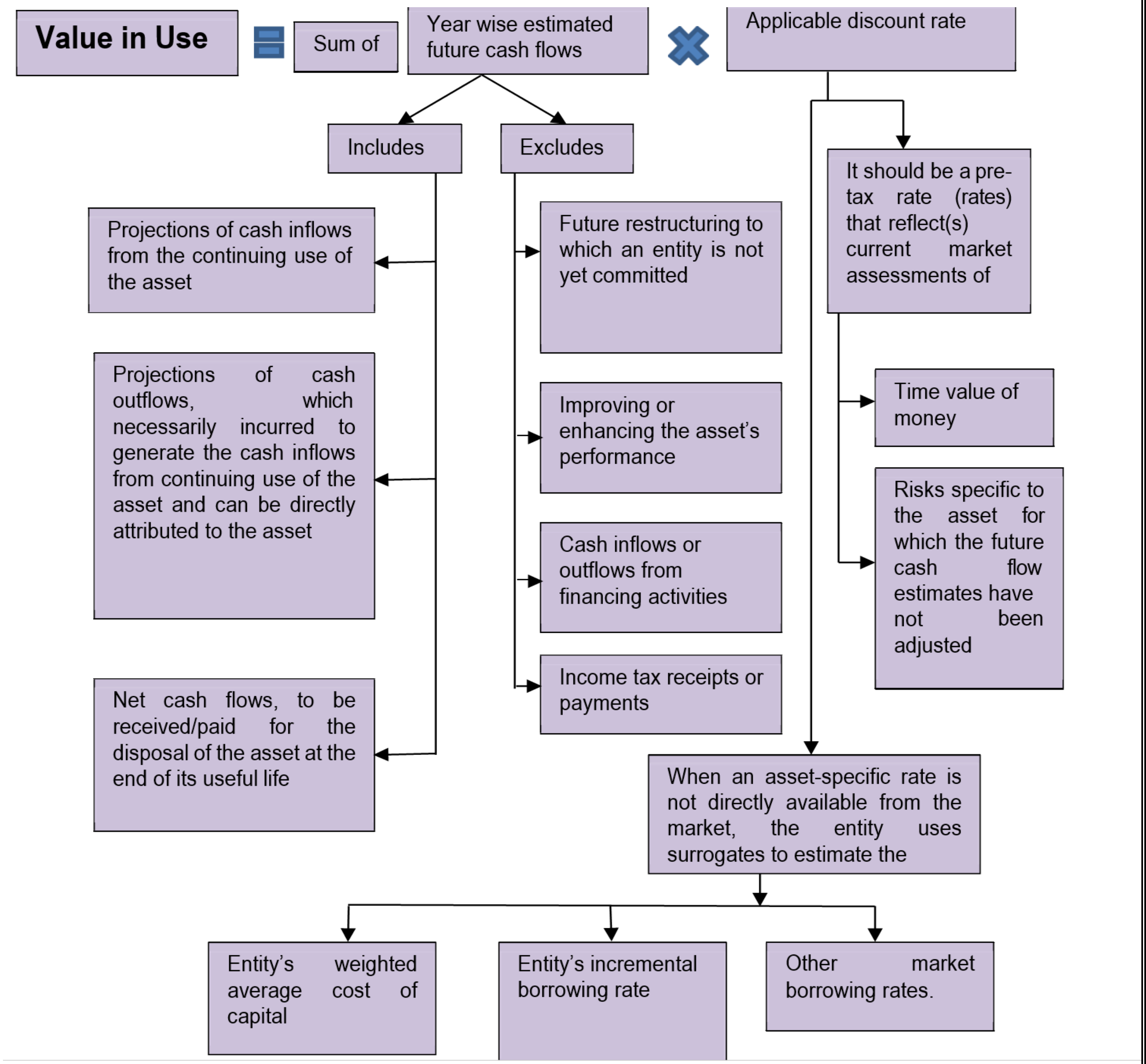
   <u>2nd Preference:</u>

   WACC

   <u>Else</u>

   Any other basis
3. Discounting rate should be based on the basis of CFs estimated. If CFs are projected in real terms (excluding inflation effect) disc rate should also be real rate, else nominal rate to be used

Projection of Future CFs: Guidance
1. Latest CFs as projected in business plans to be considered
2. However, Business Plan of only up to 5 years is considered.
3. Growth Rate of CFs, beyond Business Plan period not to exceed Industry growth rate.



12. IMPAIRMENT OF ASSET MEASURED AT REVALUATION MODEL:

When a PPE/ITA is measured in accordance with Ind AS 16/38, the asset appears at an amount equal to or nearly matching its fair value.

If indicators exist for impairment, impairment testing is to be done only if cost of disposal is considered significant.

13. LIABILITIES IN DETERMINING RECOVERABLE AMOUNT

If the Recoverable amount [FVLCTS (or) VIU] is determined after considering the liability that is related to the asset, the CA of the asset also has to be adjusted with such related liability. This adjusted CA should be compared with the Recoverable amount to identify any Impairment loss. The resulting impairment loss shall be adjusted to the asset only.

14. INDICATORS FOR IMPAIRMENT

1) When indicators exist, a formal estimate should be made for testing Impairment loss

2) External Indicators:

i. Substantial decline in the market price of the asset.
ii. Significant Increase in the market interest rates.
iii. Adverse changes in the market relating to demand, technology or Govt. polices.
iv. The market capitalization of the entity is lower than the carrying amount of Net assets

3) Internal Indicators:

i. There has been a physical damage to the asset
ii. Poor Economic performance of the asset
iii. The Entity has entered into any restructuring programme or is in a plan discontinue any operations in which asset is included.

4) Investment in Subsidiary, Associate or Joint Venture

The Investment in these Entities shall be tested for impairment if

a) The CA of the Investment > our share of net assets in the Investee including Goodwill.
b) The dividend received from these entities exceeds the total comprehensive income of the entity. (i.e., Dividend declared form past profits).

15. COMPULSORY IMPAIRMENT TESTING

1) In the following three situations Impairment testing has to be done even if no Indicators exist
   i. Goodwill arising in a business combination
   ii. Intangible assets having indefinite life
   iii. Intangible assets under development
2) Impairment testing on above assets can be done at any time during the year. However in each Accounting period, the Impairment testing has to be done on same date.

Note: If there is an indicator of impairment arising after Impairment testing done as above the asset has to be tested for Impairment again.

16. CASH GENERATING UNIT (CGU)

1) If Impairment testing has to be done, the asset should be capable of generating independent cash flows. If the asset is not capable of generating cash flows on its own we cannot compute value in use for the asset.
2) CGU is a **smallest group of identifiable assets** which are capable of generating independent cash flows. Impairment testing will be done on this CGU and not on the Individual asset.
3) If a CGU partially supplies its output to another unit in the same entity then, the CGU will be treated as a separate CGU only if it capable of generating its CFS independently i.e. it can sell all its output to market and is not necessarily dependent on the other unit for selling its output.
4) When there is a physical damage to the asset and the entity is committed to replace such asset in the near future, its VIU will be almost equal to FVLCTS, Therefore, we are in a position to ascertain the recoverable amount of the damaged asset. Hence there is no requirement to identify a CGU.
5) If the management decides to continue with the damaged asset, then we have to perform impairment testing for the CGU. In case of any Impairment loss, such loss is allocated to all the assets in the CGU proportionately based on their carrying amount.
   However, if the Recoverable amount of CGU exceeds the carrying amount of the CGU then there is no impairment loss that will be recognized. It means the damaged asset in the CGU will be continued at its carrying amount. Even if its CA is higher than FVLCTS.

Notes

a) Sometimes plants / Factory working on inter changeable production plans may not be identified as CGU. However, all the plants put together may be Qualified as CGU.
b) It is not necessary that the output of an asset (or) CGU should be sold in the market. Its output can be transfer internally to other CGU's. However an active market should exist for the output.

Steps for Impairment testing on CGU

I	Determine RA & CA of CGU as a whole
II	IL = CA – RA (if CA > RA of CGU as a whole
III	**<u>Allocation of IL:</u>** i. Allocate IL to individual assets of CGU in proportion of their respective CA, ensuring no individual asset is reduced below its Own RA (if determinable, usually RA of individual asset is its FVLCTS). ii. IL non-allocable to an individual asset (since its RA = or > CA), IL will be allocated to **other** individual assets of CGU on same basis as above iii. If any IL remains unallocated (as all individual assets RA $\geq$ CA of asset) such IL will be ignored.

17. GOOD WILL IMPAIRMENT TESTING

We know that Goodwill has to be tested or impairment annually. However it is not possible to calculate FVLCTS / VIU of Goodwill independently. Therefore, goodwill has to be allocated to a CGU or a group of CGUs' which one getting benefited because of the Synergy effects on acquisition of Business.

A. <u>GOODWILL UNALLOCABLE TO CGU</u>

Eg: ABC acquired XYZ for 2000 Cr. XYZ comprises of Factory 1: Rs.800; Factory 2: Rs.600; Factory 3: Rs.200. Each factory is a CGU. Goodwill of 200 (2000 – (800 + 600 +200) is not allocable to any individual factory.

<u>Analysis</u>

1) Goodwill is unallocable.
2) **Impairment test at CGU level**: First check Impairment Loss at CGU level, ignoring Goodwill and Impairment Loss, if any to be recognized by allocating loss to individual assets of CGU following principles / steps as discussed before in Impairment Loss of CGU.
3) **Impairment test on group of CGUs (sometimes this represents entire business i.e entire entity):** Revised CA of all CGUs (after recognizing Impairment Loss, if any) to which Goodwill relates **+ CA of Goodwill** to be compared with RA of all such CGUs as a whole (i.e. at Enterprise level), and Impairment Loss if any
   a) first allocated to G/w, and
   b) excess if any will be again allocated to individual assets of CGU using principles / steps as discussed before

B. GOODWILL ALLOCABLE TO CGUs

Eg: A.Ltd acquired B.Ltd for 4000 Cr

Which had Net Identifiable Assets (FV)

CGU A - 800 Cr

CGU B - 900 Cr

Goodwill is allowable in ratio of 2:1 to the CGUs

Analysis

1) Goodwill is allocable
2) First allocate Goodwill to each CGU to which it relates
3) Check Impairment Loss for each CGU by comparing
   a) CGU's RA
   b) CA of CGU asset + allocated g/w
4) Any Impairment Loss first fully adjusted from Goodwill allocated to that CGU & excess Impairment Loss to individual assets of CGU, using principle / steps as discussed before for Impairment Loss in CGU.

18. CORPORATE ASSETS

a) Corporate assets are assets that do not generate independent CFs but assist other CGUs in generating CFs.

b) No need to do annual impairment check on Corp. Assets rather check is to be done only when indication exist

c) Corp. Assets can be allocable or non-allocable amongst CGUs

d) Impairment a/cing just like Goodwill except Impairment Loss if any will be proportionately adjusted from corporate assets & CGU assets

   Eg: Ho Building, Training & Research Centre etc.

19. REVERSAL OF IMPAIRMENT LOSS

Reversal of IL

Other than Goodwill (CGU Assets & Corp. Assets)

1. Only when there are indication (External or internal), that suggest recovery of earlier recognized IL, existing, Entity to reverse IL
2. No reversal permitted if there are no improvements in indications that had to impairment i.e. only if entity has indication that conditions that to impairment have reversed or are not impacting biz. as significantly as expected or other biz conditions have improved post impairment.
3. Simply if RA has ↑ due nearing of cash flows, no impairment loss will be reversed
4. Max. Amt. of IL Reversal, is lower of
   a) RA-CA [or]
   b) CA had no IL had been earlier recognized – CA
5. A/cing for IL reversal
   Reverse IL from where it was earlier recognized (OCI or P/ L)

Goodwill

- **Ind AS:** Impairment loss once recognized on goodwill will never be reversed due to risk of recognizing self generated goodwill.

Alternatively:

After reversal of Impairment loss, asset should never be recognized at more than its RA and CA of asset compared assuming as if no IL was ever recognized.

20. REVERSAL OF IMPAIRMENT LOSS OF CGU

✓ A reversal of an impairment loss for a cash-generating unit shall be allocated to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and recognised as discussed above.

✓ In allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset shall not be increased above the lower of:

a) its recoverable amount (if determinable); and

b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset is allocated pro rata to the other assets of the unit, except for goodwill

21. BUSINESS COMBINATION

1) The Goodwill calculated under IND AS 103 can be either a full Goodwill or partial Goodwill.
2) If Non-controlling Interest is measured on fair value basis, the Goodwill is called as Full Goodwill on the other hand if non-controlling Interest is measured using proportionate share of net assets, the Goodwill is called as partial Goodwill.
3) While checking impairment loss in case of partial goodwill, goodwill has to be **grossed up** while computing the CARRYING AMOUNT of Subsidiary. This is because the RECOVERABLE AMOUNT of subsidiary reflects the FULL value of subsidiary.
4) The Impairment loss on full Goodwill should be allocated to parent and non-controlling Interest proportionately. Impairment loss on partial Goodwill should be allocated only to parent.

IND AS 105 NON-CURRENT ASSETS HELD FOR SALE & DISCONTINUED OPERATIONS

1) The standard deals with classification, measurement & presentation of

   I) Non-Current assets held for sale and II) Discontinued operations

2) IND AS 105 is applicable to all non-current assets and disposal groups Except for
   i. Deferred Tax assets
   ii. Financial assets which are covered under IND AS 109 (Investments & Trade receivables)
   iii. Inventories
   iv. Non-current assets that are measured at Fair value less cost to sell [FVLCTS] as covered in IND AS 41.

3) An asset is identified as held for sale when its carrying amount is Expected to be principally recovered through a sale transaction rather than usage.

4) This standard covers individual non-current assets that are held for sale and also its covers disposal groups.

5) A disposal group is a group of assets to be disposed off by a sale together as a group in single transaction and also may include liabilities that are directly associated with such assets that will be transferred.

   A disposal group may include Non-current assets, current assets and also liabilities. This standard covers only the measurement principle of non-current assets in the disposal group.

6) Abandonment:

Assets which are abandoned from active usage shall not be automatically classified as held for sale. This is because the entity may use this assets again in the future.

7) Parameters for identifying a NCA as held for sale.

Condition 1: The asset (or) Disposal group must be available for immediate sale in its present condition and

Condition 2: The sale must be highly probable. The condition of HIGHLY PROBABLE will be satisfied if

a) An **appropriate level of management is committed** to a plan to sell the asset and all necessary approvals have been obtained

b) An **active programme** to find a buyer must be initiated.

c) The asset must be **actively marketed for sale** at a price reasonable to its current fair value.

d) The **sale** is expected to be **completed within one year** from the date of classification.

Exception: -
A period higher 12 months can be considered if

- The delay is caused by circumstances which are beyond the control of the management AND
- There is evidence that the management is committed to plan of sale

e) There are **no chances of any change / with drawl** from the plan of sale.

Note:

1. There are a total of six conditions to be satisfied for an asset / Disposal group to be classified as held for sale.
2. The above conditions have to be satisfies even when NCA or group of assets are held for distributing to the owners.
3. Sale transaction includes exchange of non-current assets for other non-current assets when the exchange has commercial substance in accordance of Ind AS 16 Property, Plant and Equipment.
4. When an entity acquires a non-current asset (or disposal group) exclusively with a view to its subsequent disposal, the non-current asset (or disposal group) is classified as held for sale at the acquisition date. This standard provides a short period (usually three months) to meet the classification criteria that don’t met at the acquisition except requirement of one year.

   For example, An entity has acquired a building exclusively with a view of its subsequent disposal. The management is highly confident that the property can be sold in one year. The property requires refurbishing it to enhance its value which is highly probable to be completed in less than a period of three months. The building will be classified as held for sale on the date of acquisition itself even though it is not immediately available for sale.

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.

Key requirements for Non-current Assets held for sale or held for distribution to owners

- Available for immediate sale* / distribution
  - In its present condition
- Sale / distribution must be highly probable
  - Management is committed to a plan to sell /distribute the asset
  - An active programme to locate a buyer and complete the plan /distribution has been initiated.
  - Asset is actively marketed for sale at a price that is reasonable in relation to its current fair value***
  - Sale / distribution should be expected to qualify for recognition as a completed sale / distribution within one year from the date of classification**
  - It is unlikely that the significant changes to the plan will be made for completion of plan / sale /distribution or plan / distribution should not be withdrawn

*Sale transactions include exchanges of non-current assets for other non-current assets when the exchange has commercial substance

**If the entity remains committed to its plan to sell the asset (or disposal group), events or circumstances beyond the entity's control may extend the period to complete the sale beyond one year

***Not applicable for non-current assets held for distribution to owners.

S.No	Particulars	Details
1.	Acquisition of non-current asset (or disposal group) with intention to subsequent sale within a year	Classify the non-current asset (or disposal group) as held for sale subject to the conditions specified in the above chart
2.	Non-current assets that are to be abandoned	It shall not be classified as held for sale since its carrying amount will be recovered principally through continuing use and not from sale

8) MEASUREMENT OF NON-CURRENT ASSETS HELD FOR SALE

Step 1: Initial Measurement before the NCA is classified as held for sale.

a) If Entity uses cost model calculate the carrying amount by providing depreciation till the date of classification and check for any Impairment if conditions exist.

b) If Entity adopts Revaluation model, depreciate the asset till the date of classification and revalue the asset at its fair value.

Step 2: Initial Measurement on date of classification as held for sale.

The NCA should be measured at lower of

i. Carrying amount

(or)

ii. Fair value less cost to sell (FVLCTS)

Any loss is recognized in **P or L A/c** immediately as **impairment loss** but Gain should not be recognized. From thereafter no depreciation or amortization should be provided on the asset.

Step 3: Subsequent Measurement on first Balance sheet date.

The Carrying amount of the asset shall be compared with FVLCTS and any loss is recognized in P or L A/c. Any Gain can also be recognized to the extent of Accumulated Impairment loss provided till date (Before step 1, In step 1, and in step 2)

Step 4: Measurement on further Balance sheet dates

This will happen only if there is a delay in disposal. Measurement principles are same as in step 3 above.

Step 5: Gain / loss on actual sale of asset

Once the asset is sold any Gain / loss is transferred to P/L immediately.

Example 1 Original cost of asset 1000, accumulated depreciation – 300, Accumulated Impairment loss 150.The Building is decided to be sold. There are no indicators for impairment. The FVLCTS of the asset is determined at 500 as on today. On the subsequent Reporting date i.e., 31.03.2017, The FVLCTS is Rs 625. The asset could not be sold within 12m due to situations beyond the control of the Entity. On 31.03.2018 the FVLCTS is identified at 750.Finally the asset is sold for Rs 670 on 30.06.2018.

Solution:

Step 1: CA = 1000 Θ 300 Θ 150 = 550

No Impairment loss since no indications exist

Step 2: Measurement on date of classification

Lower of

i. CA = 550 (or)

ii. FVLCTS = 500

∴ Impairment loss

= 550 – 500 = 50 → Debit to P/L

No DEPRECIATION HERE AFTER

Step 3: On 1st Balance sheet date (31.03.17)

CA = 500

FVLCTS = 625

There is a gain of 125. Total cumulative Impairment loss till date = 150 + 50 = 200

∴ Gain of 125 can be recognized

Revised CA = 625 (500+125)

Step 4: On 2nd balance sheet date (31.03.18)

CA = 625

FVLCTS = 750

There is a gain of 125. Accumulated Impairment loss = 150 +50 = 200. Out of this 125 is reversed on 31.03.17. ∴ Gain can be recognized only to the extent of 75 (200-125)

Revised CA = 625 + 75 = 700

Step 5: On the date of sale (31.06.2018)

CA = 700

Sale price = 670

There is a loss Rs 30 which should be transferred to P&L immediately.

9) MEASUREMENT OF PRINCIPLES FOR A DISPOSAL GROUP

A disposal group can consist of NCA CA also liabilities which are scoped out of the standard.

Step 1: Measurement before initial classification as held for sale

Arrive at the Carrying amounts of all the Individual assets (whether Scoped in or scoped out) and all liabilities as per the respective applicable standards.

Step 2: Measurement on initial classification

a) The FVLCTS of the entire disposal group is to be determined and will be compared with the total carrying amount of the Disposal group. Any Impairment loss shall be recognized in P/L immediately. No Gain shall be recognized.

b) The impairment loss should be first allocated against Goodwill in the disposal group and any further loss is allocated on proportionate basis to the scoped in assets. No depreciation / amortization thereafter.

Step 3: Subsequent Measurement on balance sheet date.

1. The scoped-out items within the disposal group are first measured as per their respective standards. The **scoped in** assets will be carried at the values determined on the date of classification. The total carrying amount of the disposal group has to be determined.

2. This carrying amount will be compared with the FVLCTS on the Balance sheet date. Loss is recognized immediately by reducing the carrying amount of **scoped in** assets proportionately. Gain also can be recognized not exceeding the cumulative impairment loss till date. This gain has to be allocated to scoped in assets proportionately. <u>We should not recognize the gain to the extent of impairment loss recognized on goodwill.</u>

Step 4: Measurement on further Balance sheet dates

This will happen only if there is a delay in disposal. Measurement principles are same as in step 3 above.

Step 5: Gain / loss on actual sale of asset

Once the asset is sold any Gain / loss is transferred to P or L immediately.

CHANGE IN THE PLAN FROM HELD FOR SALE.

When the Entity withdraws itself from a plan to sell the assets which are previously classified as held for sale, the asset shall be re-measurement at lower of

i. Deemed carrying amount of the asset if IND AS 105 was not applied. (i.e., after considering depreciations and revaluations till date)

ii. Its Recoverable amount on the date of the reversal of its decision.

SPECIAL POINTS

1. If the classification as held for sale criteria is satisfied after the Balance sheet date but before the date of approval, it shall be treated as a non adjusting event. A disclosure of the fact has to be given in the notes to accounts.

2. A Entity that is committed to a sale plan for of its Investment tin the subsidiary resulting into a loss of control, should classify all the assets and liabilities of the subsidiary as held for sale in preparation of CFS. This may also qualify as discontinued operation form group point of view.

PRESENTATION IN BALANCE SHEET

The NCA held for sale or the disposal group shall be presented as a separate line item in the Balance sheet. Any liabilities/ Reserves relating to the disposal group or non-current assets shall also be presented separately.

ASSETS

1. NON-CURRENT ASSETS
2. CURRENT ASSETS
3. **NON-CURRENT ASSETS / DISPOSAL GROUP HELD FOR SALE**

EQUITY

1. SHARE CAPITAL
2. OTHER EQUITY
3. **RESERVES RELATED TO NCA / DISPOSAL GROUP HELD FOR SALE**

   (Eg: - Revaluation Reserve)

LIABILITIES

1. NON-CURRENT LIABILITIES
2. CURRENT LIABILITIES
3. **LIABILITIES ASSOCIATED WITH DISPOSAL GROUP**

DISCONTINUED OPERATIONS

Ind AS 105 defines Discontinued Operation as a component of an entity that either has been disposed of or is classified as held for sale and:

(a) represents a separate major line of business or geographical area of operations; or

(b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or

(c) is a subsidiary acquired exclusively with a view to resale.

A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will be a cash-generating unit or a group of cash-generating units while being held for use.

PRESENTATION AND DISCLOSURE REQUIREMENTS FOR DISCONTINUED OPERATIONS

1. An entity shall disclose a single amount in the statement of profit and loss comprising the total of:

(a) the **post-tax profit or loss** of discontinued operations; and

(b) the **post-tax gain or loss** recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

2. In addition, this single amount **must be analyzed** into:

(a) the revenue, expenses and pre-tax profit or loss of discontinued operations;

(b) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and

(c) the related income tax expense on above items as required by Ind AS 12.

3. The analysis may be presented in the notes or in the statement of profit and loss. EPS has to be presented separately for continuing operations and discontinuing operations.

Notes:

1. Decrease in sales over a period of time, change in product mix, stopping any process to achieve cost savings or quality Improvements, relocation of business cannot be identified as DCO.
2. If there is any change in the decision as to continue the operations then the FS should now include their revenues and expenses of the component which was earlier classified as DCO.

IND AS 21 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

1. The objective of the Standard is to address the accounting for foreign activities which include transactions in foreign currencies; or foreign operations.

2. TYPES OF CURRENCY

a) FUNCTIONAL CURRENCY

The currency of the primary economic environment in which the entity operates. In this regard, the primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates. The functional currency is normally the currency of the country in which the entity is located. It might, however, be a different currency. **An entity measures its assets, liabilities, equity, income and expenses in its functional currency.**

b) FOREIGN CURRENCY

A currency other than the functional currency of the entity.

c) PRESENTATION CURRENCY

The currency in which the financial statements are presented.

IDENTIFICATION OF FUNCTIONAL CURRENCY

The following are the factors that may be considered in determining an appropriate functional currency **(Primary indicators):**

(a) the currency:

i. that **mainly influences sales prices** for its goods and services. This will often be the currency in which sales prices are denominated and settled; and

ii. of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

(b) the currency that **mainly influences labour, material and other costs** of providing goods and services. This will often be the currency in which these costs are denominated and settled.

Other factors that may provide supporting evidence to determine an entity's functional currency are (**Secondary indicators**):

(a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and

(b) the currency in which receipts from operating activities are usually retained.

When the above indicators are mixed and the functional currency is not obvious, the management will be required to **use its judgement** to determine the functional currency by giving **priority to the primary indicators** before considering the other indicators, which are designed to provide additional supporting evidence to determine an entity's functional currency.

Example ABC Ltd is an Indian Co in which 70% shares are held by ABC incorporation – A US Based Co. The Indian Co provides export services where the revenue is denominated in US dollars. The Cost incurred by Indian Co comprise of expenses incurred in 'Rs' and also in '$'. Identify the functional currency of the Indian Co.

Sol: Since sales are denominated in '$' and a portion of expenses are incurred in '$', we can conclude that the functional currency of Indian Co – ABC Ltd is US '$'. It will maintain its books of accounts in '$' currency. However for statutory requirements, it has to present financial statements in 'Rs'. 'Rs' is the presentation currency for ABC Ltd Any currency other than US dollar is a Foreign Currency.

FOREIGN OPERATIONS [subsidiary/joint venture/associate]

Functional currency should be identified based on following factors:

- If such foreign operation is **extension of business of entity**, it should have **same Functional currency as of entity.**
- If such F.O is not extension of business of entity, it should **identify its own functional currency** (FNC.)

Meaning of "EXTENSION OF BUSINESS"

(a) Whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy;

(b) Whether the transactions with the reporting entity are a high or a low proportion of the foreign operation's activities;

(c) Whether cash flows from the activities of the foreign operations directly affect the cash flows of the reporting entity and are readily available for remittance to it.

(d) Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

MONETARY & NON-MONETARY ITEMS

S. No.	Particulars	Monetary items	Non-monetary item
1.	Units of currency	Units of currency held and assets and liabilities to be received or paid are in a fixed or determinable number of units of currency.	There is no fixed or determinable number of units of currency

✓ Examples of monetary items include:

- pensions and other employee benefits to be paid in cash;
- provisions that are to be settled in cash;
- lease liabilities;
- cash dividends that are recognised as a liability
- Most debt securities are considered as monetary items because their contractual cash flows are fixed or determinable.

✓ Examples of non-monetary items include:

- amounts prepaid for goods and services and income received in advance, on the basis that no money will be paid or received in the future;
- goodwill;
- intangible assets;
- inventories;
- property, plant and equipment;
- right-of-use assets;
- provisions that are to be settled by the delivery of a non-monetary asset.

FOREIGN CURRENCY TRANSACTIONS

A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency (i.e., a currency other than the functional currency of the entity), including transactions arising when an entity:

(a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds with amounts denominated in a foreign currency; or

(c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

Accounting for FC Transactions

- **Initial Recognition**
  - Use spot Rate or Avg Rate of specialized period (having low fluctuations) like for a week / month etc.
- **Subsequent Measurement**
  - See below

Subsequent Measurement

i. Settled Transactions ⇒ Any exchange Diff with be T/F to P or L A/c

ii. Balance from unsettled Transactions

a) Monetary items ⇒ use closing Rate to convert

b) Non-monetary items at his historical cost ⇒ Use rate on the date of transaction.

c) Non-Monetary items at fair value ⇒ Use rate on the date of calculating Fair value

Any difference due to above conversion will be recorded in P or L A/c. If non-monetary item is revalued through OCI, then exchange differences shall be shown in OCI.

Special Treatment on Transition in respect of Para 46/46A in AS 11

AS – 11 (Old GAAP) had paragraph 46 & 46A which specified following

Exchange Difference arising on long term Foreign currency monetary item were treated as following

Relating to Depreciable Assets, ED was capitalized with Depreciable Asset. [Then Depreciation Amt would change for current period of subsequent periods, due to capitalisation of E.D]. This capitalisation was allowed till 31.3.2020.

Not Relating to Depreciable Assets, ED was capitalized under head "Foreign Currency Monetary Item translation Diff A/c". Such FCMITDA A/c needed to be amortised over period of loan.

Exchange Diff arising on short term was always transferred to P&L A/c. Upon application of Ind AS – 21, following points are relevant.

- Now Forward Exchange contracts are covered by Ind AS 109 as Hedging item. Hence Ind AS – 21 does not deals with them.
- Regarding LT foreign Exchange monetary item, a new para D-13AA was introduced in Ind AS – 101, which gave an option (Entities may not follow it) - Exchange Diff on Long term Foreign Exchange Monetary item, can still be capitalized with Depreciable Asset / FCMIT Diff A/c as given in AS – 11 and keep on amortizing as earlier, but these ED should only relate to items on Date of transition.If any new loan or any earlier sanctioned loan is received, post date of transition, then para D-13 AA CANNOT be applied on such item.If entity has capitalized ED earlier with Depreciable asset and has now opted not to follow D-13AA, it is NOT required to change its carrying Amt which includes previously capitalized Exchange differences.

TRANSLATION FROM FUNCTIONAL CURRENCY TO PRESENTATION CURRENCY

Entity can present in financial statements in any currency. Such financial statements are called "presentation currency based Financial Statements". Following rules are applied.

All Assets	→	Closing Rate
All Liabilities	→	Closing Rate
Profit for Year	→	Actual Rate
Retained Earnings/Capital	→	Exchange Rate on the date of obtaining control.
		OR based on accounting policy of entity.

Any difference after translation is transferred to a separate A/c named **FCTR**. This FCTR A/c will directly reflected in OCI and shown under other equity.

In case o**f foreign subsidiary:**

a) the resulting FCTR should be allocated to NCI also to the extent of their share.

b) **Any goodwill and any fair value adjustments** to the carrying amounts of assets and liabilities arising on a foreign operation's acquisition are treated as assets and liabilities of the foreign operation. Hence, they are expressed in the functional currency of the foreign operation and **should be translated at the closing exchange rate** as is the case for other assets and liabilities.

Example The following is Trial balance as on 31.03.18 of A Ltd

	Dr ($)	Cr ($)
Assets	20,000	
Liabilities		15000
Share capital		1000
Op. Bal balance of Reserves		1500
Current year profit		2500
	20,000	**20,000**

ER are 01.04.17 1$ = Rs 50

Average ER 1$ = Rs 56

31.03.18 1$ = Rs 60

Convert the above Trial Balance into Presentation currency (Rs.)

Solution:

Trial balance

	Dr (Rs)	Cr (Rs)
Assets	12,00,000	
Liabilities		9,00,000
Share capital		50,000
Opening Bal balance of Reserves		75,000
Current year profit		1,40,000
FCTR (Gain)		35000
	12,00,000	**12,00,000**

Verification

Closing Net assets = [20000 $ Θ 15000$] x 60 = Rs 3,00,000

(-) op. value of Net assets = (1,25,000)

[1000 + 1500] x Rs 50

(-) Current Year profit (↑ in net assets) = (1,40,000)

[2500 x 56)

Gain **<u>Rs 35000</u>**

APPLICATION OF IND AS – 21 IN RESPECT TO CONSOLIDATED FINANCIAL STATEMENTS

i. Treatment of Contra Balance (Short term) in financial statements

- Amt payable & Receivable within group should be treated as per "Initial Recognition & Subsequent Recognition" principles of Ind AS – 21. Such exchange differences will be recognized in P&L.
- In Consolidated Financial Statement, Contra balances will get cancelled. Exchange Differences recorded in SFS will Continue in CFS.

ii. If any payable or receivable is within group and its settlement is not planned (generally Long Term in nature) such receivable / Payable are dealt as follows

- In parent company SFS, it is recorded as "Net Investment in Foreign operation" along with Investment in Equity shares of subsidiary.
  Initial & subsequent Recognition is required for Payable / Receivable within group (ED t/f to P&L)
- In Parent Co CFS, Payable / Receivable are cancelled. Its Exchange Difference recognized in individual P or L is now shown in OCI section in Consolidated financial statements.

Example

On 1-4-18, A Ltd has given a loan of 1000$ to its US subsidiary B Ltd. The functional currencies exchange rate on 1-4-18 is 1$ = Rs. 60;31-3-191$ = Rs 64

Show the presentation of the above transaction while preparing consolidated financial as at 31-3-19 under the following assumption:

1) The loan is repayable by B ltd by the end of 31-3-2021
2) The repayment date is not decided. We can assume that the loan is of a very long term in nature.

LOSS OF CONTROL OVER FOREIGN SUBSIDIARY

Whenever subsidiary is sold and control is lost, then in CFS we should Journalize following entry

Bank A/c	Dr	Proceeds	
NCI	Dr	C.A	
FCTR A/C	Dr	C.A	
To Goodwill			C.A
To Identifiable Net Assets of subsidiary			C.A

Any difference is transferred to P&L A/c. as gain / Loan on sale of subsidiary. FCTR is an OCI item that can be reclassified to P or L when control is lost on subsidiary.

CHANGE IN FUNCTIONAL CURRENCY

- ✓ Once an entity has determined its functional currency, it is not changed unless there is a change in the relevant underlying transactions, events and conditions.
- ✓ If circumstances change and a change in functional currency is appropriate, then the change is accounted for prospectively from the date of the change.

  For example, a change in the currency that mainly influences the sales price of goods and services may lead to a change in an entity's functional currency.
- ✓ For accounting the effect of a change in functional currency prospectively:

a) All items are translated into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost.

b) Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income are not reclassified from equity to profit or loss until the disposal of the operation.

c) Exchange gain or loss from long-term monetary items accumulated in equity (where such option is exercised) are not transferred to profit or loss immediately on change of the entity's functional currency; the balance would be transferred to profit or loss as per the manner provided by the option.

✓ Since entities prefer to present financial statements in their functional currency, a change in functional currency may be accompanied by a change in presentation currency. The choice of presentation currency represents an accounting policy, and any change should be applied retrospectively in accordance with Ind AS 8, unless impracticable. This means that the change should be treated as if the new presentation currency had always been the entity's presentation currency, with comparative amounts being restated into the new presentation currency.

IND AS 12 INCOME TAXES

1. This Ind AS deals with taxes on income, whether domestic or foreign. The objective of Ind AS 12 is application of annual concept income taxes.
2. Tax expense should be shown in profit & Loss A/c, other comprehensive income, and statement of changes in Equity, wherever appropriate.
3. Accounting Income means PBT & Taxable income means Income as per Tax laws.

4. **<u>Current tax</u>** Current tax being current tax consequence that arises due to transactions and other events of the current period that are recognised in an entity's financial statements. Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

5. **<u>Deferred tax</u>** is future tax consequence that arises due to the

   a) Future recovery of the carrying amount of assets or
   b) Settlement of carrying amount of the liabilities that are recognised in an entity's balance sheet.

   Ind AS 12 adopts Balance sheet approach where we determine Deferred tax on the ASSETS & LIABILITIES in Balance sheet which is different from Income approach followed in AS 22.

   1. Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.
   2. Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:
      a) deductible temporary differences;
      b) the carry forward of unused tax losses; and
      c) the carry forward of unused tax credits.

   Deferred Tax could be

   a) Creation or Reversal of Deffered Tax Asset (DTA)
   b) Creation or Reversal of Deferred Tax Liability (DTL)

6. **TEMPORARY DIFFERENCES** are differences between the **carrying amount** of an asset or liability in the balance sheet and its **tax base.**

   Temporary differences may be either:

   a) **taxable temporary differences,** which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

   b) **deductible temporary differences,** which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

7. **TAX BASE**

   a) It is calculated for Assets and liabilities (not for share capital or Reserves)

   b) Tax base of asset (or) liability is amount attributed to asset or liability as per taxation laws.

   c) **TAX BASE FOR ASSET** It means "deductible" amount for tax calculations from taxable economic benefits. If benefits are not taxable, then tax base will be equal to carrying amt.

   d) TAX BASE FOR LIABILITIES

Other Cases
Tax base =
CA – future deductions

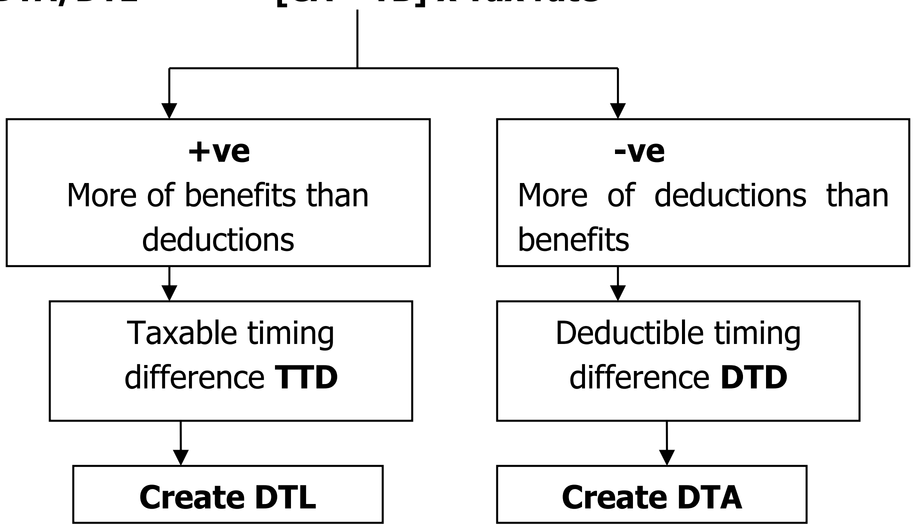
Loan
Tax base = Face Value

Advance Income which is not taxable in future
Tax Base = CA – advance income not taxable in future

8. DEFERRED TAX ASSET OR DEFERRED TAX LIABILITY

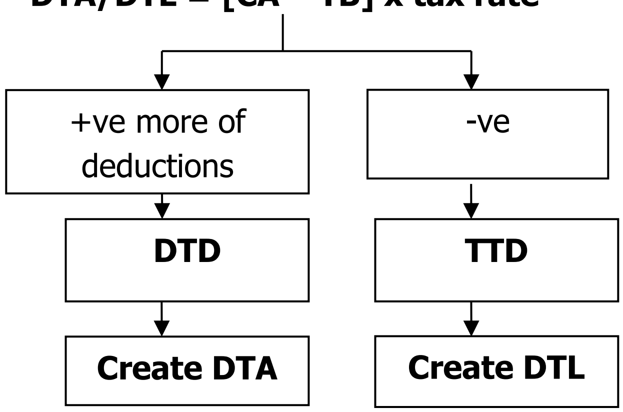
FOR ASSETS OF ENTITY

DTA/DTL = [CA – TB] x Tax rate



FOR LIABILITIES OF ENTITY

DTA/DTL = [CA – TB] x tax rate



9. Deferred tax liability & Deferred Tax Asset recognition

Deferred tax liabilities and deferred tax assets needs to be recognised in most of the cases. But the recognition of deferred tax liabilities or deferred tax assets are subject to exceptions with respect to the following items:

i. the initial recognition of goodwill arising in a business combination **(exception 1);**

ii. the initial recognition of an asset or liability in a transaction which:

   a) is not a business combination; and

   b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss). **(exception 2)**

   The Standard implies that if the carrying amount of any asset or liability is not equal to its tax base at the time of its transaction where the transaction is:

   - Not in the nature of business combination.
   - Not impacting either the accounting profit or the taxable profit.
   - Neither deferred tax liability nor deferred tax asset should be recognised.

iii. Temporary differences arise when the **carrying amount** of investments in subsidiaries, branches and associates or interests in joint ventures (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from **the tax base** (which is often cost) of the investment or interest. **(exception 3)**

   An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:

   a) the parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and

   b) it is probable that the temporary difference will not reverse in the foreseeable future.

Subsidiary/branches: As a parent controls the dividend policy of its subsidiary,therefore, when the parent has determined that those profits will not be distributed in the foreseeable future the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.

Associate: An investor in an associate does not control that entity and is usually not in a position to determine its dividend policy. Therefore, in the absence of an agreement requiring that the profits of the associate will not be distributed in the foreseeable future, an investor recognises a deferred tax liability arising from taxable temporary differences associated with its investment in the associate.

Joint Venture: When the venturer can control the sharing of profits and it is probable that the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised.

Similarly, The principle is:

An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint ventures, to the extent that, and only to the extent that, it is probable that:

(i) the temporary difference will reverse in the foreseeable future; and

(ii) taxable profit will be available against which the temporary difference can be utilised.

Both the conditions have to be satisfied.

10. PRUDENCE LIMITS FOR DTA

1) For creation of DTA, recognition criteria / prudence limits must be satisfied.
2) DTA's arise due to
   a. Deductible temporary differences
   b. Unabsorbed losses carried forward for set off
   c. Carry forward of unlisted tax credits

3) When deductions are claimed in future for above items, tax savings are earned. To earn this tax savings by claiming deductions, taxable income should exist in future. DTA's benefit can be realised by entity only when sufficient future profits exist against which deductions can be claimed.

4) The standard provides 3 step criteria:
    1. Existence of Taxable Temporary Differences whose reversal patterns matched with the reversal pattern of deductible Temporary differences. Create DTA to the extent of such <u>expected taxable profits</u>.
    2. Probability of earning sufficient future taxable profits against which deductions can be claimed. Create DTA to the extent of such <u>expected taxable profits</u>.
    3. Availability of tax planning opportunities which can generate taxable income in future against which dedications can be claimed. Create DTA to the extent of such <u>expected taxable profits</u>.

5) When an entity has unabsorbed carry forward losses (or) unutilized tax credits, it can create DTA to the extent that it is probable to earn sufficient future taxable profits with convincing supporting evidence.

11. RATES OF TAX

a) For calculation of current tax, tax rates applicable for the period shall be used.
b) For calculation of deferred tax always use rates of taxes "**expected to apply**" upon realisation benefits / settlement of Liabilities
   We can take the rates from enacted (or) Substantively enacted laws **on reporting date**.

12. <u>SPECIAL CASES:</u>

A. BUSINESS COMBINATION

a. When acquirer entity records assets and liabilities on date of acquisition, they shall be recorded @ FAIR VALUES [Ind AS 103]
b. In Income tax Act, the carrying amounts of Assets & liabilities relating to acquiree for tax purposes are continued as it is even for acquirer's tax purposes.
   [Tax base of acquiree = Tax base of acquirer]
c. Along with the assets & liabilities, recognise DTA/DTL arising due to the difference between carrying amt [Fair value] & Tax base [Tax base of acquiree is continued]
d. Only after recognizing DTA/DTL compute Goodwill/Capital Reserve. Do not create any DTA/DTL on Goodwill.

B. UNREALIZED PROFIT ON STOCKS IS CFS

On elimination of URP from Stock/ assets transferred within group; DTA has to be created in CFS.

C. REVALUATION OF ASSETS

Whenever assets are revalued (or) impaired then DTA / DTL should be created on such revaluation / Impairment effect.

<u>Journal Entries for revaluation:</u>

a) Asset
 To Revaluation Surplus (OCI)

b) OCI Dr.
 To DTL

<u>Journal Entries for Impairment:</u>

i. PL/ Rev. reserve (OCI) Dr
 To Provision for Impairment
 +

ii. DTA
 To P/L

D. EMPLOYEE STOCK OPTIONS

a. On ESOPS issued, the company recognizes option expense each year in its P or L in accordance with Ind AS 102.
b. Under the tax laws, such expense is usually disallowed in each year.
c. If future, the tax laws may or may not give deduction when options are exercised.

<u>Possibility 1:</u> Tax laws do not offer any deduction in future

DO NOT CREATE DTA

<u>Possibility 2:</u> Tax laws permit deduction in future

- Create DTA in each year based on estimated future deduction under tax laws.
- If any excess deduction is expected to be received under tax laws, then DTA on such excess deduction is to be created through equity [i.e. Retained Earnings].

E. MAT CREDIT ENTITLEMENT

a) If an entity pays tax under Minimum Alternate Tax (MAT) provisions of Income tax act, then the excess tax paid under MAT over and above the tax computed under normal provisions of the act, is given as credit to the entity. MAT = Adjusted Book profits x MAT Rate.

b) Such MAT represents an excess tax paid and is used to reduce the tax liability in future when the company pays tax as per normal provisions of the act. This MAT credit entitlement is an asset and it is to be presented as DTA.

c) In the year in which company pays tax as per MAT, DTA/DTL on temporary differences should be created in the usual manner only applying normal tax rates.

d) If MAT credit is expected to lapse, then book as expense by writing off DTA.

13. Sometimes the manner in which entity recovers the carrying amount of asset (or) settles a liability may affect the tax rate and sometimes the tax base also. We have to recognise DTA/ DTL considering the expected manner of utilization of asset / liability.

14. DTA & DTL should be set off if both are under same governing law & are intended to be settled on net basis.

15. Dividend distribution tax is recognised in SOCE.

16. DISCLOSURE

i. A statement should be prepared as follows

Accounting income	Xxx
Tax on Accounting income	Xxx
Tax effects on differences	Xxx
Tax expenses	Xxx

ii. A reconciliation should be given for tax rates

Tax rate applicable	Xxx
I tax rate effects of Differences	Xxx
Effective tax rate	Xxx

ADDITIONAL NOTES ON DEFERRED TAXES

1. **Income Approach for understanding DTA and DTL.**
   Income approach is there in AS -22 but IND AS 12 follows Balance sheet approach. The objective of creating deferred taxes is to ensure that the tax expense in P/L A/c is measured on accrual basis matching with the Incomes & Expenses recognized during the year.

2. Accounting Income (AI) is the profit before Tax in Profit and loss A/c. Taxable Income is the Income determined as per tax Laws.

3. Current Tax is the Tax on taxable Income. Deferred Tax is Tax on differences between accounting Income & Taxable Income.

Example 1: The following is the Extract of SPL of A Ltd. During year 1 they have recognized a Bonus Expense which is not paid during year 1. It could be paid only at the end of Year 2

Particulars	**Y_1**	**Y_2**
Sales	10,00,000	10,00,000
COGs	(6,00,000)	(6,00,000)
Profit before Tax	4,00,000	4,00,000
Tax Expense		
Current Tax	**1,35,000→ WN-1**	**105000**
Deferred Tax	**(15,000) → WN -2**	**15000**
along with year 2's Bonus.	2,80,000	2,80,000

WN – 1 Calculation of taxable Income and Current tax

Particulars	**Y_1**	**Y_2**
PBT	4,00,000	4,00,000
(±) Bonus	50,000	(-) 50,000
Tax Income	4,50,000	3,50,000
Current Tax	1,35,000	1,05,000

WN – 2 Calculation of Deferred tax:

During year 1 bonus Expense is disallowed to the extent of Rs 50,000 as a result we had to pay higher tax. This Bonus will be allowed as a deduction in subsequent years on actual payment. Therefore, the excess tax paid in current year leads to creation of DTA

DTA A/c Dr 15,000
To P/L A/c 15,000 [50,000 x 30%]

During year 2 the Bonus of Year 1 is allowed as deduction and hence less tax is paid. Therefore, DA created in Year 1 is to be reversed.

P/L A/c Dr 15,000
To DTA 15,000

Eg-2: The following are Extract of P/L of X Ltd. During Year 1 it has purchased a plant & machinery for Rs 6,00,000 which has a life of 2 years. The company follows SIM depreciation. However as per IT Act 100% depreciation is allowed in year 1 itself.

	Y_1	**Y_2**
EBDT	10,00,000	10,00,000
(-) Depreciation [6,00,000 x 1/2]	(3,00,000)	(3,00,000)
PBT	7,00,000	7,00,000
Tax Expense		
Current Tax WN -1	**1,20,000**	**3,00,000**
Deferred Tax WN - 2	**90,000**	**(90,000)**
PAT	4,90,000	4,90,000

WN – 1 Calculation of taxable Income and Current tax

	Y_1	**Y_2**
PBT	7,00,000	7,00,000
(±) Depreciation disallowed	3,00,000	3,00,000
(-) Depreciation (100% in Y_1)	(6,00,000)	-
Taxable Income	4,00,000	10,00,000
Current Tax (30%)	1,20,000	3,00,000

WN-2:

During Year 1 Excess depreciation allowed is Rs 3,00,000. Due to this we have paid lower taxes. In subsequent years there will be disallowance of depreciation. Therefore we have to pay higher taxes in future

∴ In Year 1 the lower tax paid results into creation of DTL.

P/L A/c Dr 90,000

To DTL 90,000 (3,00,000 x 30%)

In Year 2 there is a disallowance of Rs 3,00,000 and hence we paid higher tax. Therefore the on created in year 1 shall be reversed

DTL A/c Dr 90,000

To P/L 90,000

Summary:

➢ **If we pay higher tax Now**	→Creation of Deferred Tax Asset
➢ **Subsequent when we pay lower taxes**	→ Reverse the Deferred Tax asset created Earlier
➢ **If we pay lower taxes now**	→ Creation of Deferred tax liability
➢ **Subsequent when we pay higher tax**	→ REVERSE the DTL created Earlier

BUSINESS COMBINATIONS IND AS 103

1. MEANING

a) A business combination is a transaction in which **one entity obtains control of another entity's business.**

- The entity which has a control is known as **ACQUIRER** and
- the entity to whom control is made is known as **ACQUIREE.**

b) **Meaning of control:** Already discussed under **Ind AS 110**

c) **Meaning of business:** 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.

A business consists of **3 elements:**

1) **Input =** any economic resource that creates or can create outputs when one or more processes are applied to it, e.g. intellectual property, inventories, non-current assets, intangible assets, human resource in IT company etc.;
2) **Process** = any system, standard, protocol, convention or rule that when applied to an input(s), creates outputs, e.g. operational process, management processes, Manual process, etc. (production work force is necessary but not sales work force). Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs so their presence or exclusion generally will not affect whether an acquired set of activities and assets is considered a business.
3) **Output** = the result of inputs and processes applied to those inputs that provide or can provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners.

Although businesses usually have outputs, <u>outputs are not required</u> for an integrated set of activities and assets to qualify as a business.

- 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.
- A business need not include all the inputs or processes that the seller used in operating that business.
- However, to be considered a business, an integrated set of activities and assets must include, **<u>at a minimum, an input, and a substantive process.</u>**

1) How to identify whether it is a business acquisition (or) asset acquisition?

STEP I: APPLY CONCENTRATION TEST

This test is purely optional. Without applying this test, we may proceed to step II to evaluate. However, if this Test is applied and

TEST PASSED → There is no business. It is an asset acquisition

TEST FAILED → Then apply step (II) to evaluate.

1) For apply concentration test, first calculate the fair value of gross assets acquired other than cash as follows:

	Fair value of PC paid	xxxx
(+)	Fair value of earlier acquisition, if any	xxx
(+)	NCI, if any at fair value	xxx
(+)	Fair value by all liabilities excluding DTL	xxx
		xxxx
(-)	Cash & cash equivalents	(xxx)
	Fair value of gross assets	**<u>xxx</u>**

2) Identify the fair value of a single identifiable asset (or) a group of similar identifiable assets.
3) Check the % = $\frac{\text{Fair value of single identified asset (or)group of assets}}{\text{Fair value of Gross assets excluding cash}}$ x 100

If it is substantial (judgement required) then concentration test is passed & it is an Asset acquisition.

STEP II: DETAILED BUSINESS ASSESSMENT TEST

To qualify as a business, compulsorily Inputs & substantive Process / Processes shall be acquired.

Output is not mandatory but there should be ability to generate output.

Whether the acquired process is substantive or nor is determined as under:

WHEN THERE IS NO OUTPUT	WHEN THERE IS OUTPUT
Process is substantive if a) Process is critical to create output and b) Input acquired should include organized workforce with necessary skill knowledge or experience to for form the process & other input which organised work force will have ability to create output.	Process is substantive if a) Process is critical & inputs include organized workforce with necessary skill knowledge & experience. (or) b) Process is unique / scarce (or) cannot be replaced without significant cost (or) delay.

Example On Concentration test

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

The fair value of assets acquired and Liabilities assumed are as follows:

Building	- Rs. 1000 Crores
Cash and Cash Equivalent	- Rs. 200 Crores
Financial Liabilities	- Rs. 800 Crores
DTL	- Rs. 150 crores

Fair value of Entity B is Rs. 400 Crores and Fair value of NCI is Rs. 120 Crores (400 x 30%) Fair value of Entity A's previously held interest is Rs. 80 Crores (400 x 20%)

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

i) Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held) = 300 + 120 + 80 = Rs. 500 Crores

ii) Fair value of liability assumed (excluding deferred tax) – Rs. 800 crores

iii) Cash and cash equivalent – Rs. 200 crores.

Fair value of gross assets acquired - Rs. 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.

2. Comparison between Asset Acquisition and Business Combination

Business combination accounting does not apply to the acquisition of an asset or asset group that does not constitute a business. The accounting for an asset purchase differs from business combination accounting in several key respects, some of which are summarized below:

Particulars	Business Combination	Asset Acquisition
Control	A business combination is defined as a transaction or other event in which an acquirer (an investor entity) obtains control of one or more businesses.	No control exist in asset acquisition
Measurement of net assets	Measured at fair value with some exceptions	Total price paid is allocated in the ratio of fair value.
Goodwill/Bargain gain	Recognized as goodwill (asset) or bargain gain (income)	No goodwill / bargain gain
Transaction costs	Expenses are charged to P/L	Mostly capitalized

Example 1: A Ltd purchased following from B Ltd:

	Carrying amount	Fair value
Plant, Property, Equipment	2,00,000	2,30,000
Investment property	90,000	1,18,000
Current Assets	50,000	52,000
Liabilities	Nil	Nil

Consideration paid Rs 4,50,000. You are required to calculate goodwill and at what value individual assets will be recorded. Assume both (i) asset acquisition and (ii) business combination.

Solution: Assume asset acquisition:
No Goodwill will be calculated.
Cost of each asset will be the apportionment of consideration over each asset in fair value ratio.

	Fair value	Cost
Plant, Property, Equipment	2,30,000	2,58,750
Investment property	1,18,000	1,32,750
Current Assets	52,000	58,500
Total:	**4,00,000**	**4,50,000**

Assume business combination:
Assuming 100% control.

	Fair value	
Plant, Property, Equipment	2,30,000	
Investment property	1,18,000	
Current Assets	52,000	4,00,000
Consideration paid:		**4,50,000**
Goodwill		**50,000**

3. ACCOUNTING TREATMENT OF BUSINESS COMBINATION

Once the investor acquires a subsidiary, it has to account for each business combination by applying **THE ACQUISITION METHOD.** The acquisition method involves 6 steps:

1) Identifying the acquirer,
2) Determining the acquisition date,
3) Recognizing and measuring the identifiable assets acquired, the liabilities assumed
4) Any non-controlling interest it the acquire;
5) Transfer of consideration
6) Recognizing goodwill or a gain from a bargain purchase.

4. How to identify the acquirer? (STEP 1)

Acquirer is the entity which obtains control.

i. To identify business combination first check control under IND AS 110. In case IND AS 110 does not clearly indicate which entity is the acquirer then check the additional guidelines under IND AS 103 like the entity which issue shares, voting rights, composition of governing body etc.

ii. At most of the time it is straight forward,

- The acquirer is generally the investor, which acquire an investment or control into another company.
- The acquiree is the business which is obtained by acquirer

iii. However, sometime substantially

- The legal acquiree becomes acquirer /Accounting Acquirer and
- legal acquirer becomes substantially Acquiree / Accounting Acquiree; known as reverse acquisition (mostly in merger cases).

iv. Generally, following factors are described for determination of acquirer and acquiree:-

- **Primarily the person who made cash payment** or **issue of share capital** and acquires assets and liabilities of acquiree is known as acquirer.
- The acquiree is usually combining the entity whose relative size is significantly minor.

5. Identify the acquisition date (DOA - STEP 2)

The acquisition date is the date on which acquirer obtain control to the acquiree.

- It is the date on which acquirer legally a transfer consideration, acquires the asset and liability (also called closing date). However, the acquirer might obtain control on a date that is either earlier or later than the closing date.
- For identifying date of obtaining control various factor like substance over form, final authority, legal permission etc, has to be considered.
- Sometimes Acquisition is subject to approval of approving authority;

  - ✓ **Approval is a substantive approval:** Acquisition date cannot be earlier than the date on which approval is obtained.
  - ✓ **Approval is not a substantive approval:** Acquisition date is the date when parties are agreed.

6. RECOGNITION AND MEASUREMENT OF THE IDENTIFIABLE ASSETS ACQUIRED, THE LIABILITIES ASSUMED AND NCI IN THE ACQUIREE (STEP 3).

Rule 1 → An acquirer or investor shall recognize **all** identifiable assets acquired, liabilities assumed and non-controlling interests in the acquiree separately from goodwill. Sometimes, there is some unrecognized asset in an acquiree, and an investor needs to recognize this asset if it meets the criteria for the recognition.

Rule 2 → All assets and liabilities are **measured at acquisition-date AT FAIR VALUE.** NCI is also recorded at fair value except where it is recorded on the basis of share in Net identifiable Asset of acquire or on proportionate basis.

EXCEPTION TO THE RECOGNITION OR MEASUREMENT PRINCIPLE: Exception of recognition of assets and liabilities by applying fair value measurement principles.

a) **Intangible assets:** In a business combination the acquirer shall record the identifiable intangible asset separately from Goodwill which was not recorded earlier by acquiree. Provided such asset qualify the definition of intangible assets under Ind AS 38 on the date of acquisition. E.g. Brand Name, Trademark etc.

b) **Assembled, workforce:** The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. Because the assembled workforce is not an identifiable asset to be recognised separately.

c) **Contingent liability under Ind AS 37:** The requirement in Ind AS 37 does not apply in determining which contingent liabilities to be recognised as of the acquisition date. 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 recognizes 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.

d) **Reacquired rights:** As a part of business combination, an acquirer may reacquire a right that it held, previously granted to acquiree to use one or more recognized/unrecognized assets of the acquirer. It does not matter whether the assets was recorded in the financial statements of the acquirer or not. E.g. license to use the brand name, Franchisee rights etc.

Following treatment will be done under Business Combination:

i. The acquirer shall measure the value of the re-acquired right recognised as an intangible Asset on the basis of remaining contractual term of the related contract without considering the effect of potential renewals at its fair value.
ii. Any settlement amount shall be recognised as a separate transaction cost which shall be charged into SPL subject to difference between fair value of the right and carrying amount (unamortized Amount) of the right.

e) **Employee benefit under Ind AS 19**: The acquirer records the fair value of the obligation for any post-retirement obligation as per the principle of Ind AS 19 which is an exception of the general fair value rule.

f) **Unearned revenue**: Unearned revenue arises because of the application of the revenue recognition criteria applied by the acquiree. It should be evaluated whether there is any obligation on the acquisition date to be fulfilled and accordingly an asset or liability against it should be recorded.

g) **Indemnification assets**: The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability, The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. **Recognise Indemnification asset not exceeding the amount of the liability recognised provided it is collectible.**

h) **Income taxes:** As per the requirement of Ind AS 12, no deferred tax consequence should be recorded on initial recognition of deferred tax except assets and liabilities acquired during business combination. Accordingly, the acquirer shall recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, Income Taxes, the acquirer shall account for the potential tax effects of temporary differences and carry forwards of an acquiree that exist at the acquisition date or arise because of the acquisition in accordance with Ind AS 12.

i) **Assets held for sale under IND AS 105:** The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with Ind AS 10S, Non-current Assets Held for Sale and Discontinued Operations, at **fair value less costs to sell** in accordance with that Ind AS.

j) LEASES

A. Acquiree is a lessee

i. The acquirer shall recognise ROU assets and lease liabilities for leases identified in, accordance with Ind AS 116.

ii. The acquirer is not required to recognise ROU assets and lease liabilities for:

  a) leases for which the lease term ends within 12 months of the acquisition date; or

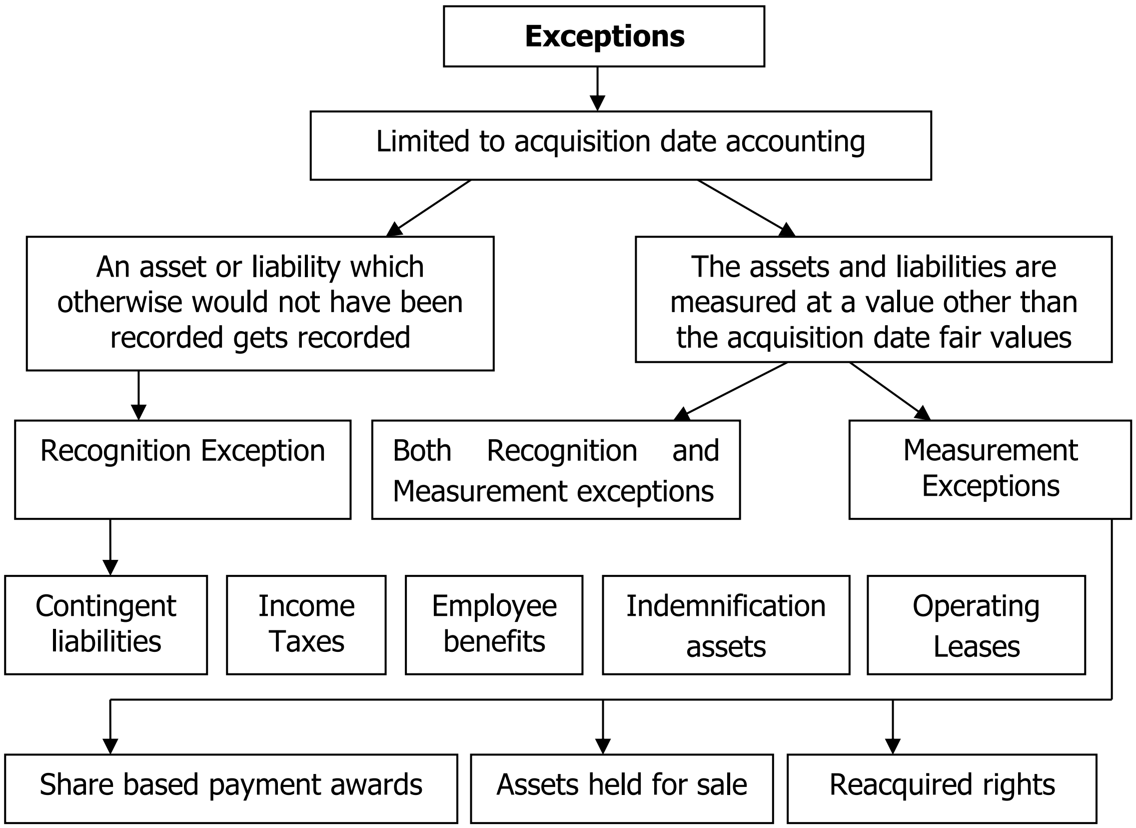
  b) leases for which the underlying asset is of low value.

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

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

B. **Acquiree is a lessor**

In measuring the acquisition-date fair value of an asset, the acquirer shall take into account the terms of the lease. The acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms.



7. STEP 4: NON - CONTROLLING INTEREST

Non-Controlling Interest (NCI) for each business combination, any non-controlling interest is measured either:

- at **fair value** of equity interest held in acquiree; or
- at the **proportionate share of the acquiree's identifiable net assets** at fair value.

Measuring the fair value of non-controlling interests:

The acquisition-date fair value on the basis of active market prices for the equity shares not held by the acquirer can be taken. When a market price for the equity shares is not available because the shares are not publicly traded, the acquirer should measure the fair value of the non-controlling interests using other valuation techniques (Ind AS-113).

Subsequent measurement of non-controlling interests:

Whichever choice is made at date of acquisition Na is subsequently adjusted by the non-controlling interests' share or changes in equity (profit or loss) from the date of the combination.

Debit balances on non-controlling interests:

As NCI is part of equity share of losses after date of acquisition can result in debit balance of NCI.

NCI measurement options:

The basis on which NCI is measured affects goodwill at the acquisition date. When the fair value model is used, 100% of the goodwill in the acquiree is recognised (both the acquirer's and the NCI's share). This is sometimes described as the full goodwill model. Under the proportionate interest model only the acquirer's interest in the goodwill is recognised (a lesser amount).

8. STEP 5 PURCHASE CONSIDERATION:

Consideration Transferred: (what the acquirer is paying acquiree)

Particulars	Amount (Rs.)
Fair value of Equity share capital issued	XXX
Fair value of other security issued (Debentures, preference share etc.)	XXX
Cash and bank paid	XXX
Fair value of Assets, transferred	XXX
Present Value of Deferred payment liability	XXX
Fair Value of Contingent consideration	XXX
SBP Reserve for pre-combination periods	XXX
Purchase Consideration	**XXX**

i. **Deferred Consideration liability** means which is being paid on a later date in comparison to other payment. On DOA it shall be recorded at present value. Subsequently it shall be recognized by using amortized cost method .

ii. **Contingent Consideration (CC):** Contingent consideration should be measured at **its fair value at the acquisition date** and recognised by the acquirer as either a liability or as equity according to its nature.

- CC recognized and measured at **fair value on** acquisition date, irrespective of the probability of an outflow of resources
- subsequent changes in contingent consideration classified as a liability usually affect post-combination earnings [FVTPL Accounting]

iii. **Transfer of acquirer's assets as consideration:**

Consideration transferred includes the transfer of a non-cash asset of the acquirer to the vendor (e.g. property, plant and equipment or a business), the asset is re-measured at its fair value on the acquisition date. Any difference between its fair value and its carrying amount is recognised immediately in profit or loss.

iv. Exchange of shares

A business combination can be effected by a share-for-share exchange (i.e. acquirer issues its shares to the vendors in exchange for the acquiree's shares). Generally consideration transferred is determined based on the fair value of the shares issued by the acquirer. However, Ind AS-103 provides a mandatory alternative if the fair value of shares acquired are more reliably measurable.

v. **Business combinations with no consideration transferred:**

A business combination can be affected without paying any consideration.

Ind AS-103 provides examples of these situations:

- an investee repurchases its own shares held by other investors resulting in an existing shareholder becoming the majority shareholder
- cancellation or expiry of veto or similar voting rights of other shareholders that prevented the investor from exercising control.
- business combinations achieved by contract alone.

Since there is no consideration transferred in these situations, Ind AS-103 provides specific guidance on how goodwill is determined:

In determining goodwill, the acquirer substitutes the fair value of consideration transferred with the acquisition-date fair value of the acquirer's interest in the acquire company (determined using an appropriate valuation technique).

In a business combination achieved by contract alone the acquirer holds no equity interest in the acquiree before or after the acquisition date. Ind AS-103 then requires the acquirer to attribute all of the equity interest held by parties other than the acquirer as NCI, even if this results in 100% NCI.

vi. **Acquisition related costs:** The acquirer incurs like finder's fees (broker), advisory, legal, accounting, valuation and other professional or consulting fees; general administrative expenses, including costs incurred on maintaining an internal acquisition department, are **recognized as an expense** in the period of incurrence.

9. STEP 6: GOODWILL OR BARGAIN PURCHASE GAIN

Method 1: FULL GOODWILL

Cost of investment by parent company	XX
Fair value of non-controlling interest (NCI) at date of acquisition	XX
Fair value of net assets at date of acquisition (share capital + reserves)	(XX)
Goodwill	XX

Method 2: Proportionate Share Method/Proportionate Net Asset Method

Particulars	Amount
Consideration paid	xxx
(+) Proportionate share of non-controlling interest in Net assets of Acquiree Company on the date of acquisition of control	xxx
Total	xxx
(-) Net assets of acquiree company on the date of acquisition of control	(xxx)
Goodwill / bargain Purchase	xxx

Bargain Purchase gain: In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the net assets value acquired in a business combination exceeds the purchase consideration.

a) The acquirer shall recognise the resulting gain in OCI on the acquisition date and accumulate the same in equity as capital reserve.
b) A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion.
c) The Ind AS itself acknowledges that it is very rare that a bargain purchase in a business combination will arise and accordingly the standard re-emphasise the above point by requiring the entities to reassess and identify the clear reason why it is a bargain purchase business combination, e.g., acquisition of business in a bankruptcy sale, or sale of business due to a regulatory requirement.

JOURNAL ENTRIES IN THE BOOKS OF ACQUIRER CO.

i. On the date of acquisition of control/business

Business combination Alc………….. Dr (at PC)	XXX	
To liquidator of acquiree Co /vendor		XXX

ii. On acquisition of assets and assume liability

Identifiable assets A/c Dr (at fair value)	XXX	
Goodwill A/c/ Bargain Purchase A/c (B/f)		
To Liability A/c (at fair value)		XXX
To Business combination A/c (Pc)		XXX
To NCI A/c		XXX

iii. On the date of payment of consideration

Vendor/liquidator of acquiree co. A/c ……. Dr (at PC)	XXX	
To Equity share capital A/c (at face value)		XXX
To other equity A/c		XXX
To other security issued		
To cash and bank A/c		XXX
To differed payment liability A/c		XXX
To Contingent consideration A/c		XXX
To Assets A/c (at Fair value)		XXX
To SBP Reserve etc.		XXX

iv. On payment of transaction cost

P & L A/c Dr.	XXX	
To bank A/c		XXX

10.MEASUREMENT PERIOD (Initial accounting for the business combination is incomplete at the reporting date)

a) Measurement Period is the period after the acquisition date during which the acquirer company may adjust a provisional amount recognized in respect of acquisition of acquire. Such period cannot exceed more than one year after the acquisition date.

b) Ind AS 103 gives a measurement period window where in if all the required information is not available on acquisition date. The entity on acquisition date will record at provisional fair values for assets (or) liabilities (or) PC (or) NCI whose fair value could not be determined.

c) Subsequently **within 1 year from acquisition date,** the acquirer can obtain fair value of the above items & update them by adjusting Goodwill/Capital Reserve, if it related to facts & circumstances on acquisition date. If subsequent information obtained about fair values is not relating to facts & circumstances on acquisition date, then its to be accounted prospectively only without adjusting Goodwill/capital reserve.

d) Within this period, acquirer may also Recognise additional assets/ liabilities if new information is obtained relating to the date of acquisition, by adjusting Goodwill/Capital Reserve.

e) If changes is due to any error or omission: Any impact shall be taken on Retrospective Basis (effect shall be taken on goodwill/capital Reserve)

11.ADJUSTMENTS NOT FORMING PART OF BUSINESS COMBINATION

The acquirer and the acquiree may have a pre-existing relationship or Other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, i.e. amounts that are not part of the exchange for the acquiree. The acquirer shall recognise as part of applying the acquisition method only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. Separate transactions shall be accounted for in accordance with the relevant Ind AS.

The following are examples of separate transactions that are not to be included in applying the acquisition method:

- a transaction that in effect settles **pre-existing relationships** between the acquirer and acquiree;
- transaction that **remunerates employees or former owners** of the acquiree for future services; and
- a **transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.**

Factors one should note for transactions separate from business combination:

1) **Reason for the transaction:** If the transaction benefits acquirer or combined entity rather than benefitting acquiree then it is less likely to be a part of business combination.
2) **Who initiated the transaction:** Understanding who initiated the transaction may provide insight into whether it is part of the exchange for the acquire a transaction or arrangement initiated by the acquiree or the former owners is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the business combination transaction.
3) **Timing of transaction:** If the transaction is entered in midst of the negotiation process it may be more likely form part of business combination.
4) **Beneficiary of Contract/ transaction**

Primarily for the benefit of:	**Transaction is likely to be**
Acquirer or combined entity	Separate transaction
Acquiree or its former owners	Part of the business combination

A. SETTLEMENT OF PRE-EXISTING RELATIONSHIP

The parties to a business combination may give an existing relationship, either through a contractual commercial arrangement (eg supplier Vs customer relationship) or a non-contractual relationship (eg plaintiff Vs. Defendant). A business combination between such parties is viewed as an effective settlement of this pre-existing relationship. It is then assumed that the contractual price will include an amount relating to the settlement. Consequently:

- on the acquisition date, the acquirer recognises a settlement gain or loss
- the contractual purchase price is adjusted for the amount deemed to relate to the effective settlement in arriving at consideration transferred in exchange for the acquiree.

PRE EXISTING RELATIONSHIP BETWEEN ACQUIRER & ACQUIREE

NON-CONTRACTUAL

Example

Acquiree filed a case on Acquirer in the past.

- Acquirer shall determine the fair value of this obligation & it is deemed to be settled @ fair value.
- Adjust the PC with fair value of non-contractual relation.
- Record settlement of this relation separately

Possibility 1: Acquirer has not created any liability:

Now Recognise liability @ fair value

P or L

To liability / provision

&

Provision / liability

To Bank

Possible 2: Acquirer has created liability

Fair value the liability (provision) and settle it.

CONTRACTUAL

Example

Contracts to buy(or) sell goods / services, licenses given etc.

The consideration will be adjusted with settlement loss (or) gain in the contract which is **LOWER** of following:

i. The extent to which contract is favorable (or) unfavorable to acquirer on comparison with market terms an Acquisition date

[Or]

ii. Penalty payable by any party for cancellation of contract.

B. CONTINGENT CONSIDERATION IN CASE OF EXISTING SHAREHOLDERS

Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. When there is a contingent consideration arrangement in a deal, there are circumstances when those payments represent **compensation expense in the post-combination period rather than purchase price.**

The contingent payments that are agreed by acquirer towards the employee shareholder of Acquiree needs to be identified whether:

Contingent consideration is offered in capacity

Include as part of purchase consideration

[Or]

Contingent consideration is offered in capacity of employee for rendering services in future to acquirer.

Not a part of purchase consideration

For evaluating the above, we take into consideration factors like terms of continuing employment, Duration of continuing employment, level of compensation, the formula used etc.

If contingent payments are forfeited upon termination of employment, it indicates that such consideration was offered only in capacity of employee & ∴ Not to be part of purchase consideration.

C. SHARE BASED AWARDS

1. Acquirer may **replace the share-based awards** issued by acquiree to its employees. Replacement means Acquirer entity will issue its own shares under ESOP's to employees of Acquiree (in place of existing ESOPS)

2. Calculate the value of services received from the employee's up to the date of acquisition & **include this as part of P.C calculation.**

Value of services relating to pre combination period = **Fair value of ORIGINAL SBP awards** X $\frac{\textbf{Vesting period completed}}{[\textbf{Original vesting period (or) Revised vesting period}]\uparrow}$

3. **Value of SBP awards representing post combination services** = **Fair value of REPLACED SBP awards** (-) **Value of pre-combination services as computed in (2) above**

↓

This will be recognized in books of acquirer as expense during the remaining vesting period after DOA applying IND AS 102

4. **If Acquirer does not replace the SBP awards of Acquiree:** It means Acquiree will issue its own shares to their employees in future.

Calculate the fair value of ESOPs on DOA

Value of pre combination services → Calculation same as in (2) above → **Include in NCI**

XXX (b/fig) → Value of services to be received during remaining vesting period. → Accounted subsequently by applying Ind AS 102

If there is no further vesting period, then include the total Fair Value of ESOPs in NCI.

D. RESTRUCTURING (OR) SIMILAR ARRANGEMENTS TAKEN UP BY ACQUIREE DURING BUSINESS COMBINATION

Any restructuring or similar arrangements of acquiree are to be treated as separate from business combinations if they are initiated by the acquirer, for obtaining benefits after the acquisition & such restructuring arrangement is a pre-condition for Business combination.

However, if acquiree has initiated on their own for its own benefit and such restructuring plan was announced much before the negotiations for Business combination, indicates that is originally in substance the liability of Acquiree.

∴ During BC transaction, Acquirer will have to incorporate the liability as part at BC.

12.SUBSEQUENT MEASUREMENT

Ind AS 103 has provided specific guidance on few items subsequent to initial recognition.

(i) **Reacquired rights:** amortized over the remaining contractual period of the original contract, excluding any renewal period if the reacquired right is subsequently sold to a third party, the carrying amount of the intangible asset is included in the determination of the gain or loss on sale.

(ii) **Contingent liabilities:** after initial recognition of contingent liability till it is settled / expires / written back it is recognised at the higher of the amount that would be recognised in accordance with Ind AS-37: Provisions; Contingent Liabilities and Contingent Assets or the amount initially recognised.

(iii) **Indemnification asset:** If the indemnification asset is not subsequently measured at fair value, the valuation used should consider management's assessment of its collectability the indemnification asset is only derecognized when the acquirer collects, sells or otherwise loges the right to the asset

(iv) **Contingent consideration:** Subsequently CC should be adjusted as follows: (i) if CC is an equity instrument no fair value change applicable, (ii) if CC is a liability as per Ind AS-109: then fair value changes are applicable.

13.PIECEMEAL ACQUISITION

It is possible that the business combination may have occurred in stages. Successive share purchases may have resulted in control being gained by the acquirer.

Before qualifying as a business combination, the transaction may in fact be treated as an Investment in an Associate and be accounted for in accordance with Ind AS - 28 or Investments as per Ind AS 109. If this is the case, then the fair values of the net assets acquired will have been established at this point, and goodwill will also have been determined.

Rules for business acquisition in stages:

- Goodwill is determined on the date the acquirer obtains control
- Any previously held investment is re-measured to its acquisition date. fair value
- Any resulting gain or loss from the re-measurement is recognised in Profit or loss.

COMMON CONTROL TRANSACTIONS

COMMON CONTROL TRANSACTION means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

Whenever combining entities are controlled before & after by the same party, it is called as common control transaction. The accounting has to be done using **POOLING OF INTERESTS METHOD.**

The following are examples of Common Control Transactions:

- Merger of Subsidiaries
- Parent Co taking over subsidiary Co.
- Creation of a subsidiary & transferring the NA of parent
- De-merger with Common Control

Accounting in case of Common Control

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

a) The assets and liabilities of the combining entities are reflected at their carrying amounts.
b) No adjustments are made to reflect fair values, or recognise any new assets or liabilities. The only adjustments that are made are to harmonise accounting policies.
c) The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

d) The identity of the reserves shall be preserved and shall appear in the financial Statements of the transferee in the same form in which they appeared in the financial statements of the transferor.

e) The difference, if any, between the amounts recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes.

ACCOUNTING TREATMENT IN THE BOOKS OF COMPANY TRANSFERRING NA

Sundry Liabilities a/c	Dr	BV	
Capital Reserve a/c (b/f)	Dr		
To Sundry Assets			BV

NOTE:- If any PC is receivable it would be recorded in the above entry

ACCOUNTING IN THE BOOKS OF TRANSFEREE ENTITY

Sundry assets a/c	Dr	BV of transferor	
Capital Reserve a/c			**(b/F)**
To Sundry Liabilities		BV of transferor	
To Reserves		BV of transferor	
To Capital Reserve			**(b/F)**

NOTE:

1) If any PC is payable, record in the above entry
2) Do Not create GOODWILL

Any difference in above entry is adjusted against CAPITAL RESERVE

DEMERGER OF COMPANY

Demerger means where existing creates a new company, and then transfer any of its business unit to such newly opened company. In consideration the existing company does not claim any consideration from newly opened company rather newly opened company pays consideration to the members of existing company. The existing Co. is called **Demerged Co**, and Newly opened co, is called **Resulting Co.** For accounting purpose demerger are of two types:

A. Demerger if entities are not under common control
B. Demerger if entities are under common control

A. Journal entry for Demerger if entities are not under common control:

In the books of de-merged Co, this transaction will be accounted as **distribution of dividend to shareholders** in accordance with Ind AS-10 & in the books of resulting entity, its recorded as normal BC transaction applying Acquisition Method in accordance with Ind AS – 103.

i. In the Books of Demerged Company:

a) Calculate the fair value of Net assets to be transferred & pass the following JE:

Retained Earnings a/c	Dr		
To Dividend payable			

b) Remeasure the assets & liabilities being transferred to Fair value. The resulting gain or loss is transferred to P or L.

c) Now transfer the assets & liabilities and cancel the dividend payable account.

Dividend payable A/c	Dr.	XXX	
Sundry Liabilities A/c	Dr.	XXX	
To Sundry Assets A/c (At book value)			XXX

ii. In the Books of Resulting company:

a) On Acquisition of Asset and liabilities

Sundry Assets A/c (At Fair value)	Dr.	XXX	
Goodwill/Capital Reserve A/c (B/F)			
To Sundry liability A/c (At Fair value)			XXX
To Vendor A/c (At PC)			XXX

b) On Payment of Purchase consideration

Vendor A/c ………………… Dr.		XXX	
To Equity Share Capital A/c (At Face value)			xxx
To security premium A/c			xxx

B. Journal entry for Demerger if entities are under common control

i. **In the Books of Demerged Company**

<u>On transfer of Division</u>

Sundry Liabilities A/c(At book value)	Dr	XXX	
Accumulated Depreciation A/c(At book value)	Dr	XXX	
Profit or loss on demerger A/c **(B/F)**			
To sundry Assets A/c (At book value**)**			XXX

\# Profit or loss on demerger shall be transfer into **Capital Reserve A/c**

ii. In the Books of Resulting company

a) On Acquisition of Asset and liabilities

Sundry Assets A/c(At book value)	Dr.	XXX	
Profit or loss on demerger A/c **(B/F)**			
To Sundry liability A/c (At book value)			XXX
To Members of Demerged co. A/c (At PC)			XXX

\# Profit or loss on demerger shall be transfer into **Capital Reserve A/c**

On Payment of Purchase consideration

Members of demerged co. A/c ……………	Dr	XXX	
To Equity Share Capital A/c (At Nominal value)			XXX

Note: Intrinsic Value/Net Asset Value per share which shall be calculated as follows:

Particular	Amount
Sunday Asset at fair value	XXX
(-) Sunday Liability at fair value	(XXX)
Net asset	XXX
÷ No. Of eq. Shares	XXX
Intrinsic value per equity share	XXX

Note: In case of demerger, it question is silent whether entity is under common control or not, gives the answer with the assumption' that entity is under common control (as followed by ICAI).

REVERSE ACQUISITION

Reverse Acquisition means where Legal acquirer becomes In-Substance/Accounting acquiree. This is happened where shares are allocated in a way that control obtained by the legal acquiree. This can be of two types:

A. In case of Absorption.
B. In case of Amalgamation.
C. Control Acquisition.

A. In case of Absorption

Example. Capital structure of

A Ltd.; 100000 ES of Rs 10 each: Rs 1000000

B Ltd.: 50000 ES of Rs 10 each: Rs 500000

A Ltd, Acquired B Ltd, & issue 3 equity Share for each equity share held by shareholders of B Ltd, Find out the Acquirer.

Solution: % of shareholder post business Acquisition

Shareholder of	No. of ES held	(%)
A Ltd.	100000	40%
B Ltd. [(3/1) *50000]	150000	60%
	250000	100%

Legal Acquirer	= A Ltd.	Legal Acquiree = B Ltd.	
Accounting Acquirer	= B Ltd.	Accounting Acquiree = A Ltd	

Journal Entries (On the basis of above example)

Entry shall be journalised in the books of A Ltd, in a way that B Ltd, acquired A Ltd.

i. **Eliminate all Asset, Liability, share capital & other equity of A Ltd. at book value (Legal Acquirer)**

Share capital A/C (At book value)	Dr.	XXX	
Other Equity A/C (At book value)	Dr.	XXX	
Liability A/c (At book value)	Dr.	XXX	
To Asset A/C (At book value)			XXX

ii. On recording of sundry Assets, Sundry Liabilities, Share Capital and other equity of B Ltd. (Legal Acquiree) [ACCOUNTING ACQUIRER]

Asset A/C Dr. (at B.V)	XXX	
To sundry Liability A/c (at Bv)		XXX
To share capital		XXX
To other equity (at B.V)		XXX

iii. On recording of assets and liabilities of A.Ltd [Accounting Acquiree] at Fair values.

Sundry Asset A/c Dr. (at Fair value)	XXX	
Goodwill / Capital Reserve (B/f)		
To Sundry Liability A/c (at Fair value)		XXX
To Vendor A/c (At P.C)		XXX

PC shall be calculated in a way B Ltd. Acquired A Ltd.

i. BEPS: For the purpose of calculation of earnings per share, legal share capital shall be considered, Due to this previous **year BEPS is also restated.**

B. In case of Amalgamation

Case 1: If Amalgamation is not under common control.

Case2: If Amalgamation is under common control.

Case 1: If Amalgamation is not under common control.

Example capital structure of

A Ltd. = 60000 ES

B Ltd. = 40000 ES

A Ltd. & B Ltd. create a new co. C Ltd. and transfer their business to C Lt. C Ltd. Issue equity share in the ratio of 1:1 for both A Ltd. & B Ltd. Find out the acquirer.

Solution:

Share Holder of	No. of shares held	% of holding
A Ltd	60000	60
B Ltd	40000	40
C Ltd	0	0
	100000	100

Accounting / Substance Acquirer A Ltd.

Legal Acquirer = C Ltd.

ACCOUNTING TREATMENT (on the basis of above example)

Entries shall be passed in C Ltd. with the assumption that A Ltd. acquired B Ltd.

i. Recognize asset, Liability, Share Capital & Other Equity of A Ltd at BOOK VALUES (ACCOUNTING Acquirer)

Sunday asset A/c Dr.(at B.V.)	XXX	
To Sunday Liability A/C (at B.V.)		XXX
To Other equity A/C (at B.V)		XXX
To ESC (at B.V.)		XXX

ii. Pass entries to acquire Assets & assume Liability of B Ltd. (ACCOUNTING acquiree)

Sunday Asset A/C Dr. (at Fair value)	XXX	
Goodwill 'capital reserve A/C (B/F)		
To Sundry liability A/C (at Fair Value)	XXX	
To Vendor A/C B Ltd, (At PC)		XXX

PC shall be calculated on the basis A Ltd acquired B Ltd.

For the purpose of calculation of earnings per share, legal share capital shall be considered, Due to this previous year BEPS is also restated.

Case 2: If amalgamation or merger of entities which are under common control.

In this case no impact is being taken on asset, Liability or Reserve as there is NO REVERSE ACQUISITION. Only share capital has been changed and any difference shall be transfer into **Reserves** as per **POOLING OF INTERESTS METHOD.**

A.Ltd & B.Ltd are now taken over by newly formed C.Ltd. if it's a common control transaction then all the assets & liabilities are incorporated in C Ltd only at the existing book values. IF THE QUESTION does not give PC to be issued, then take

PC = Share Capital of A + Share Capital of B &

Allocate the PC to shareholders of A & B in ratio of Net Assets [SC + Reserves]

C. CONTROL ACQUISITION

IND AS 20 ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

Scope

Ind AS – 20 deals with the accounting treatment and disclosure requirements of grants received by entities form government. It also mandates disclosure requirements of other forms of government assistance. This Standard provide four exclusions and does not deal with:

- Special problems arising in reflecting the effects of changing prices on financial statements or similar supplementary information.
- Government assistance provided in the form of tax benefits (including income tax holidays, investment tax credits, accelerated depreciation allowances, and concessions in tax rates).
- Government participation in the ownership of the entity.
- Government grants covered by Ind AS-41. Agriculture.

1. IND AS 20 deals with accounting treatment and disclosure Requirements relating to Govt. Grants. It also mandates the disclosure of any assistance received from the Govt.

2. Govt Includes central Govt, state Govt or any national or International bodies (Eg: WHO)

3. Govt Grants are assistance by the Govt in the form of transfer of resources to an entity for past or future Compliance with specified conditions.

4. Govt grants can be subsidies, incentives, duty draw backs, forgivable loans, interest free / concessional interest loans, govt grants compensating for abnormal losses suffered, non-monetary assets, govt grants for entities in backward areas.

5. **Recognition criteria for Grant**

   Govt grant can be recognised by an entity only if it has a **reasonable assurance** that

   i. It will comply with the conditions attached to the Grant &
   ii. The Grant will be Received.

Note 1: In cases where the Grant is already received but the entity does not have reasonable assurance of fulfilling the conditions, the amount received will be accounted as a Liability and not as a Grant.

Note 2: In cases where Entity is Eligible for receiving the Grant, it can recognize the Grant an accrual basis, if it has a reasonable assurance that Grant will be received.

6. Monetary Grants relating to Purchase of Assets

a) The Grant received should be **Deducted from the cost of the asset** or **Credited to Deferred Income A/c**

b) If the asset is a depreciable asset, **Deferred Income** can be credited to P or L A/c in the ratio of depreciation. In case of non-depreciable asset, the deferred income will be credited to Por L a/c over the periods in which it will bear the cost of meeting the conditions to ensure the matching of income & expense.

7. Non-Monetary Grants

a) Non-Monetary assets may be received form the Govt in the form of land or building or any Intangible asset. Such Grants may be received free of cost or at Concessional prices.

b) The assets received should be recognised at **FAIR VALUE** and the Grant component should be credited to deferred Income or P&L A/c as appropriate. [if no conditions exist recognize immediately in P&L]. **Alternatively,** the assets received can be recognized at Nominal value or concessional cost at which they have been acquired.

8. Grants Given for Expenses

a) Treat the Grant received as deferred Income and Credit to P&L A/c over the period in which expense are to be Incurred.

b) If the Grant is received for an expense already, Incurred or losses suffered in the past, it can be created to P&L A/c immediately since there are no further conditions to be complied.

9. Government Grant in the nature of promoter's Contribution

a) These Grants shall be credited to P or L A/c immediately if no conditions Exist. It will be credited to Deferred Income if conditions are to be complied in future.
b) These should NOT be Credited to Capital Reserve. The above accounting treatment is applicable for any Grants received for Setting up Industries in backward areas.
c) Government Grants which are received as Immediate Financial Support or Compensation for Huge losses Suffered Shall be credited to P&L A/c.

10. Refund of Government Grants

a) When Conditions attached to the Grant are not satisfied, the Grant may be refundable. This is treated as a change in accounting Estimate.
b) Refund of Government Grant is accounted by Debiting the balance in Deferred Income A/c and any Excess amount refunded will be debited to P&L A/c.

11. Presentation of Govt Grants in P&L A/c.

a) **Alternative 1:** Govt Grants can be Included in other Income or It can be presented as a Separate line item.
b) **Alternative 2:** Govt Grants can be shown as a reduction from the related Expense.

12. Presentation of Grants in Cash flow Statement:

Grant received for acquisition of asset, such grant should be shown as an inflow under financing activities and acquisition of asset should be shown as an outflow under Investing activities.

13. Treatment of loan @ Concessional Interest Rate:

Step 1: Identify the total amount received as loan from Govt.

Step 2: Calculate the Fair value of the loan

Fair value of loan = P.V of Future cash outflows discounted @ MARKET INTEREST RATE

Step 3: Grant Component = Step 1 - Step 2

Step 4: If there are no conditions to be fulfilled, the Grant component will be credited to P&L immediately. If Conditions Exist it will be credited to Deferred Income A/c.

14. Disclosure of Government Assistance

Govt may provide assistance in the form of free marketing advice, free technical support given, waiver of procedural requirements while setting up an Industry, promoting the products of enterprise directly or indirectly.

These Govt assistances will not be recognised. They must be disclosed in Notes to accounts.

15. DISCLOSURES:

1. The accounting policy adopted for Government Grants
2. Any Government assistances received during the year
3. Any Unfulfilled Conditions or Contingencies relating to the grant
4. Refund of Government Grant.

IND AS 2 INVENTORIES

Inventories Consists of

a) Assets held for sale in the ordinary course of business.
b) Asset held in process of production for such sale
c) Asset held in form of materials and supplies to be used in process of production of goods or rendering services.

NOTES

1. Empty tins / bottles left in a restaurant / bar can be treated as inventory if the entity is maintaining detailed inventory records. At the end of the year, it will be valued at lower of cost or NRV. If the cost CANNOT BE DETERMINED, Consider Nominal Value (Example Rs 1)

2. Primary packing material i.e. required for making the sale of the product is treated as raw-material and part of inventory. However, secondary packaging material in which inventory is sold, during transport should NOT be treated as raw material inventory.

SCOPE

Standard is applicable to all inventories, except:

a) financial instruments (to be accounted under Ind AS 32, Financial Instruments: Presentation and Ind AS 109, Financial Instruments).
b) biological assets (i.e. living animals or plants) related to agricultural activity and agricultural produce at the point of harvest (to be accounted under Ind AS 41, Agriculture).

Note: In accordance with Ind AS 41 "Agriculture", inventories comprising agricultural produce that an entity has harvested from its biological assets are measured on initial recognition at their fair value less costs to sell at the point of harvest. This fair value less costs to sell as determined in accordance with Ind AS 41 will become the cost of the inventories at that date for application of Ind AS 2 "Inventories".

This Standard does not apply to the measurement of inventories held by:

a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at **net realisable value** in accordance with well-established practices in those industries.

When such inventories are measured at net realisable value, changes in that value are recognized in profit or loss in the period of the change.

b) **commodity broker-traders who measure their inventories at fair value less costs to sell.**

When such inventories are measured at net realisable value / fair value less costs to sell, changes in those values are to be recognized in profit or loss in the period of the change.

Broker-traders are those who buy or sell commodities for others or on their own account. They acquire inventories principally with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard.

VALUATION OF INVENTORIES

- The inventories at the end of the year shall be valued at

  COST
  OR W.I.L
  NRV

  This rule is applicable only for finished goods, stock in trade & WIP.

- Raw material inventory is to be valued at COST as long as the finished goods are valued at cost. If finished goods are value below cost raw material will be valued at
  1. Cost (OR)
  2. Replacement price W.I.L

COMPUTATION OF NRV

- NRV = Estimated Sale price (-) Estimated Selling Exp (-) Estimated Cost of completion
- NRV is an **entity specific value** because the sale price is determined by the entity.
- NRV is different from fair value (FV) since FV is a market-based measurement.
- If the entity has any firm sales contract to sell the inventory at a future date. The contract price should be considered as NRV.
- Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

COST OF INVENTORIES

I. COST OF PURCHASE

Purchase price of materials (net of discount / relate)	Xxx
(+) Non-refundable taxes	Xxx
(+) Cost of Insurance, freight & other handling charges	Xxx
(+) Any other costs incurred relating to purchase of Inventory	xxx
	xxx

NOTE: If inventory is purchased on **deferred credit terms,** any interest element included in purchase price should be eliminated. It will be recorded separately, as expense and recorded in P&L a/c.

II. COST OF CONVERSION

Conversion costs pre-dominantly include Labour & overheads.

- Labour cost is allocated to inventory on a reasonable basis. (Eg:. Labour cost per unit, Labour cost Per hour spent on each unit)
- Variable OH can be directly allocated to the inventory
- Fixed production Overheads like depreciation, maintenance etc are to be allocated on the basis of Fixed OH absorption Rate

$$\text{Fixed OH absorption Rate} = \frac{\text{Fixed Production OH's}}{\text{Normal production (or)Actual Production whichever is higher}}$$

- In case of **joint products,** the cost of conversion has to be split among joint products on a rational / consistent basis. (Ex: Sale value at split off point)

  In case of any **by products** (output of manufacturing process of generally immaterial value, irrespective of intention to produce or not) or scrap arising in the process of production which has No significant value, their NRV should be reduced from total Joint costs.

III. OTHER COSTS – Inclusions and Exclusions

a. Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.
b. Borrowing costs can be included if the inventory is a Qualifying asset (IND AS – 23)
c. Storage Costs should not be included unless it is a part of production process.
d. Research costs unless it is reimbursable specifically under the contract.
e. Administration Overheads
f. Selling & distribution costs
g. Abnormal losses

CANNOT BE included

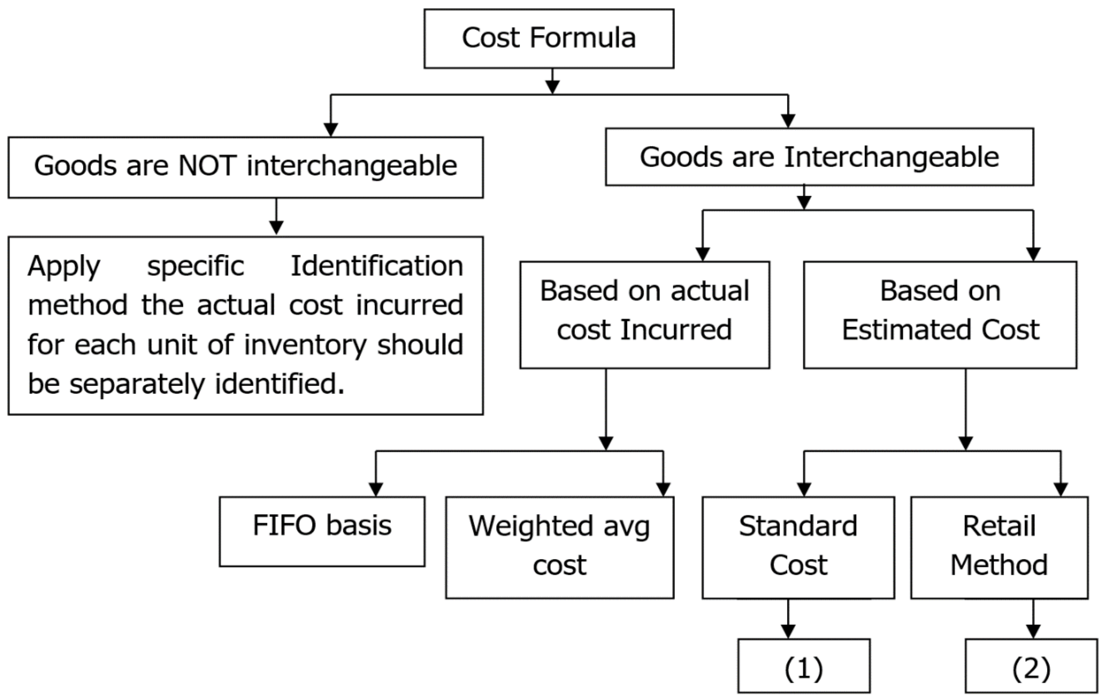
The cost of NORMAL LOSS units can be included.

Cost per unit = Total cost of purchase production/ Total Units – normal loss units

COST OF AGRICULTURAL PRODUCE HARVESIED FROM BIOLOGICAL ASSETS

The Agricultural produce would be initially recognized at FVLCTS. This itself will become the cost for valuation of Inventory.

TECHNIQUES FOR THE MEASUREMENT OF COST & COST FORMULAS



Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate to actual cost.

1) **STANDARD COST METHOD:** Cost is based on normal levels of materials and supplies, labour efficiency and capacity utilization. They are regularly reviewed and revised where necessary.

2) **RETAIL METHOD:** Cost is determined by **reducing the sales value of the inventory by the appropriate percentage gross margin.** The percentage used takes into consideration inventory that has been marked down to below its original selling price. This method is often used in the **retail industry for measuring inventories of rapidly changing items** that have similar margins. An average percentage for each retail department is often used.

The percentage has to be carefully determined to ensure that it takes into consideration the circumstances in which inventory has been marked down to below its original selling price so as to prevent any item of inventory being valued at less than both its cost and its net realisable value. An average percentage for each retail department is often used.

Sale value of Inventory	Xxx
(-) gross margin	Xxx
COST OF INVENTORIES	Xxx

COST FORMULA

The entity **must use same cost formula** for all inventories has similar nature & use. Different cost formula can be used for inventories having different characteristics.

The costs of inventories, than that are ordinarily interchangeable shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula.

First-in, First-out Cost Formula (FIFO) assumes that the items of inventory that were purchased or produced first are sold first. Hence in such a case, the items remaining in inventory at the end of the period are those which were most recently purchased or produced.

Weighted Average Cost Formula is suitable where inventory units are identical or nearly identical. It involves the computation of an average unit cost by dividing the total cost of units by the number of units. The average unit cost then has to be revised with every receipt of inventory, or alternatively at the end of predetermined periods. In practice, weighted average systems are widely used in packaged inventory systems that are computer controlled, although its results are not very different from FIFO in times of relatively low inflation, or where inventory turnover is relatively fast.

OTHER POINTS

1. NRV has to be determined at the end of each year for valuation of inventories. Due to this, it is possible that inventory valued at NRV in the previous year can have a increase in the value in the current year.
2. When the inventory is sold the cost of inventory will be written off in P&L a/c.
3. Cost OR NRV comparison has to be done on item by item basis. However if we have inventories with similar characteristics, cost or NRV comparison can be done on a group basis / Gross basis.

Disclosure in the financial statement

The financial statement should disclose the following:

- Accounting policies adopted in measuring inventories including cost formula used;
- Total carrying amount - in appropriate classifications (e.g., merchandise, raw materials, work-in-progress, finished goods);
- Carrying amount at fair value less costs to sell;

- Carrying amount of inventories pledged as security for liabilities;
- The amount of inventories recognized as an expense;
- The amount of any write-down;
- Any reversal of write-down recognized as income;
- Circumstances or events that led to reversal of a write-down.

IND AS 101 FIRST TIME ADOPTION OF IND AS

1. The standard provides accounting principles for first time adoption of Ind AS.

2. Normally, All the Ind AS must be applied retrospectively on transition to Ind AS. However, this standard provides certain mandatory exceptions and optional exemptions from retrospective application.
3. **First Ind AS financial statements** are the first annual financial statements in which entity adopts Ind AS, by an explicit and unreserved statements of compliance.
4. Opening Ind AS balance sheet means Balance sheet as per Ind AS on date of transition.
5. **Date of transition** is the beginning of earliest period for which entity presents full comparative info as per Ind AS.
6. Previous GAAP = AS as per companies' (AS) rules, 2006.
7. **General principle is to apply all Ind AS 's in the opening Ind AS Balance sheet with retrospective effect.** This may lead to
   - **Recognize** all assets and liabilities required by Ind AS.
   - **Eliminate** items which are not permitted by Ind AS as assets & liabilities.
   - **Reclassify** the items of assets and liabilities as per Ind AS.
   - **Remeasure** the items as per Ind AS.

MANDATORY EXCEPTIONS

I. ESTIMATES:

The estimates followed by entity as for AS on the date of transition should be continued even in the first Ind AS balance sheet on Date of transition. Change in estimates based on hindsight is not permitted, unless there is an error in the original estimate.

II. DE-RECOGNITION OF FINANCIAL ASSETS & FINANCIAL LIABILITIES:

Derecognition principles of Ind AS 109 have to be applied only prospectively for transactions occurring on or after the date of transition.

III. NON-CONTROLLING INTERESTS:

The following requirements of Ind AS 110 shall be only applied prospectively from date of transition:

a) Allocation of subsidiary's losses to NCI creating a deficit balance.
b) Change in parent's ownership in subsidiary without loss in control.
c) Accounting for loss of control in subsidiary.

However, if a first-time adopter elects to apply Ind AS 103 retrospectively to past business combinations, it shall also apply Ind AS 110 from that date.

IV. CLASSIFICATION & MEASUREMENT OF FINANCIAL ASSETS & FINANCIAL LIABILITIES

a) For financial assets **classification** as ACM / FVTOCI / FVTPL is to be done on the date of transition.
b) For financial assets & financial Liabilities where ACM has to be applied, if it is impracticable to retrospectively apply ACM and determine EIR the entity can fair value the financial asset (or) financial Liability on date of transition and here after apply ACM.

V. IMPAIRMENT OF FINANCIAL ASSETS

An entity **shall apply the impairment requirements of Ind AS 109 retrospectively** subject to the below:

a) At the date of transition to Ind AS, an entity shall use reasonable and supportable information that is available without undue cost or effort **to determine the credit risk** at the date that financial instruments were initially recognised. An entity is not required to undertake an exhaustive search for information whether there have been significant increases in credit risk since initial recognition.

b) If, at the date of transition to Ind ASs, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to **lifetime expected credit losses** at each reporting date until that financial instrument is derecognised, unless that financial instrument is low credit risk at a reporting date.

VI. GOVERNMENT LOANS:

a) An entity has to apply principles of Ind AS 20 & Ind AS 109 only prospectively

b) It shall not recognize the corresponding benefit of lesser Interest rate loan as govt grant.

c) Entity may do retrospective application if information required for such accounting was obtained at the time of initial accounting itself.

OPTIONAL EXEMPTIONS

I. SHARE BASED PAYMENTS

a) For options on equity Instruments, which are vested before the date of transition entity has following choices:

Apply Ind AS 102 retrospectively, if the entity disclosed publicly the fair value of those equity instruments.	No need to apply Ind AS 102 retrospectively.

b) For unvested options, Ind AS 102 has to be applied retrospectively.

II. PPE, INTANGIBLE ASSETS

An entity has the following choices.

a) To apply Ind AS retrospectively. (or)

b) To fair value the asset on date of transition and treat such fair value (or) as Deemed cost

c) Continue the carrying amt as for previous GAAP.

For Investment properties, fair valuation is not permitted. It has to apply only Cost model.

III. CUMMULATIVE TRANSLATION DIFFERENCE

Any balance of 'FCTR' created as per AS – 11 can be adjusted directly into retained earnings.

IV. PARA 46/46A OF AS -11

In respect of long term foreign currency monetary items, if the entity has elected to apply accounting treatment given in para 46/46A of AS-11, in its previous GAAP, the entity has the choice to continue applying para 46/46A even under Ind AS in respect of those Long term foreign currency monetary item existing on the date of transition.

V. INVESTMENT IN SUBSIDIARIES, ASSOCIATES & JOINT VENTURES:

Entity has the following choices

a) Cost as per Ind AS 27
b) Fair value on date of transition
c) Previous GAAP carrying amt on date of transition

VI. COMPOUND FINANCIAL INSTRUMENTS

An entity need not split its CFI into equity & liability components, if liability component is not outstanding on transition date.

If any liabilities component is outstanding as Date of transition, Ind AS 109 to be applied Retrospectively.

VII. BUSINESS COMBINATIONS

Ind AS 103 need not be applied to Business combination before the date of transition. But if one Business Combination is restated to comply with Ind AS 103, all subsequent business combinations have to be restated.

a) If any asset / liability was not recognized as per previous GAAP but would have been recognized as per Ind AS, then recognize such Asset / liability through Retained earnings.

   Similarly if any assets / liabilities was recognized as per previous GAAP but would not have been recognized as per IND as then eliminate such assets /liability by adjusting against retained earnings.

   The Adjustment shall not be made to retained earnings if it relates to recognition (or) elimination of **Intangible asset**, in which case it has to be adjusted against Goodwill / capital Reserve.

VIII. JOINT ARRANGEMENTS

Transition from Proportionate Consolidation to Equity Method

- To measure initial investment at transition date at the aggregate of carrying amount of assets and liabilities that the entity had previously proportionately consolidated including goodwill arising on acquisition.
- To test the investment for impairment, regardless of whether there are indicators of such impairment. Any resulting impairment shall be recognised as an adjustment to retained earnings at the date of transition to Ind AS.
- If aggregate of all previously recognized assets/liabilities results in negative asset and if having legal or constructive obligation, then recognize corresponding liability otherwise adjust retained earnings.

IND AS 33 EARNINGS PER SHARE

1) This standard is mandatory for all the Entities who have to prepare financial statements on the basis of IND AS.

2) EPS should be disclosed in Separate Financial Statements and in Consolidated Financial statements.

3) EPS is computed only for Ordinary shares. An ordinary share is an equity instrument that is subordinate to all other classes of equity instruments. Ordinary shares participate in profit for the period only after other types of shares such as preference shares have participated. An entity may have more than one class of ordinary shares. Ordinary shares of the same class have the same rights to receive dividends. In Indian context, the term 'ordinary shares' is equivalent to 'equity shares'.

4) Basic EPS

Basic earnings per share shall be calculated by dividing profit or loss for the period attributable to ordinary equity holders of the parent entity (the numerator) by the weighted average number of ordinary (equity) shares outstanding during the period (the denominator). It can be expressed mathematically as follows:

$$\textbf{BEPS} = \frac{\textbf{Earnings attributable to Equity Shareholders}}{\textbf{Weighted average no.of Equity shares outstanding during the year}}$$

Calculation of Numerator:

Net profit after tax as per P or L A/c	xxxx
(Excluding OCI section]	
Less: Preference dividend for year, premium on redemption of Pref shares	(xxx)
$\pm$ Any Incomes / Expenses that are directly adjusted into Reserves	Xxx
Earnings attributable to equity shareholders	**<u>XXX</u>**

I. While calculating PAT take effect of abnormal loss/Gain and exceptional Item.

II. **PREFERENCE DIVIDEND**

Mandatory Convertible/Conversion Option with the company

i. Deduct after PAT

ii. If Cumulative PSC

- Deduct irrespective of dividend declared or not **Non-cumulative PSC**
- Deduct only if dividend is declared

If question is silent always assume PSC is cumulative.

Non-Convertible or Conversion Option with PSH

i. Amount of dividend shall be considered as **interest expense**

ii. For calculation of interest expenses use **EIR**

iii. If question give information of PBT/PAT then no treatment because it has already been considered.

PREFERENCE SHARE	DIVIDEND/INTEREST	IMPACT ON NUMERATOR	IMPACT ON DENOMINATOR
Preference shares mandatorily redeemable.	Mandatoy dividend debited to p or l, discretionary dividend debited to reserves.	Dividend on preference shares to be deducted.	No impact.
Redeemable or convertible @ option of holder.	Mandatoy dividend debited to p or l, discretionary dividend debited to reserves.	Dividend on preference shares to be deducted.	No impact.
Redeemable or convertible @ option of issuer entity.	Mandatoy dividend debited to p or l, discretionary dividend debited to reserves.	Dividend on preference shares to be deducted.	No impact, but considered as potential equity share.

a) In case preference share are issued at a discount or redeemed at a premium but such discount amount or premium on redemption is already adjusted with security premium as per company Act. In such case premium on redemption and discount on issue shall be adjusted while calculate earnings attributable for ESH.

b) In case PSC is being redeemed on an earlier date before its due date, difference between redeemable amount and carrying amount shall be charged into P&L A/c in the year of redemption.

c) In case any income and expenses adjusted against security premium or other equity due to any provision of any respective Act then such income or expenditure shall be adjusted in earning for the purpose of calculation of earnings attributable to Equity Share holder. E.g. preliminary expenses.

d) In case company declared preference dividend for two or more years, then for the purpose of calculation of BEPS dividend on cumulative preference share shall be taken only for 1 year. (means Yearly basis)

e) Do not deduct any kind of appropriation irrespective of these are mandatory or not.

III. Calculation of BEPS for parent company in Consolidated Financial Statement always deduct share of profit of non-controlling interest to the extent share held by them.

$$\frac{\text{Earning of Parent co.} + (\text{Earning of Subsidiary co,} - \text{profits belong to NCI})}{\text{Weighted average of Equity share of Parent Company}}$$

CALCULATION OF DENOMINATOR / WEIGHTED AVERAGE NO OF EQUITY SHARES (WANES).

1. Since the company earns profit / loss throughout the year, the movement of Equity shares during the year assumes importance and it becomes relevant to identify how much capital is used to generate the earnings.
2. Therefore, we use weighted average no. of equity shares (WANES) o/s during the year after considering appropriate time weights.

SPECIAL CASES IN BEPS

1. Party paid Shares / shares with different paid-up value

Convert the partly paid up shares into Equivalent no. of fully paid shares. Any amount received on partly paid shares is also to be converted into Equivalent no. of fully paid shares.

Alternatively, we can compute weighted average paid up capital o/s throughout the year and then calculate the Basic Earnings for Rs 1 paid up. Now this will be used for computing BEPS.

2. Shares with different Face values

Shares with different face values implies that they belong to different classes. Computation of EPS is to be done exactly in the same manner as case 1 above.

However Basic EPS must be disclosed for each class of shares

3. Shares with differential dividend rights.

The standard requires that the earnings should be appropriated to each class of equity shares based on their rights of dividend. Differential dividend rights can be expressed either in absolute terms or in multiples.

4. Change in No of shares without any change in resources

i. This is a case of **Bonus shares, share Split (Sub division of shares) (or) Consolidation of shares**

ii. In these cases, WANES must be computed assuming that such Bonus / share Split/ Consolidation has taken place at the **BEGINNING OF EARLIEST REPORTING PERIOD.**

5. RIGHT SHARES

These are additional shares issued by the company to the existing share holders as a privilege. Usually, the Right issue is made at a price which is lower than the normal market price. Therefore, a rights issue contains a Bonus element.

Step 1: Calculate theoretical Ex Rights price

$$= \frac{(\text{No.of shares before rights X FV before rights}) + (\text{No.of Rights X Issue price})}{\text{No.of shares before rights} + \text{No.of right shares}}$$

Step 2: Cash Collected = (No. of Right shares issued x issued price)

Step 3: Paid part shares = $\frac{\text{Step 2}}{\text{Step 1}}$

This represents the number of shares that should have been issued at the Fair value

Step 4: Bonus Element = Right shares issued Θ Paid part in step 3 shares

Step 5: While computing WANES treat the Bonus element shares as Bonus shares and the paid part shares as normal public issue.

Note: Since Rights issue involves bonus issue the basic EPS of previous year needs to be restated.

6. Buy Back of shares

This is similar to RIGHT SHARES but not covered in IND AS 33 specifically.

7. Shares with calls in arrears

a) Share with arrears do not have an inherent right for participating in the dividends. Therefore these shares are totally excluded while computing BEPS. Because they do not have rights in the earning, the earnings will not be divided among shares with arrears.

b) However, if AOA permits such shares to participate in proportionate dividends, then they will be included in calculated of WANES. The treatment will be similar to partly paid shares.

c) Except in (b) above shares with arrears are excluded from computation of WANES, however on such shares when arrears are paid, such shares take the nature of ordinary shares and they are included in computation of WANES as fully paid up from the date on which call is made.

8. Date from which shares shall be included in WANES

Condition / Situation	Date to be considered for WANES in BEPS
1) When shares are issued for cash	From the date when cash is receivable
2) Shares are issued for acquisition of asset	From the date when the asset is recognized → Means ready for usage
3) On conversion of Debentures / preference shares	From the date when the interest or dividend ceases to accrue
4) Shares issued in a Business combination [Amalgamation / Absorption]	From the Acquisition Date
5) Shares issued against settlement of liability	From the date when liability is settlement (or) interest ceases to accrue
6) Contingently, issuable shares It means issuing shares on happening of some future event	From the date when all conditions for issue are satisfied even though the shares are not actually issued.
7) Issued for rendering services	When services are rendered
8) Issued upon conversion of a mandatorily convertible instrument	From the date of entering into contract.

DILUTED EPS

1) Diluted EPS is to be computed and presented if the company has potential Equity shares [PES]

2) Potential Equity shares are instruments which are entitled to be converted into equity shares on a future date.

   Eg:- Convertible debentures, convertible preference shares, share warrants options given to employees, contingently issuable shares etc.

3) Potential Equity shares are those on which the resources are already received by the company.

4) Diluted EPS is computed from BEPS after making adjustment in the numerator and denominator assuming the conversion of potential equity shares.

5) Calculation of DEPS: For the purpose of calculation of DEPS of following Steps are applied

   Step 1: Identify Potential Equity share [PES]

   Step 2: Calculate Incremental earning per share for each potential equity share.

$$\frac{\text{Effect of PES on earning}}{\text{Effect of PES on WANES}}$$

   Step 3: Test for Dilution: For the purpose of calculation of DEPS:

- Only potential ordinary shares that are dilutive are considered in the calculation of diluted EPS, Potential ordinary shares should be treated as dilutive only when their conversion to ordinary shares would decrease profit per share or increase loss per share from continuing operations attributable to ordinary equity holders.

- The effects of anti-dilutive potential ordinary shares are ignored in calculating diluted EPS. An entity might have a number of different types of potential ordinary shares in issue. Each one would need to be considered separately rather than in aggregate.

  Note: For the purpose of identification of potential equity share as diluted or anti-dilutive use incremental earning per share in ascending order.

   Step 4 DEPS formula =

$$\frac{\text{Profit / Loss attributable to ESHs after taking effect of Dilutive PES}}{\text{WANES } + \text{ Weighted average number of DPES}}$$

NOTES:

i. Effect of potential equity shares on earning and WAES shall be taken for **outstanding period** during the year.

ii. CALCULATION OF POTENTIAL EQUITY SHARE IN CASE OF SBP [OPTIONS]

1) These are instruments which entitles the holder to convert them into equity shares on a future date

2) In case of options given to Employees, the consideration will be received by the company in two forms.

   a) Exercise price when the options are exercised

   b) Services during the vesting period

3) Potential Equity shares would mean only those shares on which the resources are already received by the company.

   ∴ No. of shares to be considered in denominator for DEPS =

$$\left[\text{Total no. of shares to be issued in options} \ominus \begin{array}{l}\text{No. of shares representing the value}\\ \text{of resources yet to be received}\end{array}\right]$$

$$= \text{Total no of shares in options} \ominus \frac{[\text{No.of options X Excercise price}] + \text{Unamortized value of options}}{\text{AVG Fair value of share during the year}}$$

iii. While calculating DEPS only that PES shall be considered whose nature is dilutive.

iv. Contingency issuable shares (CIS)

a) These are those shares which will be issued by the entity on fulfillment of certain conditions.

b) Such conditions either may be market based e.g. increase in market price of share or non-market base. E.g. Decrease in cost of production or both.

c) In BEPS the shares shall be considered only in the year when all conditions are actually fulfilled.

d) However contingency issuable shares are to be considered for DEPS in case conditions relating to issuing of CIS are fulfilled on reporting date irrespective of future estimates. If the conditions are fulfilled on reporting date, then CIS should be included for DEPS from the date of contract or from the beginning of current period whichever is later.

e) No restatement of P.Y is required in case information changed in current year.

CALCULATION OF DEPS WHEN OPTIONS ARE WRITTEN BY THE CO

If the company acts as a writer of call option / put option on its own shares then these options will be considered for computing DEPS if they are "In the Money" on the B/s date [i.e. the options are likely to be exercised].

ANTI-DILUTIVE PES

PES are considered for Diluted EPS only if those PES are Dilutive in nature. They are considered Dilutive only if only when their conversion to ordinary shares would decrease profit per share or increase loss per share from continuing operations attributable to ordinary equity holders.

If the Diluted EPS from continuing operations is **>** BEPS from continuing operations, the potential Equity shares are considered **Anti Dilutive** and they will be ignored in computing Diluted EPS. In case the company has only one PES, say, convertible debenture & On testing, if we could see that DEPS from Continuing operations is higher than BEPS from continuing operations. Then debentures will be Ignored. Debentures are treated as anti-dilutive PES. In this situation DEPS and BPS would be same.

SEBI GUIDELINES ON ISSUE OF BONUS SHARES

1. Whenever a company issues bonus shares to its shareholders, the similar benefit should be extended even to any convertible debentures or preference shares.

2. Due to this, additional shares are issuable to convertible debentures apart from the originally agreed shares. Therefore, while computing DEPS we have to consider even these additional shares also along with the original shares that are to be issued for conversion. AS PER ICAI SOLUTIONS IT MUST BE CONSIDERED ONLY FOR BEPS.

PRESENTATION & DISCLOSURE

1. BEPS & DEPS Shall be calculated separately for continuing operation & discontinued operation and as a Whole.

2. **Disclosure Requirement**

   i. A Reconciliation statement of BEPS & DEPS with PES

Particular	N	D	Ratio
BEPS	XXX	XXX	XXX
(+) Effect of PES	XXX	XXX	XXX
DEPS	XXX	XXX	XXX

ii. BEPS & DEPS from continuing operation & total shall be shown on the face of SPL

iii. BEPS & DEPS from discontinuing operations in notes to accounts or at Face of SPL.

iv. Restatement of EPS due to Bonus/share split// consolidation or due to recetification of errors or change in accounting policies.

IND AS 34 INTERIM FINANCIAL REPORTING

1) Objective

Timely and reliable interim financial reporting (IFR) improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flows, its financial condition and liquidity.

The objective of this Standard is to prescribe

a) the minimum content in an IFR; and
b) the principles for recognition and measurement in complete or condensed financial statements for an interim period.

2)Scope

a) This Standard does not mandate which entities should be required to publish interim financial reports, how frequently, or how soon after the end of an interim period.
b) This Standard applies if an entity is required or elects to publish an interim financial report in accordance with Indian Accounting Standards (Ind AS).
c) If an entity's interim financial report is described as complying with Ind AS, it must comply with all of the requirements of this Standard.

3) Definitions

a) **Interim period** is a financial reporting period shorter than a full financial year.
b) **Interim financial report** means a financial report containing either a **complete set** of financial statements (as per Ind AS 1) or a condensed set of financial statements (as described in this Standard) for an interim period. (Complete **or** condensed set is an option to the entity)

4)If an entity is presenting Consolidated financial statements for the interim period, IND AS 34 Interim financial statements is mandatory for such Consolidated financial statements. However it is optional for Separate financial statements whether to apply IND AS 34 or not.

5. For Interim Financial Report An entity has an option to prepare either

COMPLETE SET OF FINANCIAL STATEMENTS

Normally this includes

a) balance Sheet;
b) statement of profit and loss;
c) Statement of changes in equity;
d) cash flow statement;
e) notes to accounts - significant accounting policies & explanatory information;
f) comparative information for PY;
g) Opening Balance sheet of PY (3 balance sheets) Only when
   i. Change in accounting policies;
   ii. Retrospective restatement of financial statements; and
   iii. Reclassification of items in FS;

❖ Form and content of these complete set of financial statements should confirm the requirements of Ind AS 1 for complete set of financial statements i.e. it should provide detailed information.

CONDENSED SET OF FINANCIAL STATEMENTS

This should include

a) condensed balance sheet;
b) condensed statement of profit and loss;
c) condensed statement of changes in equity;
d) condensed cash flow statement;
e) Notes, Material Accounting policy information & other explanatory information.

❖ Considering the timeliness, cost and repetition of previously reported information, it is preferable.

❖ Objective of condensed set of financial statements is to give an update on financial position and performance from the last reported financial statements; hence it should focus on NEW activities, events and circumstances without duplicating the information.

❖ These financial statements should include each Heading, sub-heading and selected explanatory notes (as required by this Ind AS - See below for detailed discussion);

❖ Additional line items or notes should be included if their omission would mislead the users;

❖ The entity shall present basic and dilutive EPS for the period when it is within the scope of Ind AS 33.

Selected explanatory notes to be given in condensed financial statements

Explanatory notes should focus on significant areas and explanation on significant events and transactions which are useful to understand the change in financial position and performance of the entity from the last annual reporting period.

The following is a list of events and transactions for which disclosures would be required **if they are significant and required to understand the financial statements:** the list is not exhaustive.

a) the write-down of inventories to net realisable value and the reversal of such a write-down;
b) recognition of a loss from the impairment of financial assets, PPE, intangible assets, assets arising from contracts with customers, or other assets, and the reversal of such an impairment loss;
c) the reversal of any provisions for the costs of restructuring;
d) acquisitions and disposals of items of PPE;
e) litigation settlements;
f) corrections of prior period errors;
g) changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost:
h) any loan default or breach of a loan agreement that has not been solved on or before balance sheet date:
i) related party transactions;
j) changes in the classification of financial assets as a result of a change in the purpose or use of those assets; and
k) changes in contingent liabilities or contingent assets.

However, the following information **should be included mandatorily** in the notes to IFR. The information shall normally be reported on a financial **year-to-date basis.**

a) **Accounting policies and methods of computation:** Entity should confirm that the accounting policies are followed in the IFR are same as followed in the most recent annual financial statements; or, if those accounting policies and methods of computation have been changed, a description of the nature and financial effect of such changes;
b) **Seasonality of interim operations:** Some entities business are seasonal like agricultural businesses, crackers business, tourism oriented companies. The entity should give explanatory comments about the reasonability of its operations.
c) **Unusual items:** If there are any exceptional and unusual items occurred during the interim period, the entity should disclose the nature and financial effects on assets, liabilities, equity, income, expense and cash flows.
d) **Change in estimates:** If there is any material changes in accounting estimates during the interim period compared to previous financial years or prior IFR, notes should include the nature of change and financial effect.

e) **Change in capital and borrowing:** Notes should include the information of change in the composition of capital and borrowings i.e. during the interim period, if the entity issued, bought back, repaid or restructured any of its debt, equity and potential equity shares, it should provide the same information in notes.

f) **Dividends:** Dividends paid (total paid or per share) information separately for equity shares and other shares should be included in explanatory notes;

g) **Segment information:** The following should be disclosed, only if the entity is disclosing segment information as per Ind AS 108 -Revenue from external customers & Intersegment revenues;Segment results i.e. profit or loss; material changes in segment assets & liabilities from year end; Reconciliaton.

h) **Events occurring after the interim period:** Material events occurred after the interim period, which have not been reflected in IFR should be disclosed.

i) **Changes in the composition:** the effect of changes in the composition of the entity during the interim period, such as business combinations, obtaining or losing the control of subsidiaries and long-term investments, restructurings, and discontinuing operations; In case of business combination, it should disclose information as per Ind AS 103; and

j) **Financial Instruments:** The disclosures requirement about fair value as required by Ind AS 113 & Ind AS 107 and as given in this Standard;

k) For the entities becoming or ceasing to be investment entities as per Ind AS 110 - disclosures should be given as said in Ind AS 112;

l) The entity should disclose the fact that prepared IFR are in compliance of Ind AS 34 if it is complying in all respects.

6. Periods for which Interim Financial Statements are required to be presented

Interim reports should include interim financial statements (condensed or complete) for periods as follows: (The following examples are based on the Assumption that financial year ends on 31st March)

	Current period	**Comparative period**
Balance Sheet	BS as at the end of **current Interim period;** E.g. 30th September 2015	As at the **end of immediate previous financial year**; E.g. 31st March 2015
Profit and Loss statement	i. P&L for the **current interim period;** ii. P&L cumulatively for the current financial **year to date;** and iii. P&L for 12 months period (Only if the entity is engaged in highly seasonal business)	Comparable interim periods for all the three situations. For the period in PY, P&L cumulatively for the PY financial year to date and P&L for 12 months period.
Example 1	Assume Interim report period has been assumed to be September, 2015 (2nd Quarter ending)	
	i. **3 months ending Sep 2015** (P&L period is July to Sep 2015) &	i. **3 months ending Sep 2014** (P&L period is July to Sep 2014) &

	ii. **6 months ending Sep 2015** (P&L period is Apr to Sep 2015) - (P&L cumulatively)	ii. **6 months ending Sep 2014** (P&L period is Apr to Sep 2014)
Example 2	**If the entity is Engaged in highly Seasonal business:**	
	i. **3 months ending Sep** 2015 (P&L period is July to Sep 2015) ii. **6 months ending Sep 2015** (P&L period is Apr to Sep 2015) - (P&L cumulatively) & iii. **12 months ending Sep 2015** (P&L for the period Oct 2014 to Sep 2015)	i. **3 months ending Sep 2014** (P&L period is July to Sep 2014) ii. **6 months ending Sep 2014** (P&L period is Apr to Sep 2014) - (P&L cumulatively) & iii. **12 months ending Sep 2014** (P&L for the period Oct 2013 to Sep 2014)
Statement of changes in equity	Statement of changes in equity for the **current financial year to date;** E.g. Statement period is Apr to Sep 2015	Comparable year to date period of immediately preceding financial year; E.g. Statement period is Apr to March 2014
Cash flow statement (CFS)	**6 months ending Sep 2015** (CFS period is Apr to Sep 2015)	**6 months ending Sep 2014** (CFS period is Apr to Sep 2014)
	If the entity is Engaged in highly Seasonal business:	
	12 months ending Sep 2015 (CFS for the period Oct 2014 to Sep 2015)	**12 months ending Sep 2014** (CFS for the period Oct 2013 to Sep 2014)

Periods for which interim financial statements are required to be presented

Interim reports shall include interim financial statements (condensed or complete)

balance sheet	statements of profit and loss	statement of changes in equity	statement of cash flows
• as of the end of the **current interim period** • a comparative balance sheet as of the end of the immediately **preceding** financial year	• for the **current interim period** • cumulatively forthe **current financial year to date** • comparative statements of profit and loss for the **comparable interim periods (current and year-to-date) of the immediately preceding financial year**	• cumulatively for the **current financial yearto date** • comparative statement for the **comparable year-to-date period of the immediately preceding financial year**	• cumulatively for the **current financial year to date** • a comparative statement for the comparable **year-to-date period of the immediately preceding financial year**

Note: For an entity whose business is highly seasonal, financial information for the twelve months up to the end of the interim period and comparative information for the prior twelve- month period may be useful.

7. MATERIALITY IN PREPARATION AND PRESENTATION

As per Ind AS 1, separate disclosures are required for all material items like discontinued operations; Ind AS 8 requires a disclosure of material changes in estimations and errors, etc.

Professional judgement is always required for assessing the materiality for financial reporting. In preparation of IFR, entities rely upon estimates to a greater extent compared to preparation of annual financial statements. Materiality is to be seen in context of IND AS.

One should consider materiality to recognize, measure, classify or disclose items in IFR and at the same time they should remember that IFR should include all the reliable information that is relevant to understand the entity's financial position and performance during the interim period.

8. LAST INTERIM PERIOD REPORTING

Generally an entity may not prepare separate IFR for the last interim period (say last quarter) as it is going to prepare and present audited annual financial statements. In such case, if an **estimate of an amount** reported in an interim period is **changed significantly** during the final interim period, the entity should **disclose the nature and amount** of that change in estimate in a note to the annual financial statements. Examples of such changes include change in estimation of provision for doubtful debts, inventory write downs, restructuring or impairment losses.

Say the entity has provided Rs 100 crore for loss of a excise duty legal case, the same is reduced to Rs 80 crore as it is settled during the last quarter. The same information should be given in the notes on accounts.

9. RECOGNITION AND MEASUREMENT

In preparation of interim financial statements, an entity should use the same accounting policies which were applied in its annual financial statements. In case of any change in accounting policies, it should use the new policies.

<u>The principles for recognizing assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements.</u>

i. Consider each interim period as the accounting period. All the incomes and expenses relating to interim period shall be recognized during the interim period only.
ii. Incomes / Expenses of current interim period shall not be deferred to other periods. Similarly, income / Expenses of other periods shall not be anticipated in the current period.
iii. An Income / expense can be split between 2 interim periods, if such an income / expense can be split between 2 full financial years. Eg: Interest income / interest exp, depreciation, insurance exp, property taxes.
iv. Measurement: All the Ind AS will be applicable even during the interim period. No exemption is given from any standard.
v. The preparation of interim financial reports requires a greater use of estimation methods than annual financial reports.

FEW SPECIFIC CASES of guidance given in IND AS 34.

(a) Employer payroll taxes and insurance contributions

If employer payroll taxes or contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised in interim periods using an estimated average annual effective payroll tax or contribution rate, even though a large portion of the payments may be made early in the financial year.

(b) Major planned periodic maintenance or overhaul

The cost of a planned major periodic maintenance or overhaul or other seasonal expenditure that is expected to occur late in the year is not anticipated for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation.

(c) Provisions

This Standard requires that an entity apply the same criteria for recognising and measuring a provision at an interim date as it would at the end of its financial year. The existence or non-existence of an obligation to transfer benefits is not a function of the length of the reporting period. It is a question of fact.

(d) Year-end bonuses

The nature of year-end bonuses varies widely. Some are earned simply by continued employment during a time period. Some bonuses are earned based on a monthly, quarterly, or annual measure of operating result. They may be purely discretionary, contractual, or based on years of historical precedent.

A bonus is anticipated for interim reporting purposes if, and only if, (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and (b) a reliable estimate of the obligation can be made. Ind AS 19, Employee Benefits provides guidance.

(e) Variable lease payments

Contingent lease payments can be an example of a legal or constructive obligation that is recognised as a liability. If a lease provides for contingent payments based on the lessee achieving a certain level of annual sales, an obligation can arise in the interim periods of the financial year before the required annual level of sales has been achieved, if that required level of sales is expected to be achieved and the entity, therefore, has no realistic alternative but to make the future lease payment.

(f) Intangible assets

An entity will apply the definition and recognition criteria for an intangible asset in the same way in an interim period as in an annual period. Costs incurred before the recognition criteria foran intangible asset are met, are recognised as an expense. Costs incurred after the specific point in time at which the criteria are met are recognised as part of the cost of an intangible asset. 'Deferring' costs as assets in an interim balance sheet in the hope that the recognition criteria will be met later in the financial year is not justified.

(g) Vacations, holidays, and other short-term compensated absences

Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Ind AS 19, Employee Benefits requires that an entity measure the expected cost of and obligation for accumulating compensated absences at the amount the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. That principle is also applied at the end of interim financial reporting periods.

(h) Other planned but irregularly occurring costs

An entity's budget may include certain costs expected to be incurred irregularly during the financial year, such as charitable contributions and employee training costs. Those costs generally are discretionary even though they are planned and tend to recur from year to year. Recognising an obligation at the end of an interim financial reporting period for such costs that have not yet been incurred generally is not consistent with the definition of a liability.

(i) Measuring interim income tax expense

Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

This is consistent with the basic concept set out in the Standard that the same accounting recognition and measurement principles shall be applied in an interim financial report as are applied in annual financial statements. Income taxes are assessed on an annual basis.

Step 1: Estimate Annual Accounting Income by considering Future Income with certainty. Identify any special incomes taxable at special rates [capital gains]

Step 2: Calculate taxable income & liability – using enacted / substantially enacted tax rates. Calculate DTA / DTL as per Ind AS 12

- If carried forward losses exist – but not created DTA. Set off losses in computing CY Tax Expenses.
- If carried forward losses exist – DTA also created. Same as above & reverse DTA to that extent.

Step 3: Weighted average annual effective tax rate = Step 2 / Step 1.

Calculate this rate separately for normal tax, special taxes & deferred taxes.

Step 4: Apply Step 3 rate on Accounting Income of each interim period

NOTE 1: when the accounting year is not financial year and therefore multiple tax rates are applicable, measure tax expense of interim period by applying the actual tax rate relevant for such interim period.

NOTE 2: Since we are using Estimated annual income in Step 1, there may be changes in subsequently. In such case tax expense of subsequent interim period is to be accounted on year to date basis.

NOTE 3: Expected losses in future interim periods shall not affect current interim periods tax expense. I.e ignore future period s anticipated losses.

(j) Contractual or anticipated purchase price changes

Volume rebates or discounts and other contractual changes in the prices of raw materials, labour, or other purchased goods and services are anticipated in interim periods, by both the payer and the recipient, if it is probable that they have been earned or will take effect. Thus, contractual rebates and discounts are anticipated but discretionary rebates and discounts are not anticipated because the resulting asset or liability would not satisfy the conditions in the Conceptual Framework for Financial Reporting that an asset must be a resource controlled by the entity as a result of a past event and that a liability must be a present obligation whose settlement is expected to result in an outflow of resources.

(k) Depreciation and amortisation

Depreciation and amortisation for an interim period is based only on assets owned during that interim period. It does not take into account asset acquisitions or dispositions planned for later in the financial year.

(l) Inventories

Full stock-taking and valuation procedures may not be required for inventories at interim dates, although it may be done at financial year-end. It may be sufficient to make estimates at interim dates based on sales margins. Inventories are measured for interim financial reporting by the same principles as at financial year-end. IND AS 2 measurement principles are applied for interim inventories. To save cost and time, entities often use estimates to measure inventories at interim dates to a greater extent than at the end of annual reporting periods.

NRV of inventories- The net realisable value of inventories is determined by reference to selling prices and related costs to complete and dispose at interim dates.

(m) Foreign currency translation gains and losses

Foreign currency translation gains and losses are measured for interim financial reporting by the same principles as at financial year-end.

Ind AS 21, The Effects of Changes in Foreign Exchange Rates specifies how to translate the financial statements for foreign operations into the presentation currency, including guidelines for using average or closing foreign exchange rates and guidelines for recognising the resulting adjustments in profit or loss or in other comprehensive income. Consistently with Ind AS 21, the actual average and closing rates for the interim period are used. Entities do not anticipate some future changes in foreign exchange rates in the remainder of the current financial year in translating foreign operations at an interim date.

If Ind AS 21 requires translation adjustments to be recognised as income or expense in the period in which they arise, that principle is applied during each interim period. Entities do not defer some foreign currency translation adjustments at an interim date if the adjustment is expected to reverse before the end of the financial year.

(n) Provisions

Determination of an appropriate amount of a provision (such as a provision for warranties, environmental costs, and site restoration costs) may be complex and often costly and time-consuming. Entities sometimes engage outside experts to assist in the annual calculations. Making similar estimates at interim dates often entails updating of the prior annual provision rather than the engaging of outside experts to do a new calculation.

(o) Pensions

Ind AS 19, Employee Benefits requires that an entity determine the present value of defined benefit obligations and the market value of plan assets at the end of each reporting period and encourages an entity to involve a professionally qualified actuary in measurement of the obligations. For interim reporting purposes, reliable measurement is often obtainable by extrapolation of the latest actuarial valuation.

(p) Contingencies

The measurement of contingencies may involve the opinions of legal experts or other advisers. Formal reports from independent experts are sometimes obtained with respect to contingencies. Such opinions about litigation, claims, assessments, and other contingencies and uncertainties may or may not also be needed at interim dates.

(q) **Inter-company reconciliations**

Some inter-company balances that are reconciled on a detailed level in preparing consolidated financial statements at financial year-end might be reconciled at a less detailed level in preparing consolidated financial statements at an interim date.

10. CHANGE IN ACCOUNTING POLICY REQUIRES RESTATEMENT OF PRIOR INTERIM PERIODS

A change in accounting policy, shall be reflected by

a) Restating **prior interim periods** of Current financial year;
b) Restating **comparable interim figures** of Previous year**;** and
c) If it is impracticable to determine the **cumulative effect** Prior interim periods of current year and comparable interim periods of previous year - Apply restatement as far as it is practicable. If nothing is possible, follow the new accounting policy prospectively from the beginning of the financial year.

Summary for Change in Accounting Policy

The effect of such change should be given as follows:

a) In the current interim period we shall recognize, the effect of change in accounting policy to the extent it relates to current period only
b) The effect of change in accounting policy relating to prior interim periods shall be adjusted in the year to Date [YTD] column

Example

A Ltd is preparing its interim FS in Q_3, till the end of Q_2, it has followed the policy of valuing the stock as per FIFO basis. During Q_3 it has changed its policy to Weighted Avg Cost. The following details are available.

Particulars	FIFO	WAC
Expenses in Stock in Q_1	6000	6600
Expenses in Stock in Q_2	5800	6300
Expenses in Stock in Q_3	7000	7500
	18800	**20400**

Show the Extract of P/L in each Quarter

Solution: Due to change in accounting policy, total increase in Exp is Rs. 1600. Out of this only Rs. 5000 relates to Current including period Q_3. The remaining Rs 1100 relates to Previous interim periods and it shall be adjusted in year to Date column while preparing Q_3 interim Financial Statements.

Extract of SPL:

Particulars	**Current Interim Period**	**Y.T.D**
Expenses for Q_1	6000	6600
Expenses for Q_2	5800	11800
Expenses for Q_3	7500	20400
	[7000 + 500]	[11800+7500+1100]

11. INTERIM FINANCIAL REPORTING & IMPAIRMENT

An entity is required to assess goodwill for impairment at the end of each reporting period, and, if required, to recognise an impairment loss at that date in accordance with Ind AS 36. However, at the end of a subsequent reporting period, conditions may have so changed that the impairment loss would have been reduced or avoided had the impairment assessment been made only at that date.

Accordingly, an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill.

IND AS 7 STATEMENT OF CASH FLOWS

1) An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.

2) When an entity prepares Consolidated & Separate Financial statements, Cashflow statement is to be prepared for both the set of financial statements.

3) Cash flow statement, in simple words is a statement, which provides the details about how the cash is generated by an entity during the particular reporting period and how it is applied. The cash flows are classified into following three main categories:

   a) Cash flows from Operating Activities

   b) Cash flows from Investing Activities

   c) Cash flows from Financing Activities

4) The term cash includes cash in hand and bank balances. Cash equivalents are highly short-term investments of insignificant risk and having a maturity period not exceeding 3 months.

   Cash Equivalent means investments which can be realised easily in cash in a short period from the date of investing the same.

- **Purpose**: Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.
- **Known amount of cash**: This means that the cash amount that will be received on redemption should be known at the time of the initial investment. It means that, at the time of the initial investment, the entity is satisfied that the risk of changes in value is insignificant and that therefore the amount of cash to be received on redemption is known.
- **Liquidity and Risk**: For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.
- **Equity investments are excluded** from cash equivalents unless they are, in substance,

cash equivalents.

- **Bank borrowings** are generally considered to be financing activities. However, the bank overdrafts may be an integral part of an entity's cash management in which case they will be included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn. Further, it is important to note that the bank overdraft due to issuance of cheques at the end of the cut-off period is not a part of cash and cash equivalent.
- **Cash Management**: Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

5. OPERATING ACTIVITIES [OA]

a) Cash flows from operating activities are primarily derived from the principal revenue producing activities of the entity ie from operations of the business.

b) Any other activities which cannot be classified as investing and financing activities are also treated as operating activities.

Examples of cash flows from operating activities are:

Operating Cash Inflows	**Operating Cash Outflows**
Cash receipts from the sale of goods and the rendering of services	Cash payments to suppliers for goods and services
Cash receipts from royalties, fee, commission and other revenue	Cash payments to and on behalf of employees
Cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits	Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities
Cash receipts and payments from contracts held for dealing or trading purposes	

Certain Specific Issues

1. **Properties acquired/built for let out** : Cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

TRANSACTION	CASHFLOW STATEMENT	FINANCIAL STATEMENTS
Purchase of Assets	OA	Investment property in BS
Receipt of operating lease rents	OA	Income in P or L
On classification as held for sale	No impact as no cashflow.	Classification from Investment Property to Inventory
On Sale	OA	Sale of goods Revenue.

6. INVESTING ACTIVITIES [IA]

Ind AS 7 states that investing activities represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities.

Examples of cash flows arising from investing activities are:

Cash Inflow from Investing Activities	Cash Outflow from Investing Activities
Cash receipts from sales of property, plant and equipment, intangibles and other long- term assets	Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment
Cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes)	Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution)	Cash advances and loans made to other parties (other than advances and loans made by a financial institution)

Cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes [OA], or the receipts are classified as financing activities [FA]	Cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes[OA], or the payments are classified as financing activities[FA]

When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged

7. FINANCING ACTIVITIES [FA]

The cash flows related to raising of funds and redemption of funds will be covered under Cash flows from financing activities. The cost of capital is also generally covered under the Financing Activity i. e payment of interest, dividends etc

Cash Inflows from Financing Activity	Cash Outflows from Financing Activity
Cash proceeds from issuing shares or other equity instruments;	Cash payments to owners to acquire or redeem the entity's shares;
Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other	Cash repayments of amounts borrowed; and
Short-term or long-term borrowings;	Cash payments by a lessee for the reduction of the outstanding liability relating to a lease.

8. REPORTING CASHFLOWS FROM OPERATING ACTIVITIES

An entity shall report cash flows from operating activities using either **the direct method** or **the indirect method.** Entities are encouraged to report cash flows from operating activities using the **direct method**.

✓ Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the entity; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial institution) and other items in the statement of profit and loss for:

(i) changes during the period in inventories and operating receivables and payables;other non-cash items; and

(ii) other items for which the cash effects are investing or financing cash flows.

✓ Under the **indirect method**, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as depreciation, provisions, deferred taxes, unrealised foreign currency gains and losses, and undistributed profits of associates; and

(c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

9. REPORTING CASHFLOWS FROM INVESTING & FINANCING ACTIVITIES

An entity is required to report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows are permitted to be reported on a net basis.

10. REPORTING CASHFLOWS ON NET BASIS

If nothing is specifically mentioned, then as per Ind AS 7, the cash flows will be presented on Gross Basis. Gross basis means the receipts would be shown separately and the payments will be shown separately. The above base has following **exceptions**

1. Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

   (a) **cash receipts and payments on behalf of customers** when the cash flows reflect the activities of the customer rather than those of the entity;

   Examples - the acceptance and repayment of demand deposits of a bank; funds held for customers by an investment entity; rents collected on behalf of and paid over to the owners of properties.

   (b) Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Examples of cash receipts and payments are advances made for, and the repayment of:

- principal amounts relating to credit card customers;
- the purchase and sale of investments; and
- other short-term borrowings, for example, those which have a maturity period of three months or less.

2. Cash flows arising from each of the following activities of a **financial institution** maybe reported on a net basis:

(a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(b) the placement of deposits with and withdrawal of deposits from other financial institutions; and

(c) cash advances and loans made to customers and the repayment of those advances and loans.

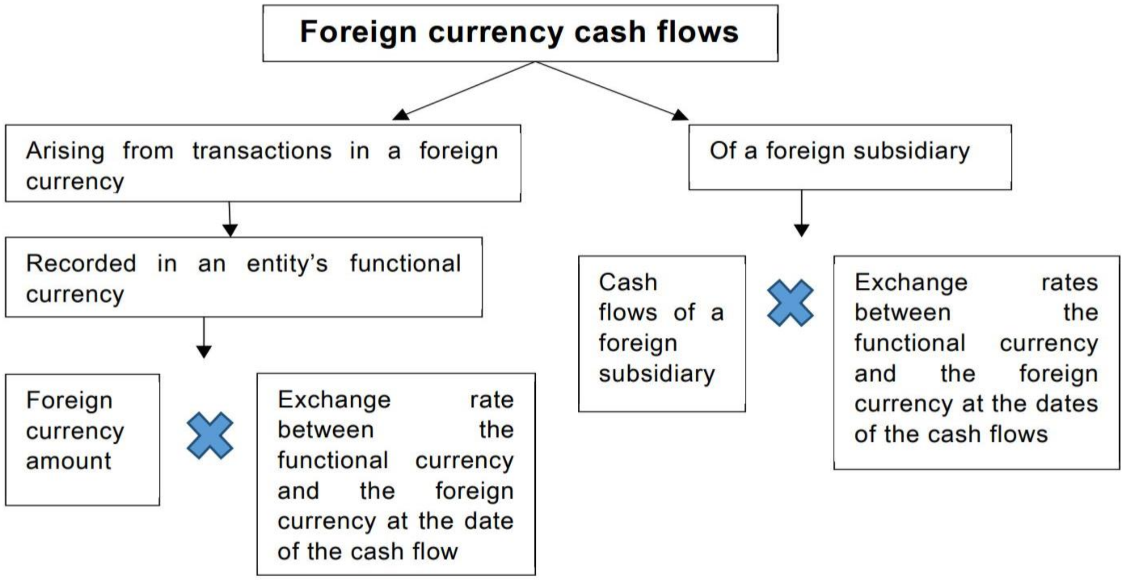
11. FOREIGN CURRENCY CASHFLOWS

a) Cash flows arising from transactions in a foreign currency shall be recorded in an entity'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.

b) Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

TREATMENT OF EXCHANGE DIFFERENCES ARISING FROM UNSETTLED TRANSACTIONS RELATING TO OA

Under indirect method, the exchange differences that arise on translation at the balance sheet date, for monetary items that form part of operating activities, will require no adjustment in the reconciliation of profit to net cash flow from operating activities.



Note:

1. Cash flows denominated in a foreign currency are reported in a manner consistent with Ind AS 21.
2. A weighted average exchange rate for a period may be used for recording foreign currency transactions or the translation of the cash flows of a foreign subsidiary
3. Ind AS 21 does not permit use of the exchange rate at the end of the reporting period when translating the cash flows of a foreign subsidiary

12. INTEREST & DIVIDENDS

Cash flows from interest and dividends received and paid shall each be disclosed separately.

	Financing company	**Other company**
Interest paid	Cash flows arising from operating activities	Cash flows from financing activities
Interest and dividends received	Cash flows arising from operating activities	Cash flows from investing activities
Dividends paid	Cash flows from financing activities	Cash flows from financing activities

13. TAXES

a) If its practicable to identify taxes to the nature of activities they relate, then it should be classified under respective activities, otherwise classified under operating activities.

b) Receipts net of TDS, should be shown in CFS net of TDS only. Theres no need to gross them up & show TDS separately because such net cashflow is the actual cashflow.

14. BUSINESS COMBINATIONS

a) When Purchase consideration paid doesn't include any cash, no impact on cash flow statement. However, disclosure is given.

b) When Purchase consideration is paid in cash, the cash paid as PC (-) cash & cash equivalents acquired, should be shown as investing activity.

15. CHANGES IN OWNERSHIP INTERESTS IN SUBSIDIARIES & OTHER BUSINESSES

CLASSIFICATION OF CASH FLOWS AS INVESTING ACTIVITY

a) The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.

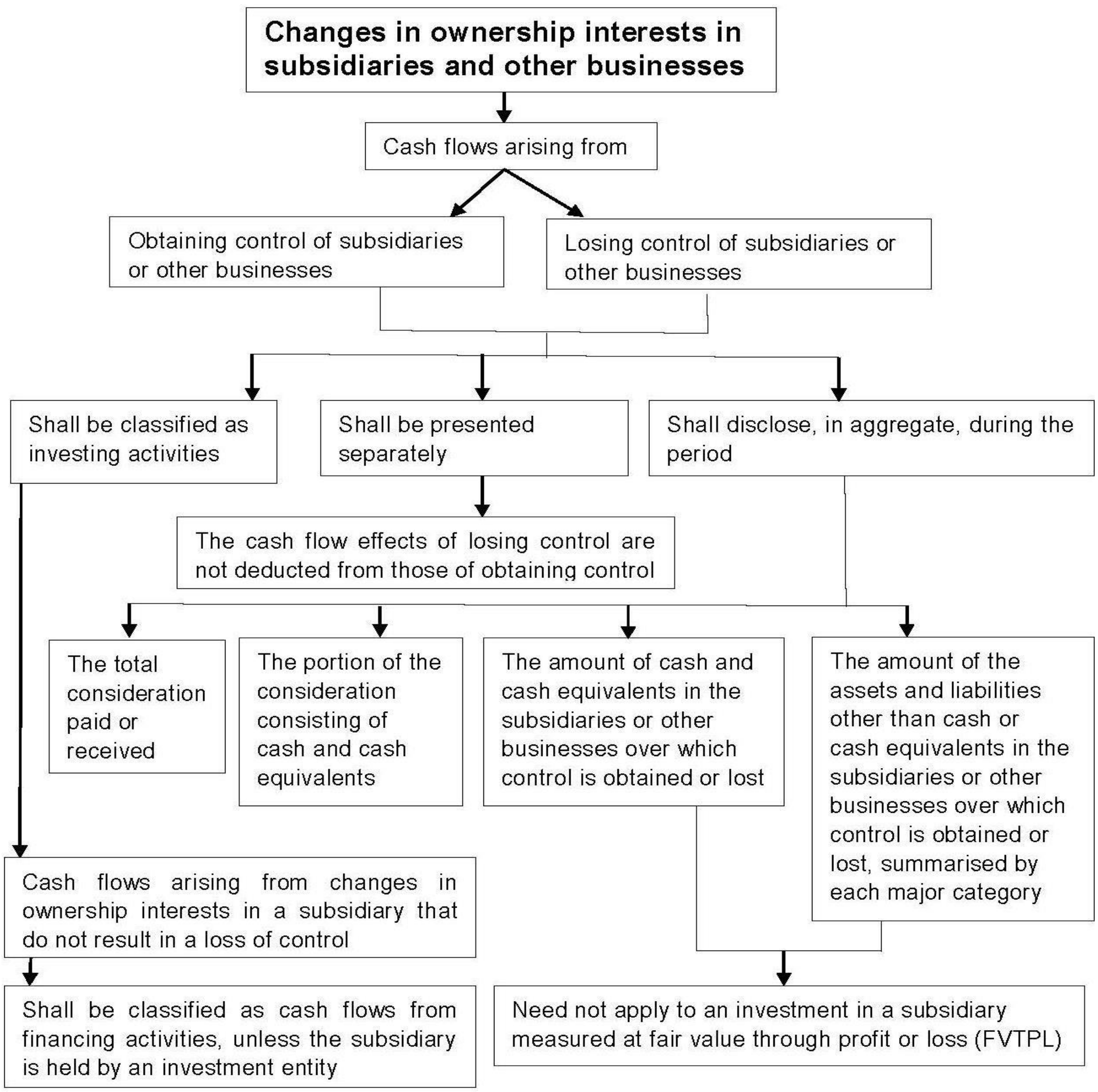
b) An entity **shall disclose**, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:

- the total consideration paid or received;
- the portion of the consideration consisting of cash and cash equivalents;
- the amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost; and
- the amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.

c) The amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses is reported in the statement of cash flows **net of** cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

CLASSIFICATION OF CASH FLOWS AS FINANCING ACTIVITY

Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions (see Ind AS 110), unless the subsidiary is held by an investment entity and is required to be measured at fair value through profit or loss.



16. NON-CASH TRANSACTIONS

a) Investing and financing transactions that do not require the use of cash or cash equivalents **shall be excluded** from a statement of cash flows.

b) Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. Such non-cash items will not form part of the cash flow statement.

Examples of non-cash transactions are:

- the acquisition of assets either by assuming directly related liabilities or by means of a lease;
- the acquisition of an entity by means of an equity issue; and
- the conversion of debt to equity

17. COMPONENTS OF CASH AND CASH EQUIVALENTS

An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet.

ISSUE 1

As per Ind AS 7 "where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn."

Bank overdraft, in the balance sheet, will be included within financial liabilities. Just because the bank overdraft is included in cash and cash equivalents for the purpose of Ind AS 7, does not mean that the same should be netted off against the cash and cash equivalent balance in the balance sheet. Instead Ind AS 7 requires a disclosure of the components of cash and cash equivalent and a reconciliation of amounts presented in the cash flow statements.

ISSUE 2

Another element on account of which there could be difference between the cash and cash equivalents presented in the balance sheet and the statement of cash flows is unrealised gains or losses arising from changes in foreign currency exchange rates, which are not considered to be cash flows.

18. DISCLOSURES

1. An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group. (Eg: existence of any legal restrictions on cash resources on overseas subsidiary)
2. Additional disclosures may be given for:
   a) Undrawn borrowing facilities for future.
   b) Cash resources maintained for increase in operating capacity in future.
   c) Cash flows arising from OA, IA and FA from each reportable segment.

IND AS 113 FAIR VALUE MEASUREMENT

a) Wherever any Ind AS refers to fair value, Ind AS 113 applies except where respective Ind AS prescribes its own basis of measurement.

   Example: Ind AS – 102, Ind AS 116, valuations similar to fair value but not fair value like NRV Ind AS 2 or Value in Use in Ind AS 36.

b) Fair Value: Fair Value is the price that would be received to **sell an asset** or paid to transfer a liability in an **orderly transaction** between **market participants** at the **measurement date.**

The objective of a fair value measurement is.

- To estimate the price
- At which an orderly transaction to sell the asset or to transfer the liability would take place
- Between market participants
- At the measurement date under current market conditions

(i.e., an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

Fair value is a market-based measurement, not an entity-specific measurement.

Note: When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that:

- Maximizes the use of relevant observable inputs and
- Minimizes the use of unobservable inputs.

The Transaction: A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

i. in the principal market for the asset or liability; or

ii. in the absence of a principal market, in the most advantageous market for the asset or liability.

1 PRINCIPAL MARKET:

Market which is normally the place in which the assets/ liabilities are being transacted with highest volume with high level of activities comparing with any other market available for similar transactions.

Example: Share of a company which is listed at BSE and NSE has different closing prices at the year end. The price at BSE has greatest volume and activity whereas at NSE it is less, Since BSE has got highest volume and significant level of activity comparing to other market although the closing price is higher at NSE, the closing price at BSE would be taken.

2 MOST ADVANTAGEOUS MARKET:

a) When the principal market cannot be specifically identified as there are multiple markets with significant volume of transactions, we must look for the fair value in the most advantageous market.

b) This is the market which maximizes the net proceeds that would be received when an entity sells an asset after considering the transaction costs.

TRANSACTION COSTS & TRANSPORT COSTS:

1. The transaction costs are not a characteristic of an asset or a liability, but a characteristic of the transaction. Therefore, they are not to be deducted while computing fair value. They are considered in identifying the Most Advantageous Market but not for computing fair value.
2. Transport costs are to be incurred for the asset to be taken to the relevant market for sale, therefore transport costs are to be deducted in computing fair value.

Example: Diamond (a commodity) has got a domestic market where the prices are lesser comparing to the price available for export of similar diamonds. The Government has a policy to cap the export of Diamond, maximum upto 10% of total output by any such manufacturer. The normal activities of diamond are being done at domestic market only i.e. 90% and balance 10% only can be sold via export. The highest level of activities with highest volume is done at domestic market. Hence, principal market for diamond would be domestic market. 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. However, if principal market is available, then its prices would be used for fair valuation of assets, liabilities.

Market participants: An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

What are market participants?

The parties which eventually transact the assets/ liabilities either in principal market or most advantageous market in their best economic interest i.e.

- They should be independent and not a related party. However, if related parties have done similar transaction on arm's length price, then it can be between related parties as well.
- The parties should not be under any stress or force
- All parties should have reasonable & sufficient information about the same.
- All parties should have willingness and capacity.

APPLYING FAIR VALUE RULES ON NON-FINANCIAL ASSETS

Fair valuation in case of non-financial assets especially buildings and other fixed assets often require to look for the **HIGHEST AND BEST USE by its market participants** and that will be the reference point to evaluate fair value of such non-financial assets. The intention of the entity on how the asset will be used is irrelevant.

Highest and best use for non-financial assets: A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits:

- By using the asset in its 'highest and best use'

  OR

- By selling it to another market participant that would use the asset in its highest and best use.

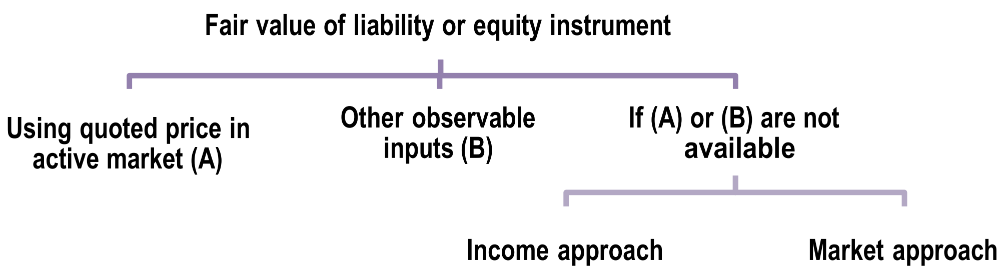
The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible. i.e after considering any restrictions. We need not exhaust all the possible uses of asset before concluding highest & best usage.

In the absence of potential best use which is not easily available, its current use would be considered as best use.

If an asset can be sold only with a group of assets then the fair value should be determined for the entire group and not for the stand alone asset.

CONSIDERATIONS FOR LIABILITY AND EQUITY

1) The fair value of identical liability or equity would be the **Quoted price in active market** if available.
2) If Quoted price in active market is not available, it shall be measured in the following manner
   a) Use Quoted price in an active market for similar liability or equity held by another party as an asset (Indirect valuation).
   b) Use observable Inputs which are not related to Equity & liability directly – Eg:- Consider Quoted Market Price in a not active market of identical liability or Equity.
3) If 1 and 2 are not possible then use valuation techniques like PV of COF's or Market based valuations like PE Ratio approach or Intrinsic value of share etc.



VALUATION TECHNIQUES

An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

Note: It is worth to be noted that in case of availability of quoted prices which are being used in an active market, there is no need to consider any valuation approach further.

Ind AS 113 specifies following three approaches to measure fair values:

1. **MARKET APPROACH:** The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as a business.

   For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables.

2. **INCOME APPROACH**: It is a present value of all future earnings from an entity whose fair values are being evaluated or in other words all future cash flows to be discounted at current date to get fair value of the asset / liability. Assumption to the future cash flows and an appropriate discount rate would be based on the other market participant's views. Standard defines the below techniques which may be considered while using Income

approach

a) Present value techniques

b) Option pricing models e.g. Black-Scholes Merton model or Binomial model,

c) The multi period excess earning method.

3. COST APPROACH: This method describes how much cost is required to replace existing asset/ liability in order to make it in a working condition. All related costs will be its fair value.

FAIR VALUE HIERARCHY/INPUTS TO VALUATION TECHNIQUES:

a) To increase consistency and comparability in fair value measurements and related disclosures, this Ind AS establishes a fair value hierarchy that categorises into three levels, the inputs to valuation techniques used to measure fair value.

b) The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

Level I Inputs: Level I inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at measurement date.
A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available.

Level 2 Inputs: Level 2 inputs are inputs other than quoted prices included within Level I that are observable for the asset or liability, either directly or indirectly.
If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

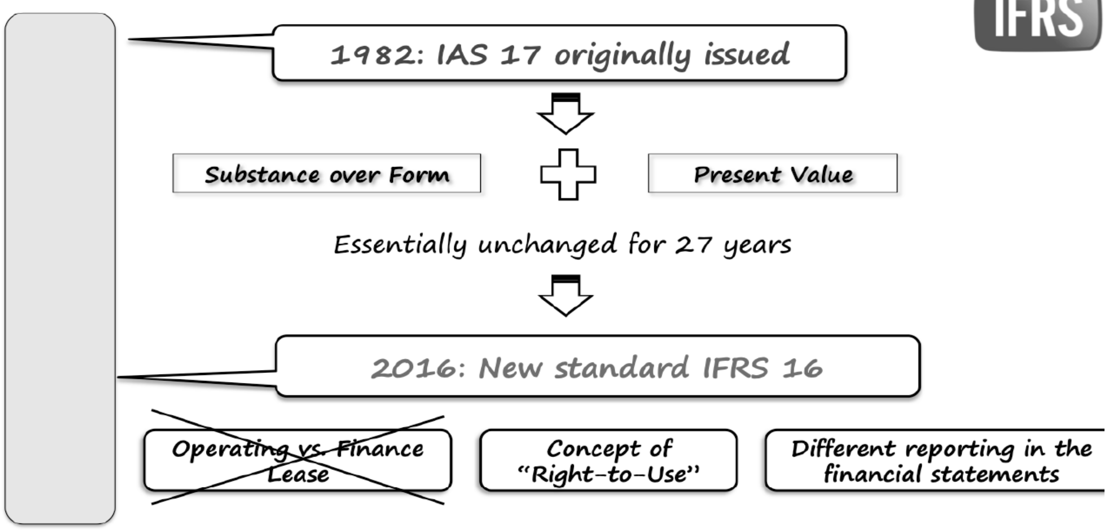
a) quoted prices for similar assets or liabilities in active markets.
b) quoted prices for identical or similar assets or liabilities in markets that are not active.
c) inputs other than quoted prices that are observable for the asset or liability, for example:
   i. interest rates and yield curves observable at commonly quoted intervals;
   ii. implied volatilities; and
   iii. credit spreads,
   iv. market-corroborated inputs.

Level 3 Inputs: Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. t revenue and cash flows arising from contract with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about the contract with customers:

- Separate disclosure of revenue from contracts with customers from other sources of revenue.
- Impairment loss recognised on receivable or contract assets is disclosed separately from other impairment losses.
- Disclosure of disaggregate revenue - some entities may meet this disclosure requirement by disclosing sales by more than one category like product-wise, market-wise or marketing channel-wise sales disclosures. It is also possible for certain entities by making disclosure by one category-product-wise sales disclosure.
- Disclosure of contract balances-receivables, contract assets and contract liabilities.
- Disclosure of performance obligations
- Disclosure of transaction price allocated to the remaining performance obligations
- Disclosure of use of practical expedients.

INDIAN ACCOUNTING STANDARD 116: LEASES

APPLICATION & OBJECTIVE



IFRS 16 Leases

=> 1 January 2019

=> IAS 17 Leases will no longer apply

=> early application only with IFRS 15!

Objective

=> To specify the principles for recognition, measurement presentation and disclosure of LEASES

✖✖✖ IFRS 16 does NOT apply to:

- ✖ Leases to explore for / use of minerals, oil, natural gas and similar
- ✖ Leases of biological assets (IAS 41)
- ✖ Service concession arrangements (IFRIC 12)
- ✖ Intellectual property licenses (IFRS 16)
- ✖ Rights under licensing agreements (IAS 38)

MCA has notified new standard on leases i.e Ind AS 116 vide its notification dated 30th March, 2019. Lease accounting has undergone significant changes on introduction of Ind AS 116 which is fully converged With IFRS 16. This new standard replaced the erstwhile Ind AS 17 and is effective from financial periods beginning on or after 1st April, 2019

Ind AS 116, Leases, requires most leases to be recognized on the balance sheet and requires enhanced disclosers. It is believed that will result in more faithful representation of leases. Assets and liabilities and greater transparency about the lessee's obligations and leasing activities However, Ind AS 116 does not make fundamental changes to existing lessor accounting model.

ASSETS OUT OF SCOPE

Ind AS 116 shall be applied to ALL LEASES **EXCEPT** for:

Sr.No.	Particulars	Reason
1	Leases to explore for minerals oil, natural gas and similar non-regenerative resources	Within the scope of Ind AS 106 'Exploration for and Evaluation of Mineral Resources
2	Leases of biological assets held by a lessee	Within the scope of Ind AS 41' Agricultur
3	Service concession arrangements	Within the scope of Appendix D of Ind AS 115 Revenue from Contracts with Customers'
4	Licenses of intellectual property granted by a lessor	Within the scope of Ind AS 115 Revenue from Contracts with Customers
5	Rights held by a lessee under licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights	Within the scope of Ind AS 38 Intangible Assets

EXPEMTIONS UNDER IND AS 116

In addition to above scope exclusions, a lessee can elect not to apply Ind AS 116's recognition requirements to:

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

If a lessee **elects to apply** the above recognition exemption, the lessee shall recognise the lease payments associated with those leases a an expense on **either a straight- line basis over the lease them or another systematic basis**, if that basis is more representative of the pattern of the lessee's benefit.

A. SHORT TERM LEASE

A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less and does not included an option to purchase the underlying asset.

As the determination is made at the commencement date, a lease cannot be classified as short-term if the lease term is subsequently reduced to lease than 12 months.

GROUP OF ASSETS

The short-term lease exemption can be made by **class of underlying asset to** which the right of use related. A class of underlying asset is a grouping of underlying assets of a similar nature and use in an entity's operations.

EXAMPLE An entity which has leased several items of office equipment – some of them for them than 12 months and some for more than 12 months, with none containing purchase options. Assuming that the items of office equipment are all considered to be the same class, if the entity wished to use the short term lease exemption it must apply that exemption for all of the leases with terms of 12 months or less. The leases with terms longer than 12 months will be accounted for in accordance with the general recognition and measurement requirements for lessees.

A lessee that makes this election must make certain quantitative and qualitative disclosures about short-term leases. Once a lessee establishes a policy for a class of underlying assets, all further short- term leases for that class requires to be accounted for in accordance with the lessee's policy.

B. LOW VALUE ASSETS

Lessees can also make an election for leases for which the underlying asset is of low value (i.e. low- value assets).

Though Ind AS 116 does not explicitly define the leases of low-value assets, it provides the conditions based on which an asset can be treated as of low-value and the said exemption can be availed accordingly for such low- value asset (s). Following are the conditions:

An underlying asset can be of low value ONLY IF BOTH the following conditions are satisfied:

- The lessee can benefit from use of the underlying asset on its own
- The underlying asset is not highly dependent on, or highly interrelated with other assets

The following boxes depicts the important points regarding the leases of low – value assets:

- Value of an underlying asset to be assessed based on the value of the asset **when it is new**, regardless of the *age of the asset being leased
- Leases of low-value assets are exempted regardless of whether those leases are material to the lessee

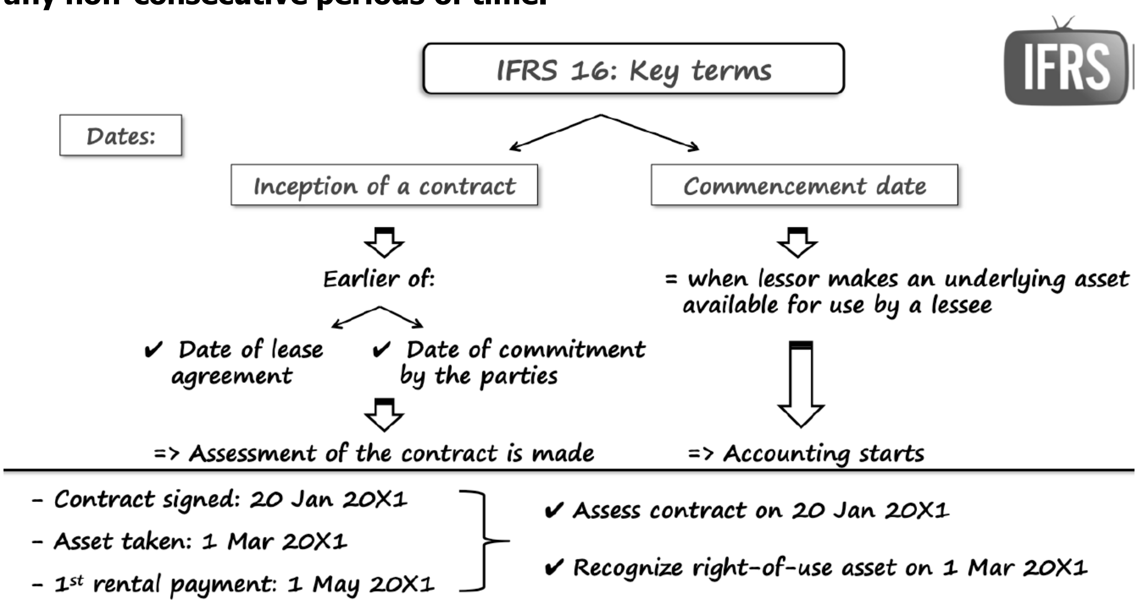
*A lease of an underlying asset does not qualify as a lease of low value asset if the nature of the asset is such that, when new, the asset is typically not of lows value.

MEANING OF LEASE

At the inception of a contract, an entity shall assess whether the contract is or contains a lease. For the purpose**, a lease is defined as a contract, or part of a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.** Ind AS 116 requires customers and suppliers to determine whether a contract is or contains a lease at the **inception of the contract.**

The inception date is defined as the earlier of the following dates: Date of a lease agreement
Date of commitment by the parties to the principal terms and conditions of the lease

A **period of time** may be described in terms of the amount of use of an identified asset (for e.g. the number of production units an item of equipment will be used to product). **It includes any non-consecutive periods of time.**



Recognition Exemptions

Short-term leases

A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less

+

A short-term lease does not include an option to purchase the underlying asset

This exemption can be made by **class of underlying asset** (assets of a similar nature and use) to which the right of use relates.

Note: A lease cannot be classified as short-term if the lease term is subsequently reduced to less than 12 months

Leases for which the **underlying asset** is of low-value

ONLY IF BOTH the conditions are satisfied

The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee

+

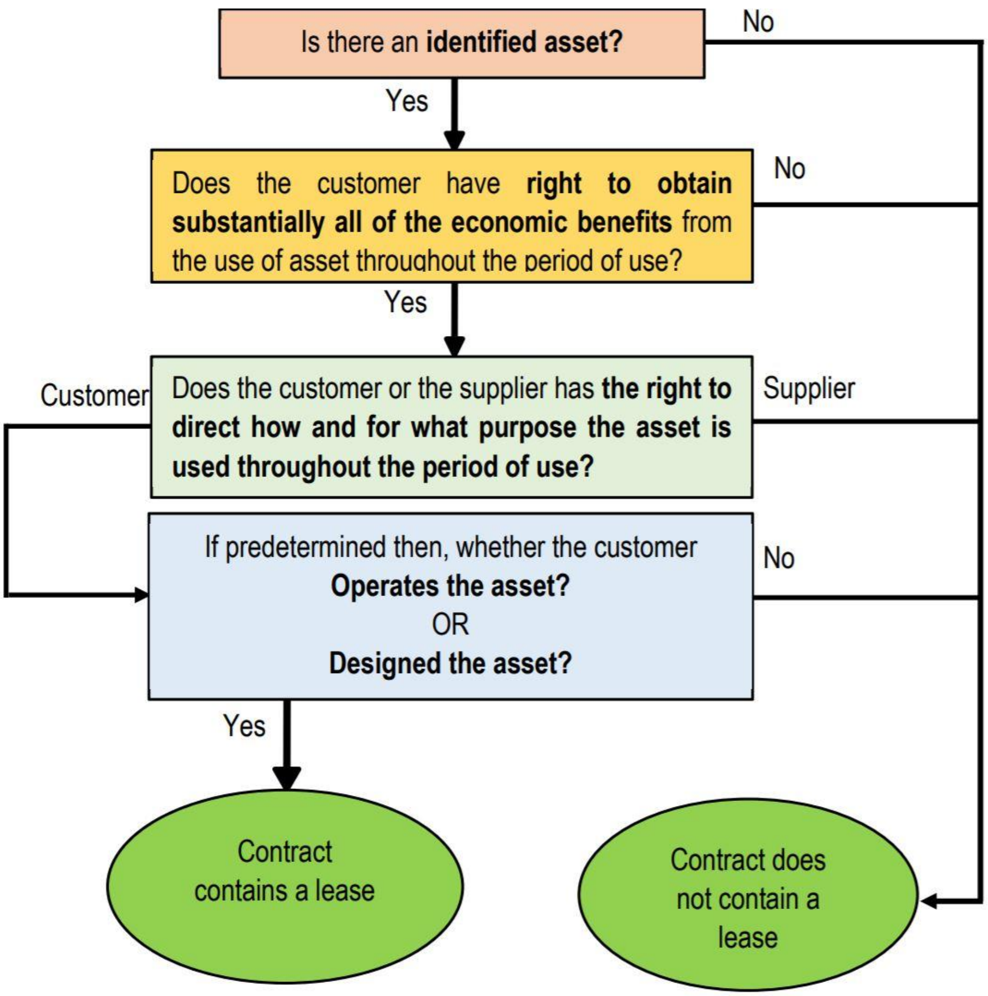
The underlying asset is not highly dependent on, or highly interrelated with, other assets

The exemption can be made on a **lease-by-lease basis**

Note:

1. The exemption for leases of low—value items intend to capture leases that are high in volume but low in value.
2. If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset, i.e., an intermediate lessor who subleases, or expects to sublease an asset, cannot account for the head lease as a lease of a low-value asset.

WHETHER THE ARRANGEMENT CONTAINS LEASE ?



CONCEPT 1: IDENTIFIED ASSET

An Arrangement only contains a lease if there is an **identified asset** under Ind as 116, **an identified asset can be explicitly specified in a contract or implicitly specified** at the time that the asset is made available for use by the customer.

NO LEASE EVEN IF THERE IS AN IDENTIFIED ASSET

Case I: Substantive substitution rights

This is a very important concept since without evaluating this condition the condition, as to whether there is identified asset cannot be attained. So, even if an asset is specified, an customer dies not have not the use an identified asset if, an inception of the contract, an supplier has the substantive right to substitute the asset throughout the period of use.

A supplier right to substitute an asset is **SUBSTANTIVE** when **BOTH** of the following conditions are met:

The supplier has the **PRACTICAL ABILITY** to substitute alternative assets throughout the period of use (For e.g. the customer cannot prevent the supplier form substituting an asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time).

+

The supplier would **BENEFIT ECONOMICALLY** From the exercise of its right to substitute the asset (i.e. the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset)

→ Substantive Substitution Rights

Further, if the supplier has a right or an obligation to substantive the asset only on or after either a **particular date,** or the occurrence of a specified event the supplier's substitution right is **not substantive** because the supplier does **not have the practical ability** to substitute alternative assets **throughout the period of use.**

An entity's evaluation of whether a supplier's substitution right is substantive is based on **facts and circumstances at inception** of the contract. At inception of the contract, an entity should not consider future events that are not likely to occur Ind AS 116 provides the following examples of circumstances that, at inception of the contract, are not likely to occur and, thus, are **excluded** from the evaluation of whether a supplier' s substitution right is substantive throughout the period of use:

(1) An agreement by a future customer to pay an above market rate for use of the asset	(2) The introduction of new technology that is not substantially developed at inception of the contract

(3) A substantial difference between the market price of the asset during the period of use, and the market price considered likely at inception of the contract

Ind AS 116 further clarifies that a customer should presume that a supplier's substitution right is not substantive when the customer cannot readily determine whether the supplier has a substantive substitution right this requirement is intended to clarify that a customer is not expected to exert undue effort to provide evidence that a substitution right is not substantive. However, suppliers should have sufficient information to make a determination of whether a substitution right is substantive.

Case II: Identified Asset – Physically Distinct:

An identified asset must be physically distinct. A physically distinct asset may be an entire asset or a portion of an asset. For example, a building is generally considered physically distinct, but one floor within the building many also be considered physically distinct if it can be used independent of the other floors.

Even if the asset is not physically distinct it can still be treated as identified asset if the customer contracts to obtain substantially all the capacity of the asset.

The term **substantially all** is not defined in Ind AS 116.

CONCEPT 2: RIGHT TO CONTROL

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

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

The right to control the use of an asset may not necessarily be documented, in from, as a lease agreement. Often, the right to use an identified asset is embedded in an arrangement that many appear to be a supply arrangement or service contract. Therefore, a reporting entity should consider all of the terms of an arrangement of determine whether it contains a lease.

If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

A. Right to Obtain Substantially All of the Economic Benefits

The first criterion in the control assessment is to determine whether the customer has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for **e.g.,** by having exclusive use of the asset throughout that period).

A customer can obtain economic benefits either **directly or indirectly** for e.g., by using holding or subleasing the asset). Economic benefits from use of an asset include:

- The asset's primary outputs (i.e., goods or services)
- Any by – products (for e.g., renewable energy credits that are generated through the use of the asset), including potential cash flows derived from these items.
- benefits from using the asset that could be realised from a commercial transaction with a third party (For e.g., subleasing the asset)

POINTS WHICH DO NOT AFFECT CUSTOMER' RIGHT
A Right that **solely protects** the supplier's interest in the underlying asset (**e.g**., limits on the number of miles a customer can drive a supplier's vehicle) does not, in and of itself, prevent the customer from obtaining substantially all of the economic benefits from use of the asset and, therefore, are **not considered** when assessing whether a customer has the right to obtain substantially all of the economic benefits. If a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from the use of an asset as consideration (**For e.g.** if the customer is required to pay the supplier a percentage of sales from use of retail space as consideration for that use) that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the retail space.

B. Right to Direct the use of the identified Asset

The second criterion in the control assessment is to determine **whether the customer has the right to direct the use** of the identified asset throughout the period of use.
Decisions about **how and for what purpose an asset will be used** are the most relevant factors to consider when assessing which party direct party directs the use of the identified asset. How and for what purpose an asset is used is **SINGLE CONCEPT** (i.e., how an asset is used is **not assessed separately** from for what purpose an asset is used).

When evaluating whether a customer has the right to change how and for what purpose the asset is used throughout the period of use, the focus should be on whether the customer has the **decision making rights will that most affect the economic benefits** that will be derived from the use of the asset. The decision-making rights that are most relevant are likely to depend on the nature of the asset and the terms and conditions of the contract.

Ind As 116 provides the following examples of decision - making rights that grant the right to change how and for what purpose an asset is used:

Particulars	Examples
The right to change the type of output that is produced by the asset	i. Deciding whether to use a shipping container to transport goods or for storage ii. Deciding on the mix of products sold from a retail unit
The right to change when the output is produced	Deciding when an item of machinery or a power plant will be used
The right to change where the output is produced	i. Deciding on the destination of a truck or a ship ii. Deciding where a piece of equipment is used or deployed
The right to change whether the output is produced and the quantity of that output	Deciding whether to produce energy from a power plant and how much energy to produce from that power plant

IMPORTANT POINTS TO BE CONSIDERED

1. The customer does **not need the right to operate** the underlying asset to have the right to direct its use, i.e. the customer may direct the use of an asset that is operated by supplier's personnel.
2. The relevant decisions about how and for what purpose an asset is used are predetermined then Significant judgement may be required to assess whether a customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

SEPARATION OF LEASE AND NON- LEASE COMPONENTS

A. IDENTIFYING AND SEPARATING LEASE COMPONENTS OF A CONTRACT

Sometimes, there are contracts that contain rights to use multiple assets (For e.g., a building and an equipment, multiple pieces of equipment, etc.). The right to use each such asset is considered as a separate' lease component **ONLY IF BOTH** the following conditions are satisfied:

- The lessee can benefit from the use of the asset either on its own OR together with other resources that are readily available to the lessee (i.e., goods or services that are sold or leased separately, by the lessor or other suppliers, or that the lessee has already obtained from the leesor or in other transactions or events) AND
- The underlying asset is nether dependent on, not highly interrelated with, the other underlying assets in the contract.

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

B. SEPARATING LEASE COMPONENTS FROM NON-LEASE COMPONENTS

There may be many contracts containing a lease coupled with an agreement to purchase or sell other goods or services (i.e., the non-lease components under Ind AS 116). For example, a supplier may lease a truck and also operate the leased asset on behalf of a customer (i.e., provide a driver). This service is not related to securing the use of the truck. Only items that contribute to securing the output of the asset are lease components. In this example, only the use of the truck is considered a lease component. Similarly, costs incurred by a supplier to provide maintenance on an underlying asset, as well as the materials and supplies consumed as a result of the use of the asset, are not lease components.

The non-lease components are identified and accounted for separately from the lease component in accordance with other standards. For e.g., the non-lease components may be accounted for as executory arrangements by lessees (customers) or as contracts subject to Ind AS 115 by lessors (suppliers). **Costs related to property taxes and insurance do not involve the transfer of a good or service. Consequently, if these costs are fixed in the contract, they should be included in the overall contract consideration to be allocated to the lease and non-lease components.**

C. OPTIONAL EXEMPTION OF USING PRACTICAL EXPEDIENT

Ind AS 116 provides a practical expedient that permits lessees to make an **accounting policy election**, by **CLASS OF UNDERLYING ASSET**, to account for each separate lease component of a contract and any associated non-lease components as a **SINGLE LEASE COMPONENT**. It is important to note the such practical expedient is not permissible for lessor.

Making this election relieves the lessee of the obligation to perform a pricing allocation, although it will increase the total lease liability to be recorded on its balance sheet. This expedient is not available for lessors. Lessees that make the policy election to account for each separate lease component of a contract and any associated non-lease components as a **SINGLE LEASE COMPONENT, allocate ALL of the contract consideration to the lease component.**

D. DETERMINING AND ALLOCATING THE CONSIDERATION IN THE CONTRACT – LESSEE

Lessees that do not make an accounting policy election (by class of underlying asset) to use the practical expedient, as discussed above, to account for each separate lease component of a contract and any associated non-lease components as a single lease component, are required to **allocate** the consideration in the contract to the lease and non-lease components on a **RELATIVE STAND-ALONE PRICE BASIS.**

Lessess are required to use observable stand-alone prices (i.e., prices at which a customer would purchase a component of a contract separately) when available if observable stand-alone prices are not readily available, lessees estimate stand - maximising the use of observable information.

E. CONTRACT COMBINATIONS

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

The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together	**OR**	The amount of consideration to be paid in one contract depends on the price or performance of the other contract	**OR**	The right to use the underlying assets conveyed in the contracts (or some of the right to use underlying assets conveyed in each of the contracts) are a single lease component

F. PORTFOLIO APPLICATION

Ind AS 116 applies to individual leases. However, entities that have a large number of leases of similar assets (for e.g., leases of a fleet of similar rolling stock) may face practical challenges in applying the leases model on a lease-by-lease basis.

Thus, Ind AS 116 includes a practical expedient that allows entities to use a portfolio approach for lease with similar characteristics if the entity reasonably expects that the effects of the financial statements would not differ materially from the application of the standard to the individual leases in that portfolio.

KEY CONCEPTS

A. INCEPTION AND COMMENCEMENT OF LEASE

Ind AS 116 requires customers and suppliers to determine whether a contract is or contains a lease at the inception of the contract.

The **inception date** is defined as the earlier of the following dates:

- Date of a lease agreement
- Date of commitment by the parties to the principal terms and conditions of the lease

The commencement date is defined as the date on which a lessor makes an underlying asset available for use by a lessee. Where the underlying asset' is an asset that is the subject of a lease, for which the right to use that asset has been provided by lessor to a lessee.

If a lessee takes possession of, or is given control over, the use of the underlying asset **before** it begins operations or making lease payments under the terms of **the lease, the lease term has commenced even if** lessee is not required to pay rent or the lease arrangement states the lease commencement date is a later date.

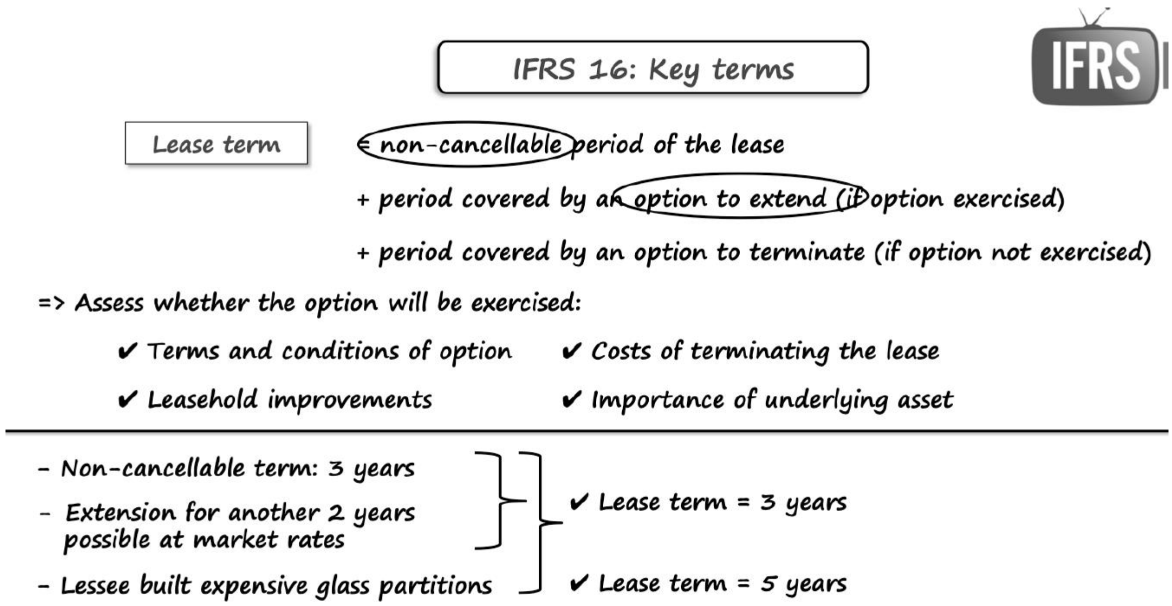
The timing of when lease payments being under the contract does not affect the commencement date of the lease.

As discussed earlier, inception date is the date when an entity shall assess if the contract is or contains lease. While the commencement date is relevant because on that date:

i. a lessee (except where the exemption of short-term lease or low- value asset is taken) **initially recognizes a lease liability** and related Right of Use Asset (hereinafter referred ROU Asset) on the commencement date
ii. a lessor (for finance leases) initially recognises its net investment in the lease on the commencement date.

Where, **ROU Asset** is defined as an asset that represents a lessee's right to use an **underlying asset** for the **lease term.**

B. LEASE TERM



Determination of lease term is a very curcial step before the calculation of Lease Liability and the corresponding ROU Asset. In simple terms, lease term is the **summation** of the following:

NON CANCELLABLE PERIOD	Periods covered by an option to EXTEND the lease if the lessee is reasonably certain To exercise that option	Periods covered by an option to TERMINATE the lease if the lessee is reasonably certain NOT TO exercise that option

C. <u>CANCELLABLE LEASES</u>

In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A 'contract' is defined as an agreement between two or more parties that creates enforceable rights and obligations.

An arrangement is **<u>not enforceable</u>** if:

i. both the lessor and lessee each have the right to terminate the lease without permission from the other party; AND
ii. with no more than an insignificant penalty

Any non-cancellable periods (by the lessee and the lessor) in contracts that meet the definition of a lease are considered part of the lease term. If only the lessor has the right to terminate a lease, the period covered by the option to terminate the lease is included in the non-cancellable period of the lease.

If only the lessee has the right to terminate a lease, that right is a termination option that is considered when determining the lease term.

If both the lessee and the lessor can terminate the contract without more than an insignificant penalty at any time at or after the end of the non- cancellable term, then there are no enforceable rights and obligations beyond the non-cancellable term (i.e., the lease term is limited to the non- cancellable term). However, if only the lessee holds a renewal option, there may be other factors to consider determining whether the lessee is reasonably certain to extend the lease, including economic disincentives (as discussed above).
This can be understood better with the help of the following illustrative situation:
Suppose the term of a contract is 10 years and the non-cancellable / lock-in period is 6 years. The lease term shall be as follows:

If the termination option is with 'Lessor'	**If the termination option is with 'Lessee'**	**If the termination option is with 'Both (i.e., any party can terminate)**
The lease term shall be 10 years. Because even after 6th year, the lessee would be contractually bound refuse to make the payment till the expiry of the contract sand also, has the right unless lessor terminates the contract.	The lease term shall be **10 years** reasonable certainty. Because after the expiry of 6th year, though the lessee is not contractually bound till 10th year, i.e., the lessee can refuse to make payment anytime without lessor's permission but, it is assumed that the lessee is reasonably certain that is will not exercise this option to terminate. Hence, though there is no enforceable obligation from lessee's point of view beyond 6th year but, basis the said assumption, the lease term shall be 10) years.	The lease term shall be 6 years. Because after 6th year, either party can terminate the contract without the consent of the other party and hence, the contract is not enforceable after 6th year ONLY in case there is insignificant penalty for termination.

D. REASSESSMENT OF LEASE TERM AND PURCHASE OPTIONS (FOR LESSEES)

After the lease commencement, Ind AS 116 requires lessees to monitor leases for significant changes that could trigger a change in the lease term. Lessees are required to reassess the lease term upon the occurrence of either a significant event OR A significant change in the circumstances that:

IS WITHIN THE CONTROL OF THE LESSEE	+	Affects whether the lessee is reasonably certain to exercise / not to exercise renewal, termination and/or purchase option, not previously included in its determination of the lease term

Following are some of the examples of significant events or significant changes in circumstances within the lessee's control:

1. Constructing significant leasehold improvements that are expected to have significant economic value for the lessee when the option becomes exercisable
2. Making significant modifications or customizations to the underlying asset
3. Making a business decision that is directly relevant to the lessee s ability to exercise, or not to exercise, an option (e.g., extending the lease of a complementary asset or disposing of an alternative asset)
4. Subleasing the underlying asset for a period beyond the exercise date of the option

Reassessment of lease term and purchase options (for lessors):

Ind AS 116 requires the lessor to revise the lease term to account for the lessee's exercise of an option to extend or terminate the lease or purchase the underlying asset, when exercise of such options was not already included in the lease term.

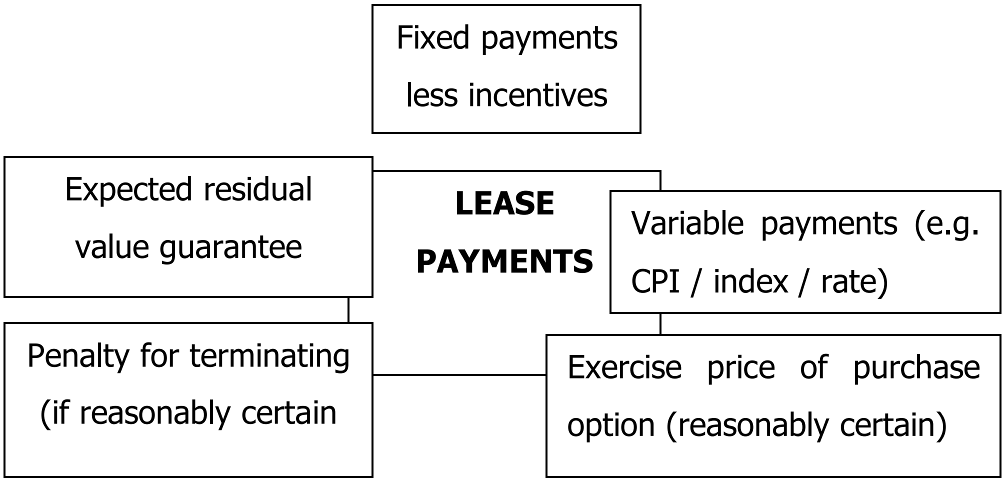
E. LEASE PAYMENTS

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

a) **Fixed payments** (including in - substance fixed payments),less any lease incentives
b) Variable lease payments that depend on an index or a rate
c) **the exercise price of a purchase option** if the lessee is reasonably certain to exercise that option
d) **payments of penalties for terminating the lease**, if the lease term reflects the lessee exercising an option to terminate the lease

For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees.

For the lessors, lease payment instead includes residual value guarantees provided by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.



<u>Exclusion of payments for calculating lease liability:</u>

a) Lease payments do not include payments allocated to non-lease components of a contract, unless the lessee elects to combine non-lease components with a lease component and to account for team a single lease component.

b) Variable lease payments that do not depend on index or rate.

FIXED LEASE PAYMENTS

Fixed payments' are defined as payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.

Fixed payments can be a fixed amount paid at various intervals in a lease.

<u>IN-SUBSTANCE FIXED LEASE PAYMENTS</u>

As mentioned above, lease payments also include any in substance fixed lease payments which are the payments that may, in form, contain variability but that, in substance, are unavoidable. Examples may include:

a) If there is more than one set of payments that a lessee could make, but only of those sets of payments is realistic. In such a case, an entity shall consider the realistic set of payments to be lease payments.

b) If there is more one realistic set of payments that a lessee could make, but it must make at least one of those sets of payments. In such a case, an entity shall consider the set of payments that aggregates to the lowest amount (on a discounted basis) to be lease payments.

<u>LEASE INCENTIVES</u>

'Lease incentives' is defined as payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee.

A lease agreement with a lessor might include incentives for the lessee to sign the lease, such as an upfront cash payment to the lessee, payment of costs for the lessee (such as moving / transportation expenses) or the assumption by the lessor of the lessee's pre-existing lease with a third party.

VARIABLE LEASE PAYMENTS THAT DEPEND ON AN INDEX OR A RATE:

'Variable lease payments' are defined as the portion of payments made by a **lessee for the right to use an underlying asset** during the lease that varies because of changes in facts or circumstance occurring after the **Commencement date**, other than the passage of time.

These may include, **for e.g.,** payments linked to a consumer price index, payments linked to a benchmark interest rate or payments that vary to reflect changes in market rental rates. Such payments are included in the lease payments and are measured using the prevailing index or rate at the measurement date (e.g., lease commencement date for initial measurement).

Lessees subsequently remeasure the lease liability if there is a change in the cash flows (i.e., when the adjustment to the lease payments takes effect) for future payments resulting from a change in index or rate used to determine lease payments.

VARIABLE LEASE PAYMENTS THAT DO NOT DEPEND ON AN INDEX OR A RATE

Variable lease payments that do not depend on an index or rate and are not, in substance, fixed as discussed above – In - substance fixed lease payments). Examples may include payments such as those based on performance (for e.g., a percentage of sales) or usage of the underlying asset (for e.g., the number of hours flown, the number of units produced), are not included as lease payments. **Instead, they are recognized in profit or loss in the period in which the event that triggers the payment occurs** (unless they are included in the carrying amount of another asset in accordance with other Ind AS).

EXERCISE PRICE OF A PURCHASE OPTION

In the lessee is reasonably certain to exercise a purchase option, the exercise price is included as a lease payment, i.e. entities consider the exercise price of asset purchase option included in lease contracts consistently with the evaluation of lease renewal and termination options (as discussed earlier).

PENALTIES FOR TERMINATING A LEASE

If it is reasonably certain that the lessee will not terminate as lease , the lease term is determined assuming that the termination option would not be exercised, and any termination penalty is excluded from the lease payments. Otherwise, the lease termination penalty is included as lease payment. The determination of whether to include lease termination penalties as lease payments is similar to the evaluation of lease renewal options (as discussed earlier).

RESIDUAL VALUE GUARANTEES (LESSEES)

'Residual value guarantee' is defined as a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

For a lessee, lease payments include amounts expected to be payable by the lessee under residual value grantees. A lessee may provide a guarantee to the lessor that the value of the underlying asset it returns to the lessor at the end of the lease will be at least of a specified amount. Such guarantees are enforceable obligation that the lessee has assumed by entering into the lease. A lessee is required to remeasure the lease liability if there is a change in the amounts expected to be payable under a residual value guarantee.

Residual value guarantees (lessors):

Ind AS 116 requires lessors to include in the lease payments, any residual value guarantees provided to the lessor by the lessee, a party related to the lessee,, or a third party unrelated to the lessor that is financially capable of financially the obligations under the guarantee. This amount included in the lease payments is different from that fort a lessee which only includes the amount expected to be payable by lessee only (as discussed above).

INITIAL DIRECT COSTS

'Initial direct costs' are defined as the incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacture or lessor in connection with a finance lease.

Examples of costs included and excluded from initial direct costs is provided below.

Included	Excluded
Commission (including payments to employees acting as selling agents)	Employee salaries
Legal fees resulting from execution of the lease	Legal fees for services rendered before the execution of the lease
Lease document preparation costs incurred after the execution of the lease	Negotiating lease term and conditions
Certain payments to existing tenants to move out	Advertising
Consideration paid for a guarantee of a residual asset by an unrelated third party	Depreciation and amortization

Lessees and lessors apply the same definition of initial direct costs. The requirements under Ind AS 116 for initial direct costs are consistent with the concept of incremental costs in Ind AS 115, Revenue from Contracts with Customers.

DISCOUNT RATES

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

For a Lessee As per Ind AS 116, the Discount Rate to be used should be:

THE INTEREST RATE IMPCLICIT IN THE LEASE, if that rate can be readily determined.	OR	If not, then the lease shall use **THE LESSEE'S INCREMENTAL BORROWINGS RATE**

Where,**Interest rate implicit in the lease'** is defined as the rate of interest that causes following:

The present value of lease payments made by the lessee for the right to use the underlying	+	The unguaranteed residual value	=	The fair value of the underlying asset	+	Any initial direct costs of the lessor

Lease payments are discounted using the interest rate implicit in the lease (as above to be calculated from the perspective of lessor)if the rate can be readily determined. But if that rate cannot be readily determined then the lessee used the incremental borrowing rate.

As discussed above, the lessee's **incremental borrowing rate** is the rate of interest that

- The lessee would, have to pay to borrow over a **similar term,**
- and with a **similar security**,
- the funds necessary to obtain an asset of a **similar value** to the Right of use Asset
- in a **similar economic environment.**

ACCOUNTING IN THE BOOKS OF LESSEE

INITIAL RECOGNITION AND MEASUREMENT

A **lessee**' is defined as an entity that obtains the right to use an **underlying asset** for a period of time in exchange for consideration.

At the commencement date, a lessee shall recognise a ROU Asset and a Lease Liability. Ind AS 116 requires lessees to recognise a liability to make lease payments and an asset representing the right to use the underlying asset (i.e., the ROU Asset) during the lease for ALL leases (except for short-term leases and leases of low-value assets, if they choose to apply such exemptions).

A. MEASURING THE LEASE LIABILITY

At the commencement date, a lessee initially measures the Lease liability at the **present value of the remaining lease payments to be made over the lease term, discounted using the rate implicit in the lease (or if that rate cannot be readily determined, the lessee's incremental borrowing rate).**

B. MEASURING THE RIGHT-OF USE ASSET

A lessee initially measures the ROU Asset at COST, which consists of ALL of the following:

Initial Measurement of Lease liability

Payments make to lessor before commencement date less lease incentives received from lessor

Initial direct costs incurred by lessee

Estimate of costs for restoration / dismantling of underlying asset

On initial measurement, a lessee is required to recognise dismantling, removal and restoration costs as part of the ROU Asset. Costs may be incurred at lease commencement or during a particular period as a consequence of having used an underlying asset. Costs that are incurred during a particular period as a consequence of having used the ROU Asset to produce inventories are accounted for under Ind AS 2 inventories. The liability associated with dismantling, removal and restoration costs is recognizes and measured n accordance with Ind AS 37 Provisions, contingent Liabilities and Contingent Assets.

SUBSEQUENT MEASUREMENT

A. RIGHT – OF USE ASSETS (ROU ASSET)

After the commencement date, the right- of use asset should be measured using a cost model, unless it applies the revaluation model as specified under Ind AS 16.

Cost model for right – of – use assets:

To follow the cost model, an entity measures a right – of use asset at cost:

a) Less **accumulated depreciation** and accumulated impairment losses (recognized in accordance with Ind As 36, Impairment of Assets); and
b) Adjusted for **re-measurements of the lease liability**

Depreciation for right – of use assets

ROU Assets measured under the cost model should be depreciated in accordance with the depreciation requirements given in Ind AS 16, subject to the following:

- If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term, or if the cost of the ROU Asset reflects that the lessee will exercise a purchase option, the ROU Asset should be depreciated from the commencement date to the end of the useful life of the underlying asset;
- Otherwise the right of use asset should be depreciated from the commencement date to the earlier of the end of the useful life of the ROU Asset and the end of the lease term.

B. LEASE LIABILITY

A lease Liability should be accounted for in a manner similar to other financial liabilities **(i.e., on an amortised cost basis)**. Consequently, the lease liability is accreted using an amount that produces a constant periodic discount rate on the remaining balance of the liability (i.e., the discount rate determined at commencement, as long as a reassessment requiring a change in the discount rate has not been triggered). Lease payments reduce the lease liability when paid

Thus, after the commencement date, a lessee shall measure the lease liability by:

a) increasing the carrying amount to reflect interest on the lease liability;
b) reducing the carrying amount to reflect the lease payments made; and
c) remeasuring the carrying amount to reflect any reassessment or lease modification or to reflect revised inn-substance fixed lease payments.

C. EXPENSE RECOGNITION

Lessees recognize the following items in expense for lease:

- Depreciation of the ROU Asset
- Interest expense on the Lease Liability
- Variable lease payment that are **not included** in the lease liability (for e.g., variable lease payments that do not depend on an index or rate)
- Impairment of the ROU Asset

LEASES DENOMINATED IN A FOREIGN CURRENCY

Lessees apply Ind AS 21 the Effects of Changes in Foreign Exchange Rates, to leases denominated in a foreign currency. Lessees remeasure the foreign currency - denominated lease liability using the exchange rate at each reporting date, like they do for other monetary liabilities. Any changes to the lease liability due to exchange rate changes are recognised in profit or loss. Because the ROU Asset is a non-monetary asset measured at historical cost, it is not affected by changes in the exchange rate.

This approach could result in volatility in profit or loss from the recognition of foreign currency exchange gains or losses, but it will be clear to the users of financial statement that the gains or losses result solely from changes in exchange rates.

REMEASUREMENT

Ind AS 116 requires lessees to **REMEAURE LEASE LIABILITIETS** upon a change in lease payments on account of **ANY** of the following:

The reassessment of lease term on account of reasonable certainty to exercise/not exercise of extension and / or termination option	The reassessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset	In – substance fixed lease payments
The amounts expected to be payable under residual value	Future lease payments resulting from a change in an index or rate	

When to use the 'original and a revised' discount rate?

Revised Discount Rate	Original Discount Rate
Lessees use a **revised** discount rate when lease payments are updated for - reassessment of the lease term OR - a reassessment of a purchase option. The revised discount rate is based on the interest rate implicit in the lease for the lease for the REMAINDER of the lease term. If that rate cannot be readily determined, the lessee uses its incremental borrowing rate.	Lessees use the **original** discount rate when lease payments are updated for - a change in expected amount for residual value guarantees AND - Payment dependent on an index or rate, unless the rate is a floating interest rate. - The variability of payments is resolved so that they become in – substance fixed payments.

LEASE MODIFICATIONS

A lease modification is a **change** in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease For e.g, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term). The following are examples of lease modifications that may be negotiated after the lease commencement date:

- A lease extension
- Early termination of the lease
- A change in the timing of lease payments
- Leasing additional space in the same building
- Surrendering a part of the underlying asset.

If a lease is modified (as stated above), the modified contract is evaluated to determine whether it is or contains a lease. If a lease continues to exist, lease modification can result in:

- A separate lease OR
- A change in the accounting for the existing lease (i.e., not a separate lease).

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

MODIFICATION – SEPARATE LEASE

A lease modification is accounted for as a separate lease if both:

a) The modification increases the scope of the lease by adding the right to use one or more underlying assets; and
b) The consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope.

Modification – Not Separate Lease:

If a lease modification fails the test above (e.g. additional right of use granted, but not at a standalone price). Or the modification is of any other type (e.g. a decrease in scope from the original contract), the lessee must modify the initially recognised components of the lease contract.

The accounting treatment required for lease modifications that are not accounted for as separate leases is summarised below:

Decrease in scope	• Remeasure lease liability using revised discount rate (1) • Decrease right of - use asset by its relative scope compared to the original lease (2) • Difference between (1) and (2) recognised in P&L

All other lease modification	• Remeasure lease liability using revised discount rate • Remeasure right of – use asset by same amount

The implicit rate in the lease is to be used. If it cannot be readily determined, the incremental rate of borrowing is to be used.

STEP V: PRESENTATION

ROU Asset and lease liabilities are subject to the same considerations as other assets and liabilities in classifying them as current and non-current in the balance sheet. The following table depicts how lease-related amounts and activities are presented in lessees financial statements:

Balance Sheet	Statement of profit or loss	Statement of cash flows
ROU Assets: They are presented either: - Separately from other assets (e.g., owned assets) OR - Together with other assets as if they were owned, with disclosures of the balance sheet line items that include ROU Assets and their amounts ROU Assets that meet the definition of investment property are presented as investment property **Lease Liabilities:** The are presented either: - Separately from other liabilities OR - Together with other liabilities with disclosure of the balance sheet line items that includes lease liabilities and their amounts	**Depreciation and interest:** Depreciation on Right of use asset and interest expense accreted on lease liabilities are presented **separately** (i.e. they **CANNOT** be combined). This is because interest expense on the lease liability is a component of **finance costs**. Which paragraph 82(b) of Ind AS 1 Presentation of Financial Statements requires to be presented separately in the statement of profit or loss.	**Principal portion of the lease liability:-** - These cash payments are presented within financing activities **Interest portion of the lease liability** - These cash payments are presented within financing activities **Short – term leases and leases of low -value assets:** - Lease payments pertaining to them (i.e., not recognised on the balance sheet as per Ind AS 116) are presented within operating activities **Variable lease payments not included in the lease liability:-** - These are also presented within operating activities - Non- cash activity: Such activity is disclosed as supplemental noncash item (e.g., the initial recognition of the lease at commencement)

STEP VI: DISCLOSURE

Disclosure objective:

The objective of the disclosures is for lessees to disclose information in the notes that, together with the information provided in the balance sheet, statement of profit and loss and statement of cash flows, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee.

Ind AS 116 requires lessess to present All disclosures in:

- A single note OR
- Separate section in the financial statements.

Quantitative Disclosure Requirement		
Balance Sheet	**Statement of profit or loss**	**Statement of cash flows**
- Additions to right-of use assets. - Carrying value of right of use assets at the end of the reporting period by class. - Maturity analysis of lease liabilities separately from other liabilities based on Ind AS 107 requirements.	- Depreciation for assets by class. - Interest expense on lease liabilities - Short-term leases expenses. - Low-value leases expenses. - Income from subleasing. - Gains or losses arising from sale and leaseback transactions.	Total cash outflow for leases.

*These disclosures need not include leases with lease terms of one month or less.

All of the above disclosures are requires to be presented in tabular format, unless another format is more appropriate. The amounts disclosed include costs that a lessee has included in the carrying amount of another asset during the reporting period. Other disclosure requirements also include:

- Commitments for short-terms leases if the current period expense is dissimilar to future commitments.
- For right- of use assets that meet the definition of investment property, the disclosure requirements of Ind AS 40, Investment property, with a few exclusions.
- For right – of use assets where the revaluation model has been applied, the disclosure requirement of Ind AS 16, Property, plant and equipment.
- Entities applying the short-term and/or low value lease exemption are required to disclose the fact.

Qualitative Disclosure Requirements
- A summary of the nature of the entity's leasing activates; - Potential cash outflows the entity is exposed to the are not included in the measured lease liability, including - Variable lease payments; - Extension options and termination options; - Residual value guarantee, and - Leases not yet commenced to which the lessee is committed. - Restrictions or covenants imposed by leases; and - Sale and lease back transaction information.

LESSOR ACCOUNTING

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

At inception, lessors classify all leases as FINANCE LEASE or OPERATING LEASE. Lease classification is very important because it determined how and when a lessor recognizes lease income and what assets are recorded. Classification is based on the extent to which the risk and rewards incidental to ownership of the underlying asset lie with the lessor or the lessee. it depends on the substance of the transaction rather than the form of the contract.

Where, a **finance lease'** is defined as a lease that transfers substantially all the risks and rewards incidental to ownership of an **underlying asset.**
Where, an **operating lease'** is defined as a **lease** that does not transfer substantially all the risks and rewards incidental to ownership of an **underlying asset**.

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

Ownership	• the lease transfers ownership of the asset to the lessee by the end of the lease term
Purchase option	• The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option become exercisable for it to be reasonably certain, at the inception date, that the option will be exercised
Lease term	• The lease term is for the major part of the economic life of the asset even if title is not transferred
PV of Minimum Lese Payments	• At the inception date, the present value of the lease payment amounts to at least substantially all of the fair value of the asset
Specialized Nature	• The asset is of such a specialised nature that only the lessee can use it without major modifications

Additionally, Ind AS 116 lists the following indicators of situations that, individually or in combination. Could also lead to a lease being classified as a **FINACE LEASE**:

Loss on cancellation	• If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
Risk of fair value of the residual asset	• Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (e.g., in the form of a rent rebate that is equal to most of the sale proceeds at the end of the lease)
Option to extend lease	• The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent

Other considerations that could be made in determining the economic substance of the lease arrangement include the following:

- Are the lease rentals based on a market rate for use of the asset (which would indicate an operating lease) or a financing rate of use of the funds, which be indicative of a finance lease?
- Is the existence of put and call options a feature of the lease? If so, are they exercisable at a predetermined price or formula (indicating a finance lease) or are they exercisable at the market price at the time the option is exercised (indicating an operating lease)?

<u>Lease classification test for land and buildings:</u> For a lease that includes both land and buildings elements, the lessor separately assesses the classification of each element as a finance lease or an operating lease, **<u>having fact that land normally has an indefinite economic life.</u>**

The lessor allocated lease payments between the land and the buildings elements in proportion to the relative fair values of the leasehold interest in the land element and buildings element of the lease at the inception date, if the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case, the entire lease is classified as an operating lease.

For a lease of land and building in which the amount for the land element is immaterial to the lease, the lessor may treat the land and buildings as single unit for the purpose of lease classification and classify it a s fiancé lease or an operating lease. Ind such a case, the lessor regards the economic life of the buildings as the economic life of the entire underlying asset.

Residual value guarantees included in the lease classification test:

In evaluating Ind AS 116's lease classification criteria, lessors are required to include in the substantially all test any (i.e., the maximum obligation) residual value guarantees provided by both lessees and any other third party unrelated to the lessor.

Reassessment of lease classification:

Lessors are required to **reassess** the lease classification only if there is a lease modification (i.e., a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease). Lessors reassess lease classification as at the **effective date of the modification** using the modified conditions at that date if a lease modification results in a separate new lease, that new lease would be classified in the **same manner** as any new lease.

Key concepts applied by the lessor:

Gross investment in the lease in the SUM of:

a) the lease payments receivable by a lessor under a finance lease; AND
b) Any unguaranteed residual value accruing to the lessor.

'Net investment in the lease' is the gross investment in the lease discounted at the interest rate implicit in the lease.

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

UNIT 1: FINANCE LEASES

RECOGNITION

At the commencement date, a lesser shall recognize assets held under a finance lease in its balance sheet and present them as a receivable at an amount equal to the net investment in the lease.

INITIAL MEASUREMENT

At lease commencement, a lessor accounts for a fiancé lease, as follows:

Derecognises the carrying amount of the underlying asset
Recognises the net investment in the lease
Recognises, in profit or loss, any selling profit or selling loss

For finance leases other than those involving manufacturer and dealer lessors), initial direct costs are included in the initial measurement of the fiancé lease receivable. Initial direct costs are included in the lease, and are not added separately to the net investment in lease.

The present value of lease payments	+	the present value of the unguaranteed residual value

Any selling profit or loss in measured as the difference between the fair value of the underlying asset or the lease receivable, if lower, and the carrying amount of the underlying asset, net of any unguaranteed residual asset.

INITIAL MEASUREMENT MANUFACTURER OR DEALER LESORS

At the commencement date, a manufacturer or dealer lessor recognizes selling profit or loss in accordance with its policy for outright sales to which Ind AS 115 applies.
Therefore, at lease commencement, a manufacture or dealer lessor recognizes the following

The fair value of the underlying asset as revenue OR the present value of the lease payments disclosed using a market rate of interest, whichever is lower.
The cost (or carrying amount) of the asset (less) the present value of the unguaranteed residual value, as cost of sale.
The selling profit or loss in accordance with the policy for outright sales

AT the commencement date, a manufacturer or dealer lessor recognizes selling profit or loss on a **finance lease**, regardless of whether the lessor transfers the underlying asset as described under Ind AS 115. Costs incurred by a manufacturer or dealer lessor in connection with obtaining a finance lease are recognised as an expense at the commencement date and are **excluded** from the net investment in the lease because they are mainly related to related to earning the manufacturer or dealers selling profit.
Accounting for initial direct costs shall be done in the following manner:

By Lessor
Finance Lease: Ind AS 116 requires lessors (other than manufacturer or dealer lessors) TO include initial direct costs in the initial measurement of their net investments in finance leases and reduce the amount of income recginnised over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease and they are not added separately. (initial direct costs related to finance leases incurred by manufacturer or dealer lessors are expenses at lease commencement). **Operating Lease:** Ind AS 116 requires lessors to include initial direct costs in the carrying amount of the underlying asset in an operating lease. These initial direct costs are recognizes as an expense over the lease term on the same basis as lease income.

SUBSEQUENT MEASUREMENT

After lease commencement, a lessor accounts for a fiancé lease, as follows:

- Recognises **finance income** in profit or loss) over the lease term in amount that produces a constant periodic rate of return on the remaining balance of the net investment in the lease (i.e., using the interest rate implicit in the lease).
  - Income is recognised on the components of the net investment in the lease, which is interest on the lease receivables.
- Reduces the net investment in the lease for lease payments received (net of finance income calculated above)
- Separately recognises income from variable lease payments that are not included in the investment in the lease (e.g., performance – or usage – based variable payments) in the period in which that income is earned
- Recognises any impairment of the net investment in the lease

REMEAUREMENT OF THE NET INVESTMENT IN THE LEASE

After lease commencement, the investment in a lease in **NOT REMEASURED UNLESS** in either of the following situations:

- The lease in modified (i.e., a change in the scope of the lee, or the consideration for that lease, that was not part of the original terms and conditions of the lease) and modified lease is not accounted for as a separate contract

OR

- The lease term is revised when is a change in the non-cancellable period of the lease.

IMPAIRMENT OF THE NET INVESTMENT IN THE LEASE:

A lessor shall apply the derecognition and impairment requirement in Ind AS 109 to the net investment in the lease. A lessor shall review regularly estimated unguaranteed residual values used in computing the gross investment in the lease. If there has been a reduction in the estimated unguaranteed residual value the lessor shall revise the income allocation over the lease term and recognise immediately any reduction in respect of amounts accrued.

UNIT II: OPERATING LEASES

RECOGNITION AND MEASUREMENT

A lessor shall recognise lease payments from operating leases as income on either a straight-line basis OR another systematic basis. The lessor shall apply another systematic if that basis is more representative of the pattern in which benefit derived from the use of the underlying asset is diminished.

Lessors subsequently recognize lease payments over the lease term on either a straight-line basis or another systematic and rational basis if that basis better represents the pattern in which benefit is expected to be derived from the use of the underlying asset. After lease commencement, lessors recognise variable lease payments that do not depend on an index or rate (e.g., performance – or usage-based payments) **as they are earned.**

In AS 116 also requires lessors of operating leases to **defer** initial direct costs at lease commencement and recognize them over the lease term on the some basis as lease income.

UNIT III: LEASE MODIFICATIONS

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

Finance Lease Modification

A lease modification is accounted for as a separate lease if both:

a) The modification increases the scope of the adding the right to use or more underlying assets' and
b) The consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope.

If both criteria are met, a lessor would follow the exiting lessor guidance on initial recognition and measurement.

MODIFICATION – NOT SEPARATE LEASE:

If a lease modification fails the test to be considered as separate lease as mentioned above, the lessor follows the following guidance;

The lease would have been classified as operating with the modifications at the inception date	• Account for the lease modification as a new lease from the effective date of the modification; and • Measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
All other lease modification	• Apply the requirements of Ind AS 109 Financial Instrument

The re-measurements above occur as of the effective date of the lease modification on a prospective basis.

OPERATING LEASE MODIFICATION

A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

UNIT IV: PRESENTATION

Lessors have the following presentation requirements under Ind AS 116, depending on the classification of leases:

Finance Leases	Operating Leases
Lessors recognize assets held under a **finance lease** in the balance sheet and present them as a receivable at an amount equal to the net investment in the lease under Ind AS 116. In addition, 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.	Lessors are required to present underlying assets subject to **operating leases** according to the nature of that asset in the balance sheet under Ind AS 116.

DISCLOSURE

The objective of the disclosure requirements for lessors to disclose information in the notes that together with information provided in the balance sheet, statement of profit or loss and statement of cash flows, gives a basis for users of financial statement to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor.
The lessor disclosure requirements in Ind AS 116 are more extensive to enable users of financial statements to better evaluate the amount, timing and uncertainty of cash flows arising from a lessor's activities.

Quantitative Disclosure Requirements	
Finance leases	- Selling profit or loss. - Finance income on the net investment; - Income from variable lease payments; - Qualitative and quantitative explanation of changes in the net investment; and - Maturity analysis of lease payments receivable
Operating leases	• Lease income, separately disclosing variable lease payments; • Disclosure requirements of Ind AS 16 for leased asset, separating leased assets from non-leased assets; • Other applicable disclosure requirements based on the nature of the underlying asset (e.g. Ind AS 36, Ind AS 38, AS 40 and Ind AS 41); and • Maturity analysis of lease payments

SUB - LEASES

Recognition and Measurement

A Sub-lease is defined as a transaction for which an underlying asset is re-leased by a lessee (intermediate lessor) to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.

Lessees often enter into arrangements to sublease a leased asset to a third party while the original lease contract is in effect, where, one party acts as both the lessee and lessor of the same underlying asset. The original lease is often referred to as a head lease' the original lessee is often referred to as an intermediate lessor or sub-lessor and the ultimate lessee is often referred to as the sub lessee

It can be demonstrate with help of a following simple diagram:

Sub Lease	Lessor	Head Lease
	Original Lessee/intermediate lessor	
	Lessee/Sub-lessee	

In some cases, the sublease is a separate lease agreement while, in other cases, a third party assumes the original lease but, the original lessee remains the primary under the original lease.

Intermediate Lessor Accounting:

Where an underlying asset is re-leased by a lessee to a third party and the original lessee retain the primary obligation under the original lease, the transaction is a sublease, i.e., the original lessee generally continues to account for the original lease (the head lease) as a lessee and accounts for the sublease as the lessor (intermediate lessor).

When the head lease is a short-term lease, the suble3ase is classified as an operating lease. Otherwise, the sublease is classified using the classification criteria (as discussed earlier) BUT, it should be by reference to the ROU Asset in the head lease (and NOT the underlying asset of the head lease). This can be understood better with help of a following illustration:

THE INTERMEDIATE LESSOR ACCOUNTS FOR THE SUBLEASE AS FOLLOWS:

IF THE SUBLEASE IS CLASSIFIED AS FINANCE LEASE'	IF THE SUBLEASE IS CLASSIFIED AS AN OPERATING LEASE'
The original lessee derecognizes the ROU Asset on the head lease at the sublease commencement date and continues to account for the original lease liability in accordance with the lessee accounting model. The original lessee (as the intermediate lessor) recognizes a net investment in the sublease and evaluates it for impairment.	The original lessee continues to accounts for the lease liability and ROU asset on the head lease like any other lease. If the total remaining carrying amount of the Rou asset on the head lease exceeds the anticipated sublease income, this may indicate that the ROU asset associated with the head lease is impaired (which is assessed for impairment under Ind AS 36).

When the intermediate lessor **enters into** a sublease, the intermediate lessor:

i. Derecognizes the ROU asset relating to the head lease that it transfers to the sublessee and recognises the net investment in the sublease;
ii. Recognises difference between the ROU asset and the net investment in the sublease in profit or loss, AND
iii. Retains the lease liability relating to the head lease in its balance sheet, which represents the lease payments owed to the head lessor.

During the term of the sublease, the intermediate lessor recognises both

- finance income on the sublease AND
- Interest expense on the head lease.

SALE AND LEASEBACK TRANSACTIONS

A sale and leaseback transaction involves the transfer of an asset by an entity (the seller-lessee) to another entity (the buyer-lessor) and the leaseback of the same asset by the seller-lessee. Sale and leaseback transactions would no longer provide lessees with a source of off-balance sheet financing because under Ind AS 116, lessees are required to recognise most leases on the balance sheet (i.e., all leases **except for** leases of low value assets and short-term leases depending on the lessee's accounting policy election). Further, both the seller-lessee and the buyer-lessor are required to apply Ind AS 115 to determine whether to account for a sale and leaseback transaction as a sale and purchase of an asset.

Transactions in which the transfer of an asset is a SALE

If the transfer of an asset by the seller-lessee satisfied the requirments of Ind AS 115 to be accounted for as a sale of the asset:

Seller-lessee	Buyer-lessor
The seller-lessee shall measure the ROU asset arising from the leaseback at the proportion of the previous carrying amount of the asset that related to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer –lessor. Thus, the seller-lessee will: - Derecognise the underlying asset - Recgongnise the gain or loss, if any, that relates to the rights transferred to the buyer-lessor (adjusted for off-market terms)	The buyer-lessor shall account for the purchase of the asset, applying applicable Ind AS and for the lease, applying the lessor accounting requirements under Ind AS 116. Thus, a buyer-lessor accounts for the purchase of the asset in accordance with other Ind Ass based on the nature of the asset (for e.g., Ind AS 16 for property, plant and equipment)
When a sale occurs, both the seller-lessee and the buyer-lessor account for the leaseback in the same as any other lease (**with adjustment for any off-market terms)**. Specifically a seller – lessee recognises a lease liability and ROU asset for the leaseback **subject to the optional exemptions** for short-term leases and leases of low value assets)	

An entity shall make the following adjustments to measeure the sale proceeds at fair value if:

- The fair value of the consideration for the sale of an asset not equal the fair value of the asset OR
- The payments for the lease are not at market rates:
  a. Any **below –** market terms shall be accounted for as prepayments of lease payments; AND
  b. any **above –** market terms shall be accounted for as an additional financing provided by the buyer-lessor to the seller – lessee.

     The entity shall measure any potential adjustment ('a' or 'b' as described above) on the basis of the following (whichever is more readily determinable):
  a. The difference between the fair value of the consideration for the sale and the fair value of the asset' OR
  b. The difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

The sale transaction and the resulting lease are **generally inter depended and negotiated as a package.** Consequently, some transactions could be structured with a negotiated sales price that is above or below the asset's fair value and with lease payments for the resulting lease that are above or below the market rates. These off market terms could mislead/ falsify the gain or loss on the sale and the recognition of lease expense and lease income for the lease. Thus, to ensure that the gain or loss on the sale and the lease-related assets and liabilities associated with such transactions are **NEITHER understated NOR overstated**, Ind AS 116 requires **adjustments for any off-market terms** of sale and leaseback transactions, on the **more readily determinable basis** (as discussed above). Thus the two possibilities of the sale price OR the present value of the lease payments being less or greater than the fair value of the asset OR present Value of the market lease payments, respectively is disclosed in detail:

<table>
<tr><th>When sale price or Present Value is LESS</th><th>When sale price or present Value is GREATER</th></tr>
<tr><td>Using the more readily determinable basis:
When the sale price is LESS than the underlying asset's fair value OR
The present value of the lease payments is LESS than present value of the market lease payments,
A seller-lessee recognizes the difference as an increase to the sales price and the initial measurement of the ROU asset as a 'lease prepayment'</td><td>Using the more readily determinable basis:
When the sale price is GREATER than the underlying asset's fair Value or The present value of the lease payments is GREATER than the present value of the market lease payments.
a seller-lessee recognizes the difference as reduction in the sales price and an additional financing received' from the buyer-lessor</td></tr>
<tr><td colspan="2">Buyer-lessors are also required to adjust the purchase price of the underlying asset for any off-market terms. Such adjustments are recognised as:
- 'lease prepayments' made by the seller-lessee OR
- 'additional financing provided' to the seller - lessee.</td></tr>
</table>

<u>Transactions in which the transfer of an asset is 'NOT a SALE':</u>
If the transfer of an asset by the seller-lessee does not satisfy the requirements of Ind AS 115 to be accounted for as a 'sale' of the asset:

Seller-lessee	Buyer-lessor
The seller-lessee shall **<u>continue</u>** to recognise the transferred asset and shall recognise a financial liability equal the transfer proceeds. It shall account for the financial liability applying Ind AS 109. Thus, the seller-lessee accounts for the transaction as a **<u>financing transaction.</u>** The seller-lessee keeps the transferred asset subject to the sale and leaseback transaction on its balance sheet and accounts for amounts received as a **<u>financial liability</u>** in accordance with Ind AS 109. The seller-lessee decreases the financial liability by the payments made less the portion considered as interest expense.	The buyer- lessor shall **not** recognize transferred asset and shall recognise financial asset **equal** to the transfer proceeds. It shall account for the financial asset applying Ind AS 109. Thus, the buyer-lessor does **<u>not recognise</u>** the transferred asset and accounts for the amounts paid as a **<u>receivable</u>** in accordance with Ind AS 109.

Transition Provisions

1. An entity shall apply Ind AS 116 for annual reporting periods beginning on or after 01 April 2019. For e.g., an entity with a reporting date of 31/03/2020, applies the transition provisions on 01/04/2019.
2. There is a practical expedient provided which permits lessees and lessors to make an election of not reassessing whether existing contracts contain a lease as defined under Ind AS 116 i.e. contracts that do not contain a lease under Ind AS 17 are not reassessed as probably it would not justify the costs/complexity.
3. This is applied to all the exiting contract and not on lease to lease basis.

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

Full Retrospective Approach	Modified Retrospective Approach
Retrospectively to each prior reporting period presented, applying Ind AS 8, i.e., an entity applies Ind AS 116 as if it had been applied since the inception of all lease contracts that are presented in the financial statements. If Ind AS 116 is applied at 01/04/2019, this means that, in the 31/03/2020 financial statements, comparative period to 31/03/2019 must be restated (assuming that this is the only comparative period presented). Restated opening balance sheet at 01/04/2018 will also need to be disclosed as required by Ind AS 1. Hence, balance	Retrospectively with cumulative effect of initially applying Ind AS 116 recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of the initial application. Therefore, restatement of comparatives is not required and only Balance sheets for reporting date and comparative date is required to

sheets for 3 period will be presented as at 31/03/2020, 31/03/2019 & 1/04/2018.	be presented.

b. Modified Retrospective Approach

<table>
<tr><th>Particulars</th><th>Measurement</th></tr>
<tr><td colspan="2">Lease previously classified as Operating Lease by lessee</td></tr>
<tr><td>Lease Liability</td><td>At PV of remaining lease payments, discounted using lessee’s IBR on initial application date.</td></tr>
<tr><td>ROU Asset (On lease by lease by Lease basis)</td><td>Alternative 1: At carrying amount had IND AS 116 been applied from commencement date using lessees IBR on initial application date.
Alternative 2: An amount equal to lease liability, adjusted for previously recognised prepaid or accrued lease payments.</td></tr>
<tr><td colspan="2">Note:
1. Lessee applies Ind AS 36 to ROU assets, unless practical expedient for Onerous leases is applied.
2. Lessee is not required to make adjustments on transition for ‘leases of low-value assets’</td></tr>
<tr><td>Practical Expedients for lessee</td><td>1. Not recognise leases whose term ends within 12m of date of initial application and account for them as short-term leases.
2. Exclude initial direct costs from measurement of ROU assets at the date of initial application.
3. Rely on its assessment of whether leases are onerous as per Ind AS 37 as opposed to performing an impairment test.
4. Apply a single discount rate to a portfolio of leases with reasonably similar characteristics.
5. Use hindsight, such as in determining the lease term for leases that contain options.</td></tr>
<tr><td colspan="2">Lease previously classified as Finance Lease by lessee</td></tr>
<tr><td>Lease Liability</td><td>At amount as per Ind AS 17 immediately before application date.</td></tr>
<tr><td>ROU Asset</td><td>At amount as per Ind AS 17 immediately before application date</td></tr>
<tr><td colspan="2">Note: For Finance Lease, lessee shall account for the ROU asset & lease liability as per Ind AS 116 prospectively. Thus, lessee will not change its initial carrying amounts for assets & liabilities.</td></tr>
</table>

Note:- Ind AS 116 is silent on as to how a lessee would separate and allocate lease and non-lease components of a contract upon transition when the modified retrospective approach is adopted. So, lessees could allocate the consideration in the contract (determined at lease commencement) to each lease and non-lease component on the basis of the relative stand-alone price of the lease component on that same date unless the lessee elects to use the practical expedient to account for each lease component and any associated non-lease components as a 'single lease component'

a. Disclosure requirements vary in accordance with the Transition Approach opted. The lessee shall disclose the following as required by Ind AS 8 (except that it is impracticable to determine the amount of the adjustment):

<table>
<tr><th>Full Retrospective Approach</th><th>Modified Retrospective Approach</th></tr>
<tr><td colspan="2">a. the title of the Ind AS.
b. when applicable, that the change in accounting policy is made in accordance with its transitional provisions.
c. the nature of the change in accounting policy.
d. when applicable, a description of the transitional provisions
e. when applicable, transitional provisions that might have an effect on future periods.</td></tr>
<tr><td>f. for current period & each prior period presented, to the extent practicable, amount of adjustment:
i. for each financial statement line item affected; and
ii. if Ind AS 33 EPS applies to the entity, for basic and diluted earnings per share</td><td>f. weighted average lessee's IBR applied to lease liabilities recognised in balance sheet at date of initial application & explanation of any difference between:
i. operating lease commitments disclosed applying Ind AS 17 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the IBR at the date of initial application; and
ii. lease liabilities recognised in balance sheet at date of application.</td></tr>
<tr><td colspan="2">g. Adjustment amounts of periods before those presented, to the extent practicable.</td></tr>
<tr><td colspan="2">h. if retrospective application required by Ind AS 8 is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to existence of that condition & a description of how and from when the change in accounting policy has been applied.</td></tr>
<tr><td></td><td>Further, if lessee uses one / more of practical expedients, it shall disclose that fact.</td></tr>
</table>

5. **BOOKS OF LESSOR:-** A lessor is not required to make any adjustments except in case of an 'Intermediate Lessor' who shall:

   a. Reassess subleases that were classified as operating leases as per Ind AS 17 & are ongoing on date of initial application, to determine whether each sublease should be classified as an operating lease /a finance lease applying Ind AS 116. Intermediate lessor shall perform this assessment at the date of initial application on basis of remaining contractual terms & conditions of head lease and sublease at that date with reference to ROU Asset associated with head lease & not the underlying asset.

b. Subleases that were classified as operating leases applying Ind AS 17 but, finance leases applying Ind AS 116, account for sublease as a new finance lease entered into at date of initial application. Any gain / loss arising is included in cumulative catch-up adjustment to retained earnings at the date of initial application.

6. **Sale & Lease back:** Lessee shall not reassess SLB transactions entered into before the date of initial application to determine whether the transfer of underlying asset satisfies the requirements under Ind AS 115 to be accounted for as a sale. The SLB is accounted for on transition in the following manner, depending on the classification:

Finance Lease	Operating Lease
If a SLB transaction was accounted for as a sale and a finance lease applying Ind AS 17, the seller-lessee shall: 1. account for it in the same way as it accounts for any other finance lease that exists at date of initial application & continue to amortise any gain on sale over the lease term.	If a SLB transaction was accounted for as a sale and operating lease applying Ind AS 17, the seller-lessee shall: 1. account for it in the same way as it accounts for any other operating lease that exists at date of initial application & adjust leaseback ROU asset for any deferred gains / losses that relate to off-market terms recognised in the balance sheet immediately before the date of initial application.

Amendment in Accounting of Rent Concessions arising due to COVID-19 Pandemic

Position before amendment:

Ind AS 116 defines a lease modification as a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease. If a change in lease payments results from a lease modification, then unless the change meets particular criteria to be accounted for as a separate lease, a lessee is required to remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The amendment does not affect lessors. Lessors are required to continue to assess if the rent concessions are lease modifications and account for them accordingly.

Amendment:

Under Ind AS 116, rent concessions often meet the definition of a lease modification. The accounting for lease modifications can be complex. For instance, the lessee may be required to calculate lease liabilities using a revised discount rate and adjust right-of-use assets. To address the challenge, in line with IASB, MCA has issued amendment to Ind AS 116 and introduces a practical expedient for lessees which allows a lessee not to account rent concessions as a direct consequence of COVID-19 as lease modifications.

Following amendments have been made with respect to accounting of COVID-19 related rent concessions such as rent holidays and temporary rent reductions:

As a practical expedient, a lessee **may elect not to assess** a rent concession as a lease modification **only** if **all** of the following conditions are met:

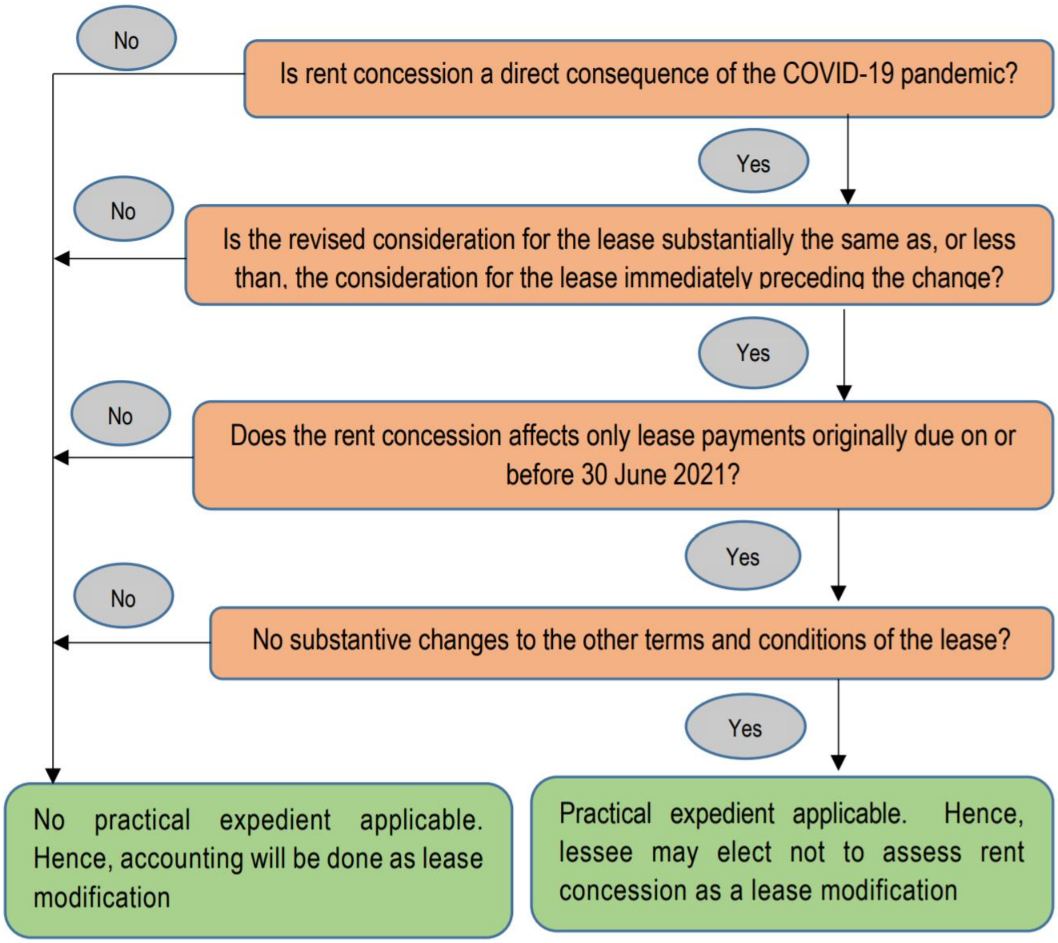
a) the change in lease payments results in revised consideration for the lease that is **substantially the same as, or less** than, the consideration for the **lease immediately preceding the change**;

b) any reduction in **lease payments affects only payments originally due on or before the 30th June, 2021** (for example, a rent concession would meet this condition if it results in **reduced lease payments on or before the 30th June, 2021 and increased** lease payments that **extend beyond the 30th June, 2021**); and

c) there is **no substantive change** to other terms and conditions of the lease.

A lessee that makes this election shall account for any change in lease payments resulting from the rent concession as if the change were not a lease modification.

Note: The above practical expedient **applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic**



What is the meaning of other substantive changes to the lease contract?

A company assesses whether there are changes to other terms and conditions in the lease contract that are not a direct consequence of the COVID-19 pandemic – i.e. those for which the practical expedient does not apply. This includes lease modifications that are negotiated at or around the same time as a rent concession relating to COVID-19.

Lease modifications 'negotiated at or around the same time' may include multiple concessions granted for the same lease but agreed at different times or formalised in separate legal documents. For example, as the crisis continues a rent deferral may be followed by a further deferral or an abatement. When determining whether there has been a substantive change to the lease, a lessee needs to consider the contract combination guidance in Ind AS 116 to evaluate whether to aggregate multiple concessions or to evaluate them separately.

The term 'substantive' has not been defined in the amendments, but this may not result in significant diversity in practice given the other eligibility criteria for the practical expedient. For example, defining 'substantive' precisely will not be necessary if the lessee concludes that the change in question is not a direct consequence of the COVID-19 pandemic or fails either the 'total consideration' or 'payments due' criteria. In all cases, a lessee is expected to make the judgement about whether other changes are substantive based on its understanding of those changes.

A rent concession granted to a lessee can take different forms. For example, a retailer may agree that fixed rent for a retail store will be replaced by a variable rent that depends on the sales at the retail store for a period of time. This may be a fixed period (e.g. a fixed number of months) or an indeterminate period (e.g. until temporary COVID-19-related measures cease). In some cases, the variable rent may be explicitly capped at the original fixed amount or may be expected to be lower than the original fixed amount.

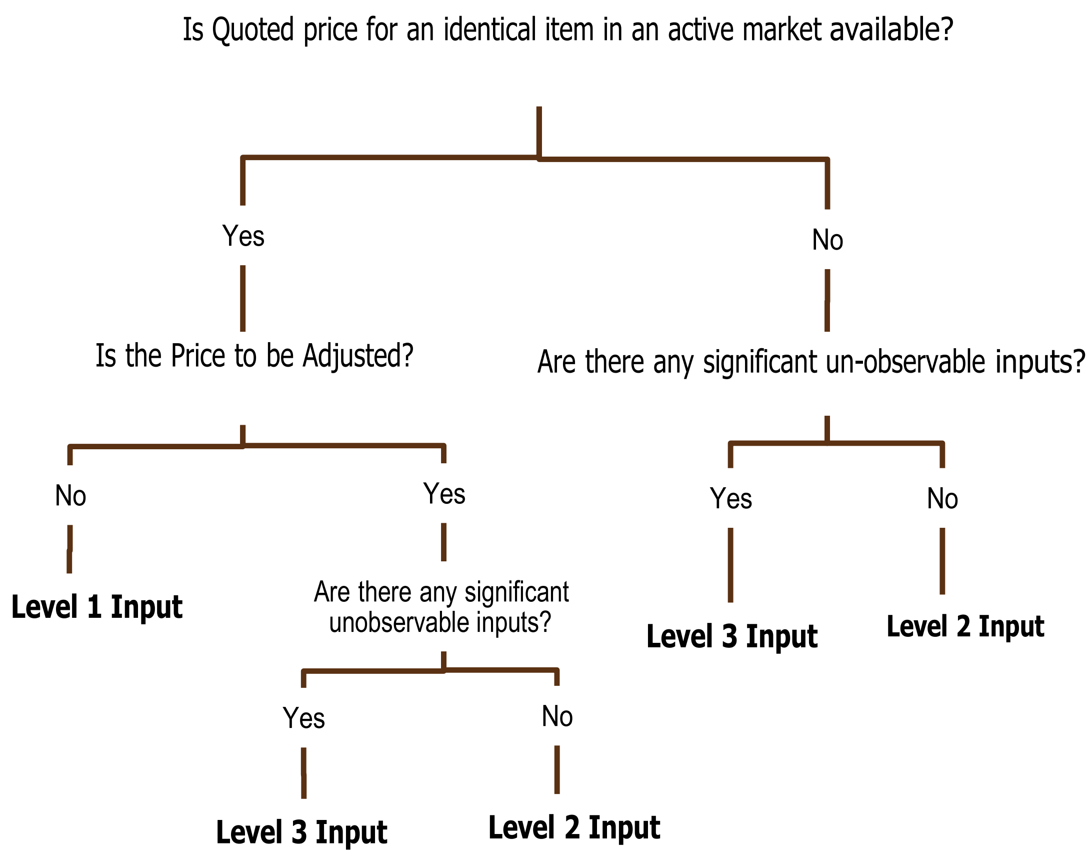
In these cases, the change in rent from fixed to variable for a period of time is a rent concession and is eligible for the practical expedient if the other eligibility criteria are met.

Companies should apply judgement when assessing whether a rent concession occurs as a direct consequence of the COVID-19 pandemic, based on the specific facts and circumstances. Factors to consider include, but are not limited to:

- the reasons for the initial negotiation between the lessor and the lessee regarding the rent concession;
- whether the reason for the rent concession is stated explicitly in the supplementary agreement between the lessor and the lessee or is otherwise apparent – e.g. from other communications;
- whether multiple concessions relating to the same lease need to be evaluated individually or in aggregate – i.e. to assess whether they are reasonably linked to the effects of the COVID- 19 pandemic and are commensurate;
- the timing of the negotiation and agreement of the rent concession;
- the relevant laws and regulations in the specific jurisdiction; and
- the extent and nature of government intervention.

The commencement of a lockdown in the country may be important evidence that a rent concession is a direct consequence of the COVID-19 pandemic but it is not determinative. Many businesses have experienced disruption to trading activities both before and after the official lockdown periods.

In some cases, a lessee may have experienced disruption to its business before lockdown started in its own country – e.g. due to the earlier emergence of COVID-19 cases in other jurisdictions. This may have disrupted its supply chain or reduced demand in key markets. This could indicate that rent concessions agreed before commencement of a lockdown were a direct consequence of COVID-19. In addition, disruption may continue after government lockdowns are lifted – e.g. due to continuing social distancing measures that limit customer access to retail stores. This could indicate that rent concessions agreed after a lockdown is lifted are a direct consequence ofCOVID-19.


Is Quoted price for an identical item in an active market available?
Yes
No
Is the Price to be Adjusted?
Are there any significant un-observable inputs?
No
Yes
Yes
No
Level 1 Input
Are there any significant unobservable inputs?
Level 3 Input
Level 2 Input
Yes
No
Level 3 Input
Level 2 Input

IND AS 115 – REVENUE FROM CONTRACTS WITH CUSTOMERS

1. Objective

The objective of the standard is to establish principles regarding revenue recognition – it includes

- Nature, amount, timing, and uncertainty of revenue recognition; and
- Cash flows, arising from a contract with a customer.

This Standard specifies the accounting for **an individual contract** with a customer but can be applied to portfolio of contracts also if the contracts have similar characteristics.

2. Core principle

An entity should recognise revenue

a) In a manner that depicts the transfer of goods/services to customer and
b) At an amount that reflects the consideration that an entity expects to be entitled in exchange of goods/services.

3. Scope

This Standard **applies to ALL CONTRACTS** with customers, except the following:

a) Revenue from lease contracts
b) Revenue from Insurance contracts which are covered by Ind AS 104 - Insurance Contracts;
c) Financial instruments
d) Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

For example, this Standard would not apply to a contract between two oil companies that agree to an **exchange of oil** (Exchanging same items is not called as barter) to fulfill demand from their customers in different specified locations on a timely basis. As the items exchanged are same, there is no commercial substance — hence it will not be treated as transaction.

4. Definitions

This standard is applicable ONLY to the contracts with customers. It means if it is a contract with other than customer - this standard is NOT applicable and the entity needs to refer other relevant standard for those transactions.

What is a contract?

Contract is an **agreement** between two or more parties that **creates ENFORCEABLE rights and obligations.**

The contract can be written, oral or as per other customary business practices. To be enforceable, none of the parties should be able to cancel the contract unilaterally without paying compensation.

A wholly unperformed contract, where entity has not transferred any goods or services may be cancelled unilaterally by any party without any compensation payable.

Who is a customer?

A party that has **contracted** (entered into an agreement) with an entity **to obtain goods or services for consideration.** These goods or services are an output of the entity's ordinary activities.

5. Recognition and Measurement

The entire recognition process can be divided into **five steps**.

Step 1: Identifying the contracts with the customer;

Step 2: Identify the separate performance obligations;

Step 3: Determine the transaction price;

Step 4: Allocate the transaction price to the performance obligations;

Step 5: Recognise revenue when performance obligation is satisfied.

STEP 1: IDENTIFYING THE CONTRACTS WITH THE CUSTOMER

This Standard is applicable only when a contract meets ALL the following conditions:

1) The contract has been **approved** by the parties to the contract **and** are **committed to perform** the obligations;
2) The entity can identify each party's **rights** regarding the goods or services to be transferred;
3) The entity can **identify the payment terms;**
4) 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
5) It is **probable** that the entity **will collect the consideration** due. For determining collectability, consider the ability and intention of the customer when it becomes due. The probability of entity giving rebates or discounts at later stages is not a violation of this condition.

When should an entity test the above conditions?

The above criteria should be assessed at the **contract inception**, an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances.

For example, if a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration.

If the above criteria do not meet?

Revenue should not be recognised. Any amount received from the customer is only accounted as a liability. However, an entity can recognise revenue in following 2 cases:

a) The agreement gets terminated & consideration received from customer is non-refundable. **OR**
b) The entity has no remaining performance obligations to deliver goods/services and all or substantially all consideration promised by customer is received and is non-refundable.

COMBINATION OF CONTRACTS

An entity shall combine two or more contracts entered **at or near the same time** with the **same customer** (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

a) the contracts are **negotiated as a package** with a single commercial objective;

b) the amount of consideration to be paid in one contract **depends** on the price or performance of the other contract; or
c) the goods or services promised in the contracts are in substance a single performance obligation.

CONTRACT MODIFICATION

A contract modification is a **change in the scope or price** (or both) of a contract that is **approved** by the parties to the contract in writing, by oral agreement or implied by customary business practices. If the modification is not approved, the entity should account only the existing contract as per this Ind AS.

Such modification may be accounted as a separate contract or modification to the existing contract. This depends on the facts and circumstances of each case.

A) An entity shall account for a contract modification **as a separate contract**, if both the conditions are satisfied
   a) Modification leads to addition of goods or services which are distinct from existing contract;(increase in scope) and
   b) It is priced at their stand-alone selling price chargeable subject to reasonable adjustments (loyalty discount, discount on savings of selling costs etc)

B) Treat modification as an adjustment to existing contract

   <u>Case 1: Goods/ Services are distinct from Goods/Services in original contract</u>

   Consider it as TERMINATION OF OLD CONTRACT & CREATION OF NEW CONTRACT.

Revenue = Unrecognised Revenue in old contract + or – revenue on modification.

   <u>Case 2: In any other case</u>

   Recognise revenue on **Cumulative catch-up** basis as per modified terms on the date of modification.

(a) Total revenue to be recognised till date based on revised Measure of progress (degree of completion)
(b) Revenue already recognised
(c) Difference between (a) and (b), adjusted to P or L.

What is "Stand alone selling price"?

It is a price at which an entity would sell a promised good or service **separately** to a customer. For example, an entity might provide a discount to a **recurring customer** that it would not provide to new customers.

If the goods or services are priced at a discount to the stand-alone selling price, management will need to evaluate the reason for the discount, because this might be an indicator that the new contract is a modification of the existing contract.

STEP 2: IDENTIFY THE SEPARATE PERFORMANCE OBLIGATIONS

1. Each promise of entity to transfer goods/ services under the contract is a performance obligation (PO). PO in the contract can may be explicit or sometimes implied.

2. Performance obligation is **a promise in a contract** to transfer to the customer either:
   a) **a good or service** (or a bundle of goods or services) that is **distinct**; or
   b) a **series of distinct goods or services** that are substantially the same and that have the same pattern of transfer to the customer [i.e entire series is treated as single PO]

3. Revenue recognition under the contract does not happen at the contract level. A **performance obligation is a unit of account** for the purpose of revenue recognition. A contract may have one or more performance obligations.

4. Once the contact has been identified, an entity needs to evaluate the terms and customary business practices to identify the promised goods or services which need to be accounted as performance obligations.
5. For each PO, revenue is recognised either
   (i) At a point in time (when control is transferred) or
   (ii) Over a period of time (as the performance takes place)

Note:

If goods or services are not distinct from the other goods or services, then all are combined into a single performance obligation.

A) SAME PATTERN OF TRANSFER:

Treat the goods/ services to have same pattern of transfer if

Same method is used to measure the progress of satisfaction of PO	AND	The series of goods/services meet the criteria of single PO as given in Step 5.

B) DISTINCT GOODS OR SERVICES

Goods or services that are promised to a customer are distinct **if both** the conditions are met:

a) the **customer can benefit** from the good or service either on its own or together with other resources that are readily available to the customer; AND

b) the entity's promise to transfer the good or service to the customer is **separately identifiable from other promises** in the contract. **NOTE 1**

NOTE 1:

Check the context of the contract and assess whether contract is to transfer goods/services individually or as a bundled item. Following factors indicate that the goods/services are not to be transferred individually and several promises are **treated as part of single PO.**

1) There is a significant integration of goods/services. or
2) One or more goods/services significantly modifies other goods/services. or
3) Goods/services are highly interrelated/interdependent between themselves.

NOTE 2:

If distinct PO's are to be delivered over a period of time, as a series, then whole series of goods/ services to be supplied treated as one PO.

STEP 3: DETERMINE THE TRANSACTION PRICE

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 i.e. GST - collected on behalf of government.

The consideration promised may include fixed amounts, variable amounts, or both. In determining the transaction price the entity should consider the following:

A. Variable consideration;
B. Time value of money i.e. if financing component is included in the contract;
C. Fair value of non-cash consideration (barter); and
D. The effect of any consideration is payable to the customer i.e. coupons or offers etc.

A. VARIABLE CONSIDERATION

If Variable Consideration (VC) is included - the entity should estimate. Variable consideration may be explicit in the contract or implicit. Typical examples of variable consideration are performance bonuses, discounts, rebates, price concessions, refunds and penalties.

There are two methods suggested by the standard to **estimate the variable consideration**

Estimation methods

The Expected value

It is a sum of **probability-weighted average** amounts in a range of possible consideration amounts.

When can this be used?
Only if there are a range of outcomes.

The Most likely amount

It is the single most likely amount of consideration.

When can this be used?
When the contract has **only two possible outcomes** (e.g., an entity either achieves a performance bonus or does not)

A single contract may have more than one variable consideration - In this case, entity can use 'expected value' method for one variable consideration and 'most likely amount' method for other variable consideration.

Penalties

If the penalty is inherent in determination of transaction price, it shall form part of variable consideration. For example, where an entity agrees to transfer control of a good or service in a contract with customer at the end of 30 days for Rs 1,00,000 and if it exceeds 30 days, the entity is entitled to receive only Rs 95,000, the reduction of Rs 5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed.

Constraining estimates of variable consideration

Variable consideration is included in the transaction price ONLY IF it is highly probable that the amount will not result in a significant revenue reversal of cumulative recognised when the uncertainty associated with the variable consideration is subsequently resolved (i.e. it is highly probable that it will not be reversed).

Following factors increase the likelihood of VC reversal:

(a) the amount of consideration is highly susceptible to factors outside the entity's influence. (Eg: market performance; legal verdict etc)

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

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

(d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.

Reassessment of variable consideration

At the end of each reporting period, an entity shall update the estimated transaction price (including updating constraints) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. Some estimates on Variable Consideration is given

Variable consideration	Estimation basis
Volume discounts	These are incentives generally given to a customer to purchase a specified amount of goods or services, after which the price is either reduced prospectively OR retrospectively reduced for all purchases during the specific period. Retrospective volume discounts include the variable consideration as the transaction price for the current purchases are not known till the uncertainty of discount is resolved. Management should use experience and other information to make a reasonable estimate.. Based on the estimation, at least a **minimum price per unit** should be **included** in the estimated transaction price at the inception of the contract.
Prompt payment discounts (Cash discounts)	Customer purchases frequently include a discount for early payment. For example, an entity might offer a 2% discount if an invoice is paid within 10 days of receipt. Management needs to **make an estimate of the consideration** that it expects to be entitled to as a result of offering this incentive. Experience with similar customers and similar transactions should be considered in determining the number of customers that are expected to receive the discount.
Rebate — Cash receipt in the future when achieved the target purchases	Customers typically pay full price for goods or services at contract inception and then receive a cash rebate in the future. This cash rebate is often tied to an aggregate level of purchases. Management needs to consider the volume of expected sales and expected rebates in such cases to determine the revenue to be recognised on each sale. The consideration is variable in these situations, because it is based on the volume of eligible transactions. It should only include amounts in the transaction price for arrangements with rebates if it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur if estimates of rebates change.
Price protection and price matching	Price protection/matching provisions require an entity to refund a portion of the transaction price if a competitor lowers its price on a similar product. Some arrangements allow for price protection only on the goods that remain in a customer's inventory. It means this rule is applicable to the unsold stock of the customer. Both of these provisions create a possibility of subsequent adjustments to the stated transaction price. Management needs to estimate the number of units to which the price protection guarantee applies in such cases, to determine the transaction price, as the reimbursement does not apply to units already sold by the customer.

B. NON-CASH CONSIDERATION

- Non-cash consideration should be measured at FAIR VALUE;
- If the entity cannot reasonably measure –

  Stand-alone selling price of such goods or services given is the value of non-cash consideration;
- If customer gives goods or services like materials, equipment or labour - Assess whether entity obtains controls over it - if Yes, add fair value of such goods/services to transaction price.
- Fair value of non-cash consideration to be determined on the date of inception of contract. Any subsequent changes in fair value are ignored.

C. TIME VALUE OF MONEY/SIGNIFICANT FINANCING COMPONENT/DEFERRED CREDIT PERIOD

In determining the transaction price, an entity shall adjust the promised amount of consideration **for the effects of the time value of money** if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. If the contract contains a significant financing component, then interest should be separated (deducted) from the transaction price and recognised in the statement of PL as expense.

If there is a significant financing component in the contract:

<u>CASE 1 : WHERE ENTITY HAS EXTENDED CREDIT TO CUSTOMER</u>

The cash price or PV of future cashflows will be treated as Transaction price.

Interest income to be recognised on the receivable in PL.

<u>CASE 2: WHERE ENTITY OBTAINED ADVANCE FROM CUSTOMER</u>

Advance amount is recognised as liability. On this advance liability, interest expense is recognised as unwinding adjustment in PL. Advance amount along with interest is identified as Transaction price.

Discounting rate

The rate can be determined by identifying **the rate that discounts** the nominal amount of the promised consideration to Cash selling price i.e. **IRR between the promised consideration and cash price (effective rate of return).**

After contract inception, an entity **shall not update the discount rate** for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

As a **PRACTICAL EXPEDIENT**, an entity **NEED NOT apply** this concept if the GAP period between consideration & transfer of promised goods/services is **less than or equal to a year.**

No significant financing component is usually assumed when:

(a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer. (prepaid SIM cards)

(b) a substantial amount of the consideration promised by the customer is variable. (for example, if the consideration is a sales-based royalty).

(c) the difference between the promised consideration and the cash selling price of the good or service arises for other reasons For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

D. CONSIDERATION PAYABLE TO A CUSTOMER

When no distinct goods services are received from the customer

a) Consideration payable to a customer should be reduced from the transaction price.
b) If consideration to customer is payable other than cash, its fair value is determined and reduced from Transaction price.
c) If the supplier offers cashback/discount coupons to the customer redeemable from a third party and the entity reimburses to such third party, then such cost is treated as sales promotion expense & not reduced from transaction price.

Consideration paid to customer for supplying a distinct goods or services to the entity

If it is paid for a distinct good or service from the customer, account for the purchases in the same way that it accounts for other purchases from suppliers.

If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service received from the customer, then such an excess amount should be reduced from the transaction price.

If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

Timing to recognise the reduction in transaction price

Recognise the reduction of revenue at the later of when

a) the entity recognises revenue; or
b) the entity pays or promises to pay the consideration (even if the payment is conditional on a future event).

STEP4: ALLOCATING THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

The objective is allocation should fairly depict the consideration that an entity expects for each PO. Transaction price should be allocated to each performance obligation identified in a contract in the **ratio of standalone selling price (SASP);** the entity should determine the standalone selling price **at the inception** of the contract.

What is standalone selling price (SASP)?

- It is price at which an entity would sell a promised good or service **separately** to a customer.
- The best evidence of standalone selling price is the **observable price** i.e. selling prices of the goods or services to similar customers in similar circumstances.
- Stated or list price **may be** SASP but it need not be presumed (because it may not be the selling price due to discounts and etc).

If the entity is not selling same goods or services separately the **entity should estimate SASP** by giving priority to observable inputs and apply estimation methods discussed below consistently.

METHODS TO ESTIMATE SASP

a) Adjusted market assessment approach

That approach includes referring to competitor's prices for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.

b) **Expected cost plus a margin approach** - In this approach –

Standalone selling price = Expected costs + appropriate margin for that good or service.

c) **Residual approach**

SASP of one item = Total transaction price – Observable SASP of other items.

An entity may use a residual approach **only if one** of the following criteria is met:

i. the entity sells the same good or service to different customers for a broad range of amounts or

ii. The good or service has not previously been sold on a stand-alone basis (i.e. the selling price is uncertain).

The value derived under residual approach (bal fig.) should be within the broad range of SASPs of the goods/services. If it is outside that range residual approach is not to be applied.

<u>EXCEPTION TO RULE OF SASP</u>

a) Allocation of a discount

A customer receives a discount when purchases a bundle of goods or services.

The discount amount should he allocated to ALL THE PO's **in the ratio of SASPs** unless it is specifically allocable to single PO or some PO's in the contract.

If a discount is allocated entirely to one or more performance obligations in the contract as discussed above, an entity shall allocate the discount before using the residual approach to estimate the stand-alone selling price of a good or service.

b) Allocation of variable consideration

Variable consideration may be attributable either to the entire contract or to a specific part of the contract.

a) If VC relates to Specific PO or part of PO in the contract - Allocate to such PO. This allocation should fairly represent the consideration the entity expects from each PO. If such allocation doesn't fairly represent the consideration expected, then the entire consideration (fixed+ variable) should be allocated proportionately in SASP

b) Other cases – Allocate in ratio of SASP.

Changes in the transaction price

The transaction price changes, after the inception, for various reasons e.g., finalization of variable consideration due to resolution of uncertainties. It should allocate the change in transaction price - in the same manner how it was allocated at the inception **retroactively.**

Amounts allocated to a satisfied performance obligation are recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

STEP 5: RECOGNISE REVENUE WHEN (OR AS) THE ENTITY SATISFIES A PERFORMANCE OBLIGATION

How an entity satisfies the performance obligation?

The entity satisfies a performance obligation by transferring control of promised good or service (i.e. an asset) to the customer.

Transferring the **control of goods or services** can occur

A. **At a point in time; or**
B. **Over time.**

An entity determines at the inception of the contract, whether it satisfies each performance obligation over time or at a point in time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

Control of an asset refers to the ability to direct the use of the asset and obtain substantially all of the remaining benefits from the asset. Control includes the ability to prevent other entities from directing the use and obtaining the benefits from the asset.

When evaluating whether a customer obtains control of an asset, an entity shall consider any agreement to repurchase the asset.

A. PERFORMANCE OBLIGATION SATISFIED OVER A PERIOD OF TIME

When **ANY ONE** of the following criteria are met, this demonstrates that the entity is transferring control of a good or service over time (i.e. satisfying a performance obligation over time) and, consequently, should recognise revenue over time:

a) the customer **simultaneously receives and consumes the benefits** provided by the entity's performance as the entity performs e.g. cleaning services;
b) the performance of the entity **creates or enhances an asset** (e.g. work in progress) that the customer controls as the asset is created or enhanced; or
c) the entity's performance **does not create an asset with an alternative use to the entity AND** the entity has an **enforceable right to payment** for performance completed to date.

It is possible for an entity to satisfy more than one of the criteria – they are not intended to be mutually exclusive.

Point (a): Simultaneous receipt and consumption of benefits of the entity's performance

In some cases, it will be straightforward and easy to identify to assess whether a customer receives and simultaneously consumes the benefits of an entity's performance as the entity performs - e.g. recurring and routine services like **cleaning services.**

But in some other cases, it can be identified if the entity can determine that customer would not need to substantially re-perform the work completed to date.

Point (b): Customer controls the asset as it is created or enhanced

To determine whether a customer controls an asset as it is created or enhanced, the entity should apply the **requirements for control.** Eg : The asset that is being created or enhanced may be construction of either tangible or intangible assets

Point (c): Entity's performance DOES NOT CREATE AN ASSET WITH AN ALTERNATIVE USE TO THE ENTITY and the entity has an enforceable right to payment for performance completed to date;

This third criterion was developed because in some cases, applying the criteria in (a) and (b) could be challenging. Criterion (c) may be necessary for services that **may be specific to a customer (e.g. consulting services that ultimately result in a professional opinion for the customer)** but also for the creation of tangible (or intangible) goods.

For assessing the **alternative use**, an entity should consider the effects of contractual restrictions and practical limitations on its ability to readily direct that asset for another use (e.g. selling it to a different customer).

Enforceable right to payment for performance completed to date
To evaluate whether an enforceable right to payment for performance completed to date exists, it should consider the **terms** of the contract; and **any laws** that apply to the contract.
However, at all times throughout the contract, the entity must be entitled to an amount approximate or exceed the selling price of the goods or services transferred to date (for example, recovery of the **costs incurred** by an entity **plus** a reasonable **profit margin**). The profit margin should reflect the IRR of the project or Cost of capital for the seller entity. A right to meagre compensation on termination is not sufficient.

Measurement of completion of performance obligation (% of completion)
For each PO satisfied over time, revenue is recognised over time by measuring the progress towards complete satisfaction of that performance obligation. The objective is to depict the performance in transferring control of goods or services promised to a customer (i.e. the satisfaction of an entity's performance obligation).
Revenue is recognised **only if the entity can reasonably measure its progress.** This is not possible if the entity lacks reliable information to measure the progress.

If an entity is not able to reasonably measure the outcome of a performance obligation it shall recognise revenue only to the extent of the costs incurred if they are recoverable.

Appropriate methods of measuring progress include **output methods** and **input methods**. In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.
The **objective** of these methods is to depict the entity's performance in transferring the control of goods or services to a customer i.e. determining the satisfaction of performance obligation faithfully.

Methods
The entity **does not have a free choice** when selecting an appropriate method of measuring progress. It is required to exercise judgment to identify a method that fulfils the objective.

Output methods - Examples of output methods include

- Surveys of performance completed to date;
- Appraisals of results achieved;
- Milestones reached;
- Time elapsed and units produced or units delivered; etc

If an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (e.g. a service contract in which an entity bills a fixed amount for each hour of service provided), **Ind AS 115 provides a practical expedient whereby the entity may recognise revenue based on the amount it has a right to invoice.**
For example, an entity may choose to use the practical expedient for a service contract in which the entity bills a fixed amount for each hour of service provided.

Input methods — general
Input methods recognise revenue

$$= \frac{\text{Entity's efforts or inputs to the satisfaction e.g.costs incurred till date}}{\text{Total expected inputs e.g.Total estimated costs}}$$

Efforts or inputs examples:

- Resources consumed;
- labour hours expended;
- costs incurred;
- time elapsed; or
- machine hours used, etc

Revenue can be recognised **on straight line basis** if inputs are used evenly throughout the performance period.

Cost recognition
Costs are recognised in the same proportion that applies to the recognition of revenue,
Except the following:

a) When a cost incurred does not contribute to progress of performance obligation.
For example: Abnormal loss of material/labour/overheads; Selling and distribution costs; general administration cost; etc.

b) Input costs that are not proportionate to construction progress;
If incurred costs are not proportionate to the progress in the satisfaction of the performance obligation - Exclude those in measuring the progress of contract.
In this situation revenue will be recognised to the extent of the actual cost incurred in respect of that component.

B. **PERFORMANCE OBLIGATION COMPLETED AT A POINT IN TIME**

When PO is not satisfied over a period of time it is treated as satisfied at a point in time. Therefore revenue is recognised at a point in time when control over goods/services is transferred.

In addition, an entity shall consider indicators (Not conditions) of the transfer of control, which include, but are not limited to, the following:

a) **The entity has a present right to payment for the asset**
b) **The customer has legal title to the asset**
c) **The entity has transferred physical possession of the asset**
d) **The customer has the significant risks and rewards of ownership of the asset**
e) **The customer has accepted the asset**.

The above should be **seen as indicators** rather than hard core criterion, and should be considered collectively to make a judgment of whether control over the goods is transferred. The assessment should be made from the customer's point of view and NOT from seller's point of view.

CONTRACT COSTS

A) INCREMENTAL COSTS OF OBTAINING A CONTRACT

- The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission, stamp duty, legal fees after contract execution). These costs should be **recognised as an asset** if the entity expects to recover those costs and **amortise** on systematic basis i.e. in proportion to the transfer of goods or services;
- Costs that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred. Examples of costs that are not treated as contract acquisition costs are travelling expenses, advertisement expenses, legal fees before contract execution.

B) COSTS TO FULFILL A CONTRACT

These costs are not part of any other Ind AS like Ind AS 16, Ind AS 38 or Ind AS 2 - If they are part, it will be dealt by the respective standard.

Costs to fulfill include

a) the costs **relate directly to a contract** that the entity can specifically identify.
b) the costs **generate or enhance resources**; and
c) the costs are expected to be recovered.

Costs that relate directly to a contract include any of the following:

a) direct labour
b) direct materials
c) allocations of costs that relate directly to the contract or to contract activities.
d) costs that are explicitly chargeable to the customer under the contract; and
e) other costs that are incurred only because an entity entered the contract

The above costs are capitalised as fulfillment **asset** and **amortised** over the average term of the contract to PL.
An entity shall **recognise** the following costs as **expenses** (P&L) when incurred:

a) general and administrative costs
b) abnormal losses
c) costs that relate to already fully or partly **satisfied** performance obligations in the contract (i.e. costs that relate to past performance); and
d) costs for which an entity **cannot distinguish** whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations.

Capitalisation & Deferral of Contract acquisition costs & fulfillment costs needs to be done only if the contract term is greater than 12 months.

SPECIAL CASES

1. WARRANTIES

Possibility 1: Service Type Warranty

a) Treated as separate PO, if sold separately to the customer.
b) Depends on Legal needs, Length of Warranty period & Nature of services to be provided during warranty period.
c) Allocate Transaction Price to Goods sold and Warranty obligation using standalone prices
Revenue on sale of goods – recognised at a point in time.
Revenue on Warranty Services – recognised over a period of time.

Possibility 2: Assurance Type Warranty

They provide a customer with assurance that the related product will function as specified. Sale of goods & warranty are treated as single PO & Recognise Full Revenue. Provision For estimated warranty obligation to be created as per Ind 37.

2. PRINCIPAL VERSUS AGENT CONSIDERATIONS

When **another party** is providing goods or services to a customer - the entity shall determine whether

- the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e. the entity is a principal); OR
- to arrange for those goods or services to be provided by the other party (i.e. the entity is an agent).

If the entity is

- **Principal -** Recognise revenue in **GROSS** amount of consideration;
- **Agent -** Recognise only the **NET** amount of consideration that the entity retains after paying the other party the consideration received in exchange for goods or services to be provided by the party.

An entity is a **principal if it controls** the specified good or service **before that is transferred** to a customer.

The following are indicators that entity is principal

1) Entity is primarily responsible to perform promise
2) Entity bears the risk of inventory like price risk, obsolescence Risk, etc.
3) Entity has discretion over the price at which goods/services are to be supplied.
4) Entity exposed to credit risk.

The following are the Indicators that the entity is an agent (and therefore does not control the good or service before it is provided to a customer)

a) Another party is primarily responsible for fulfilling the promise;
b) The entity does not have inventory risk **before** or **After** the goods have been ordered by the customer during shipping or on return.
c) The entity does not have discretion in establishing the price for the other party's goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited;
d) The entity's consideration is in the form of a commission; and
e) The entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services.

3. CUSTOMER OPTION TO BUY ADDITIONAL GOODS/ SERVICES

a) In case retailer gives reward points, discount on subsequent purchase, customer loyalty points, gift vouchers, sales incentives etc along with its goods/services, then the option to buy additional goods through such discount vouchers or loyalty points is treated as separate PO if these vouchers/points provide material right to the customers. [eg: it results in discount that the customer would not have obtained otherwise].

b) The allocation of TP at initial recognition should be based on relative SASP of the product & vouchers/points given. However, if standalone price is into clearly identifiable then the standalone price should be computed after considering Discount otherwise given & Likelihood & option being exercised

c) The liability for discount voucher/ loyalty points is created initially as if customer has paid an advance for goods/services entity is supposed to deliver in future on redeeming the points.

d) The above liability created will be reversed as and when the points are redeemed and revenue is recognised. If the loyalty points are not redeemed till the expiry date, then the balance in liability will be recognised as revenue.

4. NON-REFUNDABLE UPFRONT FEES (AND SOME RELATED COSTS)

In some contracts, an entity charges a customer a non-refundable upfront fee at or near contract inception. Examples: Joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts and initial fees in some supply contracts.

If No further PO is existing relating to such upfront fees - Recognise revenue.

If entity will transfer goods/ services at future date - Recognise whenever the goods/services are transferred.

An entity may charge a non-refundable fee in part for costs incurred in setting up a contract (or other administrative tasks). If those setup activities do not satisfy a performance obligation, the entity shall disregard those activities (and related costs) when measuring progress. That is because the costs of setup activities do not depict the transfer of services to the customer. The entity shall assess whether costs incurred in setting up a contract have resulted in an asset that shall be recognised.

5. SALE WITH A RIGHT TO RETURN

In some contracts, an entity transfers control of a product to a customer and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product).

Accounting for the transfer of products with a right of return (and for some services that are provided subject to a refund), **an entity shall recognise all of the following:**

a) **Revenue** for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);
b) A **refund liability for the consideration received on goods expected to be returned**; and
c) An **asset** (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.
d) In case restocking fees is charged to the customer on products returned, the refund liability will be recorded net of such fees & income for restocking can be recorded separately.

6. SALES BASED OR USAGE BASED ROYALTIES

When a license or other IPR is provided against which consideration is contingent / dependent on sale/usage of customer then:

a) Do not treat it as variable consideration, and
b) Recognise revenue, later of:
   i. Satisfaction of PO, if any, to be satisfied
   ii. Sales / Usage

7. CONSIGNMENT SALES

a) There is not transfer of control over asset hence no revenue to be recognized even if consideration is received in advance as a security deposit.
b) Conditions to satisfy, to classify a contract as consignment sales:
   i. Entity has legal right over goods
   ii. Entity can call back the goods
   iii. Other party, consignee has no obligation to pay for the goods if goods are unsold
c) No revenue to be recognized till control over asset is transferred.

8. BILL AND HOLD ARRANGEMENTS

A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future.

An entity shall evaluate when the control on goods is getting transferred on analysing the terms of the contract (including delivery and shipping terms).

A customer may obtain control of a product even though that product remains in an entity's physical possession, if the customer has the ability to direct the use of, and obtain substantially all benefits from, the product. Consequently, the entity does not control the product. Instead, the entity provides **custodial services** to the customer over the customer's asset.

For a customer to have obtained control of a product in a bill-and-hold arrangement, **ALL** of the following criteria must be met:

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

If all the above conditions are satisfied — it means the customer got the control over the goods and **the entity can recognise the revenue to that extent.**

If the entity recognises revenue for the sale of a product on a bill-and-hold basis, entity shall consider whether it has any remaining performance obligations (for example**, for custodial services**) to which entity shall allocate a portion of the transaction price.

9. CUSTOMER ACCEPTANCES

a) Goods/ Service has been transferred and are subject to customer acceptance / approval
b) Revenue **to be recognized on acceptance** unless acceptance is only a legal formality (based on past experience of entity)
c) If any PO pending like installation etc. which is material then Transaction Price to that extent is not recognized as revenue till PO satisfied.

Example

Entity completed the production of goods as per the specifications (i.e. size and weight) given by the customer on 30th March, 2019 but the customer accepted the same on 2nd April, 2019. Whether the revenue should be recognised in FY 2018-19 or 2019-20?

Answer:

In the given case, the customer's acceptance clause is based on meeting specified size and weight characteristics, an entity would be able to determine whether those criteria have been met before receiving confirmation of the customer's acceptance. **Receiving an acceptance is a formality in this case.** Hence the entity can recognise the revenue in FY 2018-19.

If revenue is recognised before customer's acceptance, the entity still must consider whether there are any remaining performance obligations (for example, installation of equipment) and evaluate whether to account for them separately.

However, if an entity **cannot objectively** determine that the good or service provided to the customer is in accordance with the agreed-upon specifications - **Do not recognise the revenue** until the entity receives the customer's acceptance. The reason is, the entity cannot determine whether customer got the control over the goods / services.

Example

An entity delivers the products to a customer for trial or evaluation purposes. When should the entity recognise the revenue?

Answer

If an entity delivers products to a customer for trial or evaluation purposes and the customer is not ; committed to pay any consideration until the trial period lapses, control of the product is not transferred to the customer until either the customer accepts the product or the trial period lapses.

10. LICENSING

A license establishes a customer's rights to the intellectual property (IP) of an entity. Licenses include

a) Software and technology;
b) Motion pictures, music and other forms of media and entertainment;
c) Franchises; and
d) Patents, trademarks and copyrights.

Management should determine whether a license that is distinct provides **'right to access IP'** or **'right to use IP'**, Based on this revenue will be recognised.

RIGHT TO ACCESS IP
(Over a period of time)

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

2. The licence exposes the customer to any effects of the entity's activities

3. The entity's activities are not a performance obligation under the contract

All criteria must be met

RIGHT TO USE IP
(At a point in Time)

If all 3 criteria for access (over time) are not met, the nature of the entity's promise is to provide a right to use the IP as the IP exists at the point in time the licence is granted to the customer

Effectively, this means the customer is able to direct the use of and obtain all remaining benefits from the licensed IP when granted (i.e., the IP is static)

11. REPURCHASE AGREEMENT

Repurchase agreements can be an obligation or right to repurchase a good after it is sold to a customer.

There are **three forms** of repurchase right:

1) A seller's obligation to repurchase the good (a forward).
2) A seller's right to repurchase the good (a call option).
3) A customer's right to require the seller to repurchase the good (a put option).

Forms 1 & 2: Forwards and call options

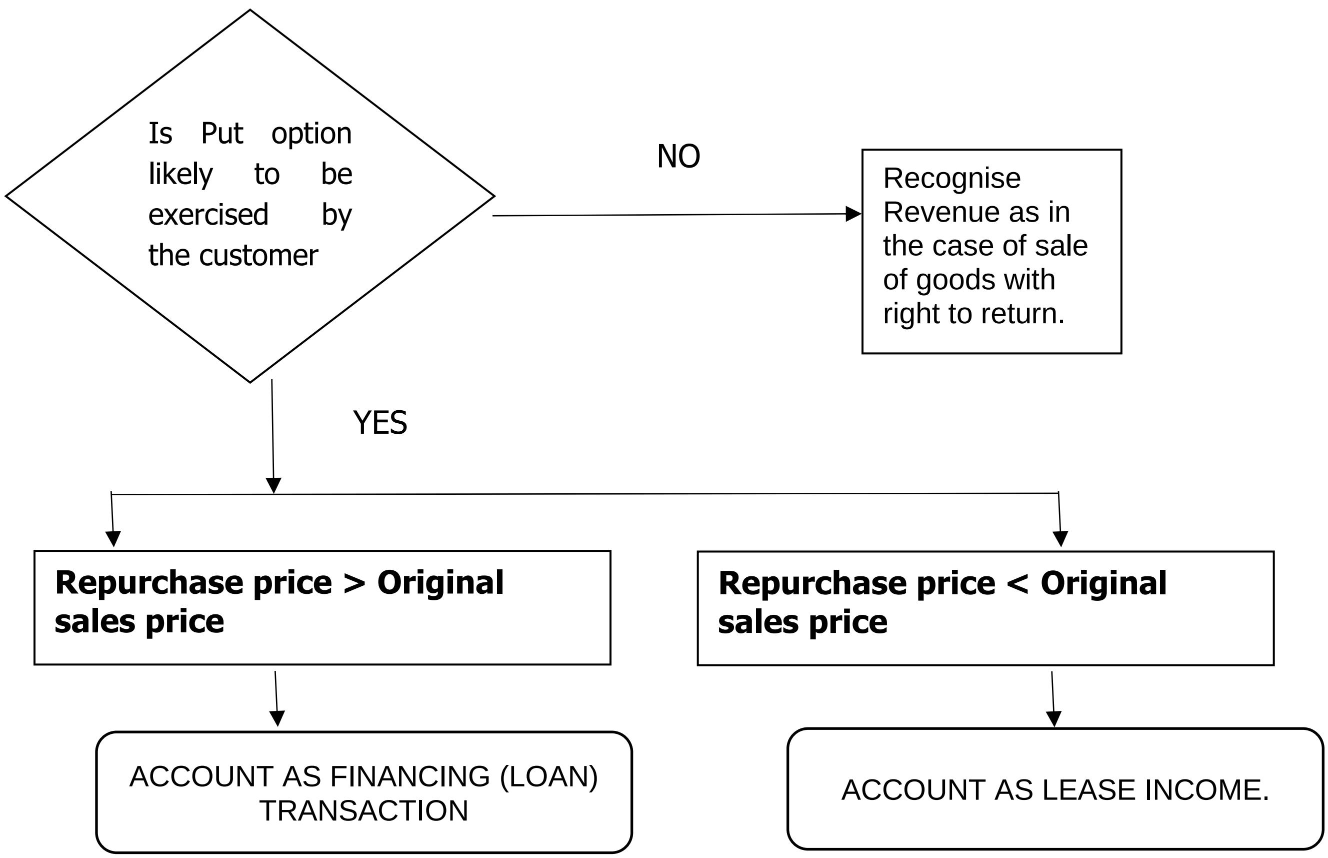
An entity that transfers a good with a **substantive forward or call option** should NOT RECOGNISE REVENUE when the good is transferred. The repurchase right **limits the customer's ability to control** the good. Generally, there is a presumption that a negotiated contract term is substantive.

Accounting is based on the amount of repurchase Say originally sold an item for Rs 1,000 and has an obligation to repurchase for under situation (1) 800 or (2) 1,100 after a year	
Situation (1) **If repurchase price < original sales price**	Situation (2) **If repurchase price < original sales price**
Account as LEASE transaction, where entity is the lessor. The difference in the price is to be accounted as lease income over the period.	Account as Financing arrangement i.e. customer is providing finance to the entity The entity will record the following JE **When sold** Cash a/c …….. Dr 1,000 To Loan taken 1,000 **When repurchased** Loan taken a/c …… Dr 1,000 Interest exp……….. Dr 2,00 To Cash a/c 1,200 Suppose NOT repurchased (not exercised call option) Liability a/c …….. Dr 1,000 Interest exp a/c….Dr 1,000 To Revenue 1,200 (Being call option is not exercised, entire liability including interest is recognized as revenue)

Form 3. Put options

A put option allows a customer, at its discretion, to require the entity to repurchase a good and indicates that the customer has control over that good. The customer has the choice of retaining the item, selling-it to a third party, or selling it back to the entity. When customer decides to sell back to the entity, the entity has to (obligation) purchase it.

Accounting is based on the amount of repurchase and whether the customer has a significant economic incentive to exercise its right (because customer has an option to sell we need to consider this). Under some circumstances, if the market value of the asset is higher than the offer price (initially agreed), customer will not be interested to sell to the entity as it is cheaper than market value.



12. SERVICE CONCESSION ARRANGEMENTS (APPENDIX C)

a) A service concession arrangement generally involves a government or other public entity (referred to as the grantor) conveying to a private sector entity (referred to as the operator) contract to build / upgrade an infrastructure (roads, dams, tunnels, subways etc) along with right to operate & maintain it. These arrangements are referred as 'build-operate-transfer' (BOT) and 'Rehabilitate-operate-transfer' (ROT) arrangements.

b) The operator is remunerated for its services, either directly by the Grantor or given the right to charge user during the period of the arrangement. In some instances, the operator may be remunerated by both the grantor and public.

c) Accounting principles

1. Determine the Transaction price (TP)
2. Allocate the TP to
   - PO representing construction or upgradation &
   - PO representing Operation & Maintenance.
3. Recognise Revenue on
   - Construction Revenue Proportionately based on construction activity &
   - Operating & Maintenance Revenue over the period

4. When Revenue is recognised initially create a corresponding CONTRACT ASSET.

If the consideration is in the nature of amount receivable , then create a **FINANCIAL ASSET** RECEIVABLE by cancelling the contract asset. Hereafter IND AS 109 is applicable.

If the consideration is in the nature of rights to recover from the public who use the infrastructure, recognise an **INTANGIBLE ASSET** (toll rights). Hereafter, amortize as per Ind AS 38.

5. Infrastructure within the scope of this Appendix shall not be recognised as property, plant and equipment of the operator. The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

PRESENTATION IN BALANCE SHEET

A Contract asset or Contract ability should be presented in the balance sheet when either party has performed in a Contract.

Contract liability: An entity's obligation to transfer goods or services to a customer for whom the entity has received consideration or consideration is due (i.e., the customer pays or owes payment before performance).

Contract asset: An entity's rights to consideration in exchange for goods or services that the entity has transferred to the customer (i.e., performance before the customer pays).

In addition any unconditional right to consideration should be presented separately as a trade receivable in accordance with Ind AS 109 Financial Instruments.

A right to consideration is unconditional if only the passage of time is required before payment is due.

Disclosure

The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of

Applying the practical expedient:

Applying the practical expedient is optional. Many lessees will be attracted by the practical relief offered by the amendments. The practical expedient reduces the effort and subjectivity involved in assessing whether eligible rent concessions are lease modifications. It also avoids some of the complexities involved in lease modification accounting. However, some lessees may prefer to apply the standard's existing requirements to all changes in lease contracts. This would increase the comparability between the accounting for rent concessions that do and do not qualify for the practical expedient. It would also enhance comparability year-on- year – e.g. if the lessee expects to have rent concessions in future years.

The amendments do not include application guidance on accounting for the practical expedient, instead refers to the standard's existing requirements.

Disclosures:

Lessees applying practical expedient are required to disclose:

a. The fact that if they have applied the practical expedient to all eligible rent concessions and, if not, the nature of contracts to which they have applied the practical expedient and
b. The amount recognized in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient.

Note: The disclosure requirements of paragraph 28(f) of Ind AS 8 do not apply on initial application of these amendments.

Effective date:

A lessee should apply the amendments for annual period beginning on or after 1 April 2020. In case lessee has not yet approved the financial statements for issue before the issue of these amendments, then the same may be applied for annual periods beginning on or after 1 April 2019

A lessee should recognize the amendments retrospectively and recognize the cumulative effect of initially applying them in the opening retained earnings of the reporting period in which they are first applied.

ANALYSIS OF FINANCIAL STATEMENTS

A. INTRODUCTION

a) Business is important organ of society that helps in its overall development. A typical business has a variety of stakeholder that include its employees, owners, banks, trade associations, government, general public and so on. These stakeholders, particularly investors are keenly interested in knowing about the financial well-being of business organisations.

b) However, with globalization and increased dependence on technology, where companies are expanding both horizontally and vertically, many even spanning across geographies; the number of stakeholders – be it be investors, suppliers, employees, or even tax authorities, have increased manifold.

c) With the increased focus on governance the significance of financial reporting has exponentially increased. The importance of robust financial reporting cannot be emphasized enough.

d) The financial statements are supplemented with the disclosures which are the key source of information and help the users in interpreting the financial statements in a better manner in taking appropriate decisions.

B. FINANCIAL STATEMENTS OF CORPORATE ENTITIES

The format and content of the financial statements for companies is required to be in accordance with Schedule III to the Companies Act, 2013. Further, there are several additional disclosure requirements both with respect to the balance sheet and statement of profit and loss.

In terms of format, Schedule III only prescribes the vertical format of balance sheet and does not provide the alternative of using the horizontal format. Further, Schedule III sets out the minimum requirements for disclosure on the face of the balance sheet and the statement of profit and loss.

Schedule III now requires all disclosures to be made as a part of the notes.

Apart from granting an overriding status to the Standards, cognizance has also been given to the requirements of Standards in the format of the balance sheet and accordingly elements such as deferred tax assets and intangible assets have been included in the balance sheet.

The terms used in Schedule III are to be considered as per the respective notified Standards. Schedule III prescribes only presentation and not treatment which is a subject matter of Standards, which has also been specifically acknowledged in Schedule III.

C. CHARACTERISTICS OF GOOD FINANCIAL STATEMENTS

The key features to any set of financial statements are:

1. **True and fair view of the affairs of the enterprise:** This is the most important feature of any set of financial statements. The user of the financial statements depends fully on the same and hence the reliability factor is supreme.
2. **Relevance:** The financial statements should provide the relevant information for the period it is presented. There is no point in presenting historical data of past several years that are redundant as of date. The key here is that the user of the financial statements should be in a position to take independent decision after reading the financial statements. This decision can be different for different users but what is important is that the users should be empowered to make decisions through the financial statements
3. **Understandability:** For the user to make sense, the financial statements should be readable and content lucid to digest. Even a layman should be able to read the same, and understand the basic information, if not the accounting policies and procedures.
4. **Consistency:** The users of the financial statements will be benefitted only if the statements are released in periodic intervals and in standard formats. Else, the entire purpose of furnishing financials will be defeated. That is the reason that laws are prescribed for presentation formats and periodicity.
5. **Regulatory Compliance:** Needless to say, the tax authorities, market regulators etc. rely hugely on financial statements to understand and gauge the compliances met by the enterprise.
6. **Universality:** Last but not the least; the financial statements should be comparable both within the industry and outside. So financial statements by two different companies should look in similar lines if both are engaged in, say, manufacturing steel. Likewise, the financials of a company manufacturing steel in India should be comparable to the set of financial statements of a company based out of US engaged in the similar line of business.

D. BEST PRACTICES - APPLICABLE TO ALL COMPANIES

Following are some of the practices, if followed by the preparers of the financial statements, it would lead to better presentation and disclosure and will also serve the meaningful purpose for various stakeholders in understanding the functioning, financial position and financial performance of the entity and in appropriate decision making:

1. **Compliance**

   Financial reporting is a regulated activity and compliance with the requirements is a must. Comply with the standards and regulations but also ensure your financial statements are an effective part of your wider communication with your stakeholders. It should be simple and understandable without any change in the interpretation.

2. **Complete**

   The information disclosed in the financial statements should be complete and should not lead to any further cross questioning in the mind of the users. Ensure consistency of disclosures across the financial statements.

3. **Simple and specific**

   Draft your notes, accounting policies, commentary on more complex areas in simple and plain English. Ensuring that there are no vague or ambiguous notes.

   Make your policies clear and specific.

   Ensure that there should not be any vague or ambiguous notes, with no further information or explanation which may lead to misinterpretation of information.

   Reduce generic disclosures and focus on company specific disclosures that explain how the company applies the policies.

4. **Transparency**

   In preparation of financial statements many a times certain assumptions, or other bases are taken. Disclose those assumptions and bases transparently, so that they users are not misled. Rather such transparency shall provide useful additional information and substantiate your decision/judgement.

5. Materiality

- The lack of clarity in how to apply the concept of materiality is perceived to be one of the main drivers for overloaded financial statements. Make effective use of materiality to enhance the clarity and conciseness of your financial statements.
- Information should only be disclosed if it is material. It is material if it could influence users' decisions which are based on the financial statements.
- Your materiality assessment is the 'filter' in deciding what information to disclose and what to omit.
- Once you have determined which specific line items require disclosure, you should assess what to disclose about these items, including how much detail to provide and how best to organise the information.

6. Integration of Notes

- Notes cover the largest portion of the financial statements. They are an effective tool of communication and have the greatest impact on the effectiveness of your financial statements.
- Group notes into categories, place the most critical information more prominently or a combination of both.
- Integrate your main note of a line item with its accounting policy and any relevant key estimates and judgements.

7. Disclosure of Material Accounting Policies

- The financial statements should disclose your material accounting policies. Disclose only your material accounting policies – remove your non-material disclosures that do not add any value.
- Your disclosures should be relevant, specific to your company and explain how you apply your policies.
- The aim of accounting policy disclosures is to help your investors and other stakeholders to properly understand your financial statements.
- Use judgement to determine whether your accounting policies are material, considering not only the materiality of the balances or transactions affected by the policy but also other factors

including the nature of the company's operations.

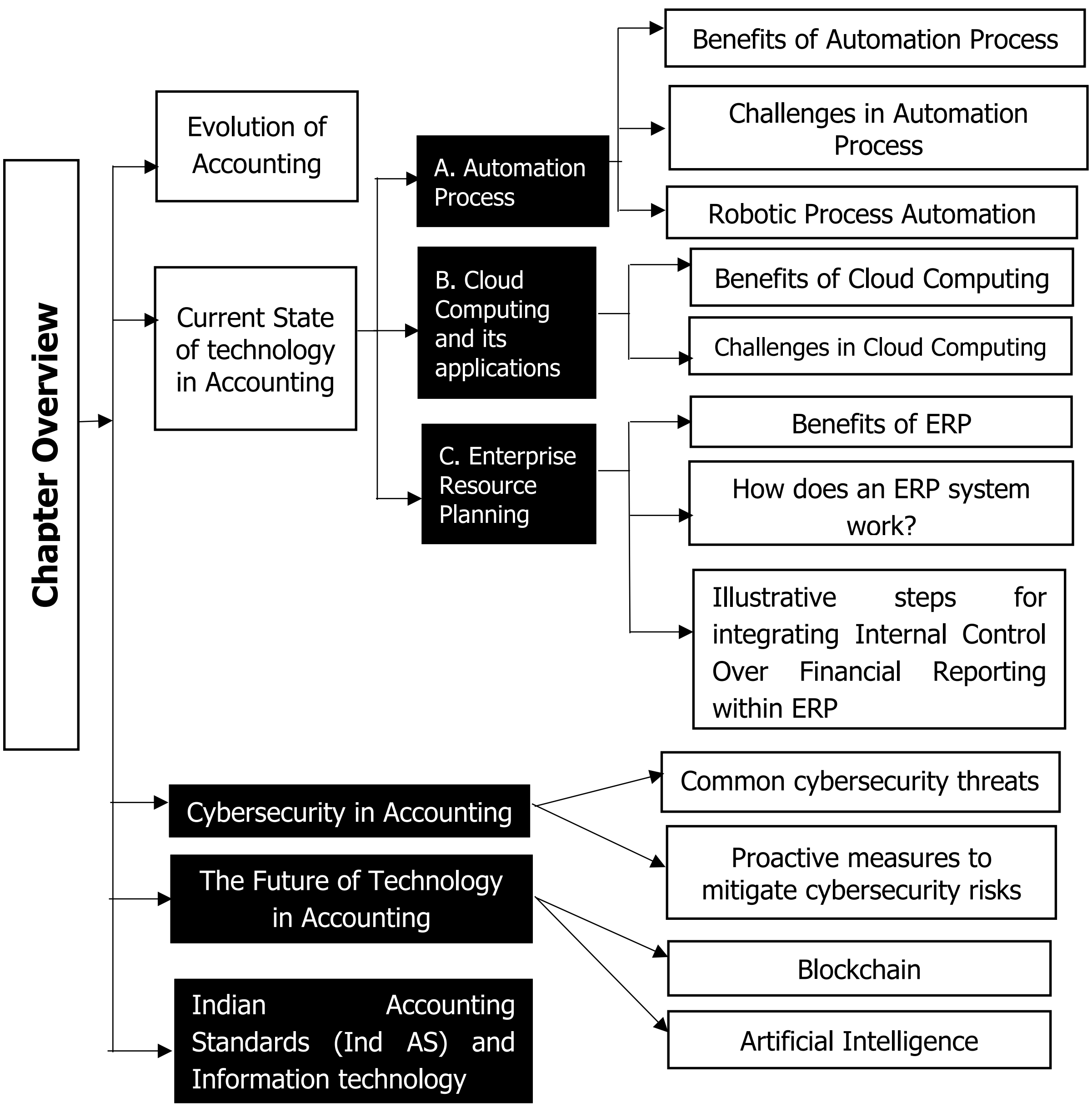
8. **Disclosures of Key Estimates and Judgements**

- Effective disclosures about the most important estimates and judgements enable investors to understand your financial statements.
- Focus on the most difficult, subjective and complex estimates.
- Include details of how the estimate was derived, key assumptions involved, the process for reviewing and an analysis of its sensitiveness.
- Provide sufficient background information on the judgement, explain how the judgement was made and the conclusion reached.

9. **Integrated Approach**

- Financial statements are just one part of your communication with the stakeholders. An annual report typically includes financial statements, a management commentary and information about governance, strategy and business developments, CSR Reporting, Business Responsibility Reporting etc. There is also a growing trend towards integrated reporting.
- To ensure overall effective communication consider the annual report as a whole and deliver a consistent and coherent message throughout.
- Ind AS 1 also acknowledges that one may present, outside the financial statements, a financial review that describes and explains the main features of the company's financial performance and financial position, and the principal uncertainties it faces.
- Many companies also present, outside the financial statements, reports and statements such as environmental reports and value added statements, particularly in industries in which environmental factors are significant and when employees are regarded as an important user group.
- Even though the reports and statements presented outside financial statements are outside the scope of AS / Ind AS, they are not out of the scope of regulation.

ACCOUNTING & TECHNOLOGY



1. INTRODUCTION

Accounting is a critical function for all businesses, as it enables them to track and manage their financial transactions, budgets, and investments.
The field of accounting has undergone significant changes in recent years, primarily due to advancements in technology.
As businesses have embraced digital transformation, the accounting profession has evolved, becoming more efficient and accurate with the help of new technologies.

This chapter intends to provide an overview of the impact of technology on the accounting profession. It highlights the trends that are transforming the industry and the challenges that accounting professionals face in adapting to new technologies.

The chapter then delves into the various technologies that have had a significant impact on the accounting profession. These technologies include cloud computing, artificial intelligence, and cybersecurity etc. The chapter discusses the benefits of each technology and how they have changed the way accountants perform their tasks. For example, cloud computing has made it possible for accountants to access financial data from anywhere in the world.

The chapter also examines the challenges that accounting professionals face in adapting to new technologies. For example, the implementation of new technologies can be costly, and many businesses may not have the resources to invest in them. Additionally, some accounting professionals may be resistant to change, preferring to stick with the traditional methods they are comfortable with.

2. EVOLUTION OF ACCOUNTING

This section provides a detailed history of accounting from its earliest origins to modern-day practices
The origins of accounting can be traced back to ancient civilizations such as the **Egyptians, Greeks, and Romans**. In these early civilizations, accounting primarily involved record-keeping for tax purposes and for the management of government resources. These early accounting systems were manual and paper-based, and the process was labour intensive.
By the time of the **Roman Empire**, the government had access to detailed financial information.

In India, Chanakya authored a manuscript similar to a financial management book during the period of the Mauryan Empire. His book **'Arthashastra'** contains few detailed aspects of maintaining books of accounts for a sovereign state.
The Italian Luca Pacioli, recognized as The Father of accounting and bookkeeping was the first person to publish a work on double-entry bookkeeping, thereby introducing the field in

Italy. Subsequently, accounting practices evolved to include double-entry bookkeeping. This system enabled businesses to create a balance sheet, which showed the financial position of the company at a given time. The introduction of double-entry bookkeeping was a significant milestone in the history of accounting and laid the foundation for modern-day accounting practices.

With the industrial revolution, significant changes came to the accounting profession. Due to the advent of machines and mass production, accounting became more complex, requiring more detailed records of financial transactions. This period also saw the rise of the accounting profession, with the establishment of the first professional accounting organizations.

The **Institute of Chartered Accountants of Scotland** is the world's oldest and first professional chartered accountants' body, being established by the Royal Charter in 1854.
Subsequently, organizations such as the **Institute of Chartered Accountants in England and Wales, Certified Practicing Accountant Australia, American Institute of Certified Public Accountants and Chartered Accountants Ireland** were established in the **19th Century.**

With the advent of the **20th Century**, the Association of Chartered Certified Accountants was established, followed by organizations such as the **Institute of Chartered Accountants of India** and the **Institute of Singapore Chartered Accountants**.

In the **post-industrial period**, technological advancements such as the computer, transformed the accounting profession. The introduction of computers enabled accountants to automate many of the manual processes associated with accounting, making the process faster and more accurate.

Currently, there is an upsurge of technology in the accounting field on account of **cloud computing and artificial intelligence**, all of which are transforming the accounting profession, making it more efficient and accurate. However, these new technologies also present challenges for accounting professionals, who must adapt to new systems and processes to remain competitive.

3. THE CURRENT STATE OF TECHNOLOGY IN ACCOUNTING

This section provides an in-depth overview of the current state of technology in the accounting profession. It discusses the various technologies used in accounting and their impact on the profession, including automation, cloud computing, and artificial intelligence

A. 1. AUTOMATION PROCESS

The major change visible is the automation of the accounting process. Automation is the use of software and other tools to automate manual processes, making them faster and more accurate. We can understand this with the help of the below example:

For instance, let us consider the activities involved in the process of procuring groceries from a departmental store such as **Walmart or Reliance Smart Bazaar** at the Front-End

Step I: The customer picks his/her groceries and reach the billing counter.

Step II: The person at the counter merely scans the item's barcode.

Step III: The scanning automatically reads the data and inputs the item procured and the corresponding selling price

Step IV: By scanning the barcode of each item, the bills are generated within a couple of minutes.

Step V: The customer makes the payment, and the bills is printed and handed over to the customer.

The entire process happens in a fraction of a second, saving valuable time and mitigating all errors. However, **at the backend, the below activities take place:**

As and when the barcode of an item is scanned at the billing counter, the inventory of the said item at the departmental store is simultaneously updated recording the issue/sale of the same. This ensures accuracy in maintenance of inventory data.
A periodical physical check of inventory will give conclusive evidence of the correctness of data generated by the system, thereby giving comfort on the management assertions of accuracy, valuation and existence of the inventory.

In certain cases, the software is so programmed that the indirect taxes (GST) levied on the sale value as per the invoice is updated simultaneously, which can get uploaded on the GST portal at the end of the day by the accounting team in the backend.
This ensures accuracy in returns uploaded, thereby minimizing the need for manual reconciliation and data maintenance.

Software are also programmed to ensure that the bill amount is automatically displayed on the Point of Sale Machine, through which the customer makes the payment either through debit/credit card or through UPI. In case the customer opts to make payment in cash, entering the amount on the Screen will open the cash drawer in which the cash paid is deposited.
Since the cash drawer is opened through the system only after logging in by the concerned person, in case of mismatch in cash balances, the concerned person can be identified, thereby reducing the chances of misappropriation of cash.

A.2. Benefits of Automation Process

- Streamlining data entry.
- Accelerating Data processing
- Enhancing Accuracy
- Improved Decision making
- Saving time & money
- Facilitating Compliance

1. **Streamlining Data Entry:** Automation tools, such as optical character recognition (OCR) or barcode recognition technology, can help to automate the entry of data from source documents such as receipts and invoices. This can reduce the amount of time and effort required for manual data entry, as well as minimizing the potential for human error.
2. **Accelerating Data Processing:** Automation can help to process large amounts of data / large volumes of transactions more quickly and accurately than manual methods. For example, software can automatically categorize transactions into the appropriate accounts, calculate tax amounts, and generate financial statements, among other tasks.
3. **Enhancing Accuracy:** Automation can help to reduce errors and discrepancies in accounting processes. By automating tasks such as data entry and calculations, businesses can minimize the risk of errors caused by human error, improving the accuracy and reliability of their financial data.
4. **Improving Decision-Making:** Automation can provide real-time insights into financial data, enabling businesses to make informed decisions more quickly. With automated reporting, the time spent on routine tasks is greatly minimized, enabling businesses to gain deeper insights into their financial performance, identify trends and patterns, and adjust their strategies accordingly.
5. **Saving Time and Money:** Automation reduces the amount of time and resources required to perform manual tasks such as data entry and reconciliations. This results in businesses saving on staffing costs and increases productivity and enabling accountants to focus on higher-level tasks such as analysis and planning.
6. **Facilitating Compliance:** Automation helps business to stay compliant with regulations and standards by ensuring accounting practices meet the necessary requirements. As seen above, automation ensures accurate data for the purposes of return filing. Further, in case the systems are so programmed, reporting tools can generate financial statements that meet the criteria of Ind AS or Indian GAAP. This would ensure minimizing the risk of non-compliance and potential penalties.

A.3. CHALLENGES IN AUTOMATION PROCESS

Automation also comes with its own set of potential drawbacks and challenges, some of them are mentioned below:

- It arises the **need for ongoing training and education** to keep up with the latest technology.
- Automation also presents a **risk of data breaches and cyber-attacks,** which can compromise the security and confidentiality of financial data.
- Due to automation, there exists **potential loss of jobs**. However, this can be mitigated by ensuring appropriate training to the workforce to remain updated with the technology.

To summarize, automation helps businesses achieve efficiency, accuracy and decision-making in accounting while saving time and money and facilitating compliance with regulations and standards.

A.4. ROBOTIC PROCESS AUTOMATION

Robotic Process Automation (RPA) is an emerging technology that revolutionizes financial reporting processes. RPA utilizes software robots or "bots" to automate manual and repetitive tasks in financial data processing, analysis, and reporting.

By mimicking human interactions with digital systems, RPA bots can extract and consolidate data, perform calculations, generate reports, and ensure compliance with accounting standards.

The adoption of RPA in financial reporting improves accuracy, enhances efficiency, and frees up valuable time for finance professionals to focus on more strategic activities. Moreover, RPA enables organizations to achieve timely reporting, cost savings, and increased data integrity, ultimately leading to more reliable and insightful financial information.

Example 1: Using RPA in Financial Reporting

Let us consider XYZ Company, a group of companies that prepares consolidated financial statements in accordance with Ind AS 110. To streamline their financial reporting processes, XYZ Company decides to leverage Robotic Process Automation (RPA). In that case, the steps involved would be:

- As XYZ Company has multiple subsidiaries, each maintaining their own financial data, RPA bots are implemented to automate the process of extracting financial data from the subsidiary systems and consolidating it into the parent company's financial system.
- The bots retrieve the relevant financial information, perform necessary currency conversions, and reconcile intercompany transactions, ensuring accurate and timely consolidation.
- As per Ind AS 110, intercompany transactions need to be eliminated to avoid double counting and provide a true representation of the group's financial position. RPA bots are programmed to identify intercompany transactions within the consolidated financial data.
- The bots automatically eliminate these transactions by adjusting the corresponding accounts and generating elimination entries, simplifying the process and reducing the potential for errors.
- The bots retrieve the consolidated financial data from the parent company's financial system and apply the necessary consolidation adjustments.
- They perform calculations for non-controlling interests, equity, and comprehensive income attributable to the parent and non-controlling interests.

- The bots generate the consolidated balance sheet, income statement, statement of changes in equity, and cash flow statement, ensuring accuracy and consistency in the financial reporting process.

B. CLOUD COMPUTING

Cloud computing refers to the delivery of computing services over the internet. It allows accountants to access their data and software from any device with an internet connection.

The entire world was hit in 2020 with probably the biggest black swan event of the past couple of decades– the COVID-19 pandemic. The continuous lockdowns severely impacted businesses, and operations came to a standstill. This in turn led to viewing cloud computing as a serious alternative compared to traditional client-server architecture in physical locations controlled by the entities themselves.

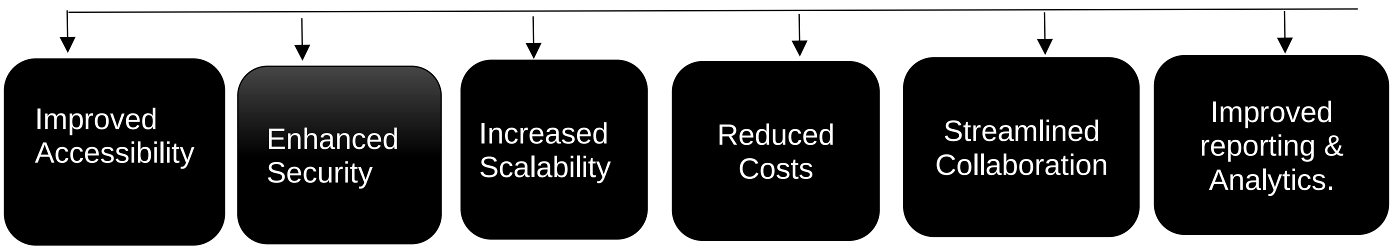
With the advent of cloud computing, persons could access the systems from their respective locations, work remotely during the lockdown and ensure that the accounting process and reporting requirements did not suffer adversely.

B.1. Common Applications / Cases of Cloud Computing

1. **Cloud Storage:** Services like **Dropbox, Google Drive, and Microsoft OneDrive** offer cloud storage solutions that allow users to store and access their files and data from anywhere with an internet connection. Users can save documents, photos, videos, and other files in the cloud and synchronize them across multiple devices.
2. **Software as a Service (SaaS):** SaaS platforms provide cloud-based software applications that users can access and utilize via the internet. Examples include **Salesforce** for customer relationship management (CRM), **Slack** for team collaboration, and **QuickBooks Online** for accounting and financial management, **Document convertors** online etc.
3. **Infrastructure as a Service (IaaS):** IaaS providers **offer virtualized computing resources**, including servers, storage, and networking infrastructure, on a pay-as-you-go basis. Examples include **Amazon Web Services** (AWS), Microsoft Azure, and **Google Cloud Platform**. These platforms allow businesses to scale their IT infrastructure based on demand without the need for physical hardware.
4. **Platform as a Service (PaaS):** PaaS providers offer cloud-based platforms that enable developers to build, deploy, and manage applications without the complexity of infrastructure management. Examples include **Microsoft Azure App** Service, and **Google App** Engine.
5. **Cloud-based Communication and Collaboration:** Applications like Microsoft Teams, Google Workspace (formerly G Suite), and Zoom provide cloud-based communication and collaboration tools that facilitate real-time messaging, video conferencing, file sharing, and project management.

6. **Cloud-based E-commerce:** Few platforms enable businesses to **set up and manage online stores** using cloud infrastructure. These platforms provide features like product catalogues, payment processing, inventory management, and customer analytics.
7. **Big Data Analytics:** Cloud computing enables organizations to process and analyze large volumes of data efficiently. Services like Amazon Redshift, Google Big Query, and Microsoft Azure Data Lake Analytics provide scalable infrastructure for big data processing and analytics, empowering businesses to derive valuable insights from their data.

B.2. Benefits of Cloud Computing



Following are some of the ways in which Cloud Computing has positively impacted accounting:

1. **Improved accessibility:** Cloud-based accounting software allows users to access their financial data from any location with an internet connection. This has increased accessibility and flexibility for accountants and business owners, allowing them to work remotely and collaborate in real-time.
2. **Enhanced security:** Cloud-based accounting software providers typically offer advanced security features such as encryption, firewalls, and multi-factor authentication helping in the protection of sensitive financial data from cyber threats and data breaches.
3. **Increased scalability:** Cloud-based accounting software allows businesses to easily scale up or down based on their changing needs. As a business grows, it can easily add new users and features without having to invest in additional hardware or software.
4. **Reduced costs:** Cloud-based accounting software typically requires less upfront investment in hardware and software, as well as ongoing maintenance costs. This can help businesses save money on IT expenses and redirect those funds to other areas of the business. For example, the costs of installing Microsoft Office Suite on a laptop or desktop is far more expensive than subscribing to the Office 365 Suite, which is a web-based download. Further, the web-based download also provides the options of continuous free updates unlike its Office Suite offline counterpart.
5. **Streamlined collaboration:** Cloud-based accounting software allows multiple users to collaborate in real-time, reducing the need for manual data entry and communication. This can help to streamline workflows and reduce errors caused by miscommunication.
6. **Improved reporting and analytics:** Cloud-based accounting software often includes powerful reporting and analytics tools that allow businesses to gain deeper insights into their financial performance. This can help businesses make more informed decisions and identify areas for improvement.

B.3 Challenges in Cloud Computing

Following are the potential challenges which may emerge in cloud computing:

- Since cloud-based software are completely online, they could be prone to hackers who could **'steal' data or passwords** or compromise the integrity of the processed data, thereby causing disruptions to the businesses.
- **Strong net connectivity** is a must for cloud-computing to be a success. Though there has been a huge surge in network and mobile connectivity in the past decade, connectivity in non-metros, tier-2 or tier-3 cities is not well-developed, which could create accessibility issues to the users of the cloud-based accounting software.

Example 2: Using Cloud Computing

The finance team at XYZ Company, consisting of chartered accountants and financial analysts, collaborates on the preparation of the Income Statement. They utilize cloud-based collaboration tools, such as Microsoft Teams or Google Workspace, to enhance their efficiency and ensure accuracy in the reporting process.

- Using cloud-based spreadsheets or shared documents, the finance professionals from various locations input the relevant financial data into the Income Statement template. They update revenue figures, operating expenses, cost of goods sold, and other relevant information, ensuring accurate and comprehensive data collection.
- Through cloud collaboration platforms, team members can work on the Income Statement simultaneously, regardless of their physical locations. They can review, edit, and make real- time updates to the document. For example, the finance team in Mumbai can update the revenue figures based on the sales data received, while the team in Bengaluru can revise the operating expenses based on the cost information provided.
- Cloud-based collaboration tools offer version control features, allowing the team to track changes made to the Income Statement over time. This ensures that the latest version is always accessible and helps in maintaining an audit trail for any revisions or modifications made during the reporting process.
- Once the Income Statement is prepared, the finance team can use cloud-based communication channels, such as instant messaging or video conferencing, to discuss the document and address any queries or concerns. The team lead or finance manager can review the Income Statement, provide feedback, and approve the final version before submission.
- Cloud-based collaboration ensures that all team members have secure access to the Income Statement from their respective locations. User access controls and permissions can be managed to restrict access to authorized personnel only, maintaining data confidentiality and security.

C. Enterprise Resource Planning (ERP)

Enterprise resource planning (ERP) is a type of software that organizations use for managing day-to-day business activities like **procurement, project management, accounting, risk management, compliance,** and **supply chain operations**.

ERP systems connects and corelates a multitude of business processes and enable the flow of data between them. It collects an organization's shared transactional data from multiple sources and thus eliminate data duplication and provide data integrity with a single source of authentication.

Nowadays, ERP systems are used by many organisations as it is critical for managing thousands of businesses of varied sizes covering all industries. Cloud-based ERP applications are embedded with next-generation technologies, such as AI, machine learning (ML), and digital assistants.

ERP systems are designed around a single, defined data structure (schema) that typically has a common database. This helps to ensure that the information used across the enterprise is normalized and based on common definitions and user experiences. These core constructs are then interconnected with business processes driven by workflows across business departments (e.g. finance, human resources, engineering, marketing, and operations), connecting systems and the people who use them.

Since data is the lifeblood of every modern company, ERP makes it easier to collect, organize, analyze, and distribute this information to every individual and system that needs it to best fulfill their role and responsibility. ERP also ensures that these data fields and attributes roll up to the correct account in the company's general ledger so that all costs are properly tracked and represented.

A key ERP principle is the central collection of data for wide distribution. With a secure and centralized data repository, everyone in the organization can be confident that data is correct, up-to-date, and complete. Data integrity is assured for every task performed throughout the organization, from a quarterly financial statement to a single outstanding receivables report.

C.1. Benefits of ERP

It's impossible to ignore the impact of ERP in today's business world. As enterprise data and processes are caged into ERP systems, businesses can align separate departments and improve workflows, resulting in significant bottom-line savings. Examples of specific business benefits include:

1. **Improved business insight** from **real-time information** generated by reports
2. **Less operational costs** through streamlined business processes and best practices
3. **Enhanced collaboration** of users sharing data in contracts, requisitions, and purchase orders
4. **Better efficiency** through a common user experience across many business functions and well-defined business processes

5. **Consistent infrastructure** from the back office to the front office
6. **Increased user-adoption rates** from a common user experience and design
7. **Reduction in risk** through improved data integrity and financial controls
8. **Less management and operational costs** through uniform and integrated systems

C.2. How does an ERP system work?

ERP systems **work by using a defined, standard data structure.** Information entered by one department is immediately available to authorized users across the business. This uniform structure helps keep everyone on the same page.

Real-time data is then woven into business processes and workflows across departments. Managers check if one location is doing significantly better than another site and can figure out why.

Finance department can use ERP for comparison of sales, profits and other financial data to help executives in understanding the performance of the organisation and also for setting new targets.

ERP systems deliver the most value when a company has modules for each major business function and ensures timely and accurate data entry. When a company uses business systems from multiple vendors, integrations are generally possible to make data automatically flow into the ERP. This real-time data can then be used throughout the ERP instance to benefit any process or workflow.

Illustrative steps for integrating Internal Control Over Financial Reporting with an ERP

Integrating Internal Control over Financial Reporting (ICOFR) with an Enterprise Resource Planning (ERP) system offers the key advantage of streamlining financial processes, ensuring data integrity, and promoting effective internal controls. By automating and standardizing procedures, the ERP system reduces manual effort and minimizes the risk of errors. It enables segregation of duties, real-time visibility into financial data, comprehensive audit trails, enhanced reporting capabilities, and proactive risk mitigation. This integration strengthens financial control, accuracy, and compliance, ultimately enabling better decision-making and reducing the likelihood of fraud or errors.

The following are illustrative steps for integrating ICOFR within ERP:

1. **Verify that the process includes identification and updating of internal and external financial reporting requirements and deadlines.**

   The finance team regularly reviews the regulatory guidelines and reporting requirements set by the regulators and ensures that the ERP system's financial closing process is aligned with these requirements. Examples are listed companies to declare quarterly results as per LODR, filing of periodical returns under GST, Income Tax, Labour laws, etc.

2. **Review the documented process to ensure it aligns with the organization's financial reporting policies and regulatory guidelines.**
   The finance team reviews the documented process in the ERP system and cross-checks it with the organization's financial reporting policies and regulatory guidelines to ensure consistency. Examples are accounting polices relating to Property plant and equipment, depreciation, Inventory etc.,
3. **Use the ERP system's change management functionality to track and validate changes made to the financial closing and reporting process.**
   When changes are made to the financial closing and reporting process, the finance team uses the ERP system's change management functionality to track and record these changes. They review system logs and audit trail for changes made to the financial closing and reporting process are as per defined roles and responsibilities for change control, including change initiators, approvers, and change management teams.
4. **Verify that changes to the process are authorized by designated individuals with appropriate authority using system logs.**
   The finance team reviews the system logs, audit trail and confirms that any changes to the financial closing and reporting process were authorized by designated individuals with the appropriate authority, such as the CFO or finance manager.
5. **Review the change requests, approvals, and documentation within the ERP system to ensure proper authorization and validation of process changes.**
6. **Validate that roles and responsibilities** in the financial closing and reporting process are clearly defined within the ERP system by reviewing users access matrix configurations and system logs.
   Review system logs and audit trail with Responsibility assignment matrix (RAM). RAM is a tool used in project management and enterprise resource planning (ERP) implementations to define and communicate the roles and responsibilities of individuals or teams involved in a project or process. The matrix clarifies who is responsible, accountable, consulted, and informed for each task or deliverable within the ERP implementation.
7. **Assess the qualifications and training records** of individuals assigned to financial reporting roles within the ERP system.
8. **Validate that individuals responsible** for financial reporting have the necessary understanding of the organization's operations and appropriate accounting knowledge.
   The finance team validates that individuals responsible for financial reporting within the ERP system have a comprehensive understanding of the organization's operations and possess appropriate accounting knowledge. For example, verify HR records of those involved in accounting have appropriate knowledge.

9. **Validate that decisions on alternative accounting treatments** for significant events or transactions are documented and approved by management.

   Reviewing the Journal vouchers listing by identifying non routine transactions. Review the system of Standardizing voucher types. This involves defining a set of predefined templates or formats for different types of journal entries to ensure consistency and accuracy in recording financial data.

10. **Review the ERP system for documentation of accounting treatment decisions, including approvals and communication to the audit committee.**

    Documentation of accounting treatment decisions refers to the process of recording and maintaining comprehensive documentation regarding the rationale, analysis, and conclusions related to accounting treatments chosen for specific transactions or events like recognising long term construction projects.

11. **Review the ERP system's user administration functionality to ensure appropriate individuals have access to the financial reporting process.**

    Review system logs and audit trail with Responsibility assignment matrix (RAM).

12. **Review whether proper KYC validation controls are in place for creating account masters and review the process for identifying related party transactions.**

    Separate ledger coding for related parties for auto tabulating transactions to present as per Schedule III of Companies Act, 2013.

13. **Validate that the ERP system captures and documents the appropriate accounting treatment for each non-routine event, transaction, and account balance by reviewing Journal Vouchers listing.**

14. Use the ERP system's audit trail and reporting capabilities to **validate that all postings** have occurred in the correct accounting period reviewing accounting period configuration controls.

    In an ERP system, the accounting date and transaction date are captured and stored as part of the transactional data. They are used in various processes, such as journal entry creation, financial statement generation, period-end closing activities, and audit trails. Understanding the distinction between these dates is important for accurate financial reporting, compliance, and analysis of business transactions within the ERP system.

15. Review the **system's controls for preventing backdating or unauthorized adjustments** to postings by reviewing the posting date and transactions date of entries.

D. CYBERSECURITY IN ACCOUNTING

This section seeks to provide an overview of cybersecurity threats and risks and explores the impact of cybersecurity breaches on accounting firms and their clients which may range from accessing the financial data of the firm or client, to an extent of modifying the financial statements without the knowledge of the management. Protecting financial information is crucial to prevent unauthorized access and data breaches.

1. COMPLIANCE: Legal and regulatory frameworks, like the Information Technology Act, 2000 (Amended in 2008), govern the collection, storage, and transmission of financial data. Non-compliance with data protection laws can lead to financial penalties and reputational damage. This section also discusses best practices for mitigating cybersecurity risks.
2. LEGAL & ETHICAL OBLIGATION: Organizations have legal and ethical obligations to disclose cybersecurity incidents with financial implications.
3. IMPACT ON FINANCIAL REPORTING: Cybersecurity incidents can affect financial reporting through financial losses, reputational damage, and legal consequences. Reporting guidelines of various regulators such as SEBI, RBI etc., address the disclosure of cybersecurity incidents in financial statements.
4. INCREASE IN RISK: Cybersecurity is a critical concern for accounting professionals, as sensitive financial data is often stored and transmitted digitally. With the increasing reliance on technology in accounting, the risk of cybersecurity threats and breaches has also increased. A cybersecurity breach can have significant consequences, including financial losses, reputational damage, and loss of sensitive client data. Some of the common cybersecurity threats are highlighted below. In all the cases, the aim of the attack would be either stealing sensitive financial data or disrupting operations or demand ransom money.

D.1 Common cybersecurity threats

a) **Phishing attacks:** Phishing attacks are a common cybersecurity threat that involves tricking users into clicking on malicious links or providing sensitive information.

b) **Malware attacks:** Malware attacks involve infecting computers or networks with malicious software that can steal data or disrupt operations.

c) **Ransomware attacks:** Ransomware attacks involve encrypting files or locking users out of systems and demanding a ransom payment in exchange for restoring access.

d) **Insider threats:** Insider threats involve malicious actions by employees or other insiders who have access to sensitive data.

e) **Denial of Service (DoS) attacks:** DoS attacks involve overwhelming a system or network with traffic to disrupt operations.

f) **Supply chain attacks:** Supply chain attacks involve compromising third-party software or hardware to gain access to a system or network.

D.2 Proactive measures to mitigate cybersecurity risks

In view of the cybersecurity attacks and threats discussed above, it is important to taking proactive measures to mitigate cybersecurity risks as listed below:

a) **Password management:** Strong passwords are critical for protecting sensitive financial data. Accounting professionals should ensure that all passwords are complex and changed regularly.

b) **Encryption:** Encryption can be used to protect sensitive data during transmission and storage. The IT Team of an organization should ensure that all sensitive data is encrypted using appropriate methods.

c) **Access control:** Access control is critical for preventing unauthorized access to financial data. Accounting professionals should ensure that access to sensitive data is limited to authorized personnel and that appropriate access controls are in place. The access controls should be continuously reviewed and updated based on any changes in the management or employee structure.

d) **Network security:** Network security is critical for protecting financial data from cyberattacks. It should be ensured that firewalls and other security measures are in place to prevent unauthorized access to the network.

e) **Employee training:** Employee training is critical for ensuring that all staff members are aware of the importance of cybersecurity and understand how to protect sensitive financial data.

f) **Data backup:** Regular data backups are critical for ensuring that financial data is not lost in the event of a cyberattack. Accounting professionals should ensure that data backups are performed regularly and that backups are stored securely.

g) **Incident response planning:** Accounting professionals should have a clear incident response plan in place in the event of a cyberattack. This plan should include procedures for detecting, containing, and mitigating the impact of a cyberattack.

Overall, cybersecurity is a critical concern for accounting professionals, and it is essential to take appropriate measures to protect sensitive financial data.

E. THE FUTURE OF TECHNOLOGY IN ACCOUNTING

1. BLOCK CHAIN

Block chain technology is revolutionizing the financial landscape, and its impact on financial statement preparation is undeniable.

At its core, block chain is a decentralized and transparent ledger that enables secure and immutable transactions. Unlike traditional centralized systems, block chain offers a distributed network where information is shared and verified by multiple participants, eliminating the need for intermediaries, and enhancing data integrity.

From a financial statement preparation perspective, blockchain holds immense potential to streamline processes, enhance transparency, and improve the accuracy and reliability of financial reporting.

By leveraging blockchain, financial professionals can ensure trustworthy and real-time financial information, revolutionizing how financial statements are prepared, audited, and shared with stakeholders.

In this dynamic landscape, embracing blockchain technology is essential for Chartered Accountants to navigate the future of financial reporting effectively.

a) <u>Key impacts of blockchain on financial reporting</u>

1. **Enhanced Transparency:** Blockchain technology provides a decentralized and immutable ledger, where transactions are recorded and stored in a transparent and tamper-proof manner. This increased transparency ensures that financial data is accurately captured and can be easily audited, promoting trust and reliability in financial reporting.
2. **Improved Data Integrity:** Blockchain's distributed ledger ensures that each transaction is verified and encrypted, preventing unauthorized modifications or tampering. This feature enhances data integrity, reducing the risk of fraudulent activities and errors in financial reporting.
3. **Streamlined Audit Processes:** Blockchain technology enables real-time access to financial data, eliminating the need for time-consuming and manual data reconciliation processes. Auditors can directly access the blockchain ledger to verify transactions, reducing audit time and enhancing efficiency in financial reporting.
4. **Enhanced Security:** Blockchain incorporates advanced cryptographic algorithms, making it highly secure against unauthorized access or data breaches. Financial data stored on the blockchain is encrypted and protected, minimizing the risk of data manipulation or unauthorized disclosure, thus strengthening the security of financial reporting.
5. **Simplified Reconciliation:** Blockchain's decentralized ledger eliminates the need for reconciling multiple versions of data across different systems. With a single shared source of truth, financial reporting processes become more streamlined, reducing reconciliation efforts and potential errors.
6. **Cost Reduction:** By eliminating intermediaries and central authorities, blockchain reduces the costs associated with traditional financial reporting processes. It eliminates the need for third-party verification and reconciliation, leading to cost savings for organizations.
7. **Enhanced Audit Trail:** Blockchain maintains a comprehensive and immutable audit trail of all transactions, providing a transparent and traceable record of financial activities. This audit trail simplifies the identification and investigation of any irregularities or discrepancies, improving the accuracy and reliability of financial reporting.
8. **Real-time Financial Reporting:** With blockchain's real-time data availability and consensus mechanism, financial reporting can be performed more frequently and with greater accuracy. Organizations can generate up-to-date financial statements, enabling stakeholders to make informed decisions based on the most current financial information.

2. ARTIFICIAL INTELLIGENCE (AI)

AI refers to the simulation of human intelligence in machines, enabling them to perform tasks that would typically require human intervention. Apart from the aspects of automation, accuracy, fraud detection and cost savings, the most important feature is enabling predictive analytics. AI can be used to analyze large amounts of data and make predictions about future trends, which can be useful for forecasting financial performance and identifying potential risks. Thus, AI has the potential to transform the accounting profession by enabling accountants to provide more accurate and timely financial information to their clients.

While technology has transformed the accounting profession, it has also presented challenges such as the need for ongoing training and education, the risk of data breaches, and the potential loss of jobs due to automation. However, technology also presents opportunities for accountants to expand their skill sets, offer new services to clients, and automate routine activities thereby freeing up human resources for tasks requiring greater application of knowledge and skill sets.

This section seeks to provide an understanding of how AI and machine learning are transforming/disrupting the accounting profession. The chapter provides an introduction to AI and machine learning, explores their applications in accounting, and discusses the benefits and challenges associated with their adoption.

Artificial Intelligence (AI) and Machine Learning (ML) are technologies that enable computers to learn and perform tasks without being explicitly programmed to do so. AI and ML are having a significant impact on the accounting profession, enabling accounting professionals to automate routine tasks, improve decision-making processes, and reduce errors.

A. BENEFITS OF AI AND ML WHEN USED IN ACCOUNTING

1. **Automated Data Entry:** AI and ML algorithms can process and extract data from invoices, receipts, and other documents, reducing the need for manual data entry. If programmed, AI and ML algorithms can also review bank statements and pass entries in the system, followed by a bank reconciliation, thereby automating the entire process, saving time and improving efficiency.
2. **Fraud Detection:** AI can help detect fraud by analysing large amounts of data and identifying patterns that may indicate fraudulent activity.
3. **Financial Forecasting:** ML can be used to develop predictive models that can forecast financial performance based on historical data, market trends, and other factors. The predictive models can be of particular advantage where estimates are required to be made in financial reporting. For instance, where a store sells goods and offers a voucher giving the customer a discount on subsequent purchases, Ind AS 115 requires a degree of estimation of the likelihood of availing such discount to record Revenue. Predictive models can track customers' preferences and likelihood of availing the voucher, in which case the estimation of revenue as required under Ind AS 115 becomes more realistic.

4. **Accounting Automation:** AI can analyse financial statements and other data to identify errors or inconsistencies, making accounting more efficient and accurate.
5. **Tax Compliance:** AI can help automate tax compliance by analysing financial data and identifying tax obligations, ensuring that businesses remain compliant with tax regulations.

B. CHALLENGES WITH ARTIFICIAL INTELLIGENCE

Along with the advantages of AI and ML, there are following potential challenges and risks associated with the adoption of AI and machine learning like:

1) data privacy
2) security concerns
3) technical complexity
4) need to train employees in an organization to extract capabilities of AI from the system

AI and ML technology is expected to continue transforming the accounting landscape, with the development of more advanced applications such as natural language processing and cognitive computing. However, the adoption of AI and ML in accounting will require careful consideration of its benefits and risks, as well as ongoing education and training for accounting professionals.

Emerging technologies are changing the accounting landscape and holds a future for accounting professionals.

Emerging technologies, such as artificial intelligence (AI), machine learning (ML), and Robotic Process Automation (RPA), have had a revolutionary impact on the accounting profession. These technologies have the potential to revolutionize the way accounting is done, by automating routine tasks, reducing errors, and providing real-time insights into business performance. For example,

AI and machine learning can be used to automate tasks such as data entry, account reconciliation, and financial analysis.

The potential benefits of these technologies for accounting professionals could include increased efficiency, accuracy, and cost savings. However, technology also comes with its own potential challenges and risks, such as the need for specialized skills and expertise, the risk of job displacement, and the need to maintain security and privacy.

Accounting professionals must be willing to adapt to these changes and develop new skills and competencies to stay relevant in the industry. The preceding sections emphasize the need for ongoing education and training to ensure that accounting professionals have the skills and knowledge required to leverage these emerging technologies.

The emergence of these technologies is likely to lead to significant changes in the industry, such as the need for new business models and the rise of new types of accounting services. As accounting professionals, it becomes imperative to understand new business models based on which accounting can be done to give a true and fair view of the affairs of the business. Accounting professionals who are willing to adapt to these changes and develop new skills and competencies will be better positioned to provide value-added services to their clients or organizations and maintain a competitive edge in the industry.

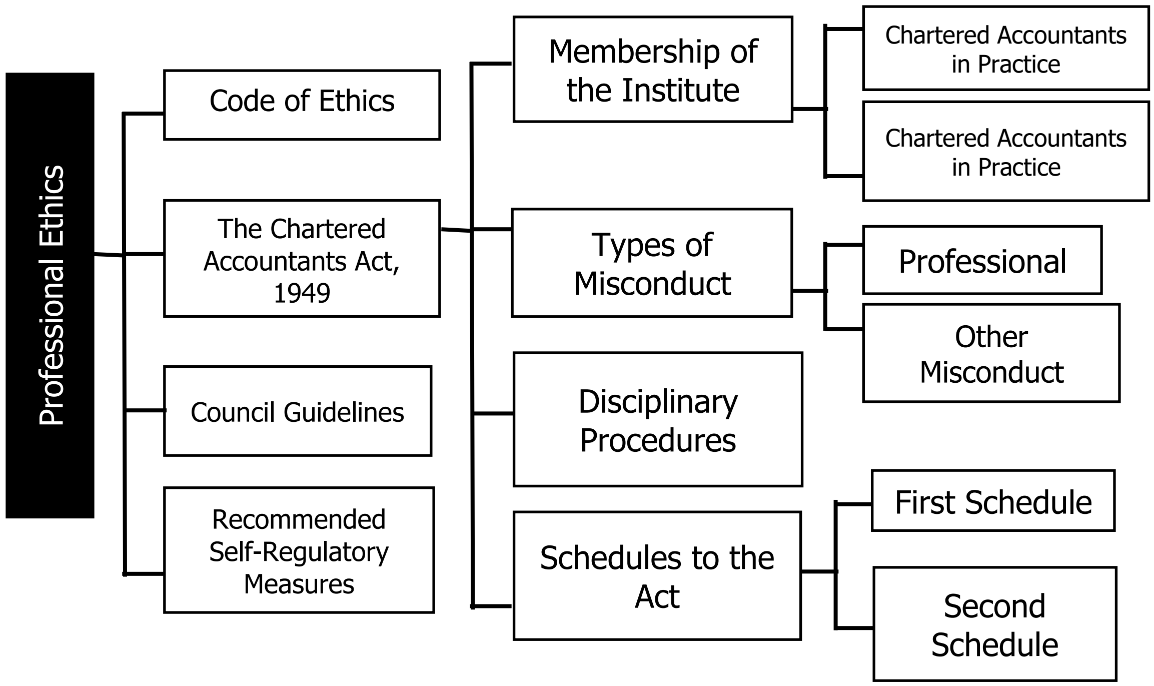
INDIAN ACCOUNTING STANDARDS (IND AS) AND INFORMATION TECHNOLOGY

Ind AS is predominantly a principle-based framework. Ind AS consists of specific principles for various accounting topics, such as revenue recognition, leasing, financial instruments, employee benefits, consolidation, and many more. These principles provide detailed guidance on how to account for transactions in accordance with the principles of measurement and recognition.

For implementation of Ind AS, the technology will play key role in automating the process of validating while generating the reports. However, the role of technology for such processing is directly related to the configuration at the Account level with rule-based validations. Configuration implements pre-defined validation rules within the system to identify discrepancies or non-compliance with Ind AS.

If the account level configuration is not done properly, then the next phase of using technology will be after generating the reports. In such scenario, the use of technology is about applications such as Microsoft Excel or Google Sheets which can be used to perform such validations from the Ind AS point of view and then generate the report. This is purely dependent on human intelligence rather than on technology, except for the cases where Artificial Intelligence is involved with proper training using machine learning.

PROFESSIONAL AND ETHICAL DUTIES OF CHARTERED ACCOUNTANT



1. WHAT ARE ETHICS

The Merriam-Webster dictionary defines ethic / ethics **to be a set of moral principles**: a theory or system of moral values, the principles of conduct governing an individual or the discipline dealing with what is good and bad and with moral duty and obligation.

2. ETHICAL PRINCIPLES IN FINANCIAL REPORTING

ICAI's Code of Ethics (2019), the "Code", which was developed on adopting the provisions of International Federation of Accountants (IFAC) Code of Ethics for the Chartered Accountants identifies the fundamental principles relevant to accountants. This Code of Ethics is applicable from **1st July, 2020.**

This Code has been derived from the International Ethics Standards Board for Accountants (IESBA) Code of Ethics, 2018 issued by the International Federation of Accountants (IFAC).

A. The Code of Ethics ("the Code") sets out **fundamental principles of ethics** for Chartered Accountants (hereinafter also called as "accountants"), reflecting the recognition and responsibility of the profession 'chartered accountant' in public interest. These principles establish the standard of behavior expected of a Chartered Accountant.

B. The Code provides a conceptual framework that Chartered Accountants are to apply in order to identify, evaluate and address threats to compliance with the fundamental principles. The Code sets out requirements and application material on various topics to help accountants apply the conceptual framework to those topics

Note: The principles laid down in the Code of Ethics pertaining to the case of audits, reviews and other assurance engagements, including Independence Standards, established by the application of the conceptual framework to threats to independence in relation to these engagements are dealt with in detail in the 'Advanced Auditing, Assurance and Professional Ethics'

3. THE CHARTERED ACCOUNTANTS ACT, 1949

A person qualifying as a Chartered Accountant becomes the member on registration with the Institute of the Chartered Accountants of India. Every member has to carry on their professional and other conduct as per the Chartered Accountants Act, 1949.

A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any Professional or Other Misconduct

4. WHAT IS PROFESSIONAL OR OTHER MISCONDUCT FOR A CHARTERED ACCOUNTANT?

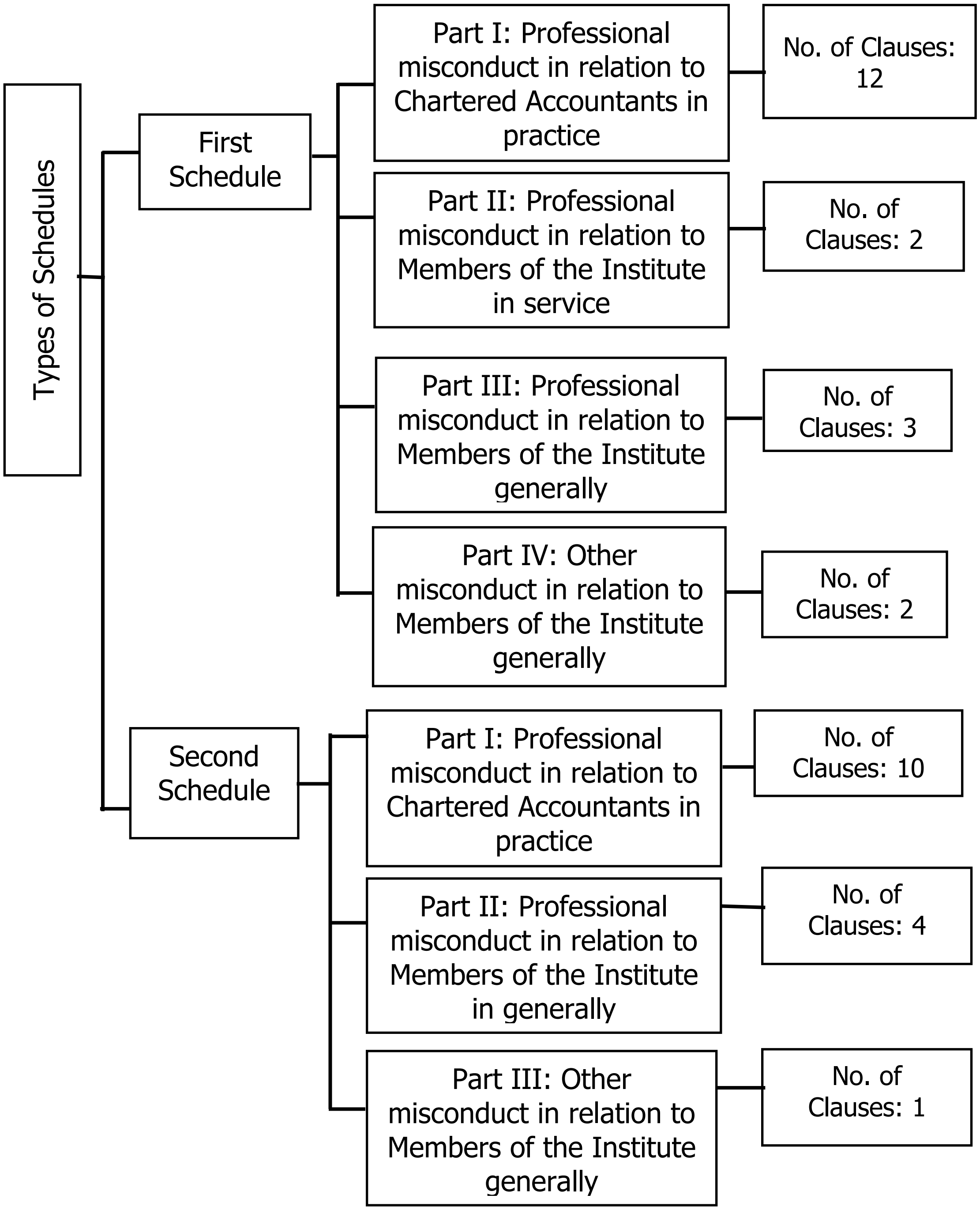
According to section 22 of the Act, the expression "professional or other misconduct" shall be deemed to include any act or omission provided in any of the Schedules (of the Act).

A. PROFESSIONAL MISCONDUCT

Professional misconduct has been defined in **Part I, II and III of the First Schedule**; and **Part I and II of the Second Schedule**. A member who is engaged in the profession of accountancy whether in practice or in service should conduct/restrict his actions in accordance with the provisions contained in the respective parts of the schedules. If the member is found guilty of any of the acts or omissions stated in any of the respective parts of the Schedule, he/she shall be deemed to be guilty of professional misconduct.

B. OTHER MISCONDUCT

Other misconduct has been defined in **Part IV of the First Schedule and Part III of the Second Schedule.** These provisions empower the Council to inquire into any misconduct of a member even if it does not arise out of his professional work. This is considered necessary because a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.



The clauses covered in Part I, II and III of Second Schedule have been shown in the form of flowchart below. However, for detail explanation, one must refer the Chapter on 'Professional Ethics' of Final Paper 3 'Advanced Auditing, Assurance and Professional Ethics'

SECOND SCHEDULE TO THE CHARTERED ACCOUNTANTS ACT, 1949

Part I – Professional Misconduct in relation to Chartered Accountants in Practice: (10 clauses)

- **Clause 1** → Discloses Information acquired in the course of his professional engagement to any person other than his client so engaging him without the consent of his client or otherwise than as required by any law for the time being in force.
- **Clause 2** → Certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice.
- **Clause 3** → Permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in manner which may lead to the belief that he vouches for the accuracy of the forecast.
- **Clause 4** → Expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.
- **Clause 5** → Fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity.
- **Clause 6** → Fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity
- **Clause 7** → Does not exercise due diligence or is grossly negligent in the conduct of his professional duties.
- **Clause 8** → Fails to obtain sufficient information which is necessary for expression of an opinion, or its exceptions are sufficiently material to negate the expression of an opinion.
- **Clause 9** → Fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances
- **Clause 10** → Fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

PART II - Professional misconduct in relation to members of the Institute generally (4 clauses)

- **Clause 1** → Contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council*.
- **Clause 2** → Being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer.
- **Clause 3** → Includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline. Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.
- **Clause 4** → Defalcates or embezzles money received in his professional capacity

Part III - Other misconduct in relation to members of the Institute generally (1 clause)

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.

***Note: Council Guidelines**

For conduct of a member being an employee, the Council Guidelines in its **Appendix 34** of the Chartered Accountants Act, 1949, states that a member of the Institute who is an employee **shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.**

The following part of the Code of Ethics shall be dealt with in Financial Reporting:

- Complying with the Code, Fundamental Principles and Conceptual Framework (applicable to all Chartered Accountants) (relevant part of this Section covered in detail in subsequent pages); and
- Chartered Accountants in Service (relevant part of this Section covered in detail in subsequent pages).

PART 1: COMPLYING WITH THE CODE, FUNDAMENTAL PRINCIPLES AND CONCEPTUAL FRAMEWORK

1. COMPLYING WITH THE CODE

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. A Chartered Accountant's responsibility is not exclusively to satisfy the needs of an individual client or employing organization. Code contains requirements and application material to enable Chartered Accountants to meet their responsibility to act in the public interest.

A Chartered Accountant shall comply with the Code. There might be circumstances where laws or regulations preclude an accountant from complying with certain parts of the Code. In such circumstances, those laws and regulations prevail, and the accountant shall comply with all other parts of the Code.

The principle of professional behavior requires a Chartered Accountant to comply with relevant laws and regulations. Accountants need to be aware of differences in local regulations from the provisions as set out in the Code and comply with the more stringent provisions unless prohibited by law or regulation.

2. THE FUNDAMENTAL PRINCIPLES

There are five fundamental principles of ethics for Chartered Accountants:

a) **Integrity** – to be straightforward and honest in all professional and business relationships.
b) **Objectivity** – not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.
c) **Professional Competence and Due Care** – to:
   i. attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
   ii. act diligently and in accordance with applicable technical and professional standards.
d) **Confidentiality** – to respect the confidentiality of information acquired as a result of professional and business relationships.
e) **Professional Behaviour** – to comply with relevant laws and regulations and avoid any conduct that the Chartered Accountant knows or should know might discredit the profession.

A Chartered Accountant shall comply with each of the fundamental principles

A Chartered Accountant might face a situation in which complying with one fundamental principle conflicts with complying with one or more other fundamental principles. In such a situation, the accountant might consider consulting, with:

- Others within the firm or employing organization.
- Those charged with governance.
- Institute
- Legal counsel.

However, such consultation does not relieve the accountant from the responsibility to exercise professional judgment to resolve the conflict or, if necessary, and unless prohibited by law or regulation, disassociate from the matter creating the conflict.

3. INTEGRITY

A Chartered Accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships.

A Chartered Accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information:

- Contains a materially false or misleading statement;
- Contains statements or information provided negligently; or
- Omits or obscures required information where such omission or obscurity would be misleading.

4. OBJECTIVITY

A Chartered Accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

Question 1

Info star Ltd. is a listed company engaged in the provision of IT services in India. The directors are paid a bonus based on the profits achieved by the company during the year as per the bonus table given below:

Range of Profit after tax	Bonus to Directors
Less than Rs 1 crore	NIL
Rs 1 crore to < Rs 5 crores	2% of Net Profit after tax
Rs 5 crores to < Rs 10 crores	4% of Net Profit after tax
Rs 10 crores to < Rs 20 crores	6% of Net Profit after tax
Rs 20 crores to < Rs 30 crores	8% of Net Profit after tax
Rs 30 crores and above	10% of Net Profit after tax

The draft Statement of Profit and Loss for the year ended 31 March 20X2 currently shows a profit of Rs 2 crores.

Issue:

On 25 March 20X2, Infostar Ltd. sold land located adjacent to its head office to a third party Zest Ltd. for a consideration of Rs 40 crores, with an option to purchase the land back on 25 May 20X2 for Rs 40 crores plus a premium of 6%. The amount received from the transaction eliminated the bank overdraft of Infostar Ltd. as on 31 March 20X2. On instructions of the Chief Financial Officer of the company, who is a chartered accountant, the transaction was treated as a sale, including the profit arising on disposal in the Statement of Profit and Loss for the year ending 31 March 20X2.

Required:

Discuss the ethical and accounting implications of the above issues with respect to a chartered accountant in service, referring to the relevant Ind AS wherever appropriate.

Solution

Accounting Treatment

The sale of land meets the conditions specified in Ind AS 115, Revenue from Contracts with Customers for qualifying as a repurchase agreement as Infostar Ltd. has an option to buy back the land from Zest Ltd. and therefore, control is not transferred as Zest Ltd.'s ability to use and gain benefit from the land is limited. Infostar Ltd. must treat the transaction as a financing arrangement and record both the asset (land) and the financial liability (the amount received which is repayable to Zest Ltd.).

Infostar Ltd. should not have derecognized the land from the financial statements because the risks and rewards of ownership are not transferred. Thus, the substance of the transaction is a loan of Rs 40 crores, with the 6% 'premium' on repurchase effectively reflecting interest payment.

Recording the aforesaid transaction as a sale is an attempt to manipulate the financial statements in order to show an improved profit figure and a more favourable cash position. The sale must be reversed and the land should be reinstated at its carrying amount prior to the transaction.

Ethical Issues

Chartered Accountants are required to comply with the fundamental principles laid down in the Code of Ethics. This includes acting with integrity. It appears that the integrity of CFO is compromised in this situation as he had accounted the transaction as sale and not as a loan or financial arrangement. The effect of accounting it as sale just before the year end is merely to improve profits and eliminate the bank overdraft, thereby making the cash position seem better than it is. This effectively amounts to 'window dressing', which is not honest as it does not present the actual performance and position of Infostar Ltd.

Accountants must also act with objectivity, which means they must not allow bias, conflict or undue influence of others to override professional or business judgments. Therefore, the management must put the interests of the company and the shareholders before their own interests. The pressure to show profits and achieve a bonus is in the self-interest of the directors and seems to have been partly driven the transaction and the subsequent accounting, which is clearly a conflict of interest.

It is further necessary for the accountants to comply with the principles of professional behaviour, which require compliance with relevant laws and regulations. In the instant case, the accounting treatment is not in conformity with Ind AS. The given facts do not make it clear whether CFO is aware of this or not. If he is aware but still applied the incorrect treatment, he has not complied with the principle of professional behaviour. It may be that he was under undue pressure from the directors to record the transaction in this manner. If, however, he is not aware that the treatment is incorrect, then he has not complied with the principle of professional competence as his knowledge and skills are not updated.

In such a case, he is subject to professional misconduct under Clause 1 of Part II of Second Schedule of the Chartered Accountants Act, 1949. Clause 1 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

5. PROFESSIONAL COMPETENCE AND DUE CARE

Maintaining professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development enables a Chartered Accountant to develop and maintain the capabilities to perform competently within the professional environment.

Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.

In complying with the principle of professional competence and due care, a Chartered Accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision.

Question 2

Rustom Ltd., a company engaged in oil extraction, has a present obligation to dismantle the oil rig installed by it at the end of the useful life of 10 years. Rustom Ltd. cannot cancel this obligation or transfer it. Rustom Ltd. intends to carry out the dismantling work itself and estimates the cost of the work to be Rs 100 crores at the end of 10 years.

The directors of Rustom Ltd. are aware of the requirements of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', read with Ind AS 16 'Property, Plant and Equipment'. However, they propose to expense the costs of dismantling the oil rig as and when incurred, with no entries or disclosures in the latest financial statements. They argue that application of Ind AS involves judgment, and although prudence is mentioned in the Conceptual Framework, it is only one among the many ways of achieving faithful representation.

Required:
Discuss whether the directors are acting unethically in the above instance what should be the practising Chartered Accountant's course of action in this regard.

Solution
The treatment proposed by the director is in contravention of Ind AS 37. As per Ind AS 16 and Ind AS 37, an entity, at the time of initial recognition of the asset, capitalises the present value of the cost of dismantling to be occurred at the end of the life of the asset, to the cost of the asset by simultaneously creating a provision for the same. In the given case, it appears to be a deliberate intention to contravene Ind AS 16 and Ind AS 37, and not an unintentional mistake.
Though the directors can exercise strong or undue influence over the chartered accountant, the chartered accountant is bound to act with integrity and remain unbiased, recommending to the directors that Ind AS 16 and Ind AS 37 must be complied with, and ensure appropriate entries are passed in the financial statements. The matter may be raised before the non-executive directors, explaining the issue to them and ensure the financial statements are true and fair and comply with the relevant Ind AS.
It is essential for the chartered accountant to inform those in governance (directors) about the necessary corrective measures in this case. By doing so, he uphold the fundamental principle of professional behaviour and demonstrate compliance with relevant laws and regulations. By communicating the corrective measures to those responsible for governance, the chartered accountant can ensure that the contravention of Ind AS 16 and Ind AS 37 is addressed and rectified. However, if he does not communicate the corrective measures to the directors, the fundamental principle of professional behaviour will be breached. Members should comply with relevant laws and regulations and avoid any action that discredits the profession. By knowingly allowing the directors not to apply the requirements of an Ind AS, the Chartered Accountant would not be acting diligently in accordance with applicable guidance and would not be demonstrating professional competence and due care. In such a situation, he will be subject to professional misconduct under Clauses 5, 6 and 7 of Part I of Second Schedule of the Chartered Accountants Act, 1949.

Clause 5 states that a chartered accountant is guilty of professional misconduct when he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity.

Clause 6 states that a CA is guilty of professional misconduct when he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity.

Clause 7 states that a Chartered Accountant is guilty of professional misconduct when he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

6. CONFIDENTIALITY

A Chartered Accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships. An accountant shall:

a) Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member;
b) Maintain confidentiality of information within the firm or employing organization;
c) Maintain confidentiality of information disclosed by a prospective client or employing organization;
d) Not disclose confidential information acquired as a result of professional and employment relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;
e) Not use confidential information acquired as a result of professional and employment relationships for the personal advantage of the accountant or for the advantage of a third party;
f) Not use or disclose any confidential information, either acquired or received as a result of a professional or employment relationship, after that relationship has ended; and
g) Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

For instance, confidentiality is a paramount ethical principle that should not be breached when providing payroll services to clients, unless required by law or authorized by the client. Chartered Accountants have a duty to uphold the confidentiality of payroll-related information and ensure the security and protection of sensitive data of the organisation.

Confidentiality serves the public interest because it facilitates the free flow of information from the Chartered Accountant's client or employing organization to the accountant in the knowledge that the information will not be disclosed to a third party. Nevertheless, the following are circumstances where Chartered Accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

a) Disclosure is required by law, for example:
   i. Production of documents or other provision of evidence in the course of legal proceedings; or
   ii. Disclosure to the appropriate public authorities of infringements of the law that come to light;
b) Disclosure is permitted by law and is authorized by the client or the employing organization; and
c) There is a professional duty or right to disclose, when not prohibited by law:
   i. To comply with the requirements of peer review or quality review of the Institute
   ii. To respond to an inquiry or investigation by a professional or regulatory body;
   iii. To protect the professional interests of a Chartered Accountant in legal proceedings; or
   iv. To comply with technical and professional standards, including ethics requirements.

Breaches of confidentiality may occur in the scenario like insider trading, where chartered accountants must avoid using or sharing material information of the entity for personal gain.

Similarly, hiding material facts which require disclosure like reporting fraud, illegal activities, or non-compliance with laws and regulations does not constitute confidentiality. Chartered accountants have an ethical duty to report fraudulent or manipulative activities that could impact the end users.
Nonetheless, confidentiality should be applied cautiously with justifiable legal or ethical grounds, and professional judgment and after due legal advice, wherever necessary.

A Chartered Accountant shall continue to comply with the principle of confidentiality even after the end of the relationship between the accountant and a client or employing organization. When changing employment or acquiring a new client, the accountant is entitled to use prior experience but shall not use or disclose any confidential information acquired or received as a result of a professional or employment relationship.

7. PROFESSIONAL BEHAVIOUR

When promoting himself and his work, a Chartered Accountant shall not bring the profession into disrepute. A Chartered Accountant is required to conduct his affairs in a manner that he remains outside the boundaries of professional and other misconduct. A Chartered Accountant shall be honest and truthful and shall not make:

a) Exaggerated claims for the services offered by, or the qualifications or experience of, the accountant; or
b) Disparaging references or unsubstantiated comparisons to the work of others.

Any direct or indirect measures to advertise any professional/other facts which are in violation of Advertisement Guidelines issued by the Council of the Institute from time to time.

THE CONCEPTUAL FRAMEWORK

The Chartered Accountant shall apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles.

a) Identify threats to compliance with the fundamental principles;
b) Evaluate the threats identified; and
c) Address the threats by eliminating or reducing them to an acceptable level.

When applying the conceptual framework, the Chartered Accountant shall:

a) Exercise professional judgment;
b) Remain alert for new information and to changes in facts and circumstances; and Use the reasonable and informed third party test.

Exercise of Professional Judgment

Professional judgment involves the application of relevant training, professional knowledge, skill and experience commensurate with the facts and circumstances, including the nature and scope of the particular professional activities, and the interests and relationships involved. In relation to undertaking professional activities, the exercise of professional judgment is required when the Chartered Accountant applies the conceptual framework in order to make informed decisions about the courses of actions available, and to determine whether such decisions are appropriate in the circumstances.

An understanding of known facts and circumstances is a prerequisite to the proper application of the conceptual framework. Determining the actions necessary to obtain this understanding and coming to a conclusion about whether the fundamental principles have been complied with also require the exercise of professional judgment.

In exercising professional judgment to obtain this understanding, the Chartered Accountant might consider, among other matters, whether:

- There is reason to be concerned that potentially relevant information might be missing from the facts and circumstances known to the accountant.
- There is an inconsistency between the known facts and circumstances and the accountant’s expectations.
- The accountant’s expertise and experience are sufficient to reach a conclusion.
- There is a need to consult with others with relevant expertise or experience.
- The information provides a reasonable basis on which to reach a conclusion.
- The accountant’s own preconception or bias might be affecting the accountant’s exercise of professional judgment.
- There might be other reasonable conclusions that could be reached from the available information.

Reasonable and Informed Third Party

The reasonable and informed third party test is a consideration by the Chartered Accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third party does not need to be an accountant but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant’s conclusions in an impartial manner.

PART 2: CHARTERED ACCOUNTANTS IN SERVICE

A. CONFLICTS OF INTEREST

A Chartered Accountant shall not allow a conflict of interest to compromise professional or business judgment.

Examples of circumstances that might create a conflict of interest include:

a) Serving in a management or governance position for two employing organizations and acquiring confidential information from one organization that might be used by the Chartered Accountant to the advantage or disadvantage of the other organization.
b) Undertaking a professional activity for each of two parties in a partnership, where both parties are employing the accountant to assist them to dissolve their partnership.
c) Preparing financial information for certain members of management of the accountant's employing organization who are seeking to undertake a management buy-out.
d) Being responsible for selecting a vendor for the employing organization when an immediate family member of the accountant might benefit financially from the transaction.
e) Serving in a governance capacity in an employing organization that is approving certain investments for the company where one of those investments will increase the value of the investment portfolio of the accountant or an immediate family member.

1. Conflict Identification

A Chartered Accountant shall take reasonable steps to identify circumstances that might create a conflict of interest, and therefore a threat to compliance with one or more of the fundamental principles. Such steps shall include identifying:

a) The nature of the relevant interests and relationships between the parties involved; and
b) The activity and its implication for relevant parties.

2. Threats created by Conflict of Interest

In general, the more direct the connection between the professional activity and the matter on which the parties' interest's conflict, the more likely the level of the threat is not at an acceptable level.

An example of an action that might eliminate threats created by conflicts of interest is withdrawing from the decision-making process related to the matter giving rise to the conflict of interest.

Examples of actions that might be safeguards to address threats created by conflicts of interest include:

a) Restructuring or segregating certain responsibilities and duties.
b) Obtaining appropriate oversight, for example, acting under the supervision of an executive or non-executive director.

3. Disclosure and Consent

It is generally necessary to:

a) Disclose the nature of the conflict of interest and how any threats created were addressed to the relevant parties, including to the appropriate levels within the employing organization affected by a conflict; and
b) Obtain consent from the relevant parties for the Chartered Accountant to undertake the professional activity when safeguards are applied to address the threat.

When addressing a conflict of interest, the Chartered Accountant is encouraged to seek guidance from within the employing organization or from the Institute, legal counsel or another accountant. When making such disclosures or sharing information within the employing organization and seeking guidance of third parties, the principle of confidentiality applies.

Question 3

Alaap Ltd.'s directors feel that the company needs a significant injection of capital in order to modernize plant and equipment as the company has been promised firm orders if it can produce goods of international standards. The current lending policies of the banks require prospective borrowers to demonstrate strong projected cash flows, coupled with a Debt Service Coverage Ratio exceeding 10. However, the current projected statement of cash flows does not satisfy the bank's criteria for lending. The directors have told the bank that the company is in an excellent financial position, the financial results and cash flow projections will meet the criteria and the chartered accountant will submit a report to this effect shortly. The chartered accountant has recently joined Alaap Ltd. and has openly stated that he cannot afford to lose his job because of financial commitments.

Required:

Discuss the potential ethical conflicts which may arise in the above scenario and the ethical principles which would guide how the chartered accountant should respond to the situation

Solution

The given scenario presents a twofold conflict of interest:

i. **Pressure to obtain finance and chartered accountant's personal circumstances**
The chartered accountant is under pressure to provide the bank with a projected cash flow statement that will meet the bank's criteria when in fact the actual projections do not meet the criteria. The chartered accountant's financial circumstances mean that he cannot lose his job, thus the ethical and professional standards required of the accountant are at odds with the pressures of his personal circumstances.

ii. **Duty to shareholders, employees and bank**
The directors have a duty to act in the best interests of the company's shareholders and employees, and a duty to present fairly any information the bank may rely on. The injection of capital to modernise plant and equipment appears to be for capacity expansion which will

lead to greater profits, thus being in the interests of the shareholders and the employees. However, if such finance is obtained based on misleading information, it could actually be detrimental to the going concern status of the company.

It could be argued that there is a conflict between the short-term and medium-term interests of the company (the need to modernise the company) and its long-term interests (the detriment to the company's reputation if its directors do not conform to ethics).

Ethical principles guiding the chartered accountant's response

The chartered accountant's financial circumstances coupled with the pressure from the directors could end up in him knowingly disclosing incorrect information to the bank, thereby compromising the fundamental principles of objectivity, integrity and professional competence.

By exhibiting bias due to the risk of losing his job through reporting favourable cash flows to the bank, objectivity is compromised. Further, integrity is also compromised as by not acting in a straightforward and honest manner, incorrect information is knowingly disclosed. Forecasts, unlike financial statements, do not specify that they have been prepared in accordance with Ind AS. However, the principle of professional competence requires the accountant to prepare the cash flow projections to the best of his professional judgment which would not be the case if the projections showed a more positive position than what is actually anticipated.

Appropriate action

The chartered accountant faces an immediate ethical dilemma and must apply his moral and ethical judgment. As a professional, he is responsible for presenting the truth, and not to indulge in 'creative accounting' owing to pressure.

Thus, the chartered accountant should put the interests of the company and professional ethics first and insist that the report to the bank be an honest reflection of the company's current financial position. Being an advisor to the directors, he must prevent deliberate misrepresentation to the bank, no matter what the consequences to him are personally. The accountant should not allow any undue influence from the directors to override his professional judgment or integrity. This is in the long-term interests of the company and its survival.

It is suggested that the chartered accountant should communicate to the directors to submit the projected statement of cash flows to the bank, which reflects the current position of the company. Knowingly providing incorrect information is considered as professional misconduct. To prevent such misconduct, a chartered accountant should not provide incorrect projected cash flows to the bank and colour the financial position of the entity. By adhering to the ethical principles, the chartered accountant will maintain his professional integrity and contribute to the trust and reliability placed in the work expected from him.

However, if he submits the incorrect projected statement of cash flows, he would be subject to professional misconduct under Clause 1 of Part II of Second Schedule of the Chartered Accountants Act, 1949. The Clause 1 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

B. PREPARATION AND PRESENTATION OF INFORMATION

When preparing or presenting information, a Chartered Accountant shall:

a) Prepare or present the information in accordance with a relevant reporting framework, where applicable;
b) Prepare or present the information in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately;
c) Exercise professional judgment to:
    i. Represent the facts accurately and completely in all material respects;
    ii. Describe clearly the true nature of business transactions or activities; and
    iii. Classify and record information in a timely and proper manner; and
d) Not omit anything with the intention of rendering the information misleading or of influencing contractual or regulatory outcomes inappropriately.

An example of influencing a contractual or regulatory outcome inappropriately is using an unrealistic estimate with the intention of avoiding violation of a contractual requirement such as a debt covenant or of a regulatory requirement such as a capital requirement for a financial institution.

1) Use of Discretion in Preparing or Presenting Information

Preparing or presenting information might require the exercise of discretion in making professional judgments. The Chartered Accountant shall not exercise such discretion with the intention of misleading others or influencing contractual or regulatory outcomes inappropriately.

Examples of ways in which discretion might be misused to achieve inappropriate outcomes include:

- Determining estimates, for example, determining fair value estimates in order to misrepresent profit or loss.
- Selecting or changing an accounting policy or method among two or more alternatives permitted under the applicable financial reporting framework, for example, selecting a policy for accounting for long-term contracts in order to misrepresent profit or loss.
- Determining the timing of transactions, for example, timing the sale of an asset near the end of the fiscal year in order to mislead.
- Determining the structuring of transactions, for example, structuring financing transactions in order to misrepresent assets and liabilities or classification of cash flows.

- Selecting disclosures, for example, omitting or obscuring information relating to financial or operating risk in order to mislead.

When performing professional activities, the Chartered Accountant shall exercise professional judgment to identify and consider:

a) The purpose for which the information is to be used;
b) The context within which the information is given; and
c) The audience to whom it is addressed.

For example, when preparing or presenting pro forma reports, budgets or forecasts, the inclusion of relevant estimates, approximations and assumptions, where appropriate, would enable those who might rely on such information to form their own judgments.

2) Relying on the Work of Others

A Chartered Accountant who intends to rely on the work of others, either internal or external to the employing organization, shall exercise professional judgment to determine what steps to take, if any, in order to fulfil the responsibilities.

Factors to consider in determining whether reliance on others is reasonable include:

- The reputation and expertise of, and resources available to, the other individual or organization.
- Whether the other individual is subject to applicable professional and ethics standards.

Such information might be gained from prior association with, or from consulting others about, the other individual or organization.

3) Addressing Information that Is or Might be Misleading

When the Chartered Accountant knows or has reason to believe that the information with which the accountant is associated is misleading, the accountant shall take appropriate actions to seek to resolve the matter.

- Actions that might be appropriate include:
- Discussing concerns that the information is misleading with the Chartered Accountant's superior and/or the appropriate level(s) of management within the accountant's employing organization or those charged with governance and requesting such individuals to take appropriate action to resolve the matter. Such action might include:
    - Having the information corrected.
    - If the information has already been disclosed to the intended users, informing them of the correct information.

Consulting the policies and procedures of the employing organization (for example, an ethics or whistle-blowing policy) regarding how to address such matters internally

The Chartered Accountant might determine that the employing organization has not taken appropriate action. If the accountant continues to have reason to believe that the information is misleading, the following further actions might be appropriate provided that the accountant remains alert to the principle of confidentiality:

- Consulting with:
  - The Institute
  - The internal or external auditor of the employing organization
  - Legal counsel.
- Determining whether any requirements exist to communicate to:
  - Third parties, including users of the information.
  - Regulatory and oversight authorities.

If after exhausting all feasible options, the Chartered Accountant determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the accountant shall refuse to be or to remain associated with the information

In such circumstances, it might be appropriate for a Chartered Accountant to resign from the employing organization.

Question 4

Sunshine Ltd., a listed company in the cosmetics industry, has debt covenants attached to some of its borrowings which are included in Financial Liabilities in the Balance Sheet. These covenants mandate the company to repay the debt in full if Sunshine Ltd. fails to maintain a liquidity ratio and operating margin above the specified limit.

The directors along with the CFO of the Company who is a chartered accountant are considering entering into a fresh five-year leasing arrangement but are concerned about the negative impact any potential lease obligations may have on the above-mentioned covenants. Accordingly, the directors and CFO propose that the lease agreement be drafted in such a way that it is a series of six ten-month leases rather than a single five-year lease in order to utilize the short-term lease exemption available under Ind AS 116, Leases. This would then enable accounting for the leases in their legal form. The directors believe that this treatment will meet the requirements of the debt covenant, though such treatment may be contrary to the accounting standards.

Required:

Discuss the ethical and accounting implications of the above issue from the perspective of CFO.

Solution

Lease agreement substance presentation

Stakeholders make informed and accurate decisions based on the information presented in the financial statements and as such, ensuring the financial statements are reliable and of utmost importance. The directors of Sunshine Ltd. are ethically responsible to produce financial statements that comply with Ind AS and are transparent and free from material error. Lenders often attach covenants to the terms of the agreement in order to protect their interests in an entity. They would also be of crucial importance to potential debt and equity investors when assessing the risks and returns from any future investment in the entity.

The proposed action by Sunshine Ltd. appears to be a deliberate attempt to circumvent the terms of the covenants. The legal form would require treatment as a series of short-term leases which would be recorded in the profit or loss, without any right-of-use asset and lease liability being recognized as required by Ind AS 116, Leases. This would be a form of 'off-balance sheet finance' and would not report the true assets and obligations of Sunshine Ltd. As a result of this proposed action, the liquidity ratios would be adversely misrepresented. Further, the operating profit margins would also be adversely affected, as the expenses associated with the lease are likely to be higher than the deprecation charge if a leased asset was recognized, hence the proposal may actually be detrimental to the operating profit covenant.

Sunshine Ltd. is aware that the proposed treatment may be contrary to Ind AS. Such manipulation would be a clear breach of the fundamental principles of objectivity and integrity as outlined in the Code of Ethics. It is important for a chartered accountants to exercise professional behaviour and due care all the time. The proposals by Sunshine Ltd. are likely to mislead the stakeholders in the entity. This could discredit the profession by creating a lack of confidence within the profession. The directors of Sunshine Ltd. must be reminded of their ethical responsibilities and persuaded that the accounting treatment must fully comply with the Ind AS and principles outlined within the framework should they proceed with the financing agreement.

However, if the CFO fails to comply with his professional duties, he will be subject to professional misconduct under Clause 1 of Part II of Second Schedule of the Chartered Accountants Act, 1949. The Clause 1 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

C. ACTING WITH SUFFICIENT EXPERTISE

A Chartered Accountant shall not intentionally mislead an employing organization as to the level of expertise or experience possessed.

A self-interest threat to compliance with the principle of professional competence and due care might be created if a Chartered Accountant has:

- Insufficient time for performing or completing the relevant duties.
- Incomplete, restricted or otherwise inadequate information for performing the duties.
- Insufficient experience, training and/or education.
- Inadequate resources for the performance of the duties.

Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining assistance or training from someone with the necessary expertise.
- Ensuring that there is adequate time available for performing the relevant duties.

If a threat to compliance with the principle of professional competence and due care cannot be addressed, a Chartered Accountant shall determine whether to decline to perform the duties in question. If the accountant determines that declining is appropriate, the accountant shall communicate the reasons.

Question 5

Agastya Ltd. is a listed company engaged in the manufacturing of automotive spare parts. The company is preparing the financial statements for the year ended 31 March 20X3. The directors of Agastya Ltd. are entitled to an incentive based on the operating profit margin of the company. You have been appointed as a consultant to advise on the preparation of the financial statements, and you notice the following issue:

Issue:

On 1 April 20X2, Agastya Ltd.'s defined benefit pension scheme was amended to increase the pension entitlement from 12% of final salary to 18.5% of final salary. This amendment was made due to the salary cuts made on account of the pandemic. The chartered accountant has shown such increase in the pension entitlement (amounting to Rs 85 crores) under the head 'Employee Benefits' forming part of the operating profit. The directors are unhappy with this presentation. They believe that the pension scheme is not integral to the operations of the company since it is paid post-retirement of the employees, and thus insist that such presentation would be misleading in computing the operating profit or loss. Accordingly, the directors propose a change in accounting policy so that all such gains or losses on pension scheme would be recognized under Other Comprehensive Income. The directors believe that this policy choice will make the financial statements more consistent, understandable thereby justifying the same on grounds of fair presentation as defined in the Framework. The pension scheme of Agastya Ltd. is currently in deficit.

Required:

Discuss the ethical and accounting implications of the above issues, referring to the relevant Ind AS wherever appropriate from the perspective of the consultant.

Solution

Ethical Implications of change in accounting policy

Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors only permits a change in accounting policy if the change is: (i) required by an Ind AS or (ii) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. A retrospective adjustment is required unless the change arises from a new accounting policy with transitional arrangements to account for the change. It is permissible to depart from the requirements of Ind AS but only in extremely rare circumstances where compliance would be so misleading that it would conflict with overall objectives of the financial statements. Practically, this override is rarely, if ever, invoked.

Ind AS 19, Employee Benefits requires all gains and losses on a defined benefit pension scheme to be recognised in profit or loss except for the re-measurement component relating to plan assets and defined benefit obligations, which must be recognized in Other Comprehensive Income. Accordingly, current service cost, past service cost and net interest cost on the net defined benefit obligation must all be recognized in profit or loss. Ind AS 19 does not offer any alternative treatment as an accounting policy choice in terms of Ind AS 8, and therefore the directors' proposals cannot be justified on the grounds of fair presentation. The directors are ethically bound to prepare financial statements which reflect a true and fair view of the entity's performance and financial position and comply with all Ind AS.

It is the self-interest in the pension scheme that is making the directors consider a change in accounting policy in order to maximize profits for maximizing their bonus potential. The amendment to the pension scheme is a past service cost in terms of Ind AS 19 which should be expensed to the profit or loss during the period such plan amendment has occurred, i.e., immediately. This would impact the operating profits of Agastya Ltd. thereby reducing the potential bonus.

Additionally, it appears that the directors wish to manipulate aspects of the pension scheme such as current service cost and, since the pension scheme is given to be in deficit, the net finance cost. The directors are purposely manipulating the presentation of these items by recording them in equity instead of Profit or Loss. The financial statements would not be compliant with Ind AS and would not give a reliable picture of the true costs to the company of operating the pension scheme and this treatment would make the financial statements less comparable with other entities correctly applying Ind AS 19. Further, the explicit statement given in the financial statements stating that all compliance with Ind AS is achieved would be an incorrect statement to make in the event of the above non-compliance. Further, such treatment would be against the fundamental principles of objectivity, integrity and professional behaviour as stated in the Code of Ethics. The directors need to understand their ethical responsibilities and avoid implementing the proposed change in policy.

As a meaningful addition, the directors could use other tools/indicators within the financial statements to explain the company's results such as drawing attention of the users to the cash generated from operations which would exclude the non-cash pension expense. Alternative measures such as EBITDA could be disclosed where non-cash items are consistently eliminated for comparison purposes.

When a Chartered Accountant discovers that a company's financial position has been compromised through misstatement, they have two options. They can either report the non-compliance to the authorities or consider withdrawing from the engagement. Both the actions ensure integrity, transparency, and the interests of stakeholders at large.

In case the consultant-chartered accountant is influenced by the director's suggestions and report accordingly, he will be subject to professional misconduct under Clauses 5,7 and 8 of Part I of Second Schedule of the Chartered Accountants Act, 1949.

Clause 5 states that a Chartered Accountant is guilty of professional misconduct when he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity.

Clause 7 states that a Chartered Accountant is guilty of professional misconduct when he does not exercise due diligence or is grossly negligent in the conduct of his professional duties.

Clause 8 of Part I of the Second Schedule of the Chartered Accountants Act 1949 states that a CA is guilty of professional misconduct when he fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion

D. FINANCIAL INTERESTS, COMPENSATION AND INCENTIVES LINKED TO FINANCIAL REPORTING AND DECISION MAKING

A Chartered Accountant shall not manipulate information or use confidential information for personal gain or for the financial gain of others.

Chartered Accountants might have financial interests or might know of financial interests of immediate or close family members that, in certain circumstances, might create threats to compliance with the fundamental principles. Financial interests include those arising from compensation or incentive arrangements linked to financial reporting and decision making.

Examples of circumstances that might create a self-interest threat include situations in which the Chartered Accountant or an immediate or close family member:

- Has a motive and opportunity to manipulate price- sensitive information in order to gain financially.
- Holds a direct or indirect financial interest in the employing organization and the value of that financial interest might be directly affected by decisions made by the accountant.
- Is eligible for a profit-related bonus and the value of that bonus might be directly affected by decisions made by the accountant.
- Holds, directly or indirectly, deferred bonus share rights or share options in the employing organization, the value of which might be affected by decisions made by the accountant.
- Participates in compensation arrangements which provide incentives to achieve targets or to support efforts to maximize the value of the employing organization's shares. An example of such an arrangement might be through participation in incentive plans which are linked to certain performance conditions being met.

Question 6

The directors of Spinz Ltd. are eligible for an incentive computed as a percentage of 'Cash Generated from Operations' as defined in Ind AS 7, Statement of Cash Flows in accordance with the terms of their appointment. Due to the onset of the pandemic, the company has not performed well, and it has, in fact, lost Cash from Operations. In order to meet the cash requirements, the directors of Spinz Ltd. are planning to dispose off under-utilized equipment and investments (not subsidiaries or associates). The directors opine that since the cash generated from sale of such equipment and investments would be used for operations, the inflows on such sale would be presented in the Statement of Cash Flows under 'Cash from Operations'. The directors are concerned about meeting the targets in order to ensure security of their jobs and feel that this treatment would enhance the 'cash flow picture' of the business. The inflows on sale of such equipment and investments have the potential to make the 'Cash from Operations' figure positive.

Required:

Discuss the ethical responsibility of Spinz Ltd.'s Chartered Accountant who is an employee to ensure that the manipulation of the Statement of Cash Flows, as suggested by the directors, does not occur.

Solution

In order to meet targets, it is quite possible that management may want to present a company's results in a favourable manner. Such an objective could be achieved by employing creative accounting techniques such as window dressing, or as can be seen in the case, inaccurate classification.

As per para 16 of Ind AS 7, separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities. Example of cash flows arising from investing activities are cash receipts from sales of property, plant and equipment, intangibles and other long-term assets.

Presenting proceeds of sale of investments and under-utilized equipment as part of 'Cash from Operations' gives a misleading picture of the financial statements. Operating cash flows are crucial for the long-term survival of the company, and a negative cash from operations figure could be a possible indicator of cash shortage in the short-term, and possibly question the going concern assumption of the entity in the long-run. Further, operating cash flows are recurring, whereas investing and financing cash flows tend to be one-off.

In the given case, it may appear that to meet cash requirements for its operations, the company is selling its investments and equipment. Selling of equipment and investments is not usually a part of trading operations. Such sales generate short-term cash flow and cannot be repeated on a regular basis. The proposed misclassification could be regarded as a deliberate attempt to mislead stakeholders about the performance of Spinz Ltd. and its future performance, which is unethical.

Chartered Accountants have a duty, not only to the company they work for, but also to their professional body (i.e., ICAI), and to the stakeholders of the company. Proceeds received from sale of equipment and investment should be presented under 'Cash Flows from Investing Activities' (instead of 'Operating Activities') in accordance with Ind AS 7, Statement of Cash Flows. As per the Code of Ethics, a Chartered Accountant should follow the fundamental principle of professional competence and due care which includes preparing financial statements in compliance with Ind AS. In case the accountant permits the treatment of the matter as proposed by the management, it would result in a breach of the principle of professional competence and due care. This treatment may be permitted by the accountant under pressure from the management.

The chartered accountant should prevent the management not to proceed with the aforesaid accounting treatment which violates Ind AS 7. In case the management insists on continuing with their suggested treatment, then the chartered accountant must bring this to the attention of the auditors. Otherwise, the chartered accountant would be subject to professional misconduct under Clause 1 of Part II of Second Schedule of the Chartered Accountants Act, 1949. The Clause 1 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

Question 7

Infostar Ltd. is a listed company engaged in the provision of IT services in India. The directors are paid a bonus based on the profits achieved by the company during the year as per the bonus table given below:

Profit Range	Bonus to Directors
NIL < Profit < Rs 1 crore	NIL
Rs 1 crore < Profit < Rs 5 crores	2% of Net Profit
Rs 5 crores < Profit < Rs 10 crores	4% of Net Profit
Rs 10 crores < Profit < Rs 20 crores	6% of Net Profit
Rs 20 crores < Profit < Rs 30 crores	8% of Net Profit
Profit > Rs 30 crores	10% of Net Profit

The draft Statement of Profit and Loss for the year ended 31 March 20X2 currently shows a profit of Rs 2 crores.

Issue:

The employees of Infostar Ltd. have historically been paid an individual-performance-based discretionary incentive for the last 15 years. Based on the past trends and performance, the bonus amount for the year 20X1-20X2 would be Rs 3 crores. In view of the possibility of the directors not receiving the bonus on account of the company's poor performance, Infostar Ltd.'s Chief Financial

Officer (CFO), who is a chartered accountant, has suggested that the discretionary incentive usually payable to the employees could be avoided in the current year, which would result in the company reporting profits. As a part of its annual report, Infostar Ltd. reports employee satisfaction scores, staff attrition rates, gender equality and employee absenteeism rates as non- financial performance measures. The CFO has also told the directors over mail that no stakeholder reads the non-financial information anyway, and thus his aforesaid suggestion of not paying the discretionary incentive would not impact the company greatly.

Required:

Discuss the ethical and accounting implications of the above issues, referring to the relevant Ind AS wherever appropriate from perspective of CA. Sushil Bhupathy.

Solution

Ethical Considerations

Long-term success of any organization strongly depends on the fair treatment of employees, which in turn is based on the ethical behaviour of the management as well as how the same is perceived by the stakeholders. In the given case, the CFO has suggested not paying the discretionary bonus, which the directors are considering as it will enable the company to record profits of Rs 2 crores, thereby ensuring a bonus pay out to the directors. This suggestion is not illegal at all as the bonus is discretionary rather than statutory/contractual. In other words, the company has no legal obligation to pay the bonus to the employees. However, the reason behind non-payment of the bonus is what gives rise to ethical considerations. The suggestion by the CFO will have the aforesaid impact of reducing expenses and improving profits.

On a moral ground, the suggestion is likely to have negative consequences for the company. The employees would be dissatisfied that the bonus has been withdrawn, and further, when they would see the directors withdrawing bonuses out of the profits arising on a saving in bonus costs, it would have a negative impact on employee morale, which would result in low employee satisfaction scores and poor retention rates, which are reported as non-financial information in the financial statements. Companies are also under increasing pressure to reduce the wage gap between the management and its employees. By not paying a bonus, this metric will be adversely affected.

The CFO's statement that the above action will not negatively impact the company as the non-financial reporting indicators are not widely read by the users is misleading. The non-financial information is becoming increasingly important to the users of financial statements as they care about companies' treatment of their employees and view it as being important in the long-term success of the company.

A chartered accountant has a responsibility to exercise due diligence and clearly consider both financial and non-financial information while discharging his professional duty. It would be unethical for a chartered accountant to guide the management on matters which may result into any kind of disadvantage (it includes even non-financial matters) to the stakeholders.

Further, a distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. A chartered accountant's responsibility is not exclusively to satisfy the needs of an individual client or employing organization. Therefore, the Code contains requirements and application material to enable chartered accountants to meet their responsibility to act in the public interest. (Refer Section 100.1 A1, Code of Ethics issued by ICAI)
Hence, it is essential for a chartered accountant to uphold the professional standards and act in accordance with the ethical principles by ensuring transparency and accuracy in financial reporting.

E. INDUCEMENTS, INCLUDING GIFTS AND HOSPITALITY

An inducement is an object, situation, or action that is used as a means to influence another individual's behaviour, but not necessarily with the intent to improperly influence that individual's behaviour. Inducements can range from minor acts of hospitality between business colleagues to acts that result in non-compliance with laws and regulations. An inducement can take many different forms, for example:

- Gifts.
- Hospitality.
- Entertainment.
- Political or charitable donations.
- Appeals to friendship and loyalty.
- Employment or other commercial opportunities.
- Preferential treatment, rights or privileges

1) Immediate or Close Family Members

A Chartered Accountant shall remain alert to potential threats to the accountant's compliance with the fundamental principles created by the offering of an inducement:

a) By an immediate or close family member of the accountant to a counterparty with whom the accountant has a professional relationship; or
b) To an immediate or close family member of the accountant by a counterparty with whom the accountant has a professional relationship.

Where the Chartered Accountant becomes aware of an inducement being offered to or made by an immediate or close family member and concludes there is intent to improperly influence the behaviour of the accountant or of the counterparty or considers a reasonable and informed third party would be likely to conclude such intent exists, the accountant shall advise the immediate or close family member not to offer or accept the inducement.
One of the factors that is relevant in determining whether there is actual or perceived intent to improperly influence the behaviour of the Chartered Accountant or of the counter party is the nature or closeness of the relationship, between:

a) The accountant and the immediate or close family member;
b) The immediate or close family member and the counterparty; and
c) The accountant and the counterparty.

For example, the offer of employment, outside of the normal recruitment process, to the spouse of the accountant by a counterparty with whom the accountant is negotiating a significant contract might indicate such intent.

F. RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS IN CASE OF EMPLOYMENT WITH LISTED ENTITIES

A Chartered Accountant might encounter or be made aware of non-compliance or suspected non-compliance in the course of carrying out professional activities. This section guides the accountant in assessing the implications of the matter and the possible courses of action when responding to non-compliance or suspected non-compliance with:

a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the employing organization's financial statements; and
b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the employing organization's financial statements, but compliance with which might be fundamental to the operating aspects of the employing organization's business, to its ability to continue its business, or to avoid material penalties.

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected noncompliance, the objectives of the Chartered Accountant are:

a) To comply with the principles of integrity and professional behaviour;
b) By alerting management or, where appropriate, those charged with governance of the employing organization, to seek to:
    i. Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
    ii. Deter the non-compliance where it has not yet occurred; and
    iii. To take such further action as appropriate in the public interest.

Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:

a) The Chartered Accountant's employing organization;
b) Those charged with governance of the employing organization;
c) Management of the employing organization; or
d) Other individuals working for or under the direction of the employing organization.

Examples of laws and regulations which this section addresses include those that deal with:

- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading
- Banking and other financial products and services.
- Data protection.

- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

1) Responsibilities of All Chartered Accountants

If protocols and procedures exist within the Chartered Accountant's employing organization to address non-compliance or suspected non-compliance, the accountant shall consider them in determining how to respond to such non-compliance.

2) Responsibilities of Senior Chartered Accountants in Service

Senior Chartered Accountants in service ("senior Chartered Accountants") are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources. There is a greater expectation for such individuals to take whatever action is appropriate in the public interest to respond to non-compliance or suspected noncompliance than other Chartered Accountants within the employing organization. This is because of senior Chartered Accountants' roles, positions and spheres of influence within the employing organization.

1. Addressing the Matter

If the senior Chartered Accountant identifies or suspects that non-compliance has occurred or might occur, the accountant shall, subject to the considerations mentioned above under the responsibilities for all Chartered Accountants, discuss the matter with the accountant's immediate superior, if any. If the accountant's immediate superior appears to be involved in the matter, the accountant shall discuss the matter with the next higher level of authority within the employing organization.

The senior Chartered Accountant shall also take appropriate steps to:

a) Have the matter communicated to those charged with governance;
b) Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority;
c) Have the consequences of the non-compliance or suspected non-compliance rectified, remediated or mitigated;
d) Reduce the risk of re-occurrence; and
e) Seek to deter the commission of the non-compliance if it has not yet occurred.

In addition to responding to the matter in accordance with the provisions of this section, the senior Chartered Accountant shall determine whether disclosure of the matter to the employing organization's external auditor, if any, is needed.

Such disclosure would be pursuant to the senior Chartered Accountant's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

2. Determining Whether Further Action Is Needed

The senior Chartered Accountant shall assess the appropriateness of the response of the accountant's superiors, if any, and those charged with governance.

Examples of circumstances that might cause the senior Chartered Accountant no longer to have confidence in the integrity of the accountant's superiors and those charged with governance include situations where:

- The accountant suspects or has evidence of their involvement or intended involvement in any non-compliance.
- Contrary to legal or regulatory requirements, they have not reported, or authorized the reporting of, the matter to an appropriate authority within a reasonable period.

Further action that the senior Chartered Accountant might take includes:

- Informing the management of the parent entity of the matter if the employing organization is a member of a group.
- Disclosing the matter to an appropriate authority as specified under respective law.
- Resigning from the employing organization.

Resigning from the employing organization is not a substitute for taking other actions that might be needed to achieve the senior Chartered Accountant's objectives under this section. However, there might be limitations as to the further actions available to the accountant. In such circumstances, resignation might be the only available course of action.

3. Seeking Advice

As assessment of the matter might involve complex analysis and judgments, the senior Chartered Accountant might consider:

- Consulting internally
- Obtaining legal advice to understand the accountant's options and the professional or legal implications of taking any particular course of action.
- Consulting on a confidential basis with the Institute.

4. Determining Whether to Disclose the Matter to an Appropriate Authority

Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. Otherwise, the purpose of making disclosure is to enable an appropriate authority to cause the matter to be investigated and action to be taken in the public interest.

5. Responsibilities of Chartered Accountants Other than Senior Chartered Accountants

If, in the course of carrying out professional activities, a Chartered Accountant becomes aware of information concerning non-compliance or suspected non-compliance, the accountant shall seek to obtain an understanding of the matter. This understanding shall include the nature of the non-compliance or suspected non-compliance and the circumstances in which it has occurred or might occur.

If the Chartered Accountant identifies or suspects that noncompliance has occurred or might occur, the accountant shall, subject to the considerations mentioned above under the responsibilities for all Chartered Accountants, inform an immediate superior to enable the superior to take appropriate action. If the accountant's immediate superior appears to be involved in the matter, the accountant shall inform the next higher level of authority within the employing organization.

In exceptional circumstances, the Chartered Accountant may determine that disclosure of the matter to an appropriate authority is an appropriate course of action. If the accountant does so, that disclosure is permitted. When making such disclosure, the accountant shall act in good faith and exercise caution when making statements and assertions

Question 8

Agastya Ltd. is a listed company engaged in the manufacturing of automotive spare parts. The company is preparing the financial statements for the year ended 31 March 20X3. The directors of Agastya Ltd. are entitled to an incentive based on the operating profit margin of the company. You have been appointed as a consultant to advise on the preparation of the financial statements, and you notice the following issue:

Issue:

The draft financial statements include an amount of Rs 75 lakhs given as loan to a director. The loan has no specific repayment terms; the same is repayable on demand. The directors have included such loan under the heading 'Cash and Cash Equivalents'. They have reasoned that since such loan, which is advanced to one of the directors, is repayable on demand, it is readily convertible to cash. Further the directors opine that such presentation should not be a problem even under the Ind AS Framework as financial statements are essentially prepared in accordance with accounting policies which is the choice of the company, and in this case, Agastya Ltd. has made a policy choice to show such loan as a cash equivalent.

Required:

Discuss the ethical and accounting implications of the above issues, referring to the relevant Ind AS wherever appropriate.

Solution

The directors have included a loan made to a director as a part of Cash and Cash Equivalents. It appears that the directors have misunderstood the definition of Cash and Cash Equivalents, believing the loan to be a cash equivalent. As per Ind AS 7, Statement of Cash Flows, cash equivalents are short-term, highly liquid investments readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value. However, the loan given to the directors is not in place to enable Agastya Ltd. to manage its short-term cash commitments, it has no fixed repayment date and the likelihood of the director defaulting is also not known. Thus, the classification as a cash equivalent is inappropriate.

Instead, the loan should be regarded as a financial asset under Ind AS 109, Financial Instruments. Further information would be required, for example is ₹ 75 lakhs fair value? It could be said that the loan will never be repaid, and accordingly could be regarded as a component of directors' remuneration, and if so, the same should be expensed and disclosed accordingly. Further, since the director is likely to fall into the category of key management personnel, related party disclosures under Ind AS 24, Related Party Disclosures are likely to be necessary.

The treatment of loan as a cash equivalent breached two fundamental qualitative characteristics prescribed in the Conceptual Framework for Financial Reporting, namely:

i. **Relevance:** The information should be disclosed separately as it is relevant to users.
ii. **Faithful representation:** Information must be complete, neutral and free from error. Clearly, this will not be the case if loan to a director is shown as Cash Equivalents.

The said treatment is also violative of the Conceptual Framework's key enhancing qualitative characteristics:

i. **Understandability:** if the loan is shown as Cash Equivalents, it masks the true nature of company's practices, thereby reducing the understandability of the financial statements to the users.
ii. **Verifiability:** Verifiability ensures that different knowledgeable and independent observers can reach consensus that a particular depiction of a transaction / account balance is a faithful representation. Verifiability gives assurance to the users that the information faithfully represents the economic phenomena it intends to represent. The treatment given by the directors of Agastya Ltd. does not meet this benchmark as it reflects the subjective bias of the directors.
iii. **Comparability:** For financial statements to be comparable year-on-year and with other companies, transactions must be correctly classified and presented, which is not happening here. If the cash balance of one year includes a loan to a director and the next year it does not, then you are not comparing like with like.

There is a potential conflict of interest between that of the director and that of the company, which mandates a separate disclosure as a minimum. Further, issues with compliance of section 185 of the Companies Act, 2013 would arise, which is why probably the directors want to hide such loan balance under cash equivalents. Directors are responsible for the financial statements required by statute, and thus it is their responsibility to put right any errors that result in the financial statements not complying with Ind AS. The directors are also legally bound to maintain proper accounting records and recording a loan as cash equivalent clashes with this requirement.

By masking the nature of the transaction, it is possible that the directors are motivated by personal interest and are thus failing in their duty to act honestly and ethically. If one transaction is misleading, it casts doubt on the credibility of the financial statements as a whole.

As a consultant, it becomes his responsibility to get the financial statements rectified and guide the directors about the principles enunciated in Ind AS and the correct treatment in accordance with the standards. Otherwise, he will be subject to professional misconduct under Clause 6 and 7 of Part I of Second Schedule of the Chartered Accountants Act, 1949.
Clause 6 of Part I of the Second Schedule of the Chartered Accountants Act 1949 states that a CA is guilty of professional misconduct when he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity.

The Clause 7, states that a Chartered Accountant is guilty of professional misconduct when he does not exercise due diligence or is grossly negligent in the conduct of his professional duties

G. PRESSURE TO BREACH THE FUNDAMENTAL PRINCIPLES

A Chartered Accountant shall not:

a) Allow pressure from others to result in a breach of compliance with the fundamental principles; or
b) Place pressure on others that the accountant knows, or has reason to believe, would result in the other individuals breaching the fundamental principles.

A Chartered Accountant might face pressure that creates threats to compliance with the fundamental principles, for example an intimidation threat, when undertaking a professional activity. Pressure might be explicit or implicit and might come from:

- Within the employing organization, for example, from a colleague or superior.
- An external individual or organization such as a vendor, customer or lender.
- Internal or external targets and expectations.

Examples of pressure that might result in threats to compliance with the fundamental principles include:

- Pressure related to conflicts of interest:
  - Pressure from a family member bidding to act as a vendor to the Chartered Accountant's employing organization to select the family member over another prospective vendor.

Discussing the circumstances creating the pressure and consulting with others about those circumstances might assist the Chartered Accountant to evaluate the level of the threat. Such discussion and consultation, which requires being alert to the principle of confidentiality, might include:

- Discussing the matter with the individual who is exerting the pressure to seek to resolve it.
- Discussing the matter with the accountant's superior, if the superior is not the individual exerting the pressure.

- Escalating the matter within the employing organization, including when appropriate, explaining any consequential risks to the organization, for example with:
    - Higher levels of management.
    - Internal or external auditors.
    - Those charged with governance.
- Disclosing the matter in line with the employing organization's policies, including ethics and whistleblowing policies, using any established mechanism, such as a confidential ethics hotline.
- Consulting with:
    - A colleague, superior, human resources personnel, or another Chartered Accountant;
    - Institute or industry associations; or
    - Legal counsel.

An example of an action that might eliminate threats created by pressure is the Chartered Accountant's request for a restructure of, or segregation of, certain responsibilities and duties so that the accountant is no longer involved with the individual or entity exerting the pressure

Question 9

As at 31 March 20X4, Mitra Ltd. had a plan to dispose off its 75% subsidiary Dosti Ltd. This plan had been approved by the board and was reported in the media as well as to the Stock Exchange where Mitra Ltd. was listed. It is expected that Jaya Ltd., the non-controlling shareholder in Dosti Ltd. holding 25% stake, will acquire the 75% equity interest as well. The sale is expected to be completed by October 20X4. Dosti Ltd. is expected to have substantial trading losses in the period up to the sale. Mr. X, a chartered accountant, who is an employee in the finance department of Mitra Ltd., wishes to show Dosti Ltd. as held for sale in the financial statements and to create a restructuring provision to include the expected costs of disposal and future trading losses. However, the Chief Operating Officer (COO) does not wish Dosti Ltd. to be categorized as held for sale nor to provide for the expected losses. The COO is concerned as to how this may affect the sales and would surely result in bonus targets not being met. He has argued that as the management, it is his duty to secure a high sales price to maximize the return for shareholders of Mitra Ltd. He has also hinted that Mr. X's job could be at stake if such a provision were to be made in the financial statements. The expected costs from the sale are as follows:

Future Trading Losses:	Rs 20 crores
Various legal costs of sale	Rs 1.5 crores
Redundancy costs for Dosti Ltd.'s employees	Rs 4 crores
Impairment losses on Property, Plant and Equipment	Rs 7 crores

Required:

a) Discuss the accounting treatment which Mitra Ltd. should adopt to address the issue above for the financial statements.

b) Discuss the ethical issues which may arise in the above scenario, including any actions which Mitra Ltd. and Mr. X should take

Solution

a) In terms of Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, 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.

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.

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, except in specific cases as permitted by the Standard, 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. The probability of required approvals (as per the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

An entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out above are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.

Based on the provisions highlighted above, the disposal of Dosti Ltd. appears to meet the criteria of held for sale. Jaya Ltd. is the probable acquirer, and the sale is highly probable, expected to be completed seven months after the year end, well within the 12-months criteria highlighted above. Accordingly, Dosti Ltd. should be treated as a disposal group, since a single equity transaction is the most likely form of disposal. In case Dosti Ltd. is deemed to be a separate major component of business or geographical area of the group, the losses of the group should be presented separately as a discontinued operation within the Financial Statements of Mitra Ltd.

In terms of Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, 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 carrying amount of Dosti Ltd. (i.e., the subsidiary of Mitra Ltd.) comprises of the net assets and goodwill less the non-controlling interest. The impairment loss recognised to reduce Dosti Ltd. to fair value less costs to sell should be allocated first to goodwill and then on a pro-rata basis across the other non-current assets of the Company.

The Chief Operating Officer (COO) is incorrect to exclude any form of restructuring provision in the Financial Statements. Since the disposal is communicated to the media as well as the Stock Exchange, a constructive obligation exists. However, ongoing costs of business should not be provided for, only directly attributable costs of restructuring should be provided. Future operating losses should be excluded as no obligating event has arisen, and no provision is required for impairment losses of Property, Plant and Equipment as it is already considered in the remeasurement to fair value less costs to sell. Thus, a provision is required for Rs 5.5 crores (Rs 1.5 crores + Rs 4 crores).

b) Ethics

Accountants have a duty to ensure that the financial statements are fair, transparent and comply with the accounting standards. Mr. X have committed several mistakes. In particular, he was unaware of which costs should be included within a restructuring provision and has failed to recognise that there is no obligating event in relation to future operating losses. A chartered accountant is expected to carry his work with due care and attention for lending credibility to the financial statements. Accordingly, he must update his knowledge and ensure that work is carried out in accordance with relevant ethical and professional standards. Failure to do so would be a breach of professional competence. Accordingly, Mr. X must ensure that this issue is addressed, for example by attending regular training and professional development courses.

It appears that the chief operating officer is looking for means to manipulate the financial statements for meeting the bonus targets. Neither is he is willing to reduce the profits of the group by applying held for sale criteria in respect of Dosti Ltd. nor is he willing to create appropriate restructuring provisions. Both the adjustment which comply with the requirements of Ind AS will result in reduction of profits. His argument that the management has a duty to maximize the returns for the shareholders is true, but such maximization must not be achieved at the cost of objective and faithful representation of the performance of the Company. In the given case, it appears that the chief operating officer is motivated by bonus targets under the garb of maximizing returns for the shareholders, thereby resulting in misrepresentation of the results of the group.

Further, by threatening to dismiss Mr. X, the COO has acted unethically. Threatening and intimidating behaviour is unacceptable and against all ethical principles. This has given rise to an ethical dilemma for Mr. X. He has a duty to produce financial statements but doing so in a fair manner could result in a loss of job for him. The chartered accountant should approach the chief operating officer and remind him the basic ethical principles and communicate him to do the necessary adjustments in the accounts so that they are fair and objective.

In case Mr. X, falls under undue influence of COO and applies the incorrect accounting treatment, he will be subject to professional misconduct under Clause 1 of Part II of Second Schedule of the

Chartered Accountants Act, 1949. The Clause 1 states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, for contravening the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties

Question 10

Shastra Ltd. desires to upgrade its production process since the directors believe that technology-led production is the only way the company can remain competitive. On 1 April 20X5, the company entered into a property lease arrangement in order to obtain tax benefits. However, the draft financial statements do not show a lease asset or a lease liability as on date.

A new financial controller, CA. Sunil Raghavan, joined Shastra Ltd. before the financial year ending 31 March 20X6 and was engaged in the review of financial statements to prepare for the upcoming audit and to begin making a loan application to finance the new technology. CA. Sunil Raghavan believes that the lease arrangement should be recognized in the Balance Sheet. However, the Managing Director, Ms. Anusha Shrivastava, an MBA (Finance), strongly disagrees. She wishes to charge the lease rentals to the Statement of Profit or Loss. Her opinion is based on the understanding that the lease arrangement is merely a monthly rental payment, without any corresponding asset or obligation, since there is no 'invoice' for transfer of asset to Shastra Ltd. Her disagreement also stems from the fact that showing a lease obligation in the Financial Statements would impact the gearing ratio of the company, which could have an adverse impact on the upcoming loan application. Ms. Anusha has made it clear to CA. Sunil Raghavan that at stake is not only the loan application but also his future prospects at Shastra Ltd.

Required:

Discuss the potential ethical conflicts which may arise in the above scenario and the ethical principles which would guide how the financial controller should respond to the situation

Answer:

As per Ind AS 116, Leases, at the inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

In accordance with the above definition, Shastra Ltd. must recognise a right-of-use asset representing the property and a corresponding lease liability for the obligation to make lease payments. At the commencement date, the right-of-use asset so recognised would include:

- The amount of the initial measurement of lease liability;
- Any initial direct costs;

- Any costs to be incurred for dismantling or removing the underlying asset or restoring the site at the end of the lease term.

The liability for the lease obligation would be measured as the present value of future lease payments including payments that would be made towards any residual value guarantee, discounted using the rate implicit in the lease or the incremental rate of borrowing of the lessor, whichever is available.

The fact that there is no 'invoice' evidencing transfer of the asset cannot be a reason to avoid recognition of the right-of-use asset. In fact, what is being recognised is not an asset, since ownership rights are not transferred. What is sought to be recognised under Ind AS 116 is the right to use the asset in the manner required by the lessee Shastra Ltd. Further, since the lease represents an obligation to pay lease rentals in the future, a corresponding lease liability should be recognised. Not recognising the right-of-use asset or lease liability would not only be a violation of Ind AS 116, Leases, but would also be an incorrect presentation of the financial position, which is critical given that Shastra Ltd. is interested in taking a loan for its operations.

Ethical issues:

The managing director's threat to the financial controller results in an ethical dilemma for the financial controller. This pressure is greater because the financial controller is new.

Threats to fundamental principles

The fact that the position of the financial controller has been threatened if the treatment suggested by the managing director is not followed indicates that there is an intimidation threat to the fundamental principles of objectivity and integrity.

Further, as the manging director has flagged the risk that the company may not obtain loan financing if the lease obligation is recorded in the balance sheet, there is an advocacy threat because the financial controller may be compelled to follow an incorrect treatment to maximise the chances of obtaining the loan. This pressure again is greater because the financial controller is new.

Professional competence

When preparing the financial statements, the financial controller should ensure that the fundamental principle of professional competence should be followed, which requires that accounts should be prepared in compliance with Ind AS.

Thus, since the arrangement meets the Ind AS 116 criteria for a lease, the right-of-use asset and a corresponding lease liability should be recognised, as otherwise the liabilities of Shastra Ltd. would be understated. The ICAI Code of Ethics and Conduct sets boundaries beyond which accountants should not act. If the managing director refuses application of Ind AS 116, Leases, the financial controller should disclose this to the appropriate internal governance authority, and thus feel confident that his actions were ethical.

If the financial controller were to bend under pressure and accept the managing director's proposed treatment, this would contravene Ind AS 116 and breach the fundamental principle of professional competence. In such a case, he would be subject to professional misconduct under Clause 1 of Part II of Second Schedule of the Chartered Accountants Act, 1949, which states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. As per the Guidelines issued by the Council, a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.