BENCHMARX
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FINANCIAL REPORTING

New Sums Added by ICAI in May 25 SM

All the questions which have been added in ICAI SM are from recent RTPs/MTPs/PYPs and have been covered in our course. This file will help you in case you have studied from Old ICAI SM of May 24

BHAVIK CHOKSHI

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1. INTRODUCTION TO INDIAN ACCOUNTING STANDARDS

Question 1 (TYK 1)

Fresh Vegetables Limited (FVL) was incorporated on 2nd April, 2011 under the provisions of the Companies Act, 2013 to carry on the wholesale trading business in vegetables. As per the audited accounts of the financial year ended 31st March, 2017 approved in its annual general meeting held on 31st August, 2017 its net worth, for the first time since incorporation, exceeded Rs 250 crore. The financial statements since inception till financial year ended 31st March, 2016 were prepared in accordance with the Companies (Accounting Standards) Rules 2006. It has been advised that henceforth it should prepare its financial statements in accordance with the Companies (Indian Accounting Standards) Rules, 2015.

The following additional information is provided by the Company:

1. FVL has in the financial year 2012-2013 entered into a 60:40 partnership with Logistics Limited and incorporated a partnership firm 'Vegetable Logistics Associates' (VLA) to carry on the logistics business of vegetables from farm to market.
2. FVL also has an associate company Social Welfare Limited (SWL) that was incorporated in July, 2015 as a charitable organization and registered under section 8 of the Companies Act, 2013. Social Welfare Limited has been the associate company of FVL since its incorporation.

Examine the applicability of Ind AS on VLA & SWL.

Answer

Applicability of Ind AS in general:

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

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

Applicability of Ind AS on VLA

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

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

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

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

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

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Applicability of Ind AS on SWL

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

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2. IND AS 1 : PRESENTATION OF FINANCIAL STATEMENTS

Question 1 (Practice Q.5)

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

(a) Receivables (viz., receivable under a contract of sale of goods in which an entity deals)

(b) Advance to suppliers

(c) Income tax receivables [other than deferred tax]

(d) Insurance spares

Answer

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

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

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

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

(b) As discussed in point (a) above, advances to suppliers for goods and services would be classified in accordance with normal operating cycle if it is given in relat ion to the goods or services in which the entity normally deals. If the advances are considered a part the normal operating cycle, it would be classified as a current asset. If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

(c) Classification of income tax receivables [other than deferred tax] will be driven by paragraph 66 (c) of Ind AS 1, i.e., based on the expectation of the entity to realise the asset. If the receivable is expected to be realised within twelve months after the reporting period, then it will be classified as current asset else non-current asset.

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

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

Question 2 (Practice Q.6)

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

Answer

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

As per Ind AS 1, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provi de financial information about a specific reporting entity. Materiality depends on the nature or magnitude of information, or both and it could be the determining factor.

When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

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Generally, items of income or expense fulfilling the abovementioned criteria are classified as exceptional items and are disclosed separately.

From the above, it appears that all material items are not exceptional items. In other words, exceptional items are those items which meet the test of 'materiality' (si ze and nature) and the test of 'incidence'.

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

(a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;

(b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

(c) disposals of items of property, plant and equipment;

(d) disposals of investments;

(e) discontinued operations;

(f) litigation settlements; and

(g) other reversals of provisions.

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3. IND AS 2 : INVENTORIES

Question 1 (Practice Q.2)

A retailer company imported goods at a cost of Rs 1,30,000 including Rs 20,000 non-refundable import duties and Rs 10,000 refundable purchase taxes. The risks and rewards of ownership of the imported goods were transferred to the retailer company upon collection of the goods from the harbour warehouse. The retailer company was required to pay for the goods upon collection. The retailer company incurred Rs 5,000 to transport the goods to its retail outlet and a further Rs 2,000 in delivering the goods to its customer. Further selling costs of Rs 3,000 were incurred in selling the goods.

State whether delivery charges and selling expenses will form part of the cost of inventory. If not, then why? Also calculate the cost of inventory.

Answer

Calculation of Inventory cost:

Particulars	**Amount (Rs)**
Purchase Price (1,30,000 – 20,000 – 10,000)	1,00,000
Non-refundable import duties	20,000
Transport cost	5,000
Total	**1,25,000**

Note: The cost of purchase excludes the refundable purchase taxes paid on acquisition of the goods as the Rs 10,000 paid will be refunded to the retailer.

Ind AS 2 specifically exclude selling cost from forming part of cost of inventory. However, selling and distribution costs are generally used as single term because both are related, as selling costs are incurred to effect the sale and the distribution costs are incurred by the seller to complete a sale transaction by making the goods available to the buyer from the point of sale to the point at which the buyer takes possession. Since these costs are not related to bringing the goods to their present location and condition, the same are not included in the cost of inventories. Accordingly, though the word 'distribution costs' is not specifically mentioned in Ind AS 2, these costs would continue to be excluded from the cost of inventories. Therefore, it excludes the selling expenses incurred (i.e., Rs 2,000 delivery costs and Rs 3,000 other selling costs).

Question 2 (Practice Q.3)

An entity has following details regarding cost and retail price of the goods purchased and unsold at the beginning of the year:

	Cost	**Retail Price**
Opening inventory	6,250	8,000
Purchases	19,500	34,000
Inventory on hand		(23,000)
Sales for the period		19,000

Applying the retail method, compute the following:

(i) Percentage of cost price over retail price;

(ii) Cost of closing inventory;

(iii) Value of cost of sales (at cost); and

(iv) Profit earned during the year on sale of inventory

Ignore the impact of mark-ups or mark-downs on the selling price.

Answer

Table showing application of Retail method for calculation of the goods sold during the year and unsold inventory

S. No.	Particulars		Rs
	Cost price of goods	6,250 + 19,500	25,750
	Retail price of goods	8,000 + 34,000	42,000
(a)	Cost percentage of retail price	25,750 / 42,000	61%
(b)	Closing inventory (at cost)	23,000 x 61%	14,030
(c)	Cost of sales for the period	[(6,250 + 19,500) - 14,030]	11,720
	Sales for the period		19,000
(d)	Profit earned on sale of goods during the year	19,000 – 11,720	7,280

Question 3 (Practice Q.4)

A Ltd. began operations in the year 2011-2012. In 2011-2012, it incurred the following expenditures on purchasing the raw materials for its product:

a. Purchase price of the raw materials = Rs 30,000;

b. Import duty and other non-refundable purchase taxes = Rs 8,000;

c. Refundable purchase taxes = Rs 1,000;

d. Freight costs for bringing the goods from the supplier to the factory's storeroom for raw materials = Rs 3,000;

e. Costs of unloading the materials into the storeroom for raw materials = Rs 20; and

f. Packaging = Rs 2,000.

On 31st March, 2012, A Ltd. received Rs 530 volume rebate from a supplier for purchasing more than Rs 15,000 from the supplier during the year.

A Ltd. incurred the following additional costs in the production run:

i. Salary of the machine workers in the factory = Rs 5,000;

ii. Salary of factory supervisor = Rs 3,000;

iii. Depreciation of the factory building and equipment used for production process = Rs 600;

iv. Consumables used in the production process = Rs 200;

v. Depreciation of vehicle used to transport the goods from the storeroom for raw materials to the machine floor = Rs 400;

vi. Factory electricity usage = Rs 300;

vii. Factory rental = Rs 1,000; and

viii. Depreciation of the entity's vehicle used by the factory supervisor is Rs 200.

During 2011-2012, A Ltd. incurred the following administrative expenses:

1. Depreciation of the administration building = Rs 500;

2. Depreciation and maintenance of vehicles used by the administrative staff = Rs 150; and

3. Salaries of the administrative personnel = Rs 3,050.

Of the administrative expenses, 20% is attributable to administering the factory. Remaining expenses are attributable, in equal proportion, to the sales and other non- production operations (eg financing, tax and corporate secretarial functions).

In 2011-2012, A Ltd. incurred the following selling expenses:

a) Advertising costs = Rs 300;

b) Depreciation and maintenance of vehicles used by the sales staff = Rs 100; and

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c) Salaries of the administrative personnel = Rs 6,000.

Pass necessary journal entries to record the cost of inventory in the books of A Ltd.

Answer

Journal Entries for the year 2011-201

		Rs	Rs
Inventory A/c (W.N.1)	Dr.	42,490	
To Cash/Bank A/c			42,490
(To recognise the cost of raw materials purchased)			
Inventory A/c (W.N.2)	Dr.	11,240	
To Cash/Bank A/c (cost of direct labour)			5,000
To Property, plant and equipment (accumulated depreciation-factory equipment)			600
To Property, plant and equipment (accumulated depreciation-raw-materials delivery vehicle)			400
To Cash/Bank A/c (cost of electricity used)			300
To Property, plant and equipment (accumulated depreciation-factory supervisor's vehicle)			200
To Cash/Bank A/c (factory management's salaries)			3,000
To Cash/Bank A/c (factory rental)			1,000
To Cash/Bank A/c (administrative salaries attributable to the factory)			610
To Property, plant and equipment (attributable portion of accumulated depreciation- administration building)			100
To Property, plant and equipment (attributable portion of accumulated depreciation- administration vehicles)			30
(To recognise the costs of conversion)			
Inventory A/c (W.N.2)	Dr.	200	
To Inventory A/c (consumable stores)			200
(To recognise the costs of consumable stores inventory consumed)			

The total cost of inventories = Costs of purchase + Costs of conversion

= Rs 42,490 + Rs 11,240 + Rs 200

= Rs 53,930

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Working Notes:

1. Computation of costs of purchas

Description	Rs
Purchase price	30,000
Import duty and other non-refundable purchase taxes	8,000
Freight costs for bringing the goods to the factory storeroom	3,000
Cost of unloading the raw materials into the storeroom	20
Packaging	2,000
Less: Trade discounts, rebates and subsidies	(530)
Cost of purchase	42,490

Note: Refundable taxes do not form part of the cost of inventories.

2. Computation of costs of conversion

Description	Rs
Direct labour	5,000
Fixed production overheads	
Depreciation and maintenance of factory equipment	600
Depreciation of vehicle used for transporting the goods	400
Depreciation of vehicle used by factory supervisor	200
Factory electricity usage	300
Factory management	3,000
Factory rental	1,000
Other costs of administering the factory	
20% of depreciation of administration building	100
20% of depreciation of administration vehicles	30
20% of administrative staff costs	610
Variable production overheads	
Indirect material—consumables	200
Cost of conversion	**11,440**

Question 4 (Practice Q.5)

B Limited has valued its Stock held for distribution as free items on claim by customers (on offers) at zero. Customers have a right to claim the free item within 14 days from date of invoice. If the time limit of 14-day exceeds, the claim is foregone by the customer.

The majority of the free items require online registration by the buyers for participation in the contest conducted by the respective brand which needs to be done by the buyers within 3 days from the date of invoice.

Out of it, a few items under this category were found damaged. The replacement cost of such items would be Rs 2,50,000.

Determine whether the entity has to book loss of inventory or provide for replacement cost of the goods that need to be given as free items to customers as per the principles of Ind AS.

Answer

Ind AS 2 deals with write-off in value of inventory. The stock of free items is valued at zero by the company. The question of "Loss of Inventory Rs 2,50,000" does not arise as the claim of free stock is subject to various conditions like claim within 14 days, online registration within 3 days, etc. which are all contingent in nature.

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A provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are met, provision shall be recognised.

Here, provision is to be made for goods to be distributed because sale took place in the reporting year and assuming that the registration for the contest are received whereby there is a high probability that the customer can claim the free items within 14 days from the date of invoice. Further, a reliable estimate of the claim of Rs 2,50,000 can be made. Hence provision of Rs 2,50,000 is to be made for in the reporting year's financial statements.

Further, on expiry of the time period, where claim had not been made by the customers, reversal of provision will be done in the next financial year.

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4. IND AS 7 : STATEMENT OF CASH FLOWS

Question 1 (Practice Q.4)

From the following data, identify the nature of activities as per Ind AS 7.

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

Answer

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

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12	Purchased goodwill	Investing activity
13	Payment of promissory notes	Financing activity

Question 2 (Practice Q.5)

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

Summarized Statement of Profit and Loss for the year ended 31st March, 2013

Particulars	Amount (Rs)
Net sales	2,52,00,000
Less: Cash cost of sales	(1,92,00,000)
Depreciation	(6,00,000)
Salaries & wages	(24,00,000)
Operating expenses	(14,00,000)
Provision for taxation	(8,80,000)
Net Operating Profit	7,20,000
Non-recurring income – profit on sale of equipment	1,20,000
	8,40,000
Retained earnings and profit brought forward	15,18,000
	23,58,000
Dividends declared and paid during the year	(7,20,000)
Profit & loss balance as on 31st March, 2013	16,38,000

Summarized Balance Sheet

Assets	31st March, 2012	31st March, 2013
Property, Plant and Equipment:		
Land	4,80,000	9,60,000
Buildings and Equipment	36,00,000	57,60,000
Current Assets		
Cash	6,00,000	7,20,000
Inventories	16,80,000	18,60,000
Trade Receivables	26,40,000	9,60,000

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

The original cost of equipment sold during the year 2012-2013 was Rs 7,20,000.

Prepare a statement of cashflows the year ended 31st March 2013.

Answer

Statement of Cash Flows for the year ended 31st March, 2013 (Indirect method)

Particulars	**Rs**	**Rs**
Cash flow from operating activities:		
Net Profit before taxes and extraordinary items (7,20,000 + 8,80,000)	16,00,000	
Add: Depreciation	6,00,000	
Operating profit before working capital changes	22,00,000	
Increase in inventories	(1,80,000)	
Decrease in trade receivables	16,80,000	
Advances	(12,000)	
Decrease in trade payables	(60,000)	
Increase in outstanding expenses	2,40,000	
Cash generated from operations	38,68,000	
Less: Income tax paid (Refer W.N.4)	(8,68,000)	
Net cash from operations		30,00,000

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Cash from investing activities:		
Purchase of land	(4,80,000)	
Purchase of building & equipment (Refer W.N.2)	(28,80,000)	
Sale of equipment (Refer W.N.3)	3,60,000	
Net cash used for investment activities		(30,00,000)
Cash flows from financing activities:		
Issue of share capital	8,40,000	
Dividends paid	(7,20,000)	
Net cash from financing activities:		1,20,000
Net increase in cash and cash equivalents		1,20,000
Cash and cash equivalents at the beginning		6,00,000
Cash and cash equivalents at the end		7,20,000

Working Notes:

1. Building & Equipment Account

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

2. Building & Equipment Accumulated Depreciation Account

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

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3. **Computation of sale price of Equipment**

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

4. **Provision for tax Account**

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

Question 3 (Practice Q.6)

Following is the Balance Sheet of Mars Ltd: Rs in Lakhs

Particulars	31.3.2013	31.3.2012
ASSETS		
Non-Current Assets		
Property, Plant and Equipment	450	410
Intangible asset	90	90
Deferred Tax Asset (net)	45	45
Other Non-current Asset	95	85
Total Non-current Assets	680	630
Current Assets		
Financial Asset		
Investments	100	60
Trade Receivables	580	600

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Cash and Cash Equivalents	300	300
Inventories	800	700
Other Current Assets	160	120
Total Current Assets	1,940	1,780
Total Assets	**2,620**	**2,410**
Equity and Liabilities		
Equity		
Equity Share Capital	280	250
Other Equity	980	820
Total Equity	**1,260**	**1,070**
Non-current Liabilities		
Financial Liabilities		
Borrowings	360	300
Other Non-current Liabilities	90	80
Total Non-current Liabilities	450	380
Current Liabilities		
Financial Liabilities		
Trade Payable	455	450
Bank Overdraft	410	420
Other current liabilities	45	90
Total Current Liabilities	910	960
Total Liabilities	1,360	1,340
Total Equity and Liabilities	**2,620**	**2,410**

Additional Information:

(a) Profit before tax for the year is Rs 200 lakhs and provision for tax is Rs 40 lakhs.

(b) Property, Plant and Equipment purchased during the year Rs 100 lakhs.

(c) Current liabilities include Capital creditors of Rs 25 lakhs as at 31st March 2013. (Nil – 31st March 2012)

(d) Long Term Borrowings raised during the year Rs 120 lakhs.

From the information given, prepare a Statement of Cash Flows following Indirect Method. Assume that Bank overdraft is an integral part of the entity's cash management.

Bhavik Chokshi

Answer

Statement of Cash Flows for the year ended 31 st March, 2013

	(Rs in lakhs)	(Rs in lakhs)
Cash flows from operating activities		
Profit before taxation	200	
Adjustments for non-cash items:		
Depreciation [410 - (450 - 100)]	60	
	260	
Increase in inventories (800 - 700)	(100)	
Decrease in trade receivables (600 - 580)	20	
Increase in other non-current assets (95 - 85)	(10)	
Increase in other current assets (160 - 120)	(40)	
Increase in non-current liabilities (90 - 80)	10	
Increase in trade payables (455 – 25 - 450)	(20)	
Other current liabilities (Refer Note 1) [(90 + 40) - 45]	(85)	
Net cash generated from operating activities		35
Cash flows from investing activities		
Cash paid to purchase PPE (100-25)	(75)	
Cash paid to acquire investment (100-60)	(40)	
Net cash outflow from investing activities		(115)
Cash flows from financing activities		
Raising of equity share capital (280 - 250)	30	
Long-term borrowings raised during the year	120	
Long-term borrowings repaid during the year [(300 + 120) - 360]	(60)	
Net cash outflow from financing activities		90
Increase in cash and cash equivalents during the year		10
Cash and cash equivalents at the beginning of the year (420-300) (Refer Note 2)		(120)

Cash and cash equivalents at the end of the year (410-300) (Refer Note 2)		(110)

Note:

1. Other current liabilities are assumed to consist of provision for taxation.
2. Other non-current assets and other non-current liabilities pertain to working capital items.

Bhavik Chokshi

5. IND AS 8 : ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

Question 1 (Practice Q.7)

In its financial statements for the year ended 31st March, 2012, Y Ltd. Reported Rs 73,500 revenue (sales), Rs 53,500 cost of sales, Rs 6,000 income tax expense,Rs 20,000 retained earnings at 1st April, 2011 and Rs 34,000 retained earnings at 31st March, 2012.

In 2012-2013, after the 2011-2012 financial statements were approved for issue, Y Ltd. discovered that some products sold in 2011-2012 were incorrectly included in inventories at 31st March, 2012 at their cost of Rs 6,500.

In 2012-2013, Y Ltd. changed its accounting policy for the measurement of investments in associates after initial recognition from cost model to the fair value model as per Ind AS 109. It acquired its only investment in an associate for Rs 3,000 many years ago. The associate's equity is not traded on a securities exchange (that is, a published price quotation is not available). The fair value of the investment was determined reliably using an appropriate equity valuation model on 31st March, 2013 at Rs 25,000 (2011-2012: Rs 20,000 and 2010-2011: Rs 18,000).

At 31st March, 2013, as a result of usage of improved lubricants, Y Ltd. reassessed the useful life of Machine A from four years to seven years. Machine A is depreciated on the straight-line method to a Nil residual value. It was acquired for Rs 6,000 on 1st April, 2010.

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

Y Ltd.'s accounting records for the year ended 31st March, 2013, before accounting for change in accounting policy and change in accounting estimate, record Rs 1,04,000 revenue (sales), Rs 86,500 cost of sales (including Rs 6,500 for the error in opening inventory and Rs 1,500 depreciation for Machine A) and Rs 5,250 income tax expense.

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

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

Draft an extract showing how the correction of the prior period error, change in accounting policy and change in accounting estimate could be presented in the Statement of Profit and Loss and Statement of Changes in Equity (Retained Earnings) and disclosed in the Notes of Y Ltd. for the year ended 31st March, 2013.

Answer

Extract of Y Ltd.'s Statement of Profit and Loss for the year ended 31st March, 2013

	2012-2013	Reference to W.N.	2011-2012 Restated	Reference to W.N.
	Rs		Rs	
Revenue	1,04,000		73,500	
Cost of sales (2011-2012 previously Rs 53,500)	(79,100)	1	(60,000)	4
Gross profit	24,900		13,500	
Other income — change in the measurement policy i.e. the value of investment in associate at FVTPL	5,000	2	2,000	5
Profit before tax	29,900		15,500	
Income tax expense	(8,970)	3	(4,650)	6
Profit for the year	20,930		10,850	

Extract of Y Ltd.'s Statement of Changes in Equity (Retained Earnings) for the year ended 31st March, 2013

	2012-2013	Reference to W.N.	2011-2012 Restated	Reference to W.N.
	Rs		Rs	
Retained earnings, as restated, at the beginning of the year				
- as previously stated	34,000		20,000	
- effect of the correction of a prior period error	(4,550)	7	-	
- effect of a change in accounting policy	11,900	13	10,500	12
	41,350		30,500	
Profit for the year	20,930		10,850	
Retained earnings at the end of the year	62,280		41,350	

Y Ltd.

Extract of Notes to the Financial Statements for the year ended 31st March, 2013

Note X : Change in Accounting Estimates

Due to usage of improved lubricants the estimated useful life of the machine used for production was increased from four years to seven years. The effect of the change in the useful life of the machine is to reduce the depreciation allocation by Rs 900 in 2012-2013 and 2013-2014. The after-tax effect is an increase in profit for the year of Rs630 for each of the two years.

Depreciation expense in 2014-2015 to 2016-2017 is increased by Rs 600 because of revision in the useful life of machinery, as under the initial estimate, the asset would have been fully depreciated at the end of 2013-2014. The after-tax effect for these three years is a decrease in profit for the year by Rs420 per year.

Note Y : Correction of Prior Period Error.

In 2012-2013 the entity identified that Rs 6,500 products that had been sold in 2011-2012 were included erroneously in inventory at 31st March, 2012. The financial statements of 2011-2012 have been restated to correct this error. The effect of the restatement is Rs 6,500 increase in the cost of sales and Rs 4,550 decrease in profit for the year ended 31st March, 2012 after decreasing income tax expense by Rs 1,950.

This resulted in Rs 4,550 (decrease) restatement of retained earnings at 31st March, 2012.

Note Z : Change in Accounting Policy

In 2012-2013 the entity changed its accounting policy for the measurement of investments in associates from cost model to fair value model as per Ind AS 109. Management judged that this policy provides reliable and more relevant information because dividend income and changes in fair value are inextricably linked as integral components of the financial performance of an investment in an associate and measurement at fair value is necessary if that financial performance is to be reported in a more meaningful way. This change in accounting policy has been accounted for retrospectively. The comparative information has been restated. A new line item, 'Other income — change in the fair value of investment in associate', has been added in the Statement of Profit and Loss and Retained Earnings. The effect of the restatement has been to add income of Rs 2,000 as a result of the increase in value of the associate during the year ended 31st March, 2012 which resulted in Rs 1,400 increase in profit for the year (after including a resulting increase in income tax expense of Rs 600). This, together with Rs 10,500 (increase) restatement of retained earnings at 31st March, 2011, resulted in a Rs 11,900 increase in retained earnings at 31st March, 2012. Furthermore, profit for

the year ended 31st March, 2013 was Rs 3,500 higher (after deducting Rs 1,500 tax effect) as a result of recording a further Rs 5,000 (W.N.2) increase in the fair value of the investment in an associate.

Working Notes:

1. Rs 86,500 (given) minus Rs 6,500 correction of error (now recognised as an expense in 2011-2012) minus Rs 900 (W.N.9) effect of the change in accounting estimate.
2. Rs 25,000 fair value (2012-2013) minus Rs 20,000 fair value (2011-2012) = Rs 5,000 (the effect of applying the new accounting policy (fair value model) in 2012-2013).
3. Rs 5,250 + Rs 1,950 (W.N.8) + 30% (Rs 900 (W.N.9) reduction in depreciation resulting from the change in accounting estimate) + 30% (Rs 5,000 increase in the fair value of investment property — change in accounting policy) = Rs 8,970.
4. Rs 53,500 as previously stated + Rs 6,500 (products sold and incorrectly included in closing inventory in 2011-2012) = Rs 60,000 (that is, the prior period error is corrected retrospectively by restating the comparative amounts).
5. Rs 20,000 fair value (2011-2012) minus Rs 18,000 fair value (2010-2011) = Rs 2,000 (the effect in 2011-2012 of the change in accounting policy for investments in associates from the cost model to the fair value model).
6. Rs 6,000 as previously stated minus Rs 1,950 (W.N.8) correction of prior period error + 30% (Rs 2,000 change in accounting policy) = Rs 4,650.
7. Rs 6,500 (products sold and incorrectly included in inventory in 2011-2012) –Rs 1,950 (W.N.8) (tax overstated in 2011-2012) = Rs 4,550.
8. Rs 6,500 (products sold and incorrectly included in inventory in 2011 -2012) x 30% (income tax rate) = Rs 1,950.
9. Rs 1,500 depreciation (using old estimate, that is, Rs 6,000 cost ÷ 4 years) minus Rs 600 (W.N.10) (using new estimate of useful life) = Rs 900.
10. Rs 3,000 (W.N.11) carrying amount ÷ 5 years remaining useful life = Rs 600 depreciation per year.
11. [Rs 6,000 cost minus (Rs 1,500 depreciation x 2 years)] = Rs 3,000 carrying amount at 31st March, 2012.
12. (Rs 18,000 fair value of investment in associates at 31st March, 2011 minus Rs 3,000 carrying amount based on the cost model at the same date) x 0.7 (to reflect 30% income tax rate) = Rs 10,500 (effect of a change in accounting policy (from cost model to fair value model)).
13. Rs 10,500 (W.N.12) + [Rs 2,000 (W.N.5) x 0.7 (to reflect 30% income tax rate)] = Rs 11,900.

Bhavik Chokshi

6. IND AS 10 : EVENTS AFTER THE REPORTING PERIOD

Question 1 (Practice Q.6)

H Ltd. constructed a warehouse at a cost of Rs 10 lakhs in 2011. It first became available for use by H Ltd. on 1st April, 2012. On 29th April, 2016, H Ltd. discovered that its warehouse was damaged. During early May 2016, an investigation revealed that the damage was due to a structural fault in the construction of the warehouse. The fault became apparent when the warehouse building leaked severely after heavy rainfall in the week ended 27th April 2016. The discovery of the fault is an indication of impairment. So, H Ltd. was required to estimate the recoverable amount of its warehouse at 31st March 2016. This estimate was Rs 6,00,000. Furthermore, H Ltd. reassessed the useful life of its warehouse at 20 years from the date that it was ready for use. Before discovering the fault, H Ltd. had depreciated the warehouse on the straight-line method to a nil residual value over its estimated 30-year useful life.

Seepage of rainwater through the crack in the warehouse caused damage to inventory worth about Rs 1,00,000 (cost price) and became un-saleable. The entire damaged inventory was on hand as at 31st March, 2016. H Ltd. has not insured against any of the losses.

It accounts for all its property, plant and equipment under the cost model. H Ltd.'s annual financial statements for the year ended 31st March, 2016 were approved for issue by the Board of Directors on 28th May, 2016.

You are required to :

(i) Prepare accounting entries to record the effects of the events after the end of the reporting period in the accounting records of H Ltd. for the year ended 31st March, 2016. Kindly ignore tax impact.

(ii) Discuss disclosure requirement in above case as per relevant Ind AS.

(iii) Will your answer be different if there was no structural fault and damage to the warehouse had been caused by an event that occurred after 31st March, 2016?

Answer

(i) Journal Entries on 31st March, 2016

Particulars	Rs	Rs
Depreciation expense A/c (W.N.1) Dr.	19,608	
To Warehouse or Accumulated depreciation A/c		19,608
(Being additional depreciation expense recognised for the year ended 31st March 2016 arising from the reassessment of the useful life of the warehouse)		
Impairment loss A/c (W.N.2) Dr.	2,47,059	
To Warehouse or Accumulated depreciation A/c		2,47,059
(Being impairment loss recognised due to discovery of structural fault in the construction of warehouse at 31st March, 2016)		

(ii) (a) The damage to warehouse is an adjusting event (occurred after the end of the year 2016-2016) for the reporting period 2015-2016, since it provides evidence that the structural fault existed at the end of the reporting period. It is an adjusting event, in spite of the fact that fault has been discovered after the reporting date.

The effects of the damage to the warehouse are recognised in the year 2015-2016 reporting period. Prior periods will not be adjusted because those financial statements were prepared in good faith (eg. Regarding estimate of useful life, assessment of impairment indicators etc.) and had not affected the financials of prior years.

(b) Damage of inventory due to seepage of rainwater Rs 1,00,000 occurred during the year 2015-2016**. It is a non-adjusting event** after the end of the 2015-2016 reporting period since the inventory was in good condition at 31st March 2016. Hence, no accounting has been done for it in the year 2015-2016.

H Ltd. must disclose the nature of the event (i.e. rain-damage to inventories) and an estimate of the financial effect (i.e. Rs 1,00,000 loss) in the notes to its 31st March 2016 annual financial statements.

(iii) If the damage to the warehouse had been caused by an event that occurred after 31st March 2016 and was not due to structural fault, **then it would be considered as a non-adjusting event** after the end of the reporting period 2015-2016 as the warehouse would have been in a good condition at 31st March 2016.

Working Notes:

1. Calculation of additional depreciation to be charged in the year 2015-2016

Original depreciation as per SLM already charged during the year 2015-2016

= Rs 10,00,000/ 30 years = Rs 33,333.

Carrying value at the end of 2014-2015 = 10,00,000 – (Rs 33,333 x 3 years)

= Rs 9,00,000

Revised depreciation = 9,00,000 / 17 years = Rs 52,941

Additional depreciation to be recognised in the books in the year 2015-2016

= Rs 52,941 – Rs 33,333 = Rs 19,608

2. Calculation of impairment loss in the year 2015-2016

Carrying value after charging depreciation for the year 2015-2016

= Rs 9,00,000 – Rs 52,941 = Rs 8,47,059

Recoverable value of the warehouse = Rs 6,00,000

Impairment loss = Carrying value - Recoverable value

= Rs 8,47,059 - Rs 6,00,000 = Rs 2,47,059

Question 2 (Practice Q.7)

The company has made sales of Rs 60,00,000 to a customer SS LLP on 31st December 2012. The normal credit is for one month. However, sometimes, it goes upto 2 months. The company expects to receive the payment by 28th February 2013. However, no payment has been received till 31st March 2013. On 15th April 2013, the sales department of the company became aware that the customer is passing through financial crisis and has major cash flow problems.

The company has agreed to allow the customer to settle the debt by 31st March 2014, by which time the customer is confident that the cashflow problem will be resolved.

The company expects that an annual interest of 9% (i.e. effective interest rate) can be received against any money lent out, yet it allowed the customer an interest-free payment period.

Determine the amount to be shown as 'trade receivable' from SS LLP in the books of the company as on 31st March 2013.

Answer

Ind AS 10 ‘Events after the Reporting Date’, classify an event as adjusting if it provides additional evidence of conditions existing at the reporting date. In this case the additional information relates to evidence of impairment of a financial asset, since the customer had financial difficulties prior to 31st March 2013.

Ind AS 109 ‘Financial Instruments’ requires financial assets to be reviewed at each reporting date for evidence of impairment. Such evidence exists here because although the customer is expected to pay the amount due the payment date has been deferred. As per para B5.5.33 of Ind AS 109, for a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit- impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset’s gross carrying amount and the present value of estimated future cash flows discounted at the financial asset’s effective interest rate. Any adjustment is recognized in the profit or loss as an impairment gain or loss. Further, para B5.5.44 of Ind AS 109 provides that expected credit losses shall be discounted to the reporting date, not to the expected default or some

other date, using the effective interest rate determined at initial recognition or an approximation thereof.

In such circumstances, Ind AS 109 requires that the financial asset be re-measured at the present value of the expected future receipt, discounted (in the case of a trade receivable) using effective interest rate. Therefore, in the financial statements for the year ended 31st March 2013, asset should be measured at Rs 55,04,587 (Rs 60,00,000 / 1.09) and an impairment loss of Rs 4,95,413 (Rs 60,00,000 – Rs 4,95,413) recognised in profit and loss.

In the year ended 31st March 2014, interest income of Rs 4,95,413 (Rs 55,04,587 x 9%) should be recognised in the profit and loss.

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7. IND AS 12 : INCOME TAXES

Question 1 (Practice Q.4)

The entity has an identifiable asset ASSOTA with a carrying amount of Rs 10,00,000. Its recoverable amount is Rs 6,50,000. The tax base of ASSOTA is Rs 8,00,000 and the tax rate is 30%. Impairment losses are not tax deductible. Entity expects to continue to earn profits in future.

For the identifiable asset ASSOTA, what would be the impact on the deferred tax asset/ liability at the end of the period?

Answer

As per Ind AS 36, the revised carrying amount of asset ASSOTA would be Rs6,50,000. The tax base of asset ASSOTA is given as Rs8,00,000.

Carrying base of asset = Rs 6,50,000

Tax base of asset = Rs 8,00,000

Since tax base is greater than carrying base of asset, so deferred tax asset would be created on the temporary difference of Rs1,50,000 (Rs8,00,000 – Rs6,50,000) at the given tax rate of 30%.

Hence, Deferred tax asset for the asset ASSOTA would be Rs1,50,000 x 30% = Rs45,000.

Question 2 (Practice Q.5)

Following is the summarized statement of profit and loss of EARTH Limited as per Ind AS for the year ended 31st March 2011:

Particulars	Rs in Crore
Revenue from operations Other income	1,160.00 56.00
Total Income (A)	1,216.00
Purchase of stock-in-trade Changes in inventories of stock-in-trade Employee benefits expense Finance costs Depreciation and amortization expense Other expenses	40.00 6.00 116.00 130.00 30.00 300.00
Total Expenses (B)	622.00
Profit Before Tax (A-B) Current tax Deferred tax	594.00 165.40 1.50
Tax Expenses	166.90
Profit after Tax	427.10

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Additional information:

- Corporate income tax rate applicable to EARTH Limited is 30%.
- Other income includes long-term capital gains of Rs 10 crore which are taxable at the rate of 10%.
- Other expenses include the following items which are not deductible for income tax purposes:

Item	Rs in Crore
Penalties	1.00
Impairment of goodwill	44.00
Corporate Social Responsibility expense	6.00

- Other expenses include research and development (R & D) expenditure of Rs 8 crore in respect of which a 200% weighted deduction is available under income tax laws.
- Other income includes dividends of Rs 4 crore, which is exempt from tax.
- Profit before tax of Rs 594 crore includes (i) agriculture income of Rs 55 crore which is exempt from tax; and (ii) profit of Rs 60 crore earned in the USA on which EARTH Limited is required to pay tax at the rate of 20%.
- Depreciation as per income tax laws is Rs 25.0 crore.

During review of the financial statements of EARTH Limited, the CFO multiplied profit before tax by the income tax rate and arrived at Rs 178.2 crore as the tax expense (Rs 594 crore x 30% = Rs 178.2 crore). However, actual income tax expense appearing in the summarized statement of profit and loss is Rs 166.9 crore.

The CFO has sought your help in reconciling the difference between the two tax expense amounts. Prepare a reconciliation containing the disclosure as required under the relevant Ind AS.

Answer

Reconciliation of income tax expense and current tax as per accounting profit for the year ended 31st March, 2011

Particulars		Rs in crore
Accounting profit		594.00
Tax at the applicable tax rate of 30%		178.20
Tax effect of expenses that are not deductible in determining taxable profits:		
Penalties (1.00 x 30%)	0.30	
Impairment of goodwill (44.00 x 30%)	13.20	
Corporate social responsibility expense (6.00 x 30%)	1.80	15.30
Tax effect of expenses that are deductible in determining taxable profits:		
Research and development expenses (8.00 x 30%)		(2.40)
Tax effect of income that are exempted in determining taxable profits:		

Dividend income (Exempt) (4.00 x 30%)	1.20	
Agriculture income (Exempt) (55.00 x 30%)	16.50	(17.70)
Tax effect of income on which different tax rates are used for determining taxable profits:		
Differential income tax on long term capital gain [10.00 x (30% - 10%)]	2.00	
Foreign income in USA [60.00 x (30%-20%)]	6.00	(8.00)
Income tax expense (Current) reported in the Statement of Profit and Loss for the current year		165.40

Reconciliation of deferred tax:

Particulars	Rs in crore
Deferred tax in relation to depreciation and amortization [(30 – 25) x 30%]	1.50
Tax expense (deferred) reported in the Statement of Profit or Loss for the current year	1.50

Question 3 (Practice Q.6)

On 1st April, 2011, an entity paying tax at 30% acquired a non-tax-deductible office building for Rs 1,00,000 in circumstances in which J prohibits recognition of the deferred tax liability associated with the temporary difference of Rs 1,00,000. The building is depreciated over 10 years at Rs 10,000 per year to a residual value of zero. The entity's financial year ends on 31st March.

On 1st April, 2012, the carrying amount of the building is Rs 90,000, and it is revalued upwards by Rs 45,000 to its current market value of Rs 1,35,000. There is no change to the estimated residual value of zero, or to the useful life of the building after revaluation.

Determine the carrying amount, depreciation for the year ended 31 st March, 2013 and defer tax thereafter till the useful life of the building. Further analyse the treatment and impact of defer tax since 31st March, 2013 till the useful life of the building.

Answer

Since there is no change to the estimated residual value of zero, or to the useful life of the building after revaluation, at the end of the 2nd year i.e. 31st March 2013, the building will be depreciated over the next 9 years at Rs 15,000 per year.

Following the revaluation, the temporary difference associated with the building is Rs 1,35,000. Of this amount, only Rs 90,000 arose on initial recognition, since Rs 10,000 of the original temporary difference of Rs 1,00,000 arising on initial recognition of the asset has been eliminated through depreciation of the asset. The carrying amount (which equals the temporary difference, since the tax base is zero) and depreciation during the year ended 31st March, 2013 and thereafter may then be analysed as follows:

Year	Carrying amount a	Tax base b	Gross temporary difference (c= a-b)	Unrecognised temporary difference d	Recognised temporary difference (e=c-d)	Deferred tax liability f = e @ 30%
0	1,00,000	-	1,00,000	1,00,000	-	-

1	90,000	-	90,000	90,000	-	-
Reval	1,35,000	-	1,35,000	90,000	45,000	13,500
2	1,20,000	-	1,20,000	80,000	40,000	12,000
3	1,05,000	-	1,05,000	70,000	35,000	10,500
4	90,000	-	90,000	60,000	30,000	9,000
5	75,000	-	75,000	50,000	25,000	7,500
6	60,000	-	60,000	40,000	20,000	6,000
7	45,000	-	45,000	60,000	15,000	4,500
8	30,000	-	30,000	20,000	10,000	3,000
9	15,000	-	15,000	10,000	5,000	1,500
10	-	-	-	-	-	-

Note: The depreciation is allocated pro rata to the cost element and revalued element of the total carrying amount.

On 31st March, 2013, the entity recognises a deferred tax liability based on the temporary difference of Rs 45,000 arising on the revaluation (i.e., after initial recognition) giving a deferred tax expense of Rs 13,500 (Rs 45,000 @ 30%) recognised in Other Comprehensive Income (OCI).

This has the result that the effective tax rate shown in the financial statements for the revaluation is 30% (Rs 45,000 gain with deferred tax expense of Rs 13,500).

As can be seen from the table above, as at 31st March, 2014 (year 3), Rs 40,000 of the total temporary difference arose after initial recognition. The entity, therefore, provides for deferred tax of Rs 12,000 (Rs 40,000 @ 30%), and a deferred tax credit of Rs 1,500 (the reduction in the liability from Rs 13,500 to Rs 12,000) is recognised in profit or loss.

The deferred tax credit can be explained as the tax effect at 30% of the additional Rs 5,000 depreciation relating to the revalued element of the building.

Question 4 (Practice Q.7)

X Ltd., an Indian company owns a freehold land with carrying value of Rs 10,00,000 which is not depreciated for tax purposes but is indexed for inflation. Indexed value and fair value of such land is Rs 15,00,000 and Rs 22,00,000 respectively as of the reporting date. What will be the tax base for such freehold land for measurement of deferred tax if:

(i) X Ltd. intends to sell it as a part of slump sale of business eventually after using it for business purpose

(ii) X Ltd. intends to sell the land individually and not on a slump sale basis

(iii) X Ltd. has classified such land as investment property and intends to sell it individually and not on a slump sale basis

(iv) X Ltd. follows a revaluation model for freehold land and intends to sell it individually and not on a slump sale

As per the applicable tax laws in the jurisdiction, indexation benefit is not available if the freehold land is sold as a part of slump sale of business, but indexation benefit is available if freehold land is sold individually.

Answer

Paragraphs 51 and 51A of Ind AS 12, state that the measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

In some jurisdictions, the manner in which an entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

(a) the tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and

(b) the tax base of the asset (liability).

In such cases, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

The expectation of the entity at the end of the reporting period with regard to the manner of recovery or settlement of its assets and liabilities will require exercise of judgement based on evaluation of facts and circumstances in each case. It may be relevant to consider that there is substance to management's expectation of the entity being able to recover the asset through slump sale or otherwise.

Depending on the facts and circumstances, it is generally assumed that the Company will act in the most economically advantageous way.

If a non-depreciable asset is measured using the revaluation model, then an entity is required to measure the DTA / DTL considering the tax consequences of recovering the carrying amount through sale.

Accordingly, based on assumption around supporting facts and circumstances to support management expectation around recovery or settlement, following will be the tax base for computing the deferred tax assets/ liability, in the given case:

(i) X Ltd. intends to sell it as slump sale eventually after using it for business purpose

If it is concluded based on evaluation of facts that the freehold land will be sold through slump sale, then the tax base of the land will be the same as the carrying amount of the land, as indexation benefit is not available in case of slump sale and hence there will not be any temporary difference.

(ii) X Ltd. intends to sell the land individually and not on a slump sale basis

In the given scenario, the company intends to sell the land individually and not on a slump sale such that the company would get indexation benefit.

Thus, book base of land, i.e. carrying amount of freehold land in the balance sheet is Rs 10,00,000. As per paragraph 51A of Ind AS 12, the tax base (amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset) is the indexed valued of Rs 15,00,000 since the company intends to sell the land individually and not on slump sale and thus get indexation benefit. Deferred tax assets will be set up, subject to recoverability, on a deductible tax difference of Rs 5,00,000.

(iii) X Ltd. has classified such land as investment property and intends to sell it individually and not on a slump sale

Paragraph 56 of Ind AS 40, Investment property, requires that after initial recognition, an entity shall measure all of its investment properties in accordance with the requirement for cost model as per Ind AS 16, other than those that meet the criteria to be classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. Ind AS 40 does not allow fair value model. Accordingly, freehold land classified as investment property will be measured at cost.

Thus, book base of land, i.e. carrying amount of freehold land in the balance sheet is Rs 10,00,000. The Company intends to sell the land individually and not on a slump sale and thus get indexation benefit. Hence, as per paragraph 51A of Ind AS 12, the tax base (amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset) is the indexed valued of Rs 15,00,000. Accordingly, deferred tax assets will be set up, subject to recoverability, on deductible tax difference of Rs 5,00,000.

(iv) X Ltd. follows a revaluation model for freehold land and intends to sell it individually and not on a slump sale. If X Ltd. follows a revaluation model, carrying amount of freehold land in the balance sheet would be Rs 22,00,000. Thus, book base of land is Rs 22,00,000.

The Company intends to sell the land individually and not on a slump sale and thus get indexation benefit. Hence, as per paragraph 51A of Ind AS 12, the tax base (amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset) is the indexed valued of Rs 15,00,000. Accordingly, deferred tax liability will be set up on taxable temporary difference of Rs 7,00,000.

As per paragraph 39 of Ind AS 16, if an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. Accordingly, the effect of deferred tax liability should also be recognised in other comprehensive income as per paragraph 57 and 61A of Ind AS 12.

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8. IND AS 16 : PROPERTY, PLANT AND EQUIPMENT

Question 1 (Practice Q.5)

On 1st January, 2011 an entity purchased an item of equipment for Rs 600,000, including Rs 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of Rs 605,000. In addition, the entity has to pay Rs 5,000 in loan raising fees to the Bank. The loan is secured against the equipment.

In January 2011 the entity incurred costs of Rs 20,000 in transporting the equipment to the entity's site and Rs 100,000 in installing the equipment at the site. At the end of the equipment's 10 -year useful life the entity is required to dismantle the equipment and restore the building housing the equipment. The present value of the cost of dismantling the equipment and restoring the building is estimated to be Rs 100,000.

In January 2011 the entity's engineer incurred the following costs in modifying the equipment so that it can produce the products manufactured by the entity:

- Materials – Rs 55,000
- Labour – Rs 65,000
- Depreciation of plant and equipment used to perform the modifications – Rs 15,000

In January 2011, the entity's production staff were trained in how to operate the new item of equipment. Training costs included:

- Cost of an expert external instructor – Rs 7,000
- Labour – Rs 3,000

In February 2011 the entity's production team tested the equipment and the engineering team made further modifications necessary to get the equipment to function as intended by management. The following costs were incurred in the testing phase:

- Materials, net of Rs 3,000 recovered from the sale of the scrapped output – Rs 21,000
- Labour – Rs 16,000

The equipment was ready for use on 1st March, 2011. However, because of low initial order levels the entity incurred a loss of Rs 23,000 on operating the equipment during March. Thereafter the equipment operated profitably.

What is the cost of the equipment at initial recognition? Also show the calculation or reason for underlying treatment.

Answer

Description	Calculation or reason	Rs
Purchase price	Rs 600,000 purchase price minus Rs 50,000 refundable purchase taxes	550,000
Loan raising fee	Offset against the measurement of the liability	-
Transport cost	Directly attributable expenditure	20,000
Installation costs	Directly attributable expenditure	100,000
Environmental restoration costs	The obligation to dismantle and restore the environment arose from the installation of the equipment	100,000
Preparation costs	Rs 55,000 materials + Rs 65,000 labour + Rs 15,000 depreciation	135,000
Training costs	Recognised as expenses in profit and loss account. The equipment was capable of operating in the manner intended by management without incurring the training costs.	-

Cost of testing	Rs 21,000 materials (ie net of the Rs 3,000 recovered from the sale of the scrapped output) + Rs 16,000 labour	37,000
Operating loss	Recognised as expenses in profit and loss account	-
Borrowing costs	Recognised as expenses in profit and loss account	-
Cost of equipment		**9,42,000**

Question 2 (Practice Q.6)

Company A incurred Rs 20,000 as cost for restoring the site on which the item of PPE was located. This item was used for manufacturing of goods and the requirement for restoring will arise due to manufacturing of goods.

What will the treatment of this Rs 20,000 in the books of Company A? Analyse on the basis of the provisions of relevant Ind AS.

Answer

Paragraph 16 of Ind AS 16, Property, Plant and Equipment, inter alia states that the cost of an item of property, plant and equipment comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Further, paragraph 18 of Ind AS 16 states that an entity applies Ind AS 2 to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with Ind AS 2 or Ind AS 16 are recognised and measured in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

Paragraph 16 of Ind AS 16 clarifies that decommissioning costs that meet the recognition criteria under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, for a provision are added to the cost of an item of property, plant and equipment if such costs are not incurred through the asset's use to produce inventories. Paragraph 18 fills the gap by clarifying where such costs are incurred through the asset's use to produce inventories, they are added to the cost of inventories.

Where the obligation to restore the asset arises due to the use of the asset to produce inventories but not due to the asset's installation, construction or acquisition, the costs are added to the costs of inventories.

Based on the above provisions and discussion, cost of restoring the site Rs 20,000 incurred during the period of production as a consequence of having used the item to produce inventories during that period should be added to the cost of inventories. However, later the inventories are measured at the lower of cost and net realisable value in accordance with paragraph 9 of Ind AS 2.

Question 3 (Practice Q.7)

Company X built a new plant that was brought into use on 1st April, 2011. The cost to construct the plant was Rs 1.5 crore. The estimated useful life of the plant is 20 years and Company X accounts for the plant using the cost model.

The initial carrying amount of the plant included an amount of Rs 10 lakh for decommissioning, which was determined using a discount rate of 10%. On 31st March, 2012, Company X remeasures the provision for decommissioning to Rs 13 lakh.

Provide necessary journal entries at the end of the year i.e. 31 st March, 2012 for recording of depreciation and decommissioning provision.

Answer

Journal Entries in the books of Company X for the year ending ended 31st March, 2012

	Rs in lakh	Rs in lakh
Depreciation (profit or loss) Dr.	7.5	
To Accumulated depreciation (plant)		7.5
(Being depreciation on plant recognised under straight-line method		

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(1,50,00,000 x 1/20))			
Interest expense (profit or loss) To Provision for decommissioning (Being unwinding of decommissioning provision @10% recognised in the books)	Dr.	1.0	1.0
Plant To Provision for decommissioning (Being increase in decommissioning provision recognised [13,00,000 – (10,00,000 +1,00,000)] at the end of the year)	Dr.	2.0	2.0

Question 4 (Practice Q.8)

On 1st October, 2011, XY Ltd. completed the construction of a power generating facility. The total construction cost was Rs 2 crore. The facility was capable of being used from 1st October, 2011 but XY Ltd. did not bring the facility into use until 1st January, 2012. The estimated useful life of the facility at 1st October, 2011 was 40 years.

Under legal regulations in the jurisdiction in which XY Ltd. operates, there are no requirements to restore the land on which power generating facilities stand to its original state at the end of the useful life of the facility. However, XY Ltd. has a reputation for conducting its business in an environmentally friendly way and has previously chosen to restore similar land even in the absence of such legal requirements. The directors of XY Ltd. estimated that the cost of restoring the land in 40 years' time (based on prices prevailing at that time) would be Rs 1 crore. A relevant annual discount rate to use in any discounting calculations is 5%. When the annual discount rate is 5%, the present value of Rs 1 receivable in 40 years' time is approximately 0.142.

Explain and show how the above event would be reported in the financial statements of XY Ltd. for the year ended 31st March, 2011. Ignore comments on potential future reclassification issues.

Answer

The facility is depreciated from the date it is ready for use, rather than when it actually starts being used. In this case, then, the facility is depreciated from 1st October, 2011.

Although XY Ltd. has no legal obligation to restore the piece of land, it does have a constructive obligation, based on its past practice and policies.

The amount of the obligation will be 14,20,000 being the present value of the anticipated future restoration expenditure (1,00,00,000 x 0.142).

This will be recognised as a provision under non-current liabilities in the balance sheet of XY Ltd. at 31st March, 2012.

As time passes the discounted amount unwinds. The unwinding of the discount for the year ended 31st March, 2012 will be Rs 35,500 (14,20,000 x 5% x 6/12).

The unwinding of the discount will be shown as a finance cost in the statement of profit and loss and the closing provision will be Rs 14,55,500 (14,20,000 + 35,500).

The initial amount of the provision is included in the carrying amount of the non-current asset, which becomes 2,14,20,000 (2,00,00,000 + 14,20,000).

The depreciation charge in profit or loss for the year ended 31st March, 2012 is Rs 2,67,750 (2,14,20,000 x 1/40 x 6/12).

The closing balance included in non-current assets will be 2,11,52,250 (2,14,20,000 – 2,67,750).

9. IND AS 19 : EMPLOYEE BENEFITS

Question 1 (Practice Q.4)

At 1 April, 2010, the fair value of the Plan Assets was Rs 10,00,000. The Plan paid benefits of Rs 1,90,000 and received contributions of Rs 4,90,000 on 30 September, 2010. The company computes the Fair Value of Plan Assets to be Rs 15,00,000 as on 31 March, 2011 and the Present Value of the Defined Benefit Obligation to amount to Rs 14,79,200 on the same date. Actuarial losses on defined benefit obligation were Rs 6,000.

Compounding happens half-yearly. The normal interest rate for 6 months period is 10%, while the effective interest rate for 12 months period is based on the following data:

At 1 April, 2010, the company made the following estimates based on market prices at that date:

Particulars	%
Interest and Dividend Income, after tax payable by the fund	9.25
Add: Realized and Unrealized Gains on Plan Assets (after tax)	2.00
Less: Administration Costs	(1.00)
Expected Rate of Return	10.25

Determine actual return and expected return on plan asset. Also compute amount to be recognized in 'Other Comprehensive Income' in this case.

Answer

Computation of Expected Return on Plan Assets

Particulars	Rs
Return on Rs 10,00,000 for 2010-2011 at 10.25% = Rs 10,00,000 x 10.25%	1,02,500
Add: Return on Rs 3,00,000 for 6 months at 10% Normal Rate = [3,00,000 (Inflow Rs 4,90,000 less Payments Rs 1,90,000) x 10% x 6/12)]	15,000
Expected Return on Plan Assets	**1,17,500**

Computation of Actual Return on Plan Assets

Particulars	Rs
Fair Value of Plan Assets at the year-end – 31 March 2011	15,00,000
Less: Fair Value of Plan Assets at the beginning – 1 April 2010	(10,00,000)
Less: Contributions received during the year 2010-2011	(4,90,000)
Add: Benefits paid during the year 2010-2011	1,90,000
Actual Return on Plan Assets	**2,00,000**

Computation of Net Actuarial Gain

Particulars	Rs
Actual Return on Plan Assets	2,00,000
Less: Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
Less: Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	**76,500**

Question 2 (Practice Q.5)

From the following particulars, compute the net defined benefit liability and expense to be recognized in Profit and Loss account.

				(Rs **in lakhs**)
Particulars	Defined benefit obligation		Plan Assets	
	31st Dec. 2012	31st Dec. 2011	31st Dec. 2012	31st Dec. 2011
Balance at the beginning of the year	63.25	47.08	21.80	14.65
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Changes in demographic assumptions	0.62	1.86	-	-
Changes in financial assumptions	3.58	1.93	-	-
Experience variance	(2.49)	4.46	-	-
Benefits paid	-	(0.61)	-	(0.61)
Investment income	-	-	1.47	1.12
Employers' contribution	-	-	8.00	7.00
Return on plan assets	-	-	2.12	(0.35)

Answer

Computation of defined benefit liability and expenses to be charged to Statement of Profit and Loss:

	Defined benefit obligation (Rs in lakhs)		Plan Assets (Rs in lakhs)	
	31st Dec 2012	31st Dec 2011	31st Dec 2012	31st Dec 2011
Balance at the beginning of year	63.25	47.08	21.80*	14.65
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-

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Changes in demographic assumptions	0.62	1.86	-	-
Changes in financial assumptions	3.58	1.93	-	-
Experience variance	(2.49)	4.46	-	-
Benefits paid	-	(0.61)	-	(0.61)
Investment income	-	-	1.47	1.12
Employers' contribution	-	-	8.00	7.00
Return on plan assets	-	-	2.12	(0.35)
Balance at the end of year	75.07	63.25	33.39	21.81*

*Difference is due to approximation.

In the BALANCE SHEET, the following will be recognised:

Net defined liability to be recognised for the period ending 31st December, 2011:

= Rs41.44 lakhs (Rs63.25 lakhs - Rs21.81 lakhs)

Net defined liability to be recognised for the period ending 31st December, 2012:

= Rs41.68 lakhs (Rs75.07 lakhs - Rs33.39 lakhs)

In the STATEMENT OF PROFIT AND LOSS, the following will be recognised:

	Defined benefit obligation (Rs in lakhs)		Plan Assets (Rsin lakhs)	
	31st Dec., 2012	31st Dec., 2011	31st Dec., 2012	31st Dec., 2011
Current service cost	5.84	4.97	-	-
Interest cost	4.27	3.56	-	-
Investment income	-	-	(1.47)	(1.12)
Total	10.11	8.53	(1.47)	(1.12)

Expense to be recognised in the Statement of Profit and Loss for the period ending 31st December, 2011 = Rs7.41 lakhs (Rs 8.53 lakhs - Rs1.12 lakhs)

Expense to be recognised in the Statement of Profit and Loss for the period ending 31st December, 2012 = Rs8.64 lakhs (Rs 10.11 lakhs - Rs1.47 lakhs).

Question 3 (Practice Q.6)

Arunachalam Ltd. operates a Defined Retirement Benefits Plan for its current and former employees. Given the large size of the company, it engaged a firm of Actuaries for advice on the Contribution Levels and overall Liabilities of the Plan to pay benefits. Following details are given:

(a) On 1st April, 2011, the actuarial valuation of the present value of the defined benefit obligation was Rs 15 crores. On the same date, the fair value of the assets of the Defined Benefit Plan was Rs 13 crores. On 1st April, 2011, the annual market yield based on Government Bonds was 5%.

(b) During the year ended 31st March, 2012, Arunachalam made contributions of Rs 1.75 crore into the Plan and the Plan paid out benefits of Rs 1.05 crore to retired members. Assume that both these payments were made on 31st March, 2012.

(c) The Actuarial Firm estimated that the current service cost for the year ended 31st March, 2012 would be Rs 1.55 crores. On 28th February, 2012, the rules of the Plan were amended with retrospective effect which led to an increase in the present value of the defined benefit obligation by Rs 37.5 lakhs from that date.

(d) During the year ended 31st March, 2012, Arunachalam was in negotiation with employee representatives regarding planned redundancies. These negotiations were completed shortly before the year end and the redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by Rs 2 crores. Before 31st March, 2012, Arunachalam made payments of Rs 1.875 crores to the employees affected by the redundancies in compensation for a curtailment of their benefits. These payments were made out of the assets of the Retirement Benefits Plan.

(e) On 31st March, 2012, the present value of the defined benefit obligation was Rs 17 crores and the fair value of the assets of the Defined Benefit Plan was Rs 14 crores.

Discuss how the above will be accounted in the books of Arunachalam Ltd. for the year 2011-2012. Also give the extracts of financial statements affected due to above transactions.

Answer

1. **Extract of Balance Sheet (Net Amount in the Balance Sheet) (Rs in lakhs)**

	31.3.2012	**1.4.2011**
PV of Defined Benefit Obligation (given)	(1,700.00)	(1,500.00)
FV of Plan Assets (given)	1,400.00	1,300.00
Net Defined Benefit Liability (under Long-term Provision)	**(300.00)**	**(200.00)**

2. Extract of Statement of Profit and Loss

	(Rs in lakhs)
Current service cost (given)	155.00
Past service cost (given)	37.50
Gain on settlement (Rs 200 lakhs – Rs 187.50 lakhs)	(12.50)
Net interest on net defined benefit liability [Rs 75 lakhs - Rs 65 lakhs]	10.00
Total to Statement of Profit and Loss	**190.00**

3. Extract of Other Comprehensive Income (Remeasurements)

	(Rs in lakhs)
Actuarial loss on defined benefit obligation (W.N.1)	(237.50)
Return on plan assets other than expected return (W.N.2)	152.50
Total	**(85.00)**

Working Notes:

1. Defined Benefit Obligation Account

Particulars	Rs in lakhs	Particulars	Rs in lakhs
To Plan Assets (benefits paid)	105.00	By Balance b/f (given) [balance as on 1.4.2011]	1,500.00
To Curtailment and Settlement	200.00	By Current Service Cost	155.00
		By Interest Cost [5% on Opening balance]	75.00
		By Past service cost	37.50
To Balance c/d (given) [balance as on 31.3.2012]	1,700.00	By Actuarial Loss **(balancing figure)**	237.50
	2,005.00		**2,005.00**

2. Plan Assets Account

Particulars	Rs in lakhs	Particulars	Rs in lakhs
To Balance b/f (given) [balance as on 1.4.2011]	1,300.00	By Defined Benefit Obligation [benefits paid]	105.00
To Expected Return [5% on Opening balance]	65.00	By Payments on curtailment and settlement	187.50
To Bank (contributions paid)	175.00	By Balance c/d (given) [balance as on 31.3.2012]	1,400.00
To Actuarial Gain **(balancing figure)**	152.50		
	1,692.50		**1,692.50**

The above Defined Benefit Obligation Account and Plan Assets Account can alternatively be presented in a statement form as follows:

Defined Benefit Obligation		Plan Assets	
Particulars	**Rs in lakhs**	**Particulars**	**Rs in lakhs**
PV of Obligation b/f.	1,500.00	FV of Plan Assets b/f.	1,300.00
Interest Cost [Rs 1,500 x 5%]	75.00	Interest Income [Rs 1,300 x 5%]	65.00

Current Service Cost	155.00	Contribution during 2011-2012	175.00
Benefits paid during 2011-2012	(105.00)	Benefits paid during 2011- 2012	(105.00)
Plan Curtailment and Settlement	(200.00)	Payment towards settlement	(187.50)
Past Service Cost	37.50		
Remeasurement Loss **(balancing figure)**	237.50	Remeasurement Gain **(balancing figure)**	152.50
PV of Obligation c/f.	**1,700.00**	FV of Plan Assets c/f.	**1,400.00**

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10. IND AS 20 : ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

Question 1 (Practice Q.3)

A Ltd. has been conducting its business activities in backward areas of the country and due to higher operating costs in such regions, it has collectively incurred huge losses in previous years. As per a scheme of government announced in March 2011, the company will be partially compensated for the losses incurred by it to the extent of Rs 10,00,00,000, which will be received in October 2011. The compensation being paid by the government meets the definition of government grant as per Ind AS 20. Assume that no other conditions are to be fulfilled by the company to receive the compensation.

When should the grant be recognised in statement of profit and loss? Discuss in light of relevant Ind AS.

Answer

Paragraph 7 of Ind AS 20 states that, Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.

Further, paragraphs 20 and 22 of Ind AS 20 state as follows:

"A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable".

"A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised in profit or loss of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood."

In accordance with the above, in the given case, as at March 2011, A Ltd. is entitled to receive government grant in the form of compensation for losses already incurred by it in the previous years. Therefore, even though the compensation will be received in the month of October 2011, A Ltd. should recognise the compensation receivable by it as a government grant in the profit or loss for the period in which it became receivable, i.e., for the financial year 2010-2011 with disclosure to ensure that its effect is clearly understood.

Question 2 (Practice Q.4)

A Limited is engaged in the manufacturing of certain specialized chemicals. During the manufacturing process, certain wastewater is produced which is released by A Limited in the nearby river. To reduce pollution of the rivers, the state government has introduced a scheme with the following salient features:

- If a manufacturer installs certain pre-approved wastewater treatment plant, the government will provide an interest free loan equal to 50% of the cost of the plant;
- Such loan will be repayable to the government in 5 years from the date of disbursal;
- The manufacturer availing the benefit of this scheme must treat the wastewater of its factory using the specified plant before releasing it to the river. If this condition is violated, the entire loan shall become immediately repayable to the government along with a penalty of Rs 10 lakh.

Cost of the wastewater treatment plant to be installed to avail the benefit of the scheme is Rs 50 lakh. A Limited decided to utilise this scheme because, if it were to obtain the similar loan from a bank, it would be available at a market interest rate of 12% per annum. Accordingly, A Limited applied for and obtained the government loan of Rs 25 lakh on 1st April, 2011. A Limited purchased and installed the plant such that it became ready for use on the same date.

A Limited has an accounting policy of recognising government grant in relation to depreciable assets in the proportion of depreciation expense. It has determined that the plant will be depreciated over a period of 5 years using straight-line method. In the month of March, 2013, government officials conducted a surprise audit, and it was found that A Limited was not using the wastewater treatment plant as prescribed. Accordingly, on 31st March, 2013, the government ordered A Limited to repay the entire loan along with penalty. A Limited repaid the loan with interest and penalty as per the order on 31st March, 2013.

Measure the amount of government grant as on 1st April, 2011. Determine the nature of the government grant and its accounting treatment (principally) for the year ended 31 st March, 2012. Also determine the impact on profit or loss if any, on account of revocation of government grant as on 31st March, 2013.

Answer

As per the principles of Ind AS 20 "Accounting for Government Grants and Disclosure of Government Assistance", the benefits of a government loan at a below market rate of interest is treated as a government grant. The loan shall be recognized and measured in accordance with Ind AS 109 "Financial Instruments". The benefit of the below market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with Ind AS 109 and the proceeds received. The benefit is accounted for in accordance with Ind AS 20. As per Ind AS 109, the loan should be initially measured at its fair value.

Initial recognition of grant as on 1st April, 2011

Fair value of loan = Rs 25,00,000 x 0.567 (PVF @ 12%, 5th year) = Rs 14,17,500

A Limited will recognize Rs 10,82,500 (25,00,000 – 14,17,500) as the government grant and will make the following entry on receipt of loan:

Date	Particulars	Dr. (Rs)	Cr. (Rs)
1.4.2011	Bank account Dr.	25,00,000	
	To Deferred Grant Income		10,82,500
	To Loan account		14,17,500
	(Being grant initially recorded at fair value)		

As per para 3 of Ind AS 20, grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets.

As per para 24-27 of Ind AS 20, Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

One method recognises the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.

The other method deducts the grant in calculating the carrying amount of the asset. The grant is recognised in profit or loss over the life of a depreciable asset as a reduced depreciation expense.

A Ltd. has adopted first method of recognising the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset. Here, deferred income is recognised in profit or loss in the proportion in which depreciation expense on the asset is recognised.

Depreciation for the year (2011-2012) = Rs 50,00,000 / 5 years = Rs 10,00,000

As the loan is to finance a depreciable asset, Rs 10,82,500 will be recognized in Profit or Loss on the same basis as depreciation.

Since the depreciation is provided on straight line basis by A Limited, it will credit Rs 2,16,500 (10,82,500 / 5) equally to its statement of profit and loss over the 5 years.

Journal Entries

Date	Particulars	Dr. (Rs)	Cr. (Rs)
31.3.2012	Depreciation (Profit or Loss A/c) Dr.	10,00,000	
	To Property, Plant & Equipment		10,00,000

	(Being depreciation provided for the year)		
	Deferred grant income Dr.	2,16,500	
	To Profit or Loss		2,16,500
	(Being deferred income adjusted)		

<u>Impact on profit or loss due to revocation of government grant as on 31st March 2013</u>

As per para 32 of Ind AS 20, a government grant that becomes repayable shall be accounted for as a change in accounting estimate. Repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment shall be recognised immediately in profit or loss.

Amount payable to Government on account of principal loan = Rs 25,00,000

Amount payable to Government on account of penalty = Rs 10,00,000

Journal Entries

Date	Particulars	Dr. (Rs)	Cr. (Rs)
31.3.2013	Deferred grant income Dr.	2,16,500	
	To Profit or Loss		2,16,500
	(Being deferred income adjusted)		
	Loan account (W.N.1) Dr.	17,78,112	
	Deferred grant income (W.N.2) Dr.	6,49,500	
	Profit or Loss Dr.	72,388	
	To Government grant payable		25,00,000
	(Being refund of government grant)		
	Profit or Loss Dr.	10,00,000	
	To Government grant payable		10,00,000
	(Being penalty payable to government)		

Therefore, total impact on profit or loss on account of revocation of government grant as on 31st March, 2013 will be Rs 10,72,388 (10,00,000 + 72,388).

Circumstances giving rise to repayment of a grant related to an asset may require consideration to be given to the possible impairment of the new carrying amount of the asset.

Working Notes:

1. Amortisation Schedule of Loan

Year	**Opening balance of Loan**	**Interest @ 12%**	**Closing balance of Loan**
31.03.2012	14,17,500	1,70,100	15,87,600
31.03.2013	15,87,600	1,90,512	**17,78,112**

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2. Deferred Grant Income

Year	Opening balance	Adjustment	Closing balance
31.03.2012	10,82,500	2,16,500	8,66,000
31.03.2013	8,66,000	2,16,500	6,49,500

Question 3 (Practice Q.5)

To encourage entities to expand their operations in a specified development zone, the government provides interest-free loans to fund the purchase of manufacturing equipment.

In accordance with the development scheme, an entity receives an interest-free loan of Rs 5,00,000 from the government for a period of three years. The market rate of interest for similar loans for 3 years is 5% per year.

There are no future performance conditions attached to the interest-free loan.

Discuss how to account for the above loan. Pass necessary journal entries in the entity's books of accounts from year 1 to year 3, as per relevant Ind AS.

Answer

The entity measures the loan on initial recognition at Rs 4,32,000, which is the present value of the loan (financial liability) — Rs $5{,}00{,}000/(1.05)^3$. Rs 68,000, the difference between the loan proceeds received Rs 5,00,000 (the loan's face value) and present value of the loan Rs 4,32,000, is a government grant and is recognised immediately as there are no specified future performance conditions.

The amount recognised on day one will accrete to Rs 5,00,000 over the three-year term using the effective interest method.

Journal Entries

On initial recognition:

	Rs	Rs
Cash/Bank (financial asset) Dr.	5,00,000	
To Loan (financial liability)		4,32,000
To Income (profit or loss)		68,000
(Being interest-free loan recognised at fair value and the receipt of a government grant)		

At the end of Year 1:

	Rs	Rs
Finance cost (profit or loss) Dr.	21,600	
To Loan (financial liability)		21,600
(Being accretion of time value recognised on the financial liability)		

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Year 2

	Rs	Rs
Finance cost (profit or loss) Dr. To Loan (financial liability) (Being accretion of time value recognised on the financial liability)	22,680	22,680

Year 3

	Rs	Rs
Finance cost (profit or loss) Dr. To Loan (financial liability) (Being accretion of time value recognised on the financial liability)	23,720	23,720

Immediately after all the accretions are recognised, the carrying amount of the loan is equal to its face value of Rs 5,00,000, which is also the amount payable to the government.

	Rs	Rs
Loan (financial liability) Dr. To Cash/Bank (Being loan repaid to the government)	5,00,000	5,00,000

Working Note:

Calculation of Amortised Cost

Year	Opening balance (A)	Interest at 5% (B) = (A) x 5%	Cash flow (C)	Closing balance (A) + (B) – (C)
1	4,32,000	21,600	—	4,53,600
2	4,53,600	22,680	—	4,76,280
3	4,76,280	23,720*	(5,00,000)	—

* Difference is due to approximation.

11. IND AS 21 : THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Question 1 (Practice Q.4)

Infotech Global Ltd. (a stand-alone entity) has a functional currency of USD and needs to translate its financial statements into the presentation currency (INR). The following is the draft financial statements of Infotech Global Ltd. prepared in accordance with its functional currency.

Balance Sheet

Particulars	31st March, 2013	31st March, 2012
	USD	USD
Property, plant and equipment	50,000	55,000
Trade Receivables	68,500	56,000
Inventory	8,000	5,000
Cash	40,000	35,000
Total assets	**1,66,500**	**1,51,000**
Share Capital	50,000	50,000
Retained earnings	29,500	18,000
Total Equity	**79,500**	**68,000**
Trade payables	40,000	38,000
Loan	47,000	45,000
Total liabilities	**87,000**	**83,000**
Total equity and liabilities	**1,66,500**	**1,51,000**

Statement of Profit and Loss

Particulars	USD
Revenue	1,77,214
Cost of sales	1,13,100
Gross Profit	**64,114**
Distribution costs	2,400
Administrative expenses	18,000
Other expenses	11,000
Finance costs	12,000
Profit before tax	**20,714**
Income tax expense	6,214
Profit for the year	**14,500**

Extracts from Statement of Changes in Equity

Particulars	**31st March, 2013 (USD)**
Retained earnings at the beginning of the year	18,000
Profit for the year	14,500
Dividends	(3,000)
Retained earnings at the end of the year	29,500

- Share capital was issued when the exchange rate was USD 1 = INR 70.
- Retained earnings on 1st April, 2011 was INR 4,00,000.
- At 31st March, 2012, a cumulative gain of INR 4,92,000 has been recognised in the foreign exchange reserve, which is due to translation of entity's financial statements into INR in the previous years.
- Entity paid a dividend of USD 3,000 when the rate of exchange was USD 1 = INR 73.5
- Profit for the year 2011-2012 of USD 8,000, translated in INR at INR 5,72,000.
- Profit for the year 2012-2013 of USD 14,500, translated in INR at INR 10,72,985.

For the sake of simplicity, items of income and expense are translated at weighted average monthly rate as there has been no significant exchange rate fluctuation during the entire year and the business of the entity is not cyclical in nature.

Relevant exchange rates are as follows:

- Rate at 31st March, 2012 USD 1= INR 73
- Rate at 31st March, 2013 USD 1= INR 75

Prepare financial statements of Infotech Global Ltd. translated from functional currency (USD) to presentation currency (INR).

Answer

As per paragraph 39 of Ind AS 21, all assets and liabilities are translated at the closing exchange rate, which is USD 1 = INR 73 on 31st March, 2012 and USD 1 = INR 75 on 31st March, 2013.

In the given case, share capital is translated at the historical rate USD 1 = INR 70. The share capital will not be restated at each year end. It will remain unchanged.

Accordingly, the translated financial statements will be as follows:

Note 1: Retained earnings at 31st March, 2013 and 31st March, 2012:

Particulars	**31st March, 2013**	**31st March, 2012**
	INR	**INR**
Opening retained earnings	9,72,000	4,00,000
Profit for the year	10,72,985	5,72,000
Dividends paid (USD 3,000 x INR 73.5)	(2,20,500)	-
Closing retained earnings	**18,24,485**	**9,72,000**

Balance Sheet

Particulars	31st March, 2013			31st March, 2012		
	USD	Rate	INR	USD	Rate	INR
Property, plant and equipment	50,000	75	37,50,000	55,000	73	40,15,000
Trade Receivables	68,500	75	51,37,500	56,000	73	40,88,000
Inventory	8,000	75	6,00,000	5,000	73	3,65,000
Cash	40,000	75	30,00,000	35,000	73	25,55,000
Total assets	**1,66,500**		**1,24,87,500**	**1,51,000**		**1,10,23,000**
Share Capital	50,000	70	35,00,000	50,000	70	35,00,000
Retained earnings (Refer note 1)	29,500		18,24,485	18,000		9,72,000
Foreign Exchange reserve (Balancing figure)			6,38,015	-		4,92,000
Total Equity	**79,500**		**59,62,500**	**68,000**		**49,64,000**
Trade payables	40,000	75	30,00,000	38,000	73	27,74,000
Loan	47,000	75	35,25,000	45,000	73	32,85,000
Total liabilities	**87,000**		**65,25,000**	**83,000**		**60,59,000**
Total equity and liabilities	**1,66,500**		**1,24,87,500**	**1,51,000**		**1,10,23,000**

The foreign exchange reserve is the exchange difference resulting from translating income and expense at the average exchange rate and assets and liabilities at the closing rate.

Other Comprehensive Income

Exchange differences on translating from USD to INR (6,38,015 - 4,92,000)	INR 1,46,015

Statement of Changes in Equity (INR)

Particulars	Share capital	Retained Earnings	Foreign exchange reserve	Total
Balance at 1st April, 2012	35,00,000	9,72,000	4,92,000	49,64,000
Dividends	-	(2,20,500)	-	(2,20,500)
Profit for the year	-	10,72,985	-	10,72,985
Exchange difference (transferred to OCI)	-	-	1,46,015	1,46,015
Balance at 31st March, 2013	35,00,000	18,24,485	6,38,015	59,62,500

12. IND AS 23 : BORROWING COSTS

Question 1 (Practice Q.3)

X Ltd. commenced the construction of a plant (qualifying asset) on 1st September, 2011, estimated to cost Rs 10 crores. For this purpose, X has not raised any specific borrowings, rather it intends to use general borrowings, which have a weighted average cost of 11%. Total borrowing costs incurred during the period, viz., 1st September, 2011 to 31st March, 2012 were Rs 0.5 crore.

The other relevant details are as follows: (Rsin crore)

Month	Cost of construction Accrued	Cash outflows (paid in advance at the start of each month)
September	1.50	3.00
October	0.50	1.70
November	1.50	2.50
December	0.50	-
January	1.80	1.00
February	0.70	-
March	3.00	1.50

Based on the above information, discuss the treatment of borrowing cost as per cash outflow basis and accrual basis and also suggest the appropriate amount of interest that should be capitalised to the cost of the plant in the financial statements for the year ended 31st March, 2012?

Answer

Paragraph 14 of Ind AS 23, inter-alia, states that to the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period. However, an entity shall exclude from this calculation borrowing costs applicable to borrowings made specifically for the purpose of obtaining a qualifying asset until substantially all the activities necessary to prepare that asset for its intended use or sale are complete. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

In this context, a question arises whether such expenditure should be based on costs accrued or actual cash outflows. To contrast these two alternatives, presented below is the computation of borrowing costs based on both the alternatives:

Month	Cost construction Accrued	Average capital expenditure	Cash outflows (paid in advance at the start of each month)	Average capital expenditure
September	1.50	1.50 x 7/12 = 0.875	3.00	3.00 x 7/12 = 1.75
October	0.50	0.50 x 6/12 = 0.25	1.70	1.70 x 6/12 = 0.85
November	1.50	1.50 x 5/12 = 0.625	2.50	2.50 x 5/12 = 1.04
December	0.50	0.50 x 4/12 = 0.17	-	-
January	1.80	1.80 x 3/12 = 0.45	1.00	1 x 3/12 = 0.25

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February	0.70	0.70 x 2/12 = 0.12	-	-
March	3.00	3.00 x 1/12 = 0.25	1.50	1.50 x 1/12 = 0.125
	9.50	**2.74**	**9.70**	**4.02**

If the average capital expenditure on the basis of costs accrued is taken, the borrowing costs eligible to be capitalised would be Rs 2.74 crore x 11% = 0.30 crore. Whereas, if average capital expenditure on the basis of cash flows is taken, the borrowing costs eligible to be capitalised would be Rs 4.02 crore x 11% = 0.44 crore. Thus, there is a wide variance in the amount of borrowing cost to be capitalised, based on the accrual basis and on actual cash flows basis. This divergence is often experienced during the implementation of large projects, for example, an advance given to a supplier involves an upfront cash outflow while the actual expenditure accrues in later periods (with the receipt of goods and services).

As per paragraph 18 of Ind AS 23, expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with the asset (see Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance). The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalization rate is applied in that period.

Where cash has been paid but the corresponding cost has not yet accrued interest becomes payable on payment of cash. Therefore, the amount so paid should be considered for determining the amount of interest eligible for capitalisation, subject to the fulfillment of other conditions prescribed in paragraph 16 of Ind AS 23. Accordingly, in the present case, interest should be computed on the basis of the cash flows rather than on the basis of costs accrued. Therefore, the amount of interest eligible for capitalisation would be Rs 0.44 crore.

Another important factor to be noted is that paragraph 14 requires, inter alia, that the amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period. Thus, the amount of borrowing costs to be capitalised should not exceed the total borrowing costs incurred during the period, that is Rs 0.5 crore.

Question 2 (Practice Q.4)

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be operational as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year: (Rs in lakh)

	Phase I	Phase II	Phase III	Phase IV
	Rs	Rs	Rs	Rs
Cash expenditure	10	30	25	30
Building purchased	24	34	30	38
Total expenditure	34	64	55	68
Total expenditure of all phases				221
Loan taken @ 15% at the beginning of the year				200

After taking substantial period of construction, at the mid of the current year, Phase I and Phase II have become operational.

Find out the total amount to be capitalized and to be expensed during the year.

Answer

	Particulars	Rs
1.	Interest expense on loan Rs 2,00,00,000 at 15%	30,00,000
2.	Total cost of Phases I and II (Rs 34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (Rs 55,00,000 + Rs 68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate Loan amount = $\frac{30,00,000}{2,21,000} \times 98,00,000$	13,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on Loan amount = $\frac{30,00,000}{2,21,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment:

1. **For Phase I and Phase II**

   Since Phase I and Phase II have become operational at mid of the year, half of the interest amount of Rs 6,65,158.50 (i.e. Rs 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of Rs 6,65,158.50 (i.e. Rs 13,30,317/2) relating to Phase I and Phase II should be expensed off during the year.

2. **For Phase III and Phase IV**

   Interest of Rs 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

Question 3 (Practice Q.5)

LT Ltd. is in the process of constructing a building. The construction process is expected to take about 18 months from 1st January 2011 to 30th June 2012. The building meets the definition of a qualifying asset. LT Ltd. incurs the following expenditure for the construction:

1st January, 2011	Rs 5 crores
30th June, 2011	Rs 20 crores
31st March, 2012	Rs 20 crores
30th June, 2012	Rs 5 crores

On 1st July 2011, LT Ltd. issued 10% Redeemable Debentures of Rs 50 crores. The proceeds from the debentures form part of the company's general borrowings, which it uses to finance the construction of the qualifying asset, ie, the building. LT Ltd. had no borrowings (general or specific) before 1st July 2011 and did not incur any borrowing costs before that date. LT Ltd. incurred Rs

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25 crores of construction costs before obtaining general borrowings on 1st July 2011 (pre-borrowing expenditure) and Rs 25 crores after obtaining the general borrowings (post-borrowing expenditure).

For each of the financial years ended 31st March 2011, 2012 and 2013, calculate the borrowing cost that LT Ltd. is permitted to capitalize as a part of the building cost.

Answer

Applying paragraph 17 of Ind AS 23 to the fact pattern, the entity would not begin capitalising borrowing costs until it incurs borrowing costs (i.e. from 1st July, 2011)

In determining the expenditures on a qualifying asset to which an entity applies the capitalisation rate (paragraph 14 of Ind AS 23), the entity does not disregard expenditures on the qualifying asset incurred before the entity obtains the general borrowings. Once the entity incurs borrowing costs and therefore satisfies all three conditions in para 17 of Ind AS 23, it then applies paragraph 14 of Ind AS 23 to determine the expenditures on the qualifying asset to which it applies the capitalisation rate.

Calculation of borrowing cost for financial year 2010-2011

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1st January 2011	Rs5 crore	0/3	Nil

Borrowing Costs eligible for capitalisation = NIL. LT Ltd. cannot capitalise borrowing costs before 1st July, 2011 (the day it starts to incur borrowing costs).

Calculation of borrowing cost for financial year 2011-2012

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1st January, 2011	Rs5 crore	9/12*	Rs3.75 crore
30th June, 2011	Rs20 crore	9/12	Rs15 crore
31st March, 2012	Rs20 crore	0/12	Nil
Total			Rs18.75 crore

Borrowing Costs eligible for capitalisation = 18.75 cr. x 10% = Rs1.875 cr.

*LT Ltd. cannot capitalise borrowing costs before 1st July, 2011 (the day it starts to incur borrowing costs). Accordingly, this calculation uses a capitalization period from 1st July, 2011 to 31st March, 2012 for this expenditure

Calculation of borrowing cost for financial year 2012-2013

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1st January, 2011	Rs5 crore	3/12	Rs1.25 crore

30th June, 2011	Rs20 crore	3/12	Rs5 crore
31st March, 2012	Rs20 crore	3/12	Rs5 crore
31st March, 2012	Rs1.875crore	3/12	Rs0.47 crore
30th June, 2012	Rs5 crore	0/12	Nil
Total			Rs11.72 crore

Borrowing costs eligible for capitalisation = Rs11.72 cr. x 10% = Rs1.172 cr.

Question 4 (Practice Q.6)

PQR Limited is engaged in Tourism business in India. The company has planned to construct a Holiday Resort (Qualifying Asset) at Shimla. The cost of the project has been met out of borrowed funds of Rs 100 lakhs at the rate of 12% p.a. Rs 40 lakhs were disbursed on 1st April 2012 and the balance of Rs 60 lakhs were disbursed on 1st June 2012. The site planning work commenced on 1st June 2012, since the Chief engineer of the project was on medical leave. The company commenced physical construction on 1st July 2012 and the work of construction continued till 30th September 2012 and thereafter the construction activities stopped due to landslide on the road which leads to construction site. The road blockages have been cleared by the government machinery by 31st December 2012. Construction activities have resumed on 1st January 2013 and has completed on 28th February 2013.

The date of opening has been scheduled for 1st March 2013, but unfortunately, the District Administration gave permission for opening on 16th March 2013, due to lack of safety measures like fire extinguishers which had not been installed by then.

Determine the amount of borrowing cost to be capitalized towards construction of the resort when

(i) Landslide is not common in Shimla and delay in approval from District Administration Office is minor administrative work leftover.

(ii) Landslide is common in Shimla and delay in approval from District Administration Office is major administrative work leftover.

Answer

As per Ind AS 23 'Borrowing Costs', the commencement date for capitalisation of borrowing cost on qualifying asset is the date when the entity first meets all of the following conditions:

(a) it incurs expenditures for the asset;

(b) it incurs borrowing costs; and

(c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Further, an entity also does not suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high-water levels are common during the construction period in the geographical region involved.

An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Further, paragraph 23 explains that an asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

In the given case since the site planning work started for the project on 1st June, 2012, the commencement of capitalisation of borrowing cost will begin from 1st June, 2012.

(i) When landslide is not common in Shimla and delay in approval from District Administration Office is minor administrative work leftover.

In such a situation, suspension of capitalisation of borrowing cost on construction work will be considered for 3 months i.e. from October, 2012 to December, 2012 and cessation of capitalization of borrowing cost shall stop at the time of completion of physical

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activities.

Accordingly, the borrowing cost to be capitalized will be effectively for 6 months i.e. from 1st June, 2012 to 30th September, 2012 and then from 1st January, 2013 to 28th February, 2013 i.e. total 6 months. The amount of borrowing cost will be Rs 6,00,000 (1,00,00,000 x 6/12 x 12%).

(ii) When landslide is common in Shimla and delay in approval from District Administration Office is major administrative work leftover

Since landslides are common in Shimla during monsoon period, there shall be no suspension of capitalisation of borrowing cost during that period.

Further, an asset can be considered to be ready for its intended use only on receipt of approvals and after compliance with regulatory requirements such as “Fire Clearances” etc. These are very important to declare the asset as ready for its scheduled operation.

In the given case, obtaining the safety approval is a necessary condition that needs to be complied with strictly and before obtaining the same the entity will not be able to use the building. Accordingly, it is appropriate to continue capitalisation until the said approvals are obtained.

Hence, the capitalisation of the borrowing cost will be for 9.5 months i.e. from 1st June, 2012 till 15th March, 2013. The amount of borrowing cost will be Rs 9,50,000 (1,00,00,000 x 9.5/12 x 12%).

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13. IND AS 24 : RELATED PARTY DISCLOSURES

Question 1 (Practice Q.3)

Entity A owns 30% of the share capital of entity B and has the ability to exercise significant influence over it.

Entity B holds the following investments:

- 70% of the share capital of its subsidiary, entity C; and
- 30% of the share capital of entity D, with the ability to exercise significant influence.

Entity A transacts with entities C and D. Should entity A disclose these transactions as related party transactions in its separate financial statements? Also explain the disclosure of such transactions in the financial statements of C and D as related party transaction.

Answer

Entity A should disclose its transactions with entity C in entity A's separate financial statements. Entity C is a related party of entity A, because entity C is the subsidiary of entity A's associate, entity B.

Entity A's management is not required to disclose entity A's transactions with entity D in its financial statements. Entity D is not a related party of entity A, because entity A has no ability to exercise control or significant influence over entity D.

Entity C is required to disclose its transactions with entity A in its financial statements, because entity A is a related partly.

Entity D is not required to disclose transactions with entity A, because they are not related parties.

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14. IND AS 33 : EARNINGS PER SHARE

Question 1 (Practice Q.2)

Following information pertains to an entity for the year ending 31st March 2011:

Net profit for the year	Rs 12,00,000
Weighted average number of equity shares outstanding during the year	5,00,000 shares
Average market price per share during the year	Rs 20
Weighted average number of shares under option during the year	1,00,000 shares
Exercise price per share under option during the year	Rs 15

Calculate basic and diluted earnings per share.

Answer

Calculation of earnings per share

	Earnings	**Shares**	**Per share**
Profit attributable to equity holders	Rs 12,00,000		
Weighted average shares outstanding during year 2011		5,00,000	
Basic earnings per share			**Rs 2.40**
Weighted average number of shares under option		100,000	
Weighted average number of shares that would have been issued at average market price: (1,00,000 × Rs 15.00) ÷ Rs 20.00	Refer Note	(75,000)	——
Diluted earnings per share	**Rs 1,200,000**	**525,000**	**Rs 2.29**

Note: Earnings have not increased because the total number of shares has increased only by the number of shares (25,000) deemed to have been issued for no consideration.

Question 2 (Practice Q.3)

Company S is a subsidiary of Company P. Following facts are in respect of Company S:

- Company S has 10,000 ordinary shares and 1,000 options outstanding, of which Company P owns 9,000 shares and 500 options, respectively.
- The options have an exercise price of Rs 40.
- The average market price of Company S's ordinary share was Rs 50 in 2011.
- In 2011, Company S's profit was Rs 30,000.

Following facts are in respect of Company P:

- Company P has 5,000 ordinary shares outstanding.
- In 2011, Company P's profit (excluding any distributed and undistributed earnings of subsidiaries) was Rs 7,000.
- The options outstanding are dilutive at P's level.

Determine the diluted EPS of Company P for the year 2011. Ignore income tax.

Answer

To determine the diluted EPS of Company P, the diluted EPS of Company S has to be calculated first.

Calculation of Company S's diluted EPS:	
Company S's earnings for the period	Rs 30,000
Weighted average ordinary shares	10,000
Incremental shares (refer W.N.)	200
Company S's diluted EPS	Rs 30,000/ (10,000 + 200) Rs 2.94
Calculation of Company P's diluted EPS:	
Company P's earning for the period	Rs 7,000
Company P's share of Company S's earning attributable to ordinary shares Rs 26,460 [(9,000 /10,000) x (2.94 x 10,000)]	Rs 26,460
Company P's share of Company S's earning attributable to options [(500 /1,000) x (2.94 x 200)]	Rs 294
Company P's weighted average ordinary shares outstanding	5,000
Company P's diluted EPS = (7,000 + 26,460 + 294) / 5,000	Rs 6.75

Working Note:

Computation of Incremental shares related to weighted average options outstanding:

All options are dilutive because their exercise price is below the average market price of Company S's ordinary shares for the period.

The incremental shares are calculated as follows:

Shares issued on assumed exercise of options	1,000
Less: Shares that would be issued at average market Price [(40 x 1,000)/50]	(800)
Incremental shares	200

Question 3 (Practice Q.4)

Company P has both ordinary shares and equity-classified preference shares in issue. The reconciliation of the number of shares during Year 1 is set out below:

Number of shares

Dates in Year 1	**Transaction**	**Ordinary shares**	**Treasury shares**	**Preference shares**
1st April	Balance	30,00,000	(5,00,000)	5,00,000
15th April	Bonus issue – 5% (no corresponding changes in resources)	1,50,000	(25,000)	-

1st May	Repurchase of shares for cash	-	(2,00,000)	-
1st November	Shares issued for cash	4,00,000	-	-
31st March	Balance	35,50,000	(7,25,000)	5,00,000

The following additional information is relevant for Year 1.

- Company P's net profit for the year is Rs46,00,000.
- On 15th February, non-cumulative preference dividends of Rs 1.20 per share were declared. The dividends were paid on 15th March. Preference shares do not participate in additional dividends with ordinary shares.
- Dividends on non-cumulative preference shares are deductible for tax purposes. The applicable income tax rate is 30%.

The financial year of Company P ends on 31st March.

Determine the Basic EPS of the Company P for Year 1. Use the number of months or part of months, rather than the number of days in the calculation of EPS.

Answer

Determination of numerator for calculation of Basic EPS

The first step in the basic EPS calculation is to determine the profit or loss that is attributable to ordinary shareholders of Company P for the period.

Non-cumulative dividends paid on equity-classified preference shares are not deducted in arriving at net profit or loss for the period, but they are not returns to ordinary shareholders. Accordingly, these dividends are deducted from net profit or loss for the period in arriving at the numerator.

		(Rs)
Net profit		46,00,000
Preference dividends (5,00,000 shares x 1.2)	(6,00,000)	
Related tax (Rs6,00,000 x 30%)	1,80,000	(4,20,000)
Profit or loss attributable to P's ordinary shareholders		**41,80,000**
Accordingly, the numerator for calculation of Basic EPS is Rs41,80,000		

Determination of denominator for calculation of Basic EPS

The second step in the basic EPS calculation is to determine the weighted-average number of ordinary shares outstanding for the reporting period.

Number of shares	**Time weighting**	**Weight**	**Weighted average number of shares**
1st April – opening balance (30,00,000 – 5,00,000)	25,00,000	1	
15th April – bonus issue (1,50,000 – 25,000)	1,25,000		
1st April to 30th April	26,25,000	1/12	2,18,750

1st May – repurchase of shares	(2,00,000)		
1st May to 31st October	24,25,000	6/12	12,12,500
1st November – new shares issued	4,00,000		
1st November to 31st March	28,25,000	5/12	11,77,083
Weighted average number of shares for the year			**26,08,333**

The denominator for calculation of Basic EPS is 26,08,333 shares.

Basic EPS = Rs41,80,000 / 26,08,333 shares = Rs1.60 per share (approx.).

Bhavik Chokshi

15. IND AS 34 : INTERIM FINANCIAL REPORTING

Question 1 (Practice Q.3)

While preparing interim financial statements for the half-year ended 30 September 2012, an entity discovers a material error (an improper expense accrual) in the interim financial statements for the period ended 30 September 2011 and the annual financial statements for the year ended 31 March 2012. The entity does not intend to restate the comparative amounts for the prior period presented in the interim financial statements as it believes it would be sufficient to correct the error by restating the comparatives in the annual financial statements for the year ended 31 March 2013.

Is this acceptable? Discuss in accordance with relevant Ind AS.

Answer

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

Paragraph 28 of Ind AS 34 requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements (except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements).

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

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

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

In view of the above, the entity is required to correct the error and restate the comparative amounts in interim financial statements for the half-year ended 30 September 2012.

Question 2 (Practice Q.4)

While preparing interim financial statements for the half-year ended 30th September, 2011, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30th June, 2011. The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management's view is acceptable?

Answer

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

As regards the assessment of materiality of an item in preparing interim financial statements, paragraph 25 of Ind AS 34, Interim Financial Statements, states that while judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.

As per the above, while materiality judgements always involve a degree of subjectivity, the overriding goal is to ensure that an interim financial report includes all the information that is relevant to an understanding of the financial position and performance of the entity

during the interim period. It is therefore not appropriate to base quantitative assessments of materiality on projected annual figures when evaluating errors in interim financial statements.

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

Bhavik Chokshi

16. IND AS 36 : IMPAIRMENT OF ASSETS

Question 1 (Practice Q.8)

On 31 March 2011, Vision Ltd acquired 80% of the equity shares of Mission Ltd for Rs 190 million. The fair values of the net assets of Mission Ltd that were included in the consolidated statement of financial position of Vision Ltd at 31 March 2011 were Rs 200 million. It is the Group's policy to value the non-controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

On 31 March 2014, Vision Ltd carried out its annual review of the goodwill on consolidation of Mission Ltd and found evidence of impairment. No impairment had been evident when the reviews were carried out at 31 March 2012 and 31 March 2013. The review involved allocating the assets of Mission Ltd into three cash- generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A Rsin million	Unit B Rsin million	Unit C Rsin million
Intangible assets	30	10	-
Property, Plant and Equipment	80	50	60
Current Assets	60	30	40
Total	170	90	100
Value in use of unit	180	66	104

It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Mission Ltd are allocated in the table shown above.

The intangible assets of Mission Ltd have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Mission Ltd as a single cash-generating unit on 31 March 2014 is Rs 350 million.

Discuss and compute the accounting treatment of impairment of goodwill as per Ind AS 36?

Answer

The goodwill on consolidation of Mission Ltd that is recognized in the consolidated balance sheet of Vision Ltd is Rs 30 million (Rs 190 million – 80% x Rs 200 million). This can only be reviewed for impairment as part of the cash generating units to which it relates. Since here the goodwill cannot be meaningfully allocated to the units, the impairment review is in two parts.

Units A and C have values in use that are more than their carrying values. However, the value in use of Unit B is less than its carrying amount. This means that the assets of unit B are impaired by Rs 24 million (Rs 90 million – Rs 66 million). This impairment loss will be charged to the statement of profit and loss.

Assets of Unit B will be written down on a pro-rata basis as shown in the table below: (Rs in million)

Asset	**Impact on carrying value**		
	Existing	**Impairment**	**Revised**
Intangible assets	10	(4)	6
Property, plant and equipment	50	(20)	30
Current assets	30	Nil*	30
Total	90	(24)	66

* The current assets are not impaired because they are expected to realize at least their carrying value when disposed of.

Following this review, the three units plus the goodwill are reviewed together i.e. treating Mission Limited as single cash generating Unit. The impact of this is shown in the following table, given that the recoverable amount of the business as a whole is Rs 350 million: **(Rs in million)**

Component	Impact of impairment review on carrying value		
	Existing	Impairment	Revised
Goodwill (see note below)	37.50	(23.50)	14.00
Unit A	170.00	Nil	170.00
Unit B (revised)	66.00	Nil	66.00
Unit C	100.00	Nil	100.00
Total	373.50	(23.50)	350.00

Note: As per Appendix C of Ind AS 36, given that the subsidiary is 80% owned the goodwill must first be grossed up to reflect a notional 100% investment. Therefore, the goodwill will be grossed up to Rs 37.50 million (Rs 30 million x 100/80).

The impairment loss of Rs 23.50 million is all allocated to goodwill, leaving the carrying values of the individual units of the business as shown in the table immediately above.

The table shows that the notional goodwill that relates to a 100% interest is written down by Rs 23.50 million to Rs 14.00 million. However, in the consolidated financial statements the goodwill that is recognized is based on an 80% interest so the loss that is actually recognized is Rs 18.80 million (Rs 23.50 million x 80%) and the closing consolidated goodwill figure is Rs 11.20 million (Rs 14.00 million x 80%) or (Rs 30 million – Rs 18.80 million).

Question 2 (Practice Q.9)

On 31st March, 2011, Jackson Ltd. purchased 80% of the equity of Kaplan Ltd. For Rs 190 million. The fair values of the net assets of Kaplan Ltd. that were included in the consolidated balance sheet of Jackson Ltd. at 31st March, 2011 were measured at Rs 200 million (their fair values at that date). It is the group policy to value the non- controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

On 31st March, 2014, Jackson Ltd. carried out its annual review of the goodwill on consolidation of Kaplan Ltd. for evidence of impairment. No impairment had been evident when the reviews were carried out on 31 st March, 2012 and 31st March, 2013. The review involved allocating the assets of Kaplan Ltd. into three cash-generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A Rs in million	Unit B Rs in million	Unit C Rs in million
Intangible assets	30	10	-
Property, Plant and Equipment	80	50	60
Current Assets	60	30	40
Total	170	90	100
Value in use of unit	180	66	104

It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Kaplan Ltd. are allocated in the table shown above.

The intangible assets of Kaplan Ltd. have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Kaplan Ltd. as a single cash-generating unit on 31st March, 2014 is Rs 350 million.

Recommend the treatment for impairment of goodwill.

Bhavik Chokshi

Answer

The goodwill on consolidation of Kaplan Ltd. that is recognized in the consolidated balance sheet of Jackson Ltd. is Rs 30 million (Rs 190 million — 80% x Rs 200 million). This can only be reviewed for impairment as part of the cash generating units to which it relates. Since here the goodwill cannot be meaningfully allocated to the units, the impairment review is in two parts.

Units A and C have values in use that are more than their carrying values. However, the value in use of Unit B is less than its carrying amount. This means that the assets of unit B are impaired by Rs 24 million (Rs 90 million – Rs 66 million). This impairment loss will be charged to the Statement of Profit and Loss.

Assets will be written down on a pro-rata basis as shown in the table below:

			Rs in million
Asset	**Impact on carrying value**		
	Existing	**Impairment**	**Revised**
Intangible assets	10	(4)	6
Property, plant and equipment	50	(20)	30
Current assets	30	Nil*	30
Total	90	(24)	66

*The current assets are not impaired because they are expected to realize at least their carrying value when disposed of.

Following this review, the three units plus the goodwill are reviewed together. The impact of this is shown in the following table, given that the recoverable amount of the business as a whole is Rs 350 million.

			Rs in million
Component	**Impact of impairment review on carrying value**		
	Existing	**Impairment**	**Revised**
Goodwill (see below)	37.50	(23.50)	14.00
Unit A	170.00	Nil	170.00
Unit B (revised)	66.00	Nil	66.00
Unit C	100.00	Nil	100.00
Total	373.50	(23.50)	350.00

As per Appendix C of Ind AS 36, given that the subsidiary is 80% owned the goodwill must first be grossed up to reflect a notional 100% investment. Therefore, the goodwill will be grossed up to Rs 37.50 million (Rs 30 million x 100/80). The impairment loss of Rs 23.50 million is all allocated to goodwill, leaving the carrying values of the individual units of the business as shown in the table immediately above.

The table shows that the notional goodwill that relates to a 100% interest is written down by Rs 23.50 million to Rs 14.00 million. However, in the consolidated financial statements the goodwill that is recognized is based on an 80% interest so the loss that is actually recognized is Rs 18.80 million (Rs 23.50 million x 80%) and the closing consolidated goodwill figure is Rs 11.20 million (Rs 14.00 million x 80%) or (Rs 30 million – Rs 18.80 million).

Question 3 (Practice Q.10)

At 31st March, 2011, the assets of a CGU are being reviewed for impairment. The carrying value of the CGU's net assets is Rs 65 lakhs (excluding any restructuring provision), and remaining useful economic life of recognised asset is eight years.

Management's approved budgets at 31st March, 2011 include restructuring costs of Rs 3,50,000 to be incurred in 2012; the restructuring is expected to generate cost savings of Rs 1,00,000 per annum from 2013 onwards. Formal budgets have been prepared for the three years to 31st March, 2014. A zero-growth rate is assumed, because market conditions are extremely competitive, and this is expected to continue for the foreseeable future. The future cash flow estimates are as follows:

Year	With restructuring consideration	Without restructuring consideration
	Rs	Rs
2011-2012	5,20,000	8,70,000
2012-2013	10,00,000	9,00,000
2013-2014	10,50,000	9,50,000
2014-2015	10,50,000	9,50,000
2015-2016	10,50,000	9,50,000
2016-2017	10,50,000	9,50,000
2017-2018	10,50,000	9,50,000
2018-2019	10,50,000	9,50,000

In 2012, the net cash flows without restructuring (Rs 8,70,000) exceed the net cash flows with restructuring (Rs 5,20,000) by the amount of the restructuring costs (Rs 3,50,000).

The future cash flows (which exclude inflation) have been discounted at a rate of 4%. For simplicity, it has been assumed that the cash flows arise at the end of each year.

Compute Impairment Loss at 31st March, 2011 when-

(i) Restructuring costs is recognised in the financial statements at 31st March, 2011

(ii) Restructuring costs is not recognised in the financial statements at 31st March, 2011

Answer

Computation of present value of cash flows under both the following conditions:

(Amount in Rs)

Year	Discount factor	With restructuring consideration		Without restructuring coordination	
	(a)	**Future net cash flows** (b)	**Present value** (c)=(a)x(b)	**Future net cash flows** (d)	**Present value** (e)=(a)x(d)
2011-2012	0.962	5,20,000	5,00,000	8,70,000	8,36,000
2012-2013	0.925	10,00,000	9,25,000	9,00,000	8,32,000
2013-2014	0.889	10,50,000	9,33,000	9,50,000	8,45,000
2014-2015	0.855	10,50,000	8,98,000	9,50,000	8,12,000
2015-2016	0.822	10,50,000	8,63,000	9,50,000	7,81,000

2016-2017	0.790	10,50,000	8,30,000	9,50,000	7,51,000
2017-2018	0.760	10,50,000	7,98,000	9,50,000	7,22,000
2018-2019	0.730	10,50,000	7,67,000	9,50,000	6,94,000
Value in use			65,14,000		62,73,000

The impairment calculations at 31st March, 2011 differ according to whether or not provision for the restructuring costs is recognised in the financial statements. This will depend on whether the requirements of Ind AS 37 have been met for recognition.

(i) Provision for restructuring costs recognised at 31st March, 2011

If provision has been made for restructuring costs, the costs and benefits of the restructuring are taken into account in determining the CGU's value in use. Here, the post – restructuring value in use (C6,514,000) exceeds the CGU's carrying value (Rs 6,500,000 less restructuring provision of Rs 350,000). Hence, there is no impairment of the CGU's assets.

In the year to 31st March, 2011, the financial statements reflect the following charges.

Restructuring provision Rs 350,000

Impairment loss Nil

(ii) No provision for restructuring costs recognised at 31st March, 2011

If no provision for restructuring costs is permitted by Ind AS 37, the costs and benefits of the restructuring have to be stripped out of the projections in determining the CGU's value in use. Here, the CGU's carrying value (Rs 65,00,000) exceeds its pre-restructuring value in use (Rs 62,73,000). Therefore, there is an impairment loss of Rs 2,27,000.

In the year to 31st March, 2011, the financial statements reflect the following charges:

Restructuring provisions Nil

Impairment loss Rs 2,27,000

Bhavik Chokshi

17. IND AS 37 : PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Question 1 (Practice Q.2)

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

On 30 April 2011, a manufacturing defect was detected in the goods manufactured by the entity between 1 March 2011 and 30 April 2011.

At 31 March 2011 (the entity's reporting date), the entity held approximately one week's sales in inventories.

The entity's financial statements for the year ended 31 March 2011 have not yet been finalised.

Three separate categories of goods require separate consideration: Category 1—defective goods sold on or before 31 March 2011 Category 2—defective goods held on 31 March 2011

Category 3—defective goods manufactured in 2011-2012

State the accounting treatment of the above categories in accordance with relevant Ind AS.

Answer

Category 1—defective goods sold on or before 31 March 2011

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

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

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

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

Category 2—defective goods held on 31 March 2011

At 31 March 2011 the entity did not have a present obligation to make good the unsold defective goods that it held in inventories. Accordingly, at 31 March 2011 the entity should not recognise a provision in respect of the defective inventories. However, the entity should test the inventories for impairment in accordance with Ind AS 36, Impairment of Assets.

For this category, the detection of the manufacturing defect in April 2011 is an adjusting event after the end of the reporting period as per Ind AS 10, Events after the End of the Reporting Period. It provides evidence of a manufacturing defect in inventories held at 31 March 2011.

Category 3—defective goods manufactured in 2011-2012

At 31 March 2011 the entity did not have a present obligation to make good any defective goods that it might manufacture in the future. Accordingly, at 31 March 2011 the entity should not recognise a provision in respect of the defective goods manufactured in 2011-2012.

For this category, the detection of the manufacturing defect in April 2011 is a non- adjusting event after the end of the reporting period as per Ind AS 10, Events After the End of the Reporting Period.

Question 2 (Practice Q.3)

XYZ Ltd. offers a six-month warranty on its small to medium sized equipment, which can be put to use by the customer with no installation support. The warranty comes with the equipment and the customer cannot purchase it separately. This equipment is typically sold at a gross margin of 40%. XYZ Ltd. has made a provision of Rs 30,000 during the year ended 31st March, 2012, which is approximately 1% of its gross margin on the sale of these equipment. Based on past experience, it is expected that 1% of equipment sold have been returned as faulty within the warranty period. Faulty equipment returned to XYZ Ltd. during the warranty period are

scrapped and the sale value is fully refunded to the customer.

Assuming that sales occurred evenly during the year, how should XYZ Ltd. evaluate whether any additional warranty provision is required on equipment sold in the past as at 31st March, 2012? Had the warranty period been 2 years instead of six months, what additional criteria would XYZ Ltd. need to consider?

Answer

Calculation of additional warranty provisions:

Warranty claim covers 1% of gross margin, whereas customers are refunded the full selling price. As the goods are scrapped it is assumed XYZ Ltd has no potential for re - imbursement from its supplier regarding the faulty goods.

A calculation of warranty provision is set out below:

1% of annual gross margin is Rs 30,000 therefore 100% of annual gross margin must be Rs 30,00,000. Since gross margin is 40%, sales should be Rs 75,00,000. As provide in the question that the sales are evenly spread during the year and given the six month warranty, half of the sales occurred in the second half of the year is still covered within the warranty period as follows.

	% age	Annual sales	Product under warranty at 31st March, 2012	Percentage expected to be returned	Warranty provision
		Rs	Rs	Rs	Rs
Gross margin Selling price	40% 100%	30,00,000 75,00,000	37,50,000	1%	37,500

The warranty provision should therefore be increased by Rs 7,500 (Rs 37,500 – Rs 30,000). As the provision is expected to be used in the next 6 months no discounting is required.

If the warranty period is 2 years:

Since the outstanding period of warranties is 6 months (i.e. less than a year), no discounting is required. However, if a longer warranty period is to be given, the entity will have to take into account the effect of the time value of money. The amount of provision shall be the present value of the expenditures expected to be required to settle the warranty obligation. (Refer Para 45 of Ind AS 37)

The discount rate shall be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The discount rate shall not reflect risks for which future cash flow estimates have been adjusted. (Refer Para 47 of Ind AS 37)

	% age	Annual sales	Product under warranty at 31st March, 2012	Percentage expected to be returned	Warranty provision
		Rs	**Rs**	**Rs**	**Rs**
Gross margin Selling price	40% 100%	30,00,000 75,00,000	75,00,000	1%	75,000

The warranty provision should therefore be increased by Rs 45,000 (Rs 75,000 – Rs 30,000). Further discounting of provision would be required.

Question 3 (Practice Q.4)

HVCL manufactures heavy equipment for construction industry. An order for supply of 90 equipment was received from ABIL. The unit price of the equipment was agreed at Rs 190 lakhs each. 64 equipment was supplied during the year 2011-2012 and balance quantity remaining to be supplied as on 31.3.2012. HVCL has 5 equipment in its inventory as on 31.3.2012. HVCL considered that the contract was an onerous contract and therefore, the net realisable value of inventory has been taken as value of inventory as

on 31.3.2012.

The management of HVCL contends that costs incurred towards administrative overheads, finance charges, R & D expenses, sales overhead, head quarter expenditure etc., are considered as period cost and hence not considered for creation of provision. Hence, the same have not been included in the computation of unavoidable cost.

The management of HVCL has submitted the details of costs that have been considered for creation of provision towards onerous contract:

- Material cost - includes cost of material procured, cost of freight & insurance incurred for material procurement and handling, loading and unloading charges incurred.
- Labour cost/ Factory Overheads - includes salaries and other expenses of direct production department, and also expenses allocated from indirect departments to direct department.
- Material Overheads - Includes salaries and other expenses (including expenses allocated from other departments) booked under departments linked with materials like purchases, stores and quality control.

Accordingly, provision has been made considering the above costs only. The value of provision created for 21 remaining equipment to be produced is as per the working shown below:

Particulars	Value (Rs in lakh)
(i) Cost of production (which includes material cost, labour cost/factory overhead and material overhead)	199.00
(ii) Selling price	(190.00)
(iii) Differential cost per equipment	9.00
(iv) Differential cost of Rs 9 Lakh per equipment for 21 equipment	189.00

Whether the company's accounting treatment of cost for creation of provision towards onerous contracts is in line with the provisions of Ind AS 37?

Answer

As per para 68 of Ind AS 37, onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable cost under a contract reflects the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation for penalties arising from failure to fulfilling it.

Ind AS 37 provides that the amount recognised shall be the best estimate of the expenditure required to settle the present obligation, which is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. In case of onerous contracts, an amount that an entity would rationally pay to settle the obligation would be the lower of the compensation or penalties arising from failure to fulfil the contacts and excess of unavoidable cost of meeting the obligations under the contract from the economic benefits expected to be received under it.

As per para 68 of Ind AS 37, the cost of fulfilling a contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract consist of both –

(i) the incremental costs of fulfilling that contract—for example, direct labour and materials; and

(ii) an allocation of other costs that relate directly to fulfilling contracts— for example, an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract among others.

The unavoidable costs of meeting the obligations under the contract are only costs that:

- "are directly variable with the contract and therefore incremental to the performance of the contract;"
- do not include allocated or shared costs that will be incurred regardless of whether the entity fulfils the contract or not; and
- cannot be avoided by the entity's future actions.

Accordingly, HVCL has correctly measured the cost for creation of provision for onerous contracts by considering material cost, labour cost (to the extent it relates directly to production) and material overheads (to the extent it relates directly to production).

Further, HVCL is correct that the period cost will not be considered for measurement of cost for the purpose of creation of provision on onerous contracts as they do not relate directly to fulfilling the contracts.

Question 4 (Practice Q.5)

On 1st January, 2012, the directors of Johansen Ltd. decided to terminate production at one of the company's divisions. This decision was publicly announced on 31st January, 2012. The activities of the division were gradually reduced from 1st April, 2012 and closure is expected to be complete by 30th September, 2012.

At 31st January, 2012, the directors prepared the following estimates of the financial implications of the closure:

(i) Redundancy costs were initially estimated at Rs 2 million. Further expenditure of Rs 8,00,000 will be necessary to retrain employees who will be affected by the closure but remained with Johansen Ltd. in different divisions. This retraining will begin in early July 2012. Latest estimates are that redundancy costs will be Rs 1.9 million, with retraining costs of Rs 8,50,000.

(ii) Plant and equipment having an expected carrying value at 31st March, 2012 of Rs 8 million will have a recoverable amount Rs 1.5 million. These estimates remain valid.

(iii) The division is under contract to supply goods to a customer for the next three years at a pre- determined price. It will be necessary to pay compensation of Rs 6,00,000 to this customer. The compensation actually paid, on 31st May, 2012, was Rs 5,50,000.

(iv) The division will make operating losses of Rs 3,00,000 per month in the first three months of 2012-2013 and Rs 2,00,000 per month in the next three months of 2012-2013. This estimate proved accurate for April, 2012 and May, 2012.

(v) The division operates from a leasehold premise. The lease is a non-cancellable operating lease with an unexpired term of five years from 31 st March, 2012. The annual lease rentals (payable on 31st March in arrears) are Rs 1.5 million. The landlord is not prepared to discuss an early termination payment.

Following the closure of the division it is estimated that Johansen Ltd. would be able to sub-let the property from 1st October, 2012.

Johansen Ltd. could expect to receive a rental of Rs 3,00,000 for the six-month period from 1st October, 2012 to 31st March, 2013 and then annual rentals of Rs 5,00,000 for each period ending 31st March, 2014 to 31st March, 2017. All rentals will be received in arrears.

Any discounting calculations should be performed using a discount rate of 5% per annum. You are given the following data for discounting at 5% per annum:

Present value of Rs 1 received at the end of year 1 = Rs 0.95

Present value of Rs 1 received at the end of year 1–2 inclusive = Rs 1.86

Present value of Rs 1 received at the end of year 1–3 inclusive = Rs 2.72

Present value of Rs 1 received at the end of year 1–4 inclusive = Rs 3.54

Present value of Rs 1 received at the end of year 1–5 inclusive = Rs 4.32

Compute the amounts that will be included in the Statement of Profit and Loss for the year ended 31st March, 2012 in respect of the decision to close the division of Johansen Ltd.

Answer

As per Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', closure of a division is a restructuring exercise. Ind AS 37 states that a constructive obligation to proceed with the restructuring arises when at the reporting date the entity has:

- Commenced activities connected with the restructuring; or
- Made a public announcement of the main features of the restructuring to those affected by it. In this case a public announcement has been made and so a provision will be necessary at 31st March, 2012.

This will result in the following charges to the Statement of Profit and Loss:

(i) Estimate of redundancy costs of Rs 1.9 million is the best estimate of the expenditure at the date the financial statements

are authorized for issue. Changes in estimates after the reporting date are taken into account for this purpose as an adjusting event after the reporting date. No charge is necessary for the retraining costs as these are not incurred in 2011 - 2012 and cannot form part of a restructuring provision as they are related to the ongoing activities of the entity.

(ii) Impairment of plant and equipment of Rs 6.5 million is although not strictly part of the restructuring provision the decision to restructure before the year-end means that related assets need to be reviewed for impairment. In this case the recoverable amount of the plant and equipment is only Rs 1.5 million. As per Ind AS 36 'Impairment of Assets', property, plant and equipment should be written down to this amount, resulting in a charge of Rs 6.5 million to the income statement.

(iii) For compensation for breach of contract of Rs 0.55 million, same principle applies here as applied to the redundancy costs.

(iv) No charge is recognized in 2011-2012 with respect to future operating losses of 2012-2013. Future operating losses relate to future events and provisions are made only for the consequences of past events.

(v) Ind AS 37 states that an onerous contract is one for which the expected cost of fulfilling the contract exceeds the benefits expected from the contract. Provision is made for the lower of the expected net cost of fulfilling the contract and the cost of early termination (not available in this case).

The net cost of fulfilling the contract is Rs 4.51 million [Rs 1.5 million x 4.32 – Rs0.3 million x 0.95 – Rs0.5 million x (4.32 – 0.95)].

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18. IND AS 38 : INTANGIBLE ASSETS

Question 1 (Practice Q.9)

PQR Ltd. is a gaming developer company. Few years back, it developed a new game called 'Cloud9'. This game sold over 10,00,000 copies around the world and was extremely profitable. Due to its popularity, PQR Ltd. released a new game in the 'Cloud9' series every year. The games continue to be the bestseller. Based on Management's expectations, estimates of cash flow projections for the 'cloud9 videogame series' over the next five years have been prepared. Based on these projections, PQR Ltd. believes that cloud9 series brand should be recognised at INR 20,00,000 in its financial statement. PQR Ltd. has also paid INR 10,00,000 to MNC Ltd. to acquire rights of another video game series called the 'Headspace' videogame series. The said series have huge demand in the market.

Discuss the accounting treatment of the above in the financial statements of PQR Ltd.

Answer

In order to determine the accounting treatment of 'cloud9 videogame series' and 'Headspace', definition of asset and intangible asset given in Ind AS 38 may be noted: "An asset is a resource:

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

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

"An intangible asset is an identifiable non-monetary asset without physical substance."

In accordance with the above, for recognising an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control and existence of future economic benefits.

In order to determine whether 'cloud9 videogame series' meet the aforesaid conditions, following provisions of Ind AS 38 regarding Internally Generated Intangible Assets may be noted:

As per paragraph 63 and 64 of Ind AS 38, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets. Expenditure on such items cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Accordingly, though the cash flow projections suggest that the cloud9 brand will lead to future economic benefits, yet the asset has been internally generated; therefore, the Cloud9 brand cannot be recognised as intangible asset in the financial statements.

In order to determine whether 'Headspace' meet the aforesaid conditions, following provisions of Ind AS 38 regarding 'Separately acquired Intangible Assets' should be analused.

As per paragraphs 25 and 26 of Ind AS 38, normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The Headspace game has been purchased for INR 10,00,000 and it is expected to generate future economic benefits to the entity. Since Headspace game i s a separately acquired asset and the future benefits are expected to flow to the entity, therefore, an intangible asset should be recognised in respect of the 'Headspace' asset at its cost of INR 10,00,000. After initial recognition, either cost model or revaluation model can be used to measure headspace intangible asset as per guidance given in paragraphs 74-87 of Ind AS 38. In accordance with this, Headspace intangible asset should be carried at its cost/revalued amount (as the case may be) less any accumulated amortisation and any accumulated impairment losses.

Question 2 (Practice Q.10)

D Ltd. a leading publishing house, purchased copyright of a book from its author for publishing the same. As per the terms of the contract, if D Ltd. chooses to make the payment upfront then, copyright consideration of Rs 80,00,000 is to be paid (which is in line with general practice in such arrangements). However, the contract also provided that, in case D Ltd. chooses to pay the consideration after 2 years, then it will be required to pay Rs 1,00,00,000. At what value should the intangible asset be recognised as per Ind AS 38?

Answer

As per paragraph 32 of Ind AS 38, "If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognized as interest expense over the period of credit unless it is capitalized in accordance with Ind AS 23, Borrowing Costs."

In the given case, if the payment for an intangible asset i.e. copyright is deferred beyond normal credit terms, the cash price equivalent Rs 80,00,000 should be considered as its cost and the intangible asset will be recorded initially at this value.

The difference of Rs 20,00,000 between cash price equivalent (i.e. Rs 80,00,000) and the total payment (i.e. Rs 1,00,00,000) should be recognised as interest expense over the period of credit (i.e. 2 years in this case), unless it is eligible for capitalisation in accordance with Ind AS 23, Borrowing Costs.

Question 3 (Practice Q.11)

A company engaged in the provision of Information Technology Products and Services incurred following expenditure during the development phase of its software product that is to be offered to its customers. The entity also purchases software from third parties for incorporating into its end software product offered to its customers. The company is in the process of launching it in the market for licensing to customers. The company also takes services of external professional software developers for such software development purpose. Costs incurred in relation to the development of its software product for the year ended 31st March, 2012 are as follows:

Particulars	Amount (Rs thousand
Purchase price of imported software	600
Employment costs (Note 1)	1,200
Testing costs	1,800
Other costs directly related to customization (Note 2)	450
Professional fees paid for external software developers	220
Costs of training provided to staff to operate the asset	195
Costs of advertising in market	1,560
Administrative and general overheads	825

Note 1: The software was developed in nine months ended 31st December, 2011 and was capable of operating in the manner intended by the entity. It was brought into use on 31st March, 2012. The employment costs are for the period of twelve months (i.e. up to 31st March, 2012). The employees were engaged in developing the software and related activities.

Note 2: Other costs directly related to development include an abnormal cost of Rs 50,000 in respect of repairing the damage which resulted from a security breach.

What will be the amount of the software development costs that can be capitalized by explaining the reason for each element of cost?

Answer

In the given fact pattern, the entity should apply the recognition and measurement principles relevant for an internally generated intangible asset. The entity has to ensure compliance with additional requirements relating to internally generated intangible assets in addition to general recognition criteria and initial measurement of intangible asset. In the instant case, for the measurement of software development cost, entity must evaluate the costs incurred for recognition of an intangible asset arising from development phase with reference to paragraphs 65 to 67 of Ind AS 38.

According to the said paragraphs, the initial carrying amount of the software will be computed as follows:

Particulars	Amount (Rs in thousands)	Amount to be capitalised as Intangible Assets (Rs in thousands)	Remarks
Purchase price of imported software	600	600	The cost of materials or / and services used or consumed in generating the intangible asset and any directly attributable cost of preparing the asset for its intended use.
Employment costs (Note 1)	1,200	900	Employment costs for the period of nine months are directly attributable costs. Therefore, the cost to be capitalized is Rs 900 thousand (i.e., 9/12 x Rs 1,200 thousand) for nine months as the asset was ready for its intended use by that time. It is assumed that Rs 100 thousand is equally incurred each month. Capitalisation of eligible costs should cease when the asset is capable of operating in the manner intended by management.
Testing costs	1,800	1,800	The cost of testing whether the asset is functioning properly is a directly attributable cost. (Refer paragraph 59 of Ind AS 38)
Other costs directly related to development (Note 2)	450	400	Cost of identified inefficiencies deducted, i.e., Rs 450 thousand – Rs 50 thousand.
Professional fees paid for bringing the software to its working condition	220	220	The cost of materials or/and services used or consumed in generating the intangible asset
Costs of training provided to staff	195	Nil	Expenditure on training staff to operate the asset cannot be capitalised. (Refer paragraph 67 of Ind AS 38)
Costs of advertising in market	1,560	Nil	Selling, administrative and other general overhead expenditure cannot be capitalised. (Refer paragraph 67 of Ind AS 38)
Administrative and general overheads	825	Nil	
Total	6,850	3,920	

Accordingly, the initial carrying value of the software is Rs 39,20,000. The remaining costs will be charged to profit or loss.

Question 4 (Practice Q.12)

SS Limited had the following transactions during the Financial Year 2011-2012.

(i) On 1st April 2011, Super Sounds Limited purchased the net assets of Music Limited for Rs 13,20,000. The fair value of Music Limited's identifiable net assets was Rs 10,00,000. Super Sounds Limited is of the view that due to popularity of Music Limited's product, the life of goodwill is 10 years.

(ii) On 4th May 2011, Super Sounds Limited purchased a Franchisee to organize musical shows from Armaan TV for Rs 80,00,000 and at an annual fee of 2% of musical shows revenue. The Franchisee expires after 5 years. Musical shows revenue were Rs 10,00,000 for financial year 2011-2012. The projected future revenues for financial year 2012-2013 is Rs 25,00,000 and Rs 30,00,000 p.a. for remaining 3 years thereafter.

(iii) On 4th July 2011, Super Sounds Limited was granted a Copyright that had been applied for by Music Limited. During financial year 2011-2012, Super Sound Limited incurred Rs 2,50,000 on legal cost to register the Patent and Rs 7,00,000 additional cost to successfully prosecute a copyright infringement suit against a competitor. The life of the Copyright is for 10 years.

SS Limited follows an accounting policy to amortize all intangible on SLM (Straight Line Method) basis or any appropriate basis over a maximum period permitted by relevant Ind AS, taking a full year amortization in the year of acquisition.

You are required to prepare:

(i) A Schedule showing the intangible section in Super Sound Limited Balance Sheet as on 31st March 2012, and

(ii) A Schedule showing the related expenses that would appear in the Statement of Profit and Loss of Super Sound Limited for the year ended 2011-2012.

Answer

(i) **SS Limited**

Balance Sheet (Extract relating to intangible asset) as at 31st March 2012

	Note No.	Rs
Assets		
(1) Non- current asset		
Intangible assets	1	69,45,000

(ii) **SS Limited**

Statement of Profit and Loss (Extract) for the year ended 31st March 2012

	Note No.	Rs
Revenue from Operations		10,00,000
Total Revenue		________
Expenses:		
Amortization expenses	2	16,25,000
Other expenses	3	7,20,000
Total Expenses		________

Notes to Accounts (Extract)

1. Intangible Assets

		Gross Block (Cost)			Accumulated amortisation			Net block	
		Opening balance Rs	Additions Rs	Closing Balance Rs	Opening balance Rs	Additions Rs	Closing Balance Rs	Opening balance Rs	Closing Balance Rs
1.	Goodwill* (W.N.1)	-	3,20,000	3,20,000	-	-	-	-	3,20,000
2.	Franchise** (W.N.2)	-	80,00,000	80,00,000	-	16,00,000	16,00,000	-	64,00,000
3.	Copyright (W.N.3)	-	2,50,000	2,50,000	-	25,000	25,000	-	2,25,000
		-	85,70,000	85,70,000	-	16,25,000	16,25,000	-	69,45,000

*As per Ind AS 36, irrespective of whether there is any indication of impairment, an entity shall test goodwill acquired in a business combination for impairment annually. This implies **that goodwill is not amortised annually but is subject to annual impairment, if any**.

**As per the information in the question, the limiting factor in the contract for the use is time i.e., 5 years and not the fixed total amount of revenue to be generated. Therefore, an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate and amortisation based on time can only be applied.

2.	**Amortization expenses**		
	Franchise (W.N.2)	16,00,000	
	Copyright (W.N.3)	25,000	16,25,000
3.	**Other expenses**		
	Legal cost on copyright	7,00,000	
	Fee for Franchise (10,00,000 x 2%)	20,000	7,20,000

Working Notes:

		Rs
(1)	**Goodwill on acquisition of business**	
	Cash paid for acquiring the business	13,20,000
	Less: Fair value of net assets acquired	(10,00,000)
	Goodwill	**3,20,000**

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(2)	**Franchise**	80,00,000
	Less: Amortisation (over 5 years)	(16,00,000)
	Balance to be shown in the balance sheet	**64,00,000**
(3)	**Copyright**	2,50,000
	Less: Amortisation (over 10 years as per SLM)	(25,000)
	Balance to be shown in the balance sheet	**2,25,000**

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19. IND AS 40 : INVESTMENT PROPERTY

Question 1 (Practice Q.1)

X Ltd owned a land property whose future use was not determined as at 31 March 2011. How should the property be classified in the books of X Ltd as at 31 March 2011?

During June 2011, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 2012

(a) How should the land property be classified by X Ltd in its financial statements as at 31 March 2012?

(b) Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?

(c) Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?

(d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 2012?

Answer

As per paragraph 8(b) of Ind AS 40, any land held for currently undetermined future use, should be classified as an investment property. Hence, in this case, the land would be regarded as held for capital appreciation. Hence the land property should be classified by X Ltd as investment property in the financial statements as at 31 March 2011.

As per Para 57 of the Standard, an entity can change the classification of any property to, and from, an investment property when and only when evidenced by a change in use. A change occurs when the property meets or ceases to meet the definition of investment property and there is evidence of the change in use. Mere management's intention for use of the property does not provide evidence of a change in use.

Accordingly, the property in different cases would be classified as under:

(a) Since X Ltd has commenced construction of office building on it for own use, the property should be reclassified from investment property to owner occupied as at 31 March 2012.

(b) As per Para 59, transfers between investment property, owner occupied and inventories do not change the carrying amount of the property transferred and they do not change the cost of the property for measurement or disclosure purposes.

(c) No. The change in classification to, or from, investment properties is due to change in use of the property. No retrospective application is required and prior period's financial statements need not be re-stated.

(d) Mere management intentions for use of the property do not evidence change in use. Since X Ltd has no plans to commence construction of the office building during 2011-2012, the property should continue to be classified as an investment property by X Ltd. in its financial statements as at 31 March 2012.

Question 2 (TYK 7/Practice Q.2)

An entity owns a two-storey building. Floor 1 is rented out to independent third parties under operating leases. Floor 2 is occupied by the entity's administration and maintenance staff. The entity can measure reliably the fair value of each floor of the building without undue cost or effort. How the same will be classified / presented in the balance sheet as per relevant Ind AS. What will be the accounting treatment as per relevant Ind AS on initial and subsequent date?

Answer

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

a) use in the production or supply of goods or services or for administrative purposes; or

b) sale in the ordinary course of business.

Property mentioned in (a) above would be covered under Ind AS 16 'Property, Plant and Equipment'.

On applying the above provisions, Floor 1 of the building is classified as an item of investment property by the entity (lessor) because it is held to earn rentals. Ind AS 40 is applicable in this case. An investment property should be measured initially at its cost. After initial recognition, an entity shall measure all of its investment properties in accordance with Ind AS 16's requirements for

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cost model. However, entities are required to measure the fair value of investment property, for the purpose of disclosure even though they are required to follow the cost model.

Floor 2 of the building will be classified as property, plant and equipment because it is held by administrative staff i.e. it is held for use for administrative purposes. Ind AS 16 is applicable in this case. An item of property, plant and equipment that qualifies for recognition as an asset should be initially measured at its cost. After recognition, an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.

Question 3 (Practice Q.3)

Besides manufacturing plants, A Ltd. has various other assets, not used for operational activities, e.g., freehold land, townships in different locations, excess of office space rented to ABC, etc. Also, A Ltd. has some land, which are kept vacant as per the government regulations which require that a specified area around the plant should be kept vacant.

The details of these assets are as under:

Property	Details
A Ltd.'s office building (registered office)	A Ltd.'s registered office in Delhi, is a 15 storey building, of which only 3 floors are occupied by A Ltd., whereas remaining floors are given on rent to other companies. These agreements are usually for a period of 3 years. According to A Ltd., such excess office space will continue to be let out on lease to external parties and have no plans to occupy it, at least in near future.
Flats in Township located in location 1	As regards township in Location 1, there are approximately 2,000 flats in the said township. It was built primarily for A Ltd.'s employees, hence, approximately 80% of the flats are allotted to employees and remaining flats are either kept vacant or given on rent to other external parties. A lease agreement is signed between A Ltd. and an individual party for every 12 months being 1st April to 31st March. The lease entered is a cancellable lease (cancellable at the option of any of the parties). Also, besides monthly rent, additional charges are levied by A Ltd. on account of electricity, water, cable connection, etc. According to A Ltd., there is no intention of selling such excess flats or allotting it to its employees.
Flats n township located in location 2	There are 1,000 flats in location 2 township, of which: • 400 flats are given to employees for their own accommodation. • 350 flats are given on rent to Central Government and State Government for accommodation of their employees. Average lease period being 12 months with cancellable clause in lease agreements. • 250 flats are kept vacant.
Hostel located in location 1	60 rooms in the hostel have been let out to G Ltd., to give accommodation to their personnel. Lease agreement is prepared for every 11 months and renewed thereafter. Besides the monthly rent amount, some charges are levied towards water, electricity and other amenities, e.g., cable connection, etc.
Land in location 1	In 2014, A Ltd. purchased a plot of land on the outskirts of a major city. The area has mainly low-cost public housing and very limited public transport facilities. The government has plans to develop the area as an industrial park in 5 years' time and the land is expected to greatly appreciate in value if the government proceeds with the plan. A Ltd. has not decided what to do with the property.
Land in location 1	A portion of land has been leased out to C Ltd. for its manufacturing operations. Land has been given on lease on a lease rental of Rs10 lacs p.a. with a lease term of 25 years.
Land in location 2	A portion of the land has been given on rent to D Ltd. which has constructed a petrol pump on such land. It has been leased for a period of 40 years and renewed for a further period of 40 years.

Determine the classification of properties which are not held for operational purposes, with suitable reasoning in the financial statements of A Ltd.

Answer

Property	Classification of properties not held for operational purpose
A Ltd.'s office building (registered office)	Excess portion of office space has been given on lease to earn rental income. Out of 15 storey building, only 3 floors are occupied by A Ltd. Such excess office space was constructed for the purpose of letting it out. According to A Ltd., such excess office space will continue to be let out on lease to external parties and have no plans to occupy it, at least in near future. Further, office space given on rent, although in same building, is separately identifiable from another owner-occupied portion and hence can be sold separately (if required). Hence, the excess space will qualify to be an investment property.
Flats in Township located in location 1	Excess flats have been given on lease to earn rental income. According to A Ltd., there is no intention of selling such excess flats or allotting it to its employees. Further, flats given on rent, can be sold separately from flats occupied by A Ltd.'s employees as they are separately identifiable. A Ltd. also charges its lessees on account of ancillary services, i.e., water, electricity, cable connection, etc., but the monthly charges in such cases are generally not significant as compared to rental payments. Hence, flats given on rent should qualify to be an 'investment property'. With regards to the flats kept vacant, A Ltd. has to evaluate the purpose of holding these flats, i.e., whether these would be kept for earning rentals or will it be allotted to its future employees. In case they are held for earning rentals, it would be classified as an investment property; and if they are held for allotment to future employees, it would form part of property, plant and equipment.
Flats in township located in location 2	350 flats are given on lease to earn rental income and assuming that management intends to let out these flats on rent in future, such flats should be classified as an 'investment property. With regards to the flats kept vacant, A Ltd. has to evaluate the purpose of holding these flats, i.e., whether these would be kept for earning rentals or will it be allotted to its future employees. In case they are held for earning rentals, it would be classified as an investment property; and if they are held for allotment to future employees, it would form part of property, plant and equipment.
Hostel located in location 1	Rooms in a hostel have been let out to G Ltd. to be used by its personnel. A Ltd. also charges G Ltd. on account of ancillary services, i.e., water, electricity, cable connection, etc., but the monthly charges in such cases are generally not significant as compared to rental payments. Hence, it should be classified as an 'Investment property'.
Land in location 1	Although management has not determined use for property after the development of park, yet in the medium-term the land is held for capital appreciation. As per Ind AS 40, if an entity has not determined that it will use the land either as owner-occupied property or for short term sale in the ordinary course of business, then it will be considered as land held for capital appreciation. Therefore, management should classify the property as an investment property.
Land in location 1	Since the land is held with an intention of giving it on lease and earning capital appreciation over a period, it should be classified as an 'Investment property'.
Land in location 2	Since the land is held with an intention of giving it on lease and earning capital appreciation over a period, it should be classified as 'Investment property'.

20. IND AS 41 : AGRICULTURE

Question 1 (Practice Q.1)

ABC Ltd. is in the business of manufacturing an apple beverage and requires large quantity of apples to manufacture such beverage. In order to satisfy its requirement of apples, it enters into 3 years lease contracts with owners of apple orchards. The lease contracts are mainly of two types:

(1) **Contract 1:** The owner of the apple orchard (i.e. the lessor) raises the apple trees to produce apples. ABC Ltd. (i.e. lessee) makes a fixed annual payment to the owner of the apple orchard who is required to cultivate the produce as per the specifications of ABC Ltd. ABC Ltd. harvests the apples itself for fulfilling its requirement of apples.

(2) **Contract 2:** ABC Ltd. obtains the apple orchard from owner (i.e. the lessor) to raise the apple trees for subsequent harvest of the apples to ensure that the apples are as per the requirements of ABC Ltd. ABC Ltd. makes a fixed annual payment to the owner of the apple orchards (i.e. the lessor).

Explain whether ABC Ltd. is engaged in agricultural activity as per Ind AS 41 in both of the cases?

Answer

Paragraph 5 of Ind AS 41, Agriculture defines agricultural activity and biological transformation as follows:

"Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets."

"Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset."

Contract 1:

As per contract 1, during the 3 years of the contract, ABC Ltd. only harvests apples from the apple orchards whereas biological transformation is managed by the owners of the apple orchards (i.e. the lessor). Since ABC Ltd. is not involved in the biological transformation of the apple orchards and is only harvesting biological assets , it cannot be said to be an agricultural activity as per Ind AS 41. Hence, ABC Ltd. is not engaged in agricultural activity as per Ind AS 41.

Contract 2:

As per contract 2, ABC Ltd. obtains the apple orchards and is actively involved in the raising of apple trees in order to ensure that the apples are as per its requirements. Since, it is actively managing the biological transformation and harvest of biological asset, Hence, ABC Ltd. is engaged in agricultural activity as per Ind AS 41.

Question 2 (Practice Q.2)

Fisheries Ltd. practices pisciculture in sweet waters (ponds, tanks and dams). The fishing activity of Fisheries Ltd. in such sweet waters consists only of catching the fish. Comment whether such fishing activity will be covered within the scope of Ind AS 41?

Answer

Paragraph 5 of Ind AS 41, defines agricultural activity as follows:

"Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets."

For fishing to qualify as agricultural activity, it must satisfy both of the below mentioned conditions:

a) management of biological transformation of a biological asset; and

b) harvesting of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

Therefore, when fishing involves managed activity to grow and procreate fish in designated areas, such fishing is an agricultural activity as per the above definition. Managing the growth of fish for subsequent sale is an agricultural activity as per Ind AS 41.

In the aforementioned scenario, only fish harvesting is managed by Fisheries Ltd. Therefore, mere fish harvesting without management of biological transformation cannot be termed as an agricultural activity as per Ind AS 41.

Hence, fishing in sweet waters (pond, tanks and dams) where only fishing (harvesting) is carried out without any management of biological transformation is outside the scope of Ind AS 41.

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Question 3 (Practice Q.3)

M. Chinnaswamy & Brothers Ltd. is a company that is engaged in growing and maintaining coconut palms and selling their output in various forms. The company has a farmland having 2,00,000 coconut palms in the coastal area of Karnataka near Mangalore.

The fair value of each coconut palm is derived based on the average realisable price of Rs 30 per nut (fruit). Each coconut palm grows 80 nuts per annum on an average basis. Each coconut palm can generate revenue for as long as 80 years and the current palms are only 20-year-old. The management thinks that considering the risk factors in business, the valuation of each palm can be considered at 5 times its annual revenue.

During August, 2015, the Ooty Hotels Association (OHA) chairman and his team visited the corporate office of the company at Mangalore. The deal was to supply tender coconuts to Ooty Hotels at an agreed price throughout the year. The agreement came into effect from 1st September, 2015 whereby the company shall reserve 15,000 coconut palms (out of 2,00,000 coconut palms) for OHA and will charge a concessional rate of Rs 15 only per nut supplied to OHA. OHA will in turn supply the tender coconuts to each Ooty Hotel at the same price. This contract price is applicable irrespective of the ownership of palm trees (it is not an entity-specific restriction). All tender coconuts of these 15,000 coconut palms were used by OHA irrespective of the agreement being effective from 1st September, 2015.

What will be the valuation of 2,00,000 coconut palms in the company's farm for the quarter ended 30th September, 2015?

Answer

Para 16 of Ind AS 41 says that entities often enter into contracts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in measuring fair value, because fair value reflects the current market conditions in which buyers and sellers would enter into a transaction. As a result, the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract.

Moreover, the OHA contract represents just 7.5% [(15,000 / 2,00,000) x 100] of the total number of palms in the farm. Hence, the contract price can't be considered for fair valuation of the entire inventory of bearer plants.

The valuation in this case would be as follows:

Adding the fair value for 15,000 coconut palm (15,000 palm x 80 nuts x Rs 15 x 5 times) and 1,85,000 coconut palm (1,85,000 palm x 80 nuts x Rs 30 x 5 times), we get total valuation of 2,00,000 coconut palm as Rs 231 crore.

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21. IND AS 101 : FIRST-TIME ADOPTION OF IND AS

Question 1 (Practice Q.2)

While preparing an opening balance sheet on the date of transition, an entity is required to:

(a) recognise all assets and liabilities whose recognition is required by Ind AS;

(b) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and

(c) apply Ind AS in measuring all recognised assets and liabilities.

Give 2 examples for each of the above categories.

Answer

The examples of the items that an entity may need to recognise, derecognise, remeasure, reclassify on the date of transition are as under:

(a) recognise all assets and liabilities whose recognition is required by Ind AS:

(i) customer related intangible assets if an entity elects to restate business combinations

(ii) share-based payment transactions with non-employees

(iii) recognition of deferred tax on land

(b) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity,but is a different type of asset, liability or component of equity in accordance with Ind AS:

(i) redeemable preference shares that would have earlier been classified as equity;

(ii) non-controlling interests which would have been earlier classified outside equity; and

(c) apply Ind ASs in measuring all recognised assets and liabilities:

(i) discounting of long-term provisions

(ii) measurement of deferred income taxes for all temporary differences instead of timing differences.

Question 2 (Practice Q.3)

GG Ltd., a listed company, prepares its first Ind AS financial statements for the year ending 31st March, 2013. The date of transition is 1st April, 2011. The functional and presentation currency is Rupee. The financial statements as at and for the year ended 31st March, 2013 contain an explicit and unreserved statement of compliance with Ind AS. Previously it was using Indian GAAP (AS) as base.

It has already published its first interim results of quarter 1, quarter 2 and quarter 3 of 2012- 2013 in accordance with Ind AS 34 and Ind AS 101. The interim financial report included the reconciliations both of total comprehensive income and of equity that are required by Ind AS 101.

Since issuing the interim financial report, its management has concluded that one of accounting policy choices applied at the interim should be changed for the full year.

How should GG Ltd. deal with the change in accounting policy under Ind AS framework?

Answer

The first annual Ind AS financial statements are prepared in accordance with the specific requirements of Ind AS 101. Subject to certain specified exemptions and exceptions, paragraph 7 of Ind AS 101 requires the entity to use the same accounting policies in its opening Ind AS balance sheet and throughout all periods presented. This override Ind AS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first Ind AS financial statements.

GG Ltd. should include an explanation of the change in policy that it has made since the interim financial report, in the notes to the annual financial statements, in accordance with paragraph 27A of Ind AS 101. The disclosure note is likely to include information , similar to what Ind AS 8 would otherwise require, to help users of the financial statements to understand the changes that have been made. The entity should also ensure that the reconciliations of total comprehensive income and of equity, presented in the first Ind AS financial statements in accordance with paragraph 24 of Ind AS 101 are updated from those included in the interim financial report to reflect the amended accounting policy.

Bhavik Chokshi

Question 3 (Practice Q.4)

On 1st April 2011, Nuogen Ltd. had granted 1,20,000 share options to its employees with the vesting condition being a service condition as follows:

- Vesting date : 31st March 2012 - 80,000 share options (1-year vesting period since grant date)
- Vesting date : 31st March 2015 - 40,000 share options (4-year vesting period since grant date)

Each option can be converted into one equity share of Nuogen Ltd. The fair value of the options on grant date, i.e., on 1st April 2011 was Rs 20.

Nuogen Ltd. is required to prepare financial statements in Ind AS for the financial year ending 31st March 2014. The transition date for Ind AS being 1st April 2012.

The entity has disclosed publicly the fair value of both these equity instruments as determined at the measurement date, as defined in Ind AS 102.

The previous applicable GAAP for the entity was IGAAP (AS) and therein, the entity had not adopted intrinsic method of valuation.

The share options have not been yet exercised by the employees of Nuogen Ltd.

How the share based payment should be reflected in, the books of Nuogen Ltd. as on 31st March 2014, assuming that the entity has erred by not passing any entry for the aforementioned transactions in the books of Nuogen Ltd. on grant date, i.e. 1st April 2011?

Answer

For 80,000 share-based options vested before transition date:

Ind AS 101 provides that a first-time adopter is encouraged, but not required, to apply Ind AS 102 on 'Share-based Payment' to equity instruments **that vested before the date of transition to Ind AS.** Hence, Nuogen Ltd. may opt for the exemption given in Ind AS 101 for 80,000 share options vested before the transition date. However, since no earlier accounting was done for these share-based options under previous GAAP too, therefore this led to an error on the transition date, as detected on the reporting date i.e. 31st March, 2014. Hence, being an error, no exemption could be availed by Nuogen Ltd. on transition date with respect to Ind AS 102.

While preparing the financial statements for the financial year 2013 -2014, an error has been discovered which occurred in the year 2011 -2012, i.e., for the period which was earlier than earliest prior period presented. The error should be corrected by restating the opening balances of relevant assets and/or liabilities and relevant component of equity for the year 2012-2013. This will result in consequential restatement of balances as at 1st April, 2012 (i.e, opening balance sheet as at 1st April, 2012).

Accordingly, on retrospective calculation of Share based options with respect to 80,000 options, Nuogen Ltd. will create 'Share based payment reserve (equity)' by Rs 16,00,000 and correspondingly adjust the same though Retained earnings.

For 40,000 share based options to be vested on 31st March, 2015:

Since share-based options have not been vested before transition date, no option as per Ind AS 101 is available to Nuogen Ltd. The entity will apply Ind AS 102 retrospectively. However, Nuogen Ltd. did not account for the same at the grant date. This will result in consequential restatement of balances as at 1st April, 2012 (i.e, opening balance sheet as at 1st April, 2012). Adjustment is to be made by recognising the ' Share based payment reserve (equity)' and adjusting the retained earnings by Rs 2,00,000.

Further, expenses for the year ended 31st March, 2013 and share based payment reserve (equity) as at 31st March, 2013 were understated because of non-recognition of 'employee benefits expense' and related reserve. To correct the above errors in the annual financial statements for the year ended 31st March, 2014, the entity should restate the comparative amounts (i.e., those for the year ended 31 st March, 2013) in the statement of profit and loss. In the given case, 'Share based payment reserve (equity)' would be credited by Rs 2,00,000 and 'employee benefits expense' would be debited by Rs 2,00,000

For the year ending 31st March, 2014, 'Share based payment reserve (equity)' would be credited by Rs 2,00,000 and 'employee benefits expense' would be debited by Rs 2,00,000.

Working Note:

Period	Lot	Proportion	Fair value	Cumulative expenses	Expenses
		a	b	d = b x a	e = d- previous period d
2011-2012	1 (1-year vesting period)	1/1	16,00,000	16,00,000	16,00,000
2011-2012	2 (4-year vesting period)	1/4	8,00,000	2,00,000	2,00,000
2012-2013	2 (4-year vesting period)	2/4	8,00,000	4,00,000	2,00,000
2013-2014	2 (4-year vesting period)	3/4	8,00,000	6,00,000	2,00,000

Question 4 (Practice Q.5)

ABC Ltd., a public limited company, is in the business of exploration and production of oil and gas and other hydrocarbon related activities outside India. It operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in associates. The company was following Accounting Standards as notified under the Companies (Accounting Standards) Rules until 31st March, 2011. However, it has adopted Indian Accounting Standards (Ind AS) with effect from 1st April, 2011.

The goodwill recognised in accordance with AS 21 and AS 27 was due to corporate structure and the line-by-line consolidation of subsidiaries'/proportionate consolidation of jointly controlled entities' financial statements which was prepared on historical costs convention. ABC Ltd. has not taken into consideration the valuation of underlying oil and gas reserves for which excess amount (i.e. goodwill calculated as per the relevant AS requirements) has been paid by the company at the time of acquisition. The company further considered that in oil and gas companies, the goodwill generated on acquisition of mineral rights either through jointly controlled entities or subsidiaries, inherently derives its value from the underlying mineral rights and, accordingly, value of such goodwill depletes as the underlying mineral resources are extracted.

Therefore, taking a prudent approach and considering the above substance, the company amortised the goodwill in respect of its subsidiaries / jointly controlled assets over the life of the underlying mineral rights using Unit of Production method. This allowed the company to utilise the value of goodwill over the life of mineral rights and completely charging off the goodwill over the life of the reserves.

For financial year 2010-2011, the company has availed transition exemption under Ind AS 101 and has not applied the principles of Ind AS 103.

ABC Ltd. considering the substance over form of the goodwill to be in the nature of 'acquisition costs' intends to continue amortisation of the goodwill recognised under AS in respect of its subsidiaries / joint ventures (jointly controlled entities under AS) over the life of the underlying mineral rights using Unit of Production method, under Ind AS also post transition date.

Comment on appropriateness of the accounting treatment, under Ind AS, for amortisation of the goodwill by the company and state whether the accounting treatment in respect of amortisation of goodwill is correct or not.

Answer

Point (g) of para C4 of Ind AS 101 states that the carrying amount of goodwill or capital reserve in the opening Ind AS Balance Sheet shall be its carrying amount in accordance with previous GAAP at the date of transition to Ind AS after the two adjustments. One of the adjustment states that the standard requires the first -time adopter to recognise an intangible asset that was subsumed in recognised goodwill or capital reserve in accordance with previous GAAP, the first -time adopter shall decrease the carrying amount of goodwill or increase the carrying amount of capital reserve accordingly (and, if applicable, adjust deferred tax and

non-controlling interests)

As per the facts given, the entity paid excess amount to avail the rights to use the underlying oil and gas reserves. However, since the rights was not recorded in the books at that time, the value of goodwill subsumed the value of that intangible asset which should be separately identified in the books. Hence, value of goodwill will be reduced accordingly and intangible asset for rights for using mine should be recognised.

Further, regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply Ind AS 36 in testing the goodwill for impairment at the date of transition to Ind AS and in recognising any resulting impairment loss in retained earnings (or, if so required by Ind AS 36, in revaluation surplus). The impairment test shall be based on conditions at the date of transition to Ind AS. No other adjustments (eg- previous amortisation of goodwill) shall be made to the carrying amount of goodwill / capital reserve at the date of transition to Ind AS.

However, once goodwill is recognised in the opening transition date balance sheet, the entity has to follow the provisions of Ind AS, which states that goodwill is not amortised but rather tested for impairment annually. Accordingly, the amortization of goodwill based on 'Unit of Production' method is not correct after implementation of Ind AS.

Bhavik Chokshi

22. IND AS 105 : NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

Question 1 (Practice Q.2)

X Ltd. acquires B Ltd. exclusively with a view to sale and it meets the criteria to be classified as discontinued operation as per Ind AS 105. Further, following information is available about B Ltd.:

- Fair value of total assets excluding liabilities on acquisition – Rs 360
- Costs to sell as on acquisition and on reporting date – Rs 10
- Fair value of liabilities on acquisition and reporting date – Rs 80
- Fair value of total assets excluding liabilities on the reporting date – Rs 340

How discontinued operation pertaining to B Ltd. should be measured in consolidated financial statements of X Ltd. on acquisition date and reporting date?

Answer

Ind AS 105 defines a disposal group as a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a cash-generating unit to which goodwill has been allocated in accordance with the requirements of paragraphs 80 –87 of Ind AS 36, Impairment of Assets, or if it is an operation within such a cash- generating unit.

In the given case, B Ltd. is acquired exclusively with a view to sell and meets the criteria to be classified as discontinued operation.

The discontinued operation would be measured in accordance with paragraphs 15 and 16 of Ind AS 105

As per para 15, an entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

As per para 16, if a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale (see paragraph 11), applying paragraph 15 will result in the asset (or disposal group) being measured on initial recognition at the lower of its carrying amount had it not been so classified (for example, cost) and fair value less costs to sell. Hence, if the asset (or disposal group) is acquired as part of a business combination, it shall be measured at fair value less costs to sell.

Therefore, on acquisition date, in line with paragraph 16, X Ltd. will measure B Ltd. as a disposal group at fair value less costs to sell which will be calculated as Fair value of total assets excluding liabilities on acquisition – Costs to sell = Rs 360 – Rs 10 = Rs 350.

Fair value of liabilities on acquisition = Rs 80.

At the reporting date, in line with paragraph 15, X Ltd. will remeasure the disposal group at the lower of its cost and fair value less costs to sell which will be calculated as:

Fair value of total assets excluding liabilities on subsequent reporting date – Costs to sell

= Rs 340 – Rs 10 = Rs 330

Fair value of liabilities on reporting date = Rs 80.

At the reporting date, X Ltd. shall present these assets and liabilities separately from other assets and liabilities in its consolidated financial statements.

In the statement of profit and loss, X Ltd. shall recognise loss on subsequent measurement (of net assets at fair value) of B Ltd. which equals to Rs 20 (Rs 270 – Rs 250).

Question 2 (Practice Q.3)

Company A has financial year ending 31st March, 2010. On 1st June, 2010, the Company has classified its Division B as held for sale in accordance with Ind AS 105. How property, plant and equipment (PPE) for which the company has adopted cost model shall be measured immediately before the classification as held for sale on 1st June, 2010?

Answer

Paragraph 18 of Ind AS 105 provides that immediately before the initial classification of the asset (or disposal group) as held for sale,

the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS.

In the instant case, Company A should measure the property, plant and equipment (for which it has adopted cost model), in accordance with Ind AS 16, Property, Plant and Equipment. Hence, depreciation should be provided upto 31st May, 2010.

Question 3 (Practice Q.4)

Company X has identified one of its division (disposal group) to be sold to a prospective buyer and the Board has approved the plan to sell the division on 30th September, 2011. The sale is expected to complete after one year but it still qualifies to be held for sale under Appendix B of Ind AS 105. Costs to sell the division is estimated to be Rs 10 crores (to be incurred in March, 2013). The fair value of the division is Rs 400 crores (on 30th September, 2011 and 31st March, 2012) and carrying value is Rs 500 crores.

How shall such a division (disposal group) be measured under Ind AS 105 on following reporting dates:

A. 30th September, 2011

B. 31st March, 2012

Consider the discounting factor @ 10% for 1 year to 0.909 and for 1.5 years to be 0.867.

Answer

Paragraph 15 of Ind AS 105 states that an entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

Further, paragraph 17 of Ind AS 105 states that when the sale is expected to occur beyond one year, the entity shall measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in profit or loss as a financing cost.

Company X has identified a disposal group and is committed to sell the same. The sale is expected to be completed after a period of one year hence, it will measure the costs to sell such disposal group at present value as per paragraph 17 of Ind AS 105.

A. On 30th September, 2011

The disposal group will be measured at fair value less costs to sell which will be as follows:

Fair value	Rs 400.00 crores	
PV of costs to sell	(Rs 8.67 crores)	(Rs 10 crores x 0.867)
Total	Rs 391.33 crores	

B. On 31st March, 2011

The disposal group will be measured at fair value less costs to sell which will be as follows:

Fair value	Rs 400.00 crores	
PV of costs to sell	(Rs 9.09 crores)	(10 x 0.909)
Total	Rs 390.91 crores	

The increase in costs to sell the division by Rs 0.42 crore (Rs 9.09 crores – Rs 8.67 crores) will be recognised in profit and loss as financing cost in accordance with paragraph 17 of Ind AS 105.

23. IND AS 108 : OPERATING SEGMENTS

Question 1 (Practice Q.2)

XYZ Ltd. has eight segments namely A, B, C, D, E, F, G and H. The information regarding respective segments for the year ended 31st March, 2011 is as follows:

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

Identify which of the above segments out of A to H would be considered as reportable segments of XYZ Ltd. for the year ending 31st March, 2011?

Answer

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

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

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

Criteria 2: 10% or more of segment result

Consider segment profit and loss separately in absolute terms

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

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

Segments	A	B	C	D	E	F	G	H	Total
% to segment loss	5	90	15	5	8	5	5	7	
Reportable segments	**-**	**B**	**C**	-	-	-	-	-	

Bhavik Chokshi

Criteria 2: 10% or more of segment assets

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

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

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

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

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

Bhavik Chokshi

24. IND AS 113 : FAIR VALUE MEASUREMENT

NO CHANGES

25. IND AS 115 : REVENUE FROM CONTRACTS WITH CUSTOMERS

Question 1 (Practice Q.5)

KK Ltd. runs a departmental store which awards 10 points for every purchase of Rs. 500 which can be discounted by the customers for further shopping with the same merchant. Unutilised points will lapse on expiry of two years from the date of credit. Value of each point is Rs. 0.50. During the accounting period 2011-2012, the entity awarded 1,00,00,000 points to various customers of which 18,00,000 points remained undiscounted. The management expects only 80% will be discounted in future of which normally 60-70% are redeemed during the next year.

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

(a) How should the recognition be done for the sale of goods worth Rs. 10,00,000 on a particular day?

(b) How should the redemption transaction be recorded in the year 2011-2012? The Company has requested you to present the sale of goods and redemption as independent transaction. Total sales of the entity is Rs. 5,000 lakhs.

(c) How much of the deferred revenue should be recognised at the year-end (2011-2012) because of the estimation that only 80% of the outstanding points will be redeemed?

(d) In the next year 2012-2013, 60% of the outstanding points were discounted Balance 40% of the outstanding points of 2011-2012 still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 2012-2013 and what will be the amount of balance deferred revenue?

(e) How much revenue will the merchant recognized in the year 2012-2013, if 3,00,000 points are redeemed in the year 2012-2013?

Answer

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

It is expected that 80% of the award points will only be redeemed. Hence, considering the likelihood of the variable consideration,
Value of points = 20,000 points x Rs 0.5 each point x 80% = Rs 8,000

Revenue recognized for sale goods	Rs. 9,90,099	[10,00,000 x (10,00,000/10,10,000)]
Revenue for points deferred	Rs. 7,937	[10,00,000 x (8,000/10,08,000)]

Journal Entry

		Rs.	Rs.
Bank A/c	Dr.	10,00,000	
To Sales A/c			9,92,063
To Liability under Customer Loyalty programme			7,937

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

Value of points considering future likelihood = 1,00,00,000 points x Rs 0.5 each point x 80% = Rs 40,00,000

Revenue recognized for sale of goods = Rs 49,60,31,746 [50,00,00,000 x (50,00,00,000 / 50,40,00,000)]

Revenue for points = Rs 39,68,254 [50,00,00,000x (40,00,000 / 50,40,00,000)]

Journal Entry in the year 2011

		Rs.	Rs.
Bank A/c To Sales A/c To Liability under Customer Loyalty programme (On sale of Goods)	Dr.	50,00,00,000	 49,60,31,746 39,68,254
Liability under Customer Loyalty programme To Sales A/c (On redemption of (100 lakhs -18 lakhs) points)	Dr.	32,53,968	 32,53,968

Revenue for points to be recognized

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

Total expected points to be redeemed within 2 years = 1,00,00,000 x 80% - 80,00,000

Points redeemed in the previous year = (1,00,00,000 – 18,00,000) x 80% = 65,60,000

Revenue to be recognised with respect to discounted point = 39,68,254 x (65,60,000/80,00,000) = 32,53,968

(c) Revenue to be deferred with respect to undiscounted point in 2011-2012 = 39,68,254 – 32,53,968 = 7,14,286

(d) In 2012-2013, KK Ltd. would recognize revenue for discounting of 60% of outstanding points as follows:

Outstanding points = 18,00,000 x 80% x 60% = 8,64,000 points

Total points discounted till date = 65,60,000 + 8,64,000 = 74,24,000 points

Revenue to be recognized in the year 2012-2013 = [{39,68,254 x (74,24,000 / 80,00,000)} – 32,53,968] = Rs 4,28,572..

Liability under Customer Loyalty programme To Sales A/c (On redemption of further 8,64,000 points)	Dr.	4,28,572	 4,28,572

The Liability under Customer Loyalty programme at the end of the year 2012-2013 will be Rs 7,14,286 – 4,28,572 = 2,85,714.

(e) In the year 2013-2014, the merchant will recognized the balance revenue of Rs. 1,84,873 irrespective of the points redeemed as this is the last year for redeeming the points. Journal entry will be as follows:

Liability under Customer Loyalty programme To Sales A/c (On redemption of remaining points)	Dr.	2,85,714	 2,85,714

Question 2 (Practice Q.6)

A property sale contract includes the following:

(a) Common areas

(b) Construction services and building material

(c) Property management services

(d) Golf membership

(e) Car park

(f) Land entitlement

Analyse whether the above items can be considered as separate performance obligations as per the requirements of Ind AS 115?

Answer

Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

- a good or service (or a bundle of goods or services) that is distinct; and
- series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

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

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and

(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

Each performance obligation is required to be accounted for separately.

Based on the above guidance, the following table discusses whether the common goods and services in property sale contract should be considered as separate performance obligation or not:

Goods/Service	**Whether a separate Performance obligation (PO) or not**	**Reason**
Common areas	Unlikely to be separate PO	Common areas are unlikely to be a separate performance obligation because the interests received in common areas are typically undivided interests that are not separable from the property itself. However, if the common areas were sold separately by the developer, then they could be considered as a separate performance obligation provided that it is distinct in the context of the contract.
Construction services and building material	Unlikely to be separate PO	Construction services and building materials can meet the first criterion as they are items that can be used in conjunction with other readily available goods or services. However, the developer would be considered to be providing a significant integration service as it is bringing together all the separate elements to deliver a complete building.
Property management services and Golf membership	Likely to be separate PO	Property management services and golf membership are likely to be separate performance obligations as they may be used in isolation or with the property already acquired, i.e., management services can be used with the property. These types of services are not significantly customised, integrated with, or dependent on the property. This is because there is no change in their function with or without the property. Also, a property management service could be undertaken by a third party.

BENCHMARX SIMPLIFYING SUCCESS

Car park and Land entitlement	Analysis required	Items such as car parks and land entitlements generally meet the first criterion – i.e., capable of being distinct – as the buyer benefits from them on their own. Whether the second criterion is met depends on the facts and circumstances. For example, if the land entitlement can be sold separately or pledged as security as a separate item, it may indicate that it is not highly dependent on, or integrated with, other rights received in the contract. In an apartment scenario, the customer can receive an undivided interest in the land on which the apartment block sits. This type of right is generally considered as highly inter-related with the apartment itself.*

* However, if title to the land is transferred to the buyer separately – for example in a single party development – then the separately identifiable criterion may be met.

PS: Other facts and circumstances of each contract should also be carefully examined to determine performance obligations.

Question 3 (Practice Q.7)

Prime Ltd. is a technology company and regularly sells Software S, Hardware H and Accessory A. The stand-alone selling prices for these items are stated below:

Software S – Rs 50,000

Hardware H – Rs1,00,000 and Accessory A – Rs 20,000.

Since the demand for Hardware H and Accessory A is low, Prime Ltd. sells H and A together at Rs 100,000. Prime Ltd. enters into a contract with Zeta Ltd. to sell all the three items for a consideration of Rs1,50,000.

What will be the accounting treatment for the discount in the financial statements of Prime Ltd., considering that the three items are three different performance obligations which are satisfied at different points in time? Further, what will be the accounting treatment if Prime Ltd. would have transferred the control of Hardware H and Accessory A at the same point in time.

Answer

Paragraph 82 of Ind AS 115 states that, "An entity shall allocate a discount entir ely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

(a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;

(b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and

(c) the discount attributable to each bundle of goods or services described in paragraph 82(b) is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.

In the given case, the contract includes a discount of Rs 20,000 on the overall transaction, which should have been allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method (in accordance with paragraph 81 of Ind AS 115). However, as Prime Ltd. meets all the criteria specified in paragraph 82 above, i.e., it regularly sells Hardware H and Accessory A together for Rs 1,00,000 and Software S for Rs 50,000, accordingly, it is evident that the entire discount should be allocated to the promises to transfer Hardware H and Accessory A.

In the given case, since the contract requires the entity to transfer control of Hardware H and Accessory A at different points in time, then the allocated amount of Rs 1,00,000 should be individually allocated to the promises to transfer Hardware H (stand-alone selling price of Rs 1,00,000) and Accessory A (stand-alone selling price of Rs20,000)

Product	Allocated transaction price (Rs)
Hardware H	83,333 (1,00,000/ 120,000 x 100,000)

Accessory A	16,667 (20,000/120,000 x 100,000)
Total	1,00,000

However, if Prime Ltd. would have transferred the control of Hardware H and Accessory A at the same point in time, then the Prime Ltd. could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, Prime Ltd. could allocate Rs 1,00,000 of the transaction price to the single performance obligation and recognise revenue of Rs 1,00,000 when Hardware H and Accessory A simultaneously transfer to Zeta Ltd.

Question 4 (Practice Q.8)

On 1st April, 2011, S Limited enters into a contract with Corp Limited to construct heavy- duty equipment for a promised consideration of rupees with a bonus of rupees if the equipment is completed within 24 months. At the inception of the contract, S Limited correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with Ind AS 115. At the inception of the contract, the Company expects the costs to be rupees and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will occur. Completion of the heavy-duty equipment is highly susceptible to factors outside of the Company's influence, mainly due to difficulties with the supply of components.

At 31st March, 2012, S Limited has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained in accordance with Ind AS 115. However, on 4 June 2012, the contract is modified with the result that the fixed consideration and expected costs increase by Rs 1,50,000 and Rs 80,000 respectively. The time allowable for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that the bonus will be achieved and that the contract remains a single performance obligation.

S Limited wants your opinion on the accounting treatment of contract with Corp Limited in light of Ind AS 115, for the year 2011-2012 and 2012-2013.

Answer

For the year 2011-2012

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

Transaction price – Rs20,00,000

Expected costs – Rs11,00,000

Expected profit (45%) – Rs9,00,000

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

By the end of the first year, the entity has satisfied 65% of its performance obligation on the basis of costs incurred to date. Costs incurred to date are therefore Rs 7,15,000 and S Limited reassesses the variable consideration and concludes that the amount is still constrained. Therefore at 31st March, 2012, the following would be recognised:

Revenue	(A)	– Rs13,00,000	(Rs20,00,000 x 65%)
Costs	(B)	– Rs 7,15,000	(Rs11,00,000 x 65%)
Gross profit	(C) i.e.(A-B)	– Rs 5,85,000	

For the year 2012-2013

On 4th June, 2012, the contract is modified. As a result, the fixed consideration and expected costs increase by Rs 1,50,000 and Rs 80,000, respectively.

The total potential consideration after the modification is Rs 24,00,000 which is Rs 21,50,000 fixed consideration + Rs 2,50,000 completion bonus. In addition, the allowable time for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that including the bonus in the transaction price will not result in a significant reversal in the

amount of cumulative revenue recognised in accordance with Ind AS 115. Therefore, the bonus of Rs 2,50,000 can be included in the transaction price.

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

S Limited has satisfied 60.60% of its performance obligation (Rs 7,15,000 actual costs incurred compared to Rs 11,80,000 total expected costs). The entity recognises additional revenue of Rs 1,54,400 [(60.60% of Rs 24,00,000) – Rs 13,00,000 revenue recognised to date] at the date of modification i.e. on 4th June, 2012 as a cumulative catch-up adjustment.

Question 5 (Practice Q.9)

A Ltd. owns 20 resorts across India. Every customer who stays in any of the resorts owned by A Ltd. is entitled to get points on the basis of total amount paid by him. Under this scheme, 1 point is granted for every Rs 100 spent for stay in the resort. As per the past experience of A Ltd., the likelihood of exercise of the points is 100% and the standalone price of each such point is Rs 5. Customer X spends Rs 10,000 in one of the resorts of A Ltd. What is the accounting treatment for the points granted by A Ltd.?

Answer

Paragraph B40 of Ind AS 115, inter alia, states that, "if in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a separate performance obligation only if the option provides a material right to the customer that it would not receive without entering into that contract".

Further, paragraph B41 states that if a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services.

In the given case, the customer does get a material right by way of a discount of Rs 500 for every 100 points that he would not receive without the previous stay in that resort. Thus, the customer in effect pays the entity in advance for future goods and the entity recognises revenue when the goods are transferred.

According to paragraph B42, paragraph 74 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the standalone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it on the basis of percentage discount the customer may obtain upon exercising the option and the likelihood of the option getting exercised.

In accordance with above, an entity shall account for award credit as a separate performance obligation of the sales transactions in which they are initially granted. The value of the consideration the entity expects to be entitled in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

In the current case, the standalone selling price of the 100 points is Rs 500. A Ltd. should allocate the fair value of the consideration (i.e. Rs 10,000) between the points and the other components of the sale as Rs 476 (500/10,500 x 10,000) and Rs 9,524 (10,000/10,500 x 10,000) respectively in proportion of their standalone selling price. Since A Ltd. supplies the awards itself (i.e. it acts as a principal), it should recognize Rs476 as revenue when points are redeemed.

Question 6 (Practice Q.10)

On 1st April, 2011, Entity X enters into a contract with Entity Y to sell mobile chargers for Rs 100 per charger. As per the terms of the contract, if Entity Y purchases more than 1,000 chargers till March 2012, the price per charger will be retrospectively reduced to Rs 90 per unit. Till September 2011, Entity X sold 95 chargers to Entity Y. Entity X estimates that Entity Y's purchases by March 2012 will not exceed the required threshold of 1,000 chargers.

In October 2011, Entity Y acquires another Entity C and from October 2011 to December 2011, Entity X sells an additional 600 chargers to Entity Y. Due to these developments, Entity X estimates that purchases of Entity Y will exceed the 1,000 chargers threshold for the period and therefore, it will be required to retrospectively reduce the price per charger to Rs 90.

Analyse the above scenario in light of Ind AS 115 and state how the revenue should be recognised in such a situation.

Answer

Paragraph 56 of Ind AS 115 states that an entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is

subsequently resolved.

Further, paragraph 57 of Ind AS 115 state that in assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

(a) the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.

(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.

(e) the contract has a large number and broad range of possible consideration amounts.

Entity X estimates that the consideration in the above contract is variable. Therefore, in accordance with paragraphs 56 and 57 of Ind AS 115, Entity X is required to consider the constraints in estimating variable consideration. Entity X determines that it has significant experience with this product and with the purchasing pattern of the Entity Y. Thus, if Entity X concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. Rs 100 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known), then the Entity X will recognise revenue of Rs 9,500 (95 chargers x Rs 100 per charger) for the half year ended 30th September, 2011.

Further, paragraphs 87 and 88 of Ind AS 115 that after contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes."

In accordance with the above, in the month of October 2011, due to change in circumstances on account of Entity Y acquiring Entity C and consequential increase in sale of chargers to Entity Y, Entity X estimates that Entity Y's purchases will exceed the 1,000 chargers threshold till March 2012 for the period and therefore, it will be required to retrospectively reduce the price per charger to Rs 90.

Consequently, the Entity X will recognise revenue of Rs 53,050 for the quarter ended December 2011 which is calculated as follows:

Particulars	**Amount in Rs**
Sale of 600 chargers (600 chargers x Rs 90 per charger)	54,000
Less: Change in transaction price (95 chargers x Rs 10 price reduction) for the reduction of revenue relating to units sold till September 2011.	(950)
Revenue recognised for the quarter ended December 2011	53,050

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26. IND AS 116 : LEASES

Illustration 39- Deferral of lease payments not a lease modification (Deleted)

Lessor L leases retail space to Lessee Z and classifies the lease as an operating lease. The lease includes fixed lease payments of Rs 10,000 per month.

Due to the COVID-19 pandemic, L and Z agree on a rent concession that allows Z to pay no rent in the period from July, 2020 to September, 2020 but to pay rent of 20,000 per month in the period from January 2021 to March 2021. There are no other changes to the lease.

How this will be accounted for by lessor?

Illustration 40 - Unamortised lease incentive: Lease modification (Deleted)

Lessor M enters into a 10-year lease of office space with Lessee K, which commences on 1 April 2015. The rental payments are 15,000 per month, payable in arrears. M classifies the lease as an operating lease. M reimburses K's relocation costs of K of 600,000, which M accounts for as a lease incentive. The lease incentive is recognised as a reduction in rental income over the lease term using the same basis as for the lease income – in this case, on a straight- line basis over 10 years.

On 1 April 2020, during the COVID-19 pandemic, M agrees to waive K's rental payments for May, June and July 2020.

This decrease in consideration is not included in the original terms and conditions of the lease and is therefore a lease modification.

How this will be accounted for by the lessor?

Illustration 41 - Modification that is not a separate lease and lease would have been classified as an operating lease (Deleted)

Lessor L enters into an eight-year lease of 40 lorries with Lessee M that commences on 1 January 2018. The lease term approximates the lorries' economic life and no other features indicate that the lease transfer or does not transfer substantially all of the risks and rewards incidental to ownership of the lorries. Assuming that substantially all of the risks and rewards incidental to ownership of the lorries are transferred, L classifies the lease as a finance lease.

During the COVID-19 pandemic, M's business has contracted. In June 2020, L and M amend the contract so that it now terminates on 31 December 2020.

Early termination was not part of the original terms and conditions of the lease and this is therefore a lease modification. The modification does not grant M an additional right to use the underlying assets and therefore cannot be accounted for as a separate lease.

How this will be accounted for by lessor?

Question 1 (Practice Q.3)

The Company has entered into a lease agreement for its retail store as on 1 st April, 2011 for a period of 10 years. A lease rental of Rs 56,000 per annum is payable in arrears. The Company recognized a lease liability of Rs 3,51,613 at inception using an incremental borrowing rate of 9.5% p.a. as at 1st April 2011. As per the terms of lease agreement, the lease rental shall be adjusted every 2 years to give effect of inflation. Inflation cost index as notified by the Income tax department shall be used to derive the lease payments. Inflation cost index was 280 for financial year 2011-2012 and 301 for financial year 2013-2014. The current incremental borrowing rate is 8% p.a.

Show the Journal entry at the beginning of year 3, to account for change in lease.

Answer

As per para 27 (b) of Ind AS 116, variable lease payments that depend on an index or a rate, are initially measured using the index or rate as at the commencement date.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of Rs 60,200 discounted at an original discount rate of 9.5% per annum as per para 43 of Ind AS 116.

Year	Revised lease rental	Discount factor @ 9.5%	Present value

3	[(56,000 / 280) x 301] = 60,200	0.913	54,963
4	60,200	0.834	50,207
5	60,200	0.762	45,872
6	60,200	0.696	41,899
7	60,200	0.635	38,277
8	60,200	0.580	34,916
9	60,200	0.530	31,906
10	60,200	0.484	29,137
			3,27,127

Table showing amortised cost of lease liability

Year	Opening balance	Interest @ 9.5%	Rental paid	Closing balance
1	3,51,613	33,403	56,000	3,29,016
2	3,29,016	31,257	56,000	3,04,273

Difference of Rs 22,854 (3,27,127 – 3,04,273) will increase the lease liability with corresponding increase in ROU Asset as per para 39 of Ind AS 116.

Journal entry at the beginning of year 3 would be:

Right-of-use asset	Dr.	Rs 22,854	
To Lease liability			Rs 22,854

Question 2 (Practice Q.4)

Case I

Scenario 1: The 'last mile' is a dedicated cable that connects Entity Y's network with the end customer's device. The use of this cable is at the discretion of the customer. Entity Y decides the location of end points and has right to replace the lines (dedicated cable), however it is not practical to replace the lines, since replacement would require additional costs to be incurred without any corresponding benefit. Whether the arrangement would be within the scope of Ind AS 116?

Scenario 2: If it is practical for the Entity Y to replace the lines and Entity Y would benefit from this replacement, would the answer be different?

Case II

Customer X enters into a 10-year contract with a utility company, Entity Y, for the right to use three specified, physically distinct fibers within a larger cable connecting Mumbai to Delhi. Customer makes the decisions about the use of the fibers by connecting each end of the fibers to its electronic equipment. Entity Y owns extra fibers but can substitute those for Customer's fibers only for reasons of repairs, maintenance or malfunction. The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116?

Case III

Customer X enters into a 10-year contract with Entity Y for the right to use a specified amount of capacity within a cable connecting Mumbai to Delhi. The specified amount is equivalent to Customer X having the use of the full capacity of three fiber strands within the cable (the cable contains multiple fibers with similar capacities). Entity Y makes decisions about the transmission of data (i.e., Entity Y lights the fibers, makes decisions about which fibers are used to transmit Customer's traffic). The useful life of the fiber is 15

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years. Whether this arrangement is covered under Ind AS 116?

Answer

Paragraph 9, B9, B13 and B14 of Ind AS 116 state the following:

“9 At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.”

“B9 To assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

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

(b) the right to direct the use of the identified asset.”

“B13 An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer.”

“B14 Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier’s right to substitute an asset is substantive only if both of the following conditions exist:

(a) the supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and

(b) the supplier would benefit economically from the exercise of its right to substitute the asset (i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).”

Paragraph B20 of Ind AS 116 which provides guidance regarding identified asset in case of portion of assets states that a capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

Paragraph B21 of Ind AS 116, inter alia, states that to control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or subleasing the asset.

Further, paragraph B24 of Ind AS 116 provides that a customer has the right to direct the use of an identified asset throughout the period of use if the customer has the right to direct how and for what purpose the asset is used throughout the period of use.

Paragraph B25 of Ind AS 116 states that a customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

Case I

Scenario 1:

(i) As per paragraph B13 of Ind AS 116, ‘Last mile’ which is a dedicated cable is an identified asset since it is physically distinct.

(ii) There are no substantive substitution rights with Entity Y, as it does not have the practical ability to substitute alternative assets throughout the period of use.

Thus, this arrangement is within the scope of Ind AS 116.

Scenario 2:

If Entity Y has the practical ability to replace the lines and it would benefit from such replacement, Entity Y has substantive substitution rights. In such case, this arrangement for the ‘last mile cable’ will not be within the scope of Ind AS 116.

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Case II

The fibers are specified in the contract and are physically distinct. Hence, in accordance with paragraph B13 and B20, the said three fibers are identified asset.

Paragraph B18, inter alia, states that the supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.

Further, paragraph B27 provides that although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and can actually be dependent on the decisions about how and for what purpose the asset is used.

In accordance with the above, as Entity Y can substitute these three distinct fibers only for reasons of repairs, maintenance or malfunction, it does not preclude them from being an identified asset.

Further, the Customer X has right to control the use of the identified fibers for 10 year since it has –

(a) the right to obtain substantially all of the economic benefits from use of the identified fibers throughout the period of use, i.e., 10 years; and

(b) the right to direct the use of the fibers as it makes the decisions about the use of the fibers, i.e., it has right to direct how and for what purpose the fibers are used throughout the period of use.

Hence, this arrangement is within the scope of Ind AS 116.

Case III

Paragraph B20 specifically provides that a capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset. In the given case, the capacity portion that will be provided to Customer X is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable, thus, it is not an identified asset. Further, Entity Y makes all decisions about the transmission of data, (i.e., supplier lights the fibers, makes decisions about which fibers are used to transmit customer's traffic).

Thus, the contract does not contain a lease and is therefore not within the scope of Ind AS 116.

Question 3 (Practice Q.5)

A company manufactures specialised machinery. The company offers customers the choice of either buying or leasing the machinery. A customer chooses to lease the machinery. Details of the arrangement are as follows:

(i) The lease commences on 1st April, 2011 and lasts for three years.

(ii) The lessee is required to make three annual rentals payable in arrears of Rs57,500.

(iii) The leased machinery is returned to the lessor at the end of the lease.

(iv) The fair value of the machinery is Rs 1,50,000, which is equivalent to the selling price of the machinery

(v) The machinery cost Rs 1,00,000 to manufacture. The lessor incurred costs ofRs2,500 to negotiate and arrange the lease.

(vi) The expected useful life of the machinery is 3 years. The machinery has an expected residual value of Rs 10,000 at the end of year three. The estimated residual value does not change over the term of the lease.

(vii) The interest rate implicit in the lease is 10.19%.

The lessor classifies the lease as a finance lease.

How should the Lessor account for the same in its books of accounts? Pass necessary journal entries.

Answer

The cost to the lessor for providing the machinery on lease consists of the book value of the machinery (Rs 1,00,000), plus the initial direct costs associated with entering into the lease (Rs 2,500), less the future income expected from disposing of the machinery at the end of the lease (the present value of the unguaranteed residual value of Rs 10,000 discounted @ 10.19%, being Rs 7,470). This gives a cost of sale of Rs95,030.

The lessor records the following entries at the commencement of the lease:

		Rs	Rs
Lease receivable	Dr.	1,50,000	
Cost of sales	Dr.	95,030	
To Inventory			1,00,000
To Revenue			1,42,530
To Creditors/Cash			2,500

The sales profit recognised by the lessor at the commencement of the lease is therefore Rs 47,500 (Rs 1,42,530 - Rs 95,030). This is equal to the fair value of the machinery of Rs 1,50,000, less the book value of the machinery (Rs 1,00,000) and the initial direct costs of entering into the lease (Rs 2,500). Revenue is equal to the lease receivable (Rs 1,50,000), less the present value of the unguaranteed residual value (Rs 7,470).

Year	Lease receivable at the beginning of year (Rs) (a)	Lease payments (Rs) (b)	Interest Income (10.19% per annum) (Rs) (c)	Decrease In lease receivable (Rs) (d)=(b)-(c)	Lease receivable at the end of year (Rs) (e)=(a)-(d)
1	1,50,000	57,500	15,285	42,215	1,07,785
2	1,07,785	57,500	10,983	46,517	61,268
3	61,268	57,500	6,232*	51,268	10,000

*Difference is due to approximation

The lessor will record the following entries:

			Rs	Rs
Year 1	Cash/Bank	Dr.	57,500	
	To Lease receivable			42,215
	To Interest income			15,285
Year 2	Cash/Bank	Dr.	57,500	
	To Lease receivable			46,517
	To Interest income			10,983
Year 3	Cash/Bank	Dr.	57,500	
	To Lease receivable			51,268
	To Interest income			6,232

At the end of the three-year lease term, the leased machinery will be returned to the lessor, who will record the following entries:

	Rs	Rs
Inventory Dr. To Lease receivable	10,000	10,000

Question 4 (Practice Q.6)

How will Entity Y account for the incentive in the following scenarios:

Scenario A:

Entity Y (lessor) enters into an operating lease of property with Entity X (lessee) for a five-year term at a monthly rental of Rs 1,10,000. In order to induce Entity X to enter into the lease, Entity Y provides Rs 6,00,000 to Entity X at lease commencement for lessee improvements (i.e., lessee's assets).

Scenario B:

Entity Y (lessor) enters into an operating lease of property with Entity X (lessee) for a five-year term at a monthly rental of Rs 1,10,000. At lease commencement, Entity Y provides Rs 6,00,000 to Entity X for leasehold improvements which will be owned by Entity Y (i.e., lessor's assets). The estimated useful life of leasehold improvements is 5 years.

Answer

Para 70 of Ind AS 116 state that at the commencement date, the lease payments included in the measurement of the net investment in the lease comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:

(a) fixed payments (including in-substance fixed payments as described in para B42), less any lease incentives payable;

(b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;

(c) any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;

(d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in para B37); and

(e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Further para 71 of the standard states that a lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished."

Scenario A

In accordance with above, in the given case, **at lease commencement**, Entity Y accounts for the incentive as follows:

To account for the lease incentive

Deferred lease incentive Dr.	Rs 6,00,000	
To Cash		Rs 6,00,000

Recurring monthly journal entries in Years 1 – 5

To record cash received on account of lease rental and amortisation of lease incentive over the lease term

Cash Dr.	Rs 1,10,000	
To Lease income		Rs 1,00,000
To Deferred lease incentive		Rs 10,000*

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*This is calculated as Rs6,00,000 ÷ 60 months.

Scenario B

Entity Y has provided lease incentive amounting to Rs 6,00,000 to Entity X for leasehold improvements in the premises. As Entity Y has the ownership of the leasehold improvements carried out by the lessee, it shall account for the same as property, plant and equipment and shall depreciate the same over its useful life.

In accordance with above, in the given case, **at lease commencement**, Entity Y accounts for the incentive as follows:

To record the lease incentive

Property, plant & Equipment	Dr. Rs6,00,000	
To Cash		Rs6,00,000

Recurring monthly journal entries in Years 1 – 5

To record cash received on account of lease rental over the lease term

Cash	Dr. Rs1,10,000	
To Lease income		Rs1,10,000

To record depreciation on PPE over the lease term using straight line method

Depreciation	Dr. Rs10,000	
To Accumulated Depreciation		Rs10,000

Question 5 (Practice Q.7)

Entity X, a utility company enters into a contract for twenty years with Entity Y, a power company, to purchase all of the electricity produced by a new solar power station. The solar power station is explicitly specified in the contract and Entity Y has no substitution rights. Entity Y owns the solar power station and will receive tax credits relating to the construction and ownership of the solar power station, and Entity X will receive renewable energy credits that accrue from use of the solar power station.

Whether Entity X has the right to obtain substantially all of the economic benefits from the solar power station during the period of arrangement?

Answer

Paragraphs B21 of Ind AS 116 states that to control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or subleasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realised from a commercial transaction with third party.

In the given case, Entity X has the right to obtain substantially all of the economic benefits from the use of the solar power station over the 20 -year period because it obtains:

– electricity produced by the power station i.e. the primary product from use of the asset over the lease term and

– renewable energy credits – i.e. the by-product from use of the asset.

Although Entity Y will receive economic benefits from the solar power station in the form of tax credits, those economic benefits relate to the ownership of the solar power station rather than the use of the power station. Thus, these credits are not considered in this assessment.

27. IND AS 102 : SHARE-BASED PAYMENT

Question 1 (Practice Q.5)

New Age Technology Limited has entered into following Share Based payment transactions:

(i) On 1st April, 2011, New Age Technology Limited decided to grant share options to its employees. The scheme was approved by the employees on 30th June, 2011. New Age Technology Limited determined the fair value of the share options to be the value of the equity shares on 1st April, 2011.

(ii) On 1st April, 2011, New Age Technology Limited entered into a contract to purchase IT equipment from Bombay Software Limited and agreed that the contract will be settled by issuing equity instruments of New Age Technology Limited. New Age Technology Limited received the IT equipment on 30th July, 2011. The share-based payment transaction was measured based on the fair value of 'the equity instruments as on 1 st April, 2011.

(iii) On 1st April, 2011, New Age Technology Limited decided to grant the share options to its employees. The scheme was approved by the employees on 30th June, 2011. The issue of the share options was however subject to the same being approved by the shareholders in a general meeting. The scheme was approved in the general meeting held on 30th September, 2011. The fair value of the equity instruments for measuring the share- based payment transaction was taken on 30th September, 2011.

Identify the grant date and measurement date in all the 3 cases of Share based payment transactions entered into by New Age Technology Limited, supported by appropriate rationale for the determination?

Answer

Ind AS 102 defines grant date and measurement dates as follows:

(a) **Grant date:** The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

(b) **Measurement date:** The date at which the fair value of the equity instruments granted is measured for the purposes of this Ind AS. For transactions with employees and others providing similar services, the measurement date is grant date. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

Applying the above definitions in the given scenarios following would be the conclusion based on the assumption that the approvals have been received prospectively:

Scenario	Grant date	Measurement date	Base for grant date	Base for measurement date
(i)	30th June, 2011	30th June, 2011	The date on which the scheme was approved by the employees	For employees, the measurement date is grant date
(ii)	1st April, 2011	30th July, 2011	The date when the entity and the counterparty entered a contract and agreed for settlement by equity instruments	The date when the entity obtains the goods from the counterparty
(iii)	30th September, 2011	30th September, 2011	The date when the approval by shareholders was obtained	For employees, the measurement date is grant date

Question 2 (Practice Q.6)

The following particulars in respect of stock options granted by a company are available:

No. of Employees covered	400	Nominal Value per share	Rs 100
No. of options per Employee	60	Exercise price per share	Rs 125

Shares offered were put in three groups. Group 1 was for 20% of shares offered with vesting period one-year. Group II was for 40% of shares offered with vesting period two- years. Group III was for 40% of shares offered with vesting period three-years. Fair value of option per share on grant date was Rs 10 for Group I, Rs 12.50 for Group II and Rs 14 for Group III.

Position on 1st Year	Position on 2nd Year	Position on 3rd Year
- No. of employees left = 40 - Estimate of employees to leave in Year 2 = 36 - Estimate of employees to leave in Year 3 = 34 - Employees exercising Options Group I = 350	- Employees left = 35 - Estimate of employees to leave in Year 3 = 30 - Employees exercising Options in Group II = 319	- Employees left = 28 - Employees exercising Options in Group III = 295

Options not exercised immediately on vesting, were forfeited. Compute expenses to recognise in each year and show important accounts in the books of the company.

Answer

Total number of Options per employee = 60

Group I - 20% vesting in Year 1	Group II - 40% vesting in Year 2	Group III - 40% vesting in Yr. 3
12 options, Vesting period = 1 Yr.	24 options, Vesting period = 2 Yrs.	24 options, Vesting period = 3 Yrs.

Computation of Expenses for all the years

Group = No. of Options	Group I = 12 Options	Group II = 24 Options		Group III = 24 Options		
	Year 1	Year 1	Year 2	Year 1	Year 2	Year 3
(a) Employees at year end = [Opening No.of Employees - Forfeiture]	400 - 40 = 360	400 - 40 = 360	360 - 35 = 325	400 - 40 = 360	360 - 35 = 325	325 - 28 = 297
(b) Expected to leave in future	NA	36	NA	36 + 34 = 70	30	NA
(c) No. of employees eligible (a - b)	360	324	325	290	295	297
(d) Options expected to Vest =	(360 x 12 sh.)	(324 x 24 sh.)	(325 x 24 sh.)	(290 x 24 sh.)	(295 x 24 sh.)	(297 x 24 sh.)

[(c) x No. of Shares]	4,320	7,776	7,800	6,960	7,080	7,128
(e) FV per option =	Rs 10	Rs 12.50	Rs 12.50	Rs 14	Rs 14	Rs 14
(f) Value of Total Options = [d x e]	Rs 43,200	Rs 97,200	Rs 97,500	Rs 97,440	Rs 99,120	Rs 99,792
(g) Total Cumulative Cost of Options = [(f) x Completed Yrs/ Total Yrs)	Rs 43,200	[(f) x 1/2] Rs 48,600	[(f) x 2/2] Rs 97,500	[(f) x 1/3] Rs32,480	[(f) x 2/3] Rs66,080	[(f) x 3/3] Rs 99,792
(h) Less: Recognized in last years	0	0	Rs 48,600	0	Rs32,480	Rs 66,080
(i) **Expenses to be recognized**	Rs 43,200	Rs 48,600	Rs 48,900	Rs32,480	Rs33,600	Rs 33,712
(j) **Employees not exercising ESOP**	10 Employees	325 - 319 = 6 Employees		297 - 295 = 2 Employees		
(k) Total Expenses for-						
Year 1	Rs 43,200 (Gr. 1) + Rs 48,600 (Gr. 2) + Rs 32,480 (Gr. 3) = Rs 1,24,280					
Year 2	Rs48,900 (Gr. 2) + Rs33,600 (Gr. 3) = Rs82,500					
Year 3	Rs33,712 (Gr. 3 only)					

Employees Benefit Expenses A/c

	Rs		Rs
Year 1			
To Share-based Payment Reserve A/c	1,24,280	By Profit and Loss A/c	1,24,280
	1,24,280		1,24,280
Year 2			
To Share-based Payment Reserve A/c	82,500	By Profit and Loss A/c	82,500
	82,500		82,500
Year 3			
To Share-based Payment Reserve A/c	33,712	By Profit and Loss A/c	33,712
	33,712		33,712

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Share-based Payment Reserve A/c

	Rs		Rs
Year 1			
To Retained Earnings [(360 - 350) Emp x 12 Options x Rs 10]	1,200	By Employees Benefit Expenses A/c	1,24,280
To Share Capital (350 Emp x 12 Options x Rs 100)	4,20,000	By Bank A/c (350 Emp x 12 Options x Rs 125)	5,25,000
To Securities Premium (350 Emp x 12 Options x Rs 35)	1,47,000		
To Balance c/d	81,080		
	6,49,280		6,49,280
Year 2			
To Retained Earnings [(325 - 319) Emp x 24 Options x Rs 12.50]	1,800	By Balance b/d	81,080
To Share Capital (319 Emp x Options x Rs 100)	7,65,600	By Employees Benefit Expenses A/c	82,500
To Securities Premium (319 Emp x 24 Options x Rs37.50)	2,87,100	By Bank A/c (319 Emp x 24 Options x Rs 125)	9,57,000
To Balance c/d	66,080		
	11,20,580		11,20,580
Year 3			
To Retained Earnings [(297 - 295) Emp x 24 Options x Rs 14]	672	By Balance b/d	66,080
To Share Capital (295 Emp x 24 Options x Rs 100)	7,08,000	By Employees Benefit Expenses A/c	33,712
To Securities Premium (295 Emp x 24 Options x Rs 39)	2,76,120	By Bank A/c (295 Emp x 24 Options x Rs 125)	8,85,000
	9,84,792		9,84,792

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Working Note:

Calculation of Securities Premium			
	Group I	**Group II**	**Group III**
	Year 1	**Year 2**	**Year 3**
Exercise Price received per share	125.00	125.00	125.00
Value of service received per share, being the FV of the Options	10.00	12.50	14.00
Total Consideration received per share	135.00	137.50	139.00
Less: Nominal Value per share	(100.00)	(100.00)	(100.00)
Securities Premium per share	35.00	37.50	39.00

Question 3 (Practice Q.7)

Entity A runs a copper-mining business. Entity A has a year-end of 31st March. Dividends declared on the shares accrue to the employees during the three-year period. If the condition is met, the employees will receive the shares together with the dividends that have been declared on those shares during the three years upto 31st March, 2013.

The entity estimates that on 1st April, 2010 its shares are valued at Rs 10 each. The grant date fair amount of each share is Rs 10.

Entity A prepares annual financial statements for the year ended 31 st March and:

- on 1st April, 2010 it estimates that 800 shares will vest;
- at the end of the first year (31st March, 2011) it has revised this estimate to 780;
- at 31st March, 2012 it has further revised this estimate to 750; and
- 750 shares vest on 31st March, 2013 based on the number of employees still employed on that date.

On 1st April, 2010 as part of a long-term incentive scheme, Entity A provisionally awards its sales employees 1,000 Entity A's shares receivable on 31st March, 2013. Explain the accounting treatment for the above share-based awards based on satisfaction of the condition that the sales employees must remain in employment until 31st March, 2013. The requirement to remain in employment is a service condition and would not be reflected in the fair value of the share awards.

Answer

The grant date fair value amount would be recognised as an expense over the three year service period adjusted by the number of shares expected to vest. Consequently, for each period, Entity A estimates how many eligible employees are expected to be employed on 31st March, 2013 and this forms the basis for that adjustment. The journal entries would be:

Year 1 (Year ended 31st March, 2011)

		Dr.	Cr.
Employee benefit expenses A/c	Dr.	Rs2,600	
To Share-based payment reserve			Rs2,600

(To recognise the receipt of employee services in exchange for shares)

Year 2 (Year ended 31st March, 2012)

		Dr.	Cr.
Employee benefit expenses A/c	Dr.	Rs2,400	
To Share-based payment reserve			Rs2,400

(To recognise the receipt of employee services in exchange for shares)

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Year 3 (Year ended 31st March, 2013)

Employee benefit expenses A/c Dr. Rs2,500

To Share-based payment reserve Rs2,500

(To recognise the receipt of employee services in exchange for shares)

Working Notes:

1. **Year 1**

   780 shares expected to vest x Rs 10 grant date fair value of each share x 1/3 of vesting period elapsed = Rs 2,600 recognised in Year 1.

2. **Year 2**

   (750 shares expected to vest x Rs 10 grant date fair value of each share x 2/3 of vesting period elapsed) less Rs 2,600 recognised in Year 1 = Rs 2,400 recognised in Year 2.

3. **Year 3**

   (750 shares x Rs 10 grant date fair value of each share) less Rs 5,000 recognised in Years 1 and 2 = Rs2,500 recognised in

   Year 3.

Question 4 (Practice Q.8)

Fashion India Ltd. (FIL) entered into an agreement with RFD Ltd. on 10th August, 2012 for purchasing a machinery. The agreement has a clause that FIL will have to settle the consideration of machinery purchased by issuing its equity shares. FIL agreed to the clause and the order was confirmed. Machinery was supplied vide invoice dated 25th October, 2012 and delivered on 1st November, 2012. Agreed purchase consideration was Rs 150 Lakhs and the fair value of the machinery supplied was estimated to be Rs 160 Lakhs. As agreed, FIL issued 1,00,000 equity shares of face value Rs 100 each to RFD Ltd.

As per Ind AS 102 'Share Based Payment', what should be the price and the date for recording the machinery purchased from RFD Ltd.?

Answer

As per para 10 of Ind AS 102, for equity settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted. Here, since the fair value of the asset received can be estimated reliably, the price for recording the machinery would be Rs 160 lakhs.

Further the control is assumed to be transferred on the date the delivery is received which is 1st November, 2012. Therefore, this will be the date for recognizing the machinery in the books.

		Dr.	Cr.
Property, plant and equipment	Dr.	Rs 160 lakhs	
To Equity share capital			Rs 100 lakhs
To Securities premium			Rs 60 lakhs

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28. ACCOUNTING AND TECHNOLOGY

NO CHANGES

29. PROFESSIONAL AND ETHICAL DUTY OF A CHARTERED ACCOUNTANT

Question 1 (TYK 2)

Astra Ltd. is a listed entity which operates in the defence and fibre optics sector. It supplies fibre optic cables and racks in the domestic country. This activity is only a trading activity for Astra Ltd. as it procures goods from pre-approved suppliers, and after inspection, sells the goods to IT companies. The sale contract requires Astra Ltd. to deliver these goods to the IT companies' locations (i.e., delivery on site). Payment terms are 30 days after the invoice date to Astra Ltd.

Ms. Suparna Dasgupta, a chartered accountant, has recently joined Astra Ltd. as the Head of the Finance Department.

The Chief Operating Officer (also the executive director) of Astra Ltd. is Ms. Padmaja Srinivasan, a mechanical engineer with an MBA from Harvard University, who rose through the ranks through her excellent skills in project management, marketing, and customer management. Her remuneration includes a bonus computed as a percentage of turnover achieved during the year, and an additional incentive for achieving an EBITDA in excess of 15% of turnover.

Astra Ltd. has sold fibre optic cables amounting to Rs 2 crores (invoice dated 31st March 2012) to Ethernet Bullet Ltd., a company providing high-speed internet connectivity services through fibre optic cables as well as dedicated leased lines. The service unit of Ethernet Bullet Ltd. is located next to the factory of Astra Ltd. Though the goods were not moved to Ethernet Bullet Ltd.'s service unit, Astra Ltd. recognized the sale for the year, based on the contention that the service unit is adjacent, and hence the transfer can happen within a few minutes.

The annual results are due for board approval, for the year ending 31 st March, and require the sign-off of Ms. Suparna Dasgupta.

Ms. Suparna Dasgupta has been given a 40% increment on joining Astra Ltd., which enables her to comfortably pay off her housing loan mortgage every month. Additionally, she is also given perquisites in the form of business class travel, an exclusive chauffeur-driven car and stock options of the company. Accordingly, she has stated that she cannot afford to lose this job as the salary and perquisites are among the best in the country.

Ms. Padmaja Srinivasan has communicated to Ms. Suparna Dasgupta that many more benefits will accrue if she agrees to present the numbers without any modifications. She has also said that the company would not hesitate to replace Ms. Suparna Dasgupta should she disagree with the contentions above.

Discuss the potential conflicts which are arising in the above scenario and the ethical principles that would guide Ms. Suparna Dasgupta in responding to the situation.

Answer

Presentation of Revenue numbers:

Ind AS 115 'Revenue from Contracts with Customers' requires revenue to be recognized only on satisfaction of the performance obligations under the contract. It is crucial that the performance obligations be identified at the commencement of the contract, so that the trigger points for revenue recognition become identifiable.

Management would always have an incentive to present higher revenue numbers. In the given case, the fact that the COO is given an incentive for revenues and EBITDA indicates that revenue is a potential area for material misstatement, given the personal interest of the COO in the same.

The sale of fibre optic cable cannot be recognized on 31 st March 2012 as the goods are not yet transferred to the customer Ethernet Bullet Ltd.'s factory premises, which is one of the critical obligations of Astra Ltd. The contention of the COO that it takes merely a few minutes to shift the goods, and hence the sale can be recognized does not hold true. One can always cross-question as to why the movement of goods did not happen, if it was merely a few minutes job. It could be a possibility that the goods may not be packed, or there may still be some pending inspection of the goods before transferring the same etc. In view of this, the performance obligation under this contract has not been completed, and hence booking the revenue has resulted in an overstatement of revenue by Rs 2 crores, and a consequent inflation of profits, assuming that Astra Ltd. is making profit on this sale transaction. Additionally, booking this sale has resulted in an understatement of inventory as at the reporting date of 31st March 2012.

In view of the above, multiple conflicts of interest arise for Ms. Suparna Dasgupta:

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(a) Pressure to present favourable revenue figures and chartered accountant's personal circumstances

The chartered accountant is under pressure to present favourable numbers, notably in favour of the COO, thereby increasing the incentives to the COO, and in turn benefiting with the continued job prospects. Thus, the ethical and professional standards required of the accountant are at odds with the pressures of her personal circumstances.

(b) Duty to stakeholders

The directors have a duty to act in the best interests of the company's stakeholders. While higher revenue numbers do indicate a good growth trajectory of the company, recognizing the revenue before fulfilling the performance obligations, or incorrectly booking grant income as revenue, results in misleading the stakeholders about the actual performance of the entity, thereby actually becoming detrimental to the stakeholders.

Ethical principles guiding the chartered accountant's response

By exhibiting bias in reporting higher revenue figures due to the risk of losing the job, objectivity stands compromised. Knowingly disclosing incorrect information compromises integrity, and erring in complying with Ind AS requirements, though continuing to report so in the financial statements, results in displaying absence of professional competence.

Appropriate action

In the given case, the chartered accountant faces an ethical dilemma, and must apply her moral and ethical judgment. As a professional, she is responsible for presenting the truth, and to avoid indulging in 'creative accounting practices' due to pressure.

The chartered accountant accordingly must put the interests of the company and professional ethics first and insist that the financial statements represent correct revenue numbers, in compliance with the relevant Ind AS. Being an advisor to the directors, she must prevent deliberate misrepresentation / fraudulent financial reporting, regardless of the personal consequences. The accountant should not allow any undue influence from the directors to override her professional judgment or integrity. This is in the long-term interests of the company.

Further, knowingly providing incorrect information is regarded as professional misconduct. To prevent such misconduct, the chartered accountant should not sign off on the financial statements containing incorrect financial information. By adhering to the ethical principles, the chartered accountant will maintain her professional integrity and contribute to the trust and reliability placed in the work expected from her.

However, if she signs the financial statements containing the inflated revenue numbers, Ms. Suparna Dasgupta would be guilty of professional misconduct under Clause I of Part II of Second Schedule to the Chartered Accountants Act, 1949. The Clause states that a member of the Institute, whether in practice or not, shall 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 Council guidelines, 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 2 (TYK 3)

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 alongwith 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.

Discuss the ethical and accounting implications of the above issue from the perspective of CFO.

Answer

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 there under 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.

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30. ANALYSIS OF FINANCIAL STATEMENTS AND SCHEDULE III

NO CHANGES

31. CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING UNDER INDIAN ACCOUNTING STANDARDS (IND AS)

Question 1 (TYK 2)

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

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

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

(i) Some equipment are procured by Defense Innovators Limited in the presence of the XYZ Private Limited's representative for technical scrutiny as well as negotiating the prices. The vendors of these equipment are paid by Defense Innovators Limited. The cost of the equipment along with the cost of installation and profit thereon is claimed and reimbursed by XYZ Private Limited to Defense Innovators Limited.

(ii) There are certain other equipment for which orders are directly placed and also paid by the XYZ Private Limited. These equipment are known as 'Buyer Furnished Equipment (BFE)' and are delivered to the company 'free of cost' for installing in the ship. The labour cost of Installation of these are already included in the price component of the contract. BFEs are returned to the buyer after completion of the ship.

The period required for construction of one ship was approximately four years.

Whether the cost of Buyer Furnished Equipment's (BFE's) supplied by XYZ Private Limited to Defense Innovators Limited for-installing the same in the ships can be considered as 'inventory' by Defense Innovators Limited and then on delivery of ship will be recognised as revenue in its books of account? Elaborate.

Answer

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

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

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

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

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

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

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

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

BENCHMARX SIMPLIFYING SUCCESS

32. FINANCIAL INSTRUMENTS [IND AS 32, 107, 109]

Question 1 (TYK 7)

On 1st April, 2011, PS Limited issued 6,000, 9% convertible debentures with a face value of Rs 100 each maturing on 31st March, 2016. The debentures are convertible into equity shares of PS Limited at a conversion price of Rs 105 per share. Interest is payable annually in cash. At the date of issue, non-convertible debt could have been issued by the company at coupon rate of 13%. On 1st April, 2014, the convertible debentures have a fair value of Rs 6,30,000. PS Limited makes a tender offer to debenture-holders to repurchase the debentures for Rs 6,30,000 which the debenture holders accepted. At the date of repurchase, PS Limited could have issued non-convertible debt with a 2 year term bearing coupon interest @ 10%.

Show accounting entries in the books of PS Limited for recording of equity and liability component::

(i) At the time of initial recognition

(ii) At the time of repurchase of the convertible debentures

Answer

(i) At the time of initial recognition

	Rs.
Liability component	
Present value of 5 yearly interest payments of Rs 54,000, discounted at 13% annuity (54,000 x 3.517)	1,89,918
Present value of Rs 6,00,000 due at the end of 5 years, discounted at 13%, compounded yearly (6,00,000 x 0.543)	3,25,800
	5,15,718
Equity component (Rs 6,00,000 – Rs 5,15,718)	84,282
Total proceeds	6,00,000

Note: Since Rs. 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs. 100 each only.

Journal Entry

	Rs.	Rs.
Bank Dr.	6,00,000	
To 9% Debentures (Liability component)		5,15,718
To 9% Debentures (Equity component)		84,282
(Being Debentures are initially recorded a fair value)		

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(ii) At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	Fair Value @ 9%	Difference
	Rs.	**Rs.**	**Rs.**
Liability component			
Present value of 2 remaining yearly interest payments of Rs. 54,000, discounted at 13% and 10%, respectively	90,072	93,690	
Present value of Rs. 6,00,000 due in 2 years, discounted at 13% and 10%, compounded yearly, respectively	4,69,800	4,95,600	
Liability component	5,59,872	5,89,290	(29,418)
Equity component	84,282*	40,710**	43,572
Total	6,44,154	6,30,000	14,154

*See Note (i)

**6,30,000 – 5,89,290 = 40,710

Journal Entries

		Rs.	Rs.
9% Debentures (Liability component)	Dr.	5,59,872	
Profit and loss A/c (Debt settlement expense)	Dr.	29,418	
To Bank A/c			5,89,290
(Being the repurchase of the liability component recognised)			
9% Debentures (Equity component)	Dr.	84,282	
To Bank A/c			40,710
To Reserves and Surplus A/c			43,572
(Being the cash paid for the equity component recognised)			

Question 2 (Practice Q.1)

On 1st April, 2001, Entity X issued a 10% convertible debenture with a face value of Rs 1,000 maturing on 31st March, 2011. The debenture is convertible into ordinary shares of Entity X at a conversion price of Rs 50 per share. Interest is payable yearly in cash. On 1st April, 2002, to induce the holder to convert the convertible debenture promptly, Entity X reduces the conversion price to Rs 40 if the debenture is converted before 1st June, 2002 (ie, within 60 days). The market price of Entity X's ordinary shares on the date the terms are amended is Rs 80 per share. How will the revised terms be accounted?

Answer

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The fair value of the incremental consideration paid by Entity X is calculated as follows:

Number of ordinary shares to be issued to debenture holders under amended terms			
Particulars			
Face value			Rs 1,000
New conversion price			Rs 40 per share
Number of ordinary shares to be issued to debenture holders under amended terms	1,000 / Rs 40		25 Shares
Number of ordinary shares to be issued to debenture holders under original terms			
Face value			Rs 1,000
Original conversion price			Rs 50 per share
Number of ordinary shares to be issued to debenture holders under original terms	1,000 / Rs 50		20 Shares
Number of additional shares to be issued to debenture holders under amended terms			5 Shares
Value of additional shares upon conversion (to be recognised as loss in P&L)			
5 shares x Rs 80 per share			Rs 400

Question 3 (Practice Q.2)

ABC Ltd. issues 4% 1,00,000 OCPS at a face value of Rs 100 per share on 1st April, 2011 and these are redeemable after 5 years, ie, on 31st March, 2016. Dividend is non-cumulative. Each preference shares entitles the holders to 10 equity shares and the preference shares are optionally convertible by the holder at any time until maturity.

How will the preference shares be classified at initial recognition assuming that a comparable instrument carries a market interest rate of 7%? Provide journal entries for year 1. Will this classification be changed subsequently in case there is likelihood that OCPS will be encashed at the end of the maturity period?

Answer

The OCPS is redeemable at the end of the 5th year. Hence, the preference share contains a liability component. Further the dividend payable on the preference shares is non-cumulative. The holder may also be able to convert the preference shares at his option any time until maturity.

Paragraph AG 37 of Ind AS 32, Financial Instruments: Presentation states that non- cumulative dividends paid at the discretion of the issuer entity is part of equity element.

Paragraph 29 of Ind AS 32, Financial Instruments: Presentation, requires separate recognition of components of a financial instrument that (a) creates a financial liability of the entity; and (b) grants an option to the holder of the instrument to convert it into fixed number of equity instruments of the entity.

From the above paragraphs it is clear that OCPS issued by ABC Ltd. has a financial liability component as well as an equity component, making it a compound financial instrument.

As per paragraph 32, in case of compound financial instruments, the issuer fi rst determines the carrying amount of the financial liability component by measuring the fair value of a similar liability that does not have an associated equity component. The carrying amount of the equity represented by (a) non-cumulative dividend feature and (b) option to convert the preference shares for fixed number of pre-determined ordinary shares is then determined by deducting the fair value of the financial liability component from the fair value of the compound financial instrument as a whole.

Measurement and recognition (Calculations have been done at full scale):

At 7% market rate of interest, the fair value of the financial liability component of the OCPS is Rs 71,29,862 [100,000 OCPS x Rs 100 x $(1/ (1+7\%))^5$]

The fair value of the equity component is (residual value) Rs 28,70,138 [Rs 1,00,00,000 - Rs 71,29,862]

Date	Particulars		Dr.	Cr.
1st April, 2011	**On Initial recognition**			
	Bank	Dr.	1,00,00,000	
	To OCPS (Financial liability)			71,29,862
	To OCPS (Equity)			28,70,138
	(Being OCPS issued and recognised)			
31st March, 2012	**Interest expense – unwinding of discount**			
	Interest expense @7% (Refer W.N.)	Dr.	4,99,090	
	To OCPS (Financial liability)			4,99,090
	(Being interest recorded as per EIR)			
	Interest entry will be passed every year till conversion option is not exercised			
	Whenever the option is exercised by the holder to convert to equity shares			
	OCPS (Financial liability)	Dr.	Balance on date of exercise of the option	
	To OCPS (Equity)			

As per paragraph 30, in case of a convertible financial instrument, the classification of the liability and equity components is not revised as a result of change in the likelihood that a conversion option will be exercised.

In other words, the amount attributable to equity component on initial recognition shall remain in equity and will not be reclassified even if the OCPS are ultimately redeemed in cash by the issuer.

Date	Particulars		Dr.	Cr.
31st March, 2016	**If redeemed in cash on maturity**			
	OCPS (financial liability) (Refer W.N.)	Dr.	1,00,00,000	
	To Bank			1,00,00,000
	(Being OCPS redeemed on maturity)			

Working Note:

Calculation of the amortised cost of the financial liability (at full scale):

Year	Opening Balance (Rs)	Interest @ 7%	Repayment	Closing Balance (Rs)
1	71,29,862	4,99,090	-	76,28,952
2	76,28,952	5,34,027		81,62,979
3	81,62,979	5,71,409		87,34,388
4	87,34,388	6,11,407		93,45,795
5	93,45,795	6,54,206	10,000,000	-

Question 4 (Practice Q.3)

State whether the following items meet the definition of Financial Asset or Financial Liability for an entity:

(i) A bank advances an entity a five-year loan. The bank also provides the entity with an overdraft facility for a number of years.

(ii) Entity A owns preference shares in Entity B. The preference shares entitle Entity A to dividends, but not to any voting rights.

(iii) An entity has a present obligation in respect of income tax due for the prior year.

(iv) In a lawsuit brought against an entity, a group of people is seeking compensation for damage to their health as a result of land contamination believed to be caused by waste from the entity's production process. It is unclear whether the entity is the source of the contamination since many entities operate in the same area and produce similar waste.

Answer

(i) The entity has two financial liabilities namely (a) the obligation to repay the five- year loan and (b) the obligation to repay the bank overdraft to the extent that it has borrowed using the overdraft facility. Both the loan and the overdraft result in contractual obligations for the entity to pay cash to the bank for the interest incurred and for the return of the principal.

(ii) For Entity B: The preference shares may be equity instruments or financial liabilities of Entity B, depending on their terms and conditions.

(iii) For Entity A: Irrespective of Entity B's treatment, the preference shares are a financial asset because the investment satisfies the definition of a financial asset.

(iv) An income tax liability is created as a result of statutory requirements imposed by the government. The rights and obligations are not created by a contract. Hence, the liability for income-tax dues is not a financial liability.

(v) The fact that a lawsuit may result in the payment of cash does not create a financial liability for the entity because there is no contract between the entity and the affected group. The entity will need to consider providing for the payment as per Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets'

Question 5 (Practice Q.4)

In an arm's length transaction, Entity X buys 10,000 convertible preference shares in Company Z for cash payments of Rs 40,000, with Rs 25,000 payable immediately and Rs 15,000 payable in two years. The market rate of annual interest for a two-year loan to the entity would be 6%.

Explain the accounting treatment for the said transaction.

Answer

Since payment of Rs 15,000 is deferred for two years, the fair value of the consideration given for the shares is equal to Rs 25,000 plus the present value of Rs 15,000. The present value of Rs 15,000 deferred payment is Rs 13,350 (Rs 15,000 ÷ 1.06^2).

Entity X will initially measure the shares purchased at Rs 38,350 (i.e., Rs 25,000 + Rs 13,350).

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Since this transaction took place at an arm's length, this is considered to be fair value for initial recognition in the absence of evidence to the contrary.

The difference between the Rs 40,000 cash paid out and the Rs 38,350, i.e. Rs 1,650, will be recognised as interest expense in profit or loss over the two year period of deferred payment.

Question 6 (Practice Q.5)

SEL has applied for a term loan from a bank for business purposes. As per the loan agreement, the loan required a personal guarantee of one of the directors of SEL to be executed. In case of default by SEL, the director will be required to compensate for the loss that bank incurs. Mr. Pure Joy, one of the directors had given guarantee to the bank pursuant to which the loan was sanctioned to SEL. SEL does not pay premium or fees to its director for providing this financial guarantee.

Whether SEL is required to account for the financial guarantee received from its director? Will there be any disclosures under Ind AS 24?

Answer

Ind AS 109 'Financial Instruments', defines a financial guarantee contract as 'a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Based on this definition, an evaluation is required to be done to ascertain whether the contract between director and Bank qualifies as a financial guarantee contract as defined in Appendix A to Ind AS 109. In the given case, it does qualify as a financial guarantee contract as:

- the reference obligation is a debt instrument (term loan);
- the holder i.e. Bank is compensated only for a loss that it incurs (arising on account of non-repayment); and
- the holder is not compensated for more than the actual loss incurred

Ind AS 109 provides principles for accounting by the issuer of the guarantee. However, it does not specifically address the accounting for financial guarantees by the beneficiary. In an arm's length transaction between unrelated parties, the beneficiary of the financial guarantee would recognise the guarantee fee or premium paid as an expense.

It is also pertinent to note that the entity needs to exercise judgment in assessing the substance of the transaction taking into consideration relevant facts and circumstances, for example, whether the director is being compensated otherwise for providing guarantee. Based on such an assessment, an appropriate accounting treatment based on the principles of Ind AS should be followed.

In the given case, SEL is the beneficiary of the financial guarantee and it does not pay a premium or fees to its director for providing this financial guarantee. Accordingly, SEL will not be required to account for such financial guarantee in its financial statements considering the unit of account as being the guaranteed loan, in which case the fair value would be expected to be the face value of the loan proceeds that SEL received.

In the given case based on the limited facts provided, SEL will be required to make necessary disclosures of such financial guarantee in accordance with Ind AS 24 as follows:

(a) the amount of the transactions;

(b) the amount of outstanding balances, including commitments, and:

   (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

   (ii) details of any guarantees given or received;

(c) provisions for doubtful debts related to the amount of outstanding balances; and

(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

Question 7 (Practice Q.6)

On 1st April, 2011, a bank provides an entity with a four-year loan of Rs 5,000 on normal market terms, including charging interest at a fixed rate of 8% per year. Interest is payable at the end of each year. The figure of 8% is the market rate for similar four-year fixed-interest loans with interest paid annually in arrears. Transaction cost of Rs 100 is incurred on originating the loan. Effective interest rate in this case is 8.612%.

In 2011-2012, the entity experienced financial difficulties. On 31st March, 2012, the bank agreed to modify the terms of the loan. Under the new terms, the interest payments in 2012-2013 to 2014-2015 will be reduced from 8% to 5%. The entity paid the bank a fee of Rs 50 for paperwork relating to the modification.

Analyse whether the modification of the loan terms constitutes an extinguishment of the original financial liability or not.

Answer

Since the interest was initially set at the market rate, on 1st April, 2011 the entity on initial recognition will measure the loan at the transaction price, less transaction costs i.e. at Rs4,900.

The following is the original amortised cost calculation at 1st April, 2011:

Time	Carrying amount at 1st April	Effective Interest @ 8.612%	Cash outflow	Carrying amount at 31st March
	(a)	(b=ax8.612%)	(c=5000x8%)	(d = a + b - c)
2011-2012	4,900.00	421.99	(400.00)	4,921.99
2012-2013	4,921.99	423.88	(400.00)	4,945.87
2013-2014	4,945.87	425.94	(400.00)	4,971.81
2014-2015	4,971.81	428.19	(5,400.00)	—

At 31st March, 2012:

1. The present value of the remaining cash flows of the original financial liability is Rs4,921.99 discounted at the original effective interest rate of 8.612%.
2. The present value of the cash flows under the new terms discounted using the original effective interest rate is Rs 4,537.25 (Refer W.N.). Including the Rs 50 fee, the present value of the total cash flows is Rs4,587.25.
3. The difference between Rs 4,921.99 and Rs 4,587.25 is Rs 334.74 which is only 6.8% (Rs 334.74 ÷ Rs 4,921.99) of the present value of the remaining cash flows of the original financial liability.

The entity applies its judgement to decide whether the terms of the instruments exchanged are substantially different. Since the difference of the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is less than 10% of the present value of the remaining cash flows of the original financial liability, this modification should not be considered a substantial modification of the terms of the existing loan. Therefore, the modification would not be accounted for as an extinguishment of the original financial liability.

Working Note:

The calculation of the present value of the cash flows under the new terms discounted using the original effective interest rate is as follows:

Time	Cash outflow	Discounting factor @ 8.612%	Present value at 31st March
31st March, 2013	250.00	0.921	230.25
31st March, 2014	250.00	0.848	212.00
31st March, 2015	5,250.00	0.780	4,095.00
Total present value			4,537.25

33. IND AS 103 : BUSINESS COMBINATIONS

Bhavik Chokshi

Question 1 (Practice Q.5)

Bima Ltd. acquired 65% of shares on 1 June, 2011 in Nafa Ltd. which is engaged in production of components of machinery. Nafa Ltd. has 1,00,000 equity shares of Rs 10 each. The quoted market price of shares of Nafa Ltd. was Rs 12 on the date of acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 2011 was Rs 80,00,000.

Bima Ltd. wired Rs 50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of shares of Bima Ltd. on the date of issue was Rs 25 per share.

Bima Ltd. also agrees to pay additional consideration of Rs 15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds Rs 1 crore over the next three years. On the date of acquisition, Nafa Ltd. assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is Rs 9,80,000. Nafa Ltd. incurred Rs 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

How will the acquisition of Nafa Ltd. be accounted by Bima Ltd., under Ind AS 103? Prepare detailed workings and pass the necessary journal entry.

Answer

Computation of Goodwill / Capital reserve on consolidation as per Ind AS 103

Particulars	Rs
Cost of investment:	
Share exchange (50,000 x 25)	12,50,000
Cash consideration	50,00,000
Contingent consideration	9,80,000
Consideration transferred at date of acquisition [A]	72,30,000
Fair value of non-controlling interest at date of acquisition [B] (1,00,000 x 35% x 12)	4,20,000
Total [C] = [A] + [B]	76,50,000
Net assets acquired at date of acquisition [D]	(80,00,000)
Capital Reserve [D] – [C]	3,50,000

In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. Therefore, Rs 1,50,000 incurred by Nafa Ltd. in relation to acquisition, will be ignored by Bima Ltd.

Journal entry at the date of acquisition by Bima Limited as per Ind AS 103:

	Rs	Rs
Identifiable net assets Dr.	80,00,000	
To Equity share capital (50,000 x 10)		5,00,000
To Securities Premium (50,000 x 15)		7,50,000
To Cash		50,00,000
To Provision for contingent consideration to Nafa Ltd.		9,80,000

To Non-controlling Interest		4,20,000
To Capital Reserve		3,50,000

Question 2 (Practice Q.6)

Entity A acquires entity B. Entity A agrees with the former shareholders of entity B to pay Rs 900, with an additional payment of Rs 500 if the subsequent earnings of entity B reach a specified target in three years. The former shareholders also become employees. On the acquisition date, the fair value of the net assets of entity B amount to Rs 850, and the fair value of additional payment is estimated at Rs 200. At the acquisition date, the outflow of additional payment is not probable.

Over the next three years, the cumulative earnings of entity B (before considering the effects of the additional payments) amount to Rs 1,050. At the end of year three, entity A pays Rs 500 as the conditions were met.

State the impact on the financial position and results of classifying the payments as remuneration and contingent consideration.

Answer

The impact on the financial position and results of classifying the payments as remuneration and contingent consideration is tabulated as follows:

	Additional Payment is classified as	
	Remuneration	**Contingent consideration**
Consideration	900	900
Fair value of additional payment	0	200
Total consideration	**900**	**1,100**
Fair value of net assets	(850)	(850)
Goodwill at acquisition date	**50**	**250**
Subsequent changes in additional payment	0	0
Total Goodwill	**50**	**250**
Cumulative earnings (before considering additional payment)	1,050	1,050
Impact of additional payment	(500)	(300)
Reported results across three years	**550**	**750**

Question 3 (Practice Q.7)

In October 2011, IHL acquired 75% of Very Relevant Limited by paying cash consideration of Rs 0.80 million. The fair value of non-controlling interest on the date of acquisition is Rs 0.20 million. The value of Very Relevant Limited's identifiable net assets as per Ind AS 103 is Rs 1.10 million.

With respect to acquisition of Very Relevant Limited, determine the value of gain on bargain purchases, when NCI is measured as per:

(a) Fair value method

(b) Proportionate share of net identifiable assets method.

Answer

(a) When NCI is measured as per fair value method

	Rs **in million**

Fair value of consideration transferred	0.80
Fair value of non-controlling interest	0.20
	1.00
Value of Very Relevant Limited's identifiable net assets as per Ind AS 103	(1.10)
Gain on bargain purchase	0.10

(b) When NCI is measured as per proportionate share method

	Rs **in million**
Fair value of consideration transferred	0.80
Proportional share of non-controlling interest in the net identifiable assets of acquiree (1.10 x 25%)	0.275
	1.075
Value of Very Relevant Limited's identifiable net assets as per Ind AS 103	(1.10)
Gain on bargain purchase	0.025

Question 4 (Practice Q.8)

An entity acquired two trade secrets (secret recipes) in a business combination. Recipe A is patented. Recipe B is not legally protected.

How the acquisition of Recipe A and Recipe B would be accounted for by the entity as per relevant Ind AS.

Answer

Para 11 and 12 of Ind AS 38 states that the definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognised in a business combination is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements.

Further, an asset is identifiable if it either:

(a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

In the given case, Recipe A meets the contractual-legal criterion for identification as an intangible asset because it is protected by a patent. This recipe is identified an recognised separately from goodwill while accounting the business combination.

Since Recipe B is not protected by a patent, it does not meet the contractual-legal criterion for identification as an intangible asset. However, Recipe B is identified as a separate intangible asset because it meets the separability criterion. Such recipes can be, and often are, exchanged, licensed or leased to others. Therefore, the unpatented Recipe B should be accounted for as a separate intangible asset acquired in the business combination.

Question 5 (Practice Q.9)

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Mini Limited is a manufacturing entity in textile industry. Mini Limited decided to reduce the cost of manufacturing by setting up its own power plant for their captive consumption. As per market research report, there was non-operational power plant in nearby area. Hence, it decided to acquire that power plant which was having capacity of 80MW along with all entire labour force. This Power entity was owned by another entity Max Limited. Mini Limited approached Max Limited for acquisition of 80MW power plant at following terms:

(i) Mini Limited will seek an independent valuation for determining fair value of 80MW power plant.

(ii) Value of other Non-current assets acquired, and Non–current financial liabilities assumed is Rs 11.10 million and Rs 32 million respectively.

(iii) Consideration agreed between both the parties is at Rs 51 million.

Both the parties agreed to the terms and entered into agreement on 1st April, 2011 with immediate effect.

Due to unavoidable circumstances, valuation could not be completed by the time Max Limited finalizes its financial statements for the year ending 31st March, 2011. Max Limited's annual financial statements records the fair value of 80 MW Power Plant at Rs 46.90 million with remaining useful life at 40 years.

Max Limited also has license to operate that power plant unrecorded in books. As on 31st March, 2011, it has fair value of Rs 5 million.

Six months after acquisition date, Mini Limited received the independent valuation, which estimated the fair value of 80MW Power Plant as Rs 54.90 million.

CFO of Mini Limited, wants you to work upon following aspects of the transaction:

(a) Determine whether transaction should be accounted as asset acquisition or business combination.

(b) Calculate Goodwill / Bargain Purchase due to the above acquisition.

(c) Pass necessary journal entities in the books of Mini Limited as per Ind AS 103 and prepare balance sheet as on date of acquisition.

(d) Determine whether any adjustment is required in case of valuation received subsequent to acquisition. If yes, pass the necessary entries in the books of Mini Limited.

Balance Sheet of Mini Limited as at 31st March, 2011

Particulars	**(Rs in Million)**
ASSETS	
Non-current assets	
Property, plant and equipment	2,158
Capital work-in-progress	12
Deferred Tax Assets (Net)	324
Other non-current assets	25
Total non-current assets	**2,519**
Current assets	
Inventories	368
Financial assets	
(i) Investments	45

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(ii) Trade Receivables	762
(iii) Cash and Cash Equivalents	110
(iv) Bank balances other than (iii) above	28
(v) Other financial assets	267
Total current assets	**1,580**
Total assets	**4,099**
EQUITY AND LIABILITIES	
Equity	
Equity Share Capital	295
Other equity	
Equity component of compound financial instruments	717
Reserves and surplus	2,481
Total equity	**3,493**
Liabilities	
Non-current liabilities	
Financial Liabilities	
Borrowings	268
Total non-current liabilities	**268**
Current liabilities	
Financial Liabilities	
(i) Trade payables	302
Other current liabilities	36
Total current liabilities	**338**
Total liabilities	**606**
Total equity and liabilities	**4,099**

Answer

(a) Ind AS 103 defines business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods and services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

In the given scenario, acquisition of power plant along with its labour force will be considered as integrated set of activity as it is capable of being generating power. Hence, transaction will be considered as business combination and not asset acquisition

and acquisition method of accounting will be applied.

Thus, following will be the case:

(i) Acquirer – Mini Ltd;

(ii) Acquiree – Max Ltd;

(iii) Acquisition date – 1st April, 2011

(b) Calculation of Goodwill:

Particulars		Rs in Million
Purchase consideration	(A)	51
Fair Value of Power Plant – PPE		46.90
Fair Value of other non-current assets		11.10
Fair Value of Intangible Asset (License) – Refer Note 1 below		5
Non-Current Liabilities assumed		(32)
Value of net assets acquired	(B)	31
Goodwill		20

Note 1: The licence to operate power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill though acquirer cannot sell or transfer it separately from the acquired power plant. Intangible Assets needs to be recorded by the acquirer at the time of accounting for acquisition though not recorded by the acquiree in its book.

(c) Journal Entries for acquiring power plant

Particulars		Rs in Million	
Fair Value of Power Plant	Dr.	46.90	
Fair Value of other assets	Dr.	11.10	
Fair Value of License acquired	Dr.	5	
Goodwill	Dr.	20	
To Liabilities assumed			32
To Bank (PC paid)			51

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Balance Sheet of Mini Limited as at 1st April, 2011

Particulars	Notes to Accounts	Rs in Million
ASSETS		
Non-current assets		
Property, plant and equipment	1	2,204.90
Intangible Asset (License acquired in business combination)		5.00
Capital work-in-progress		12.00
Goodwill on acquisition		20.00
Deferred Tax Assets (Net)		324.00
Other non-current assets	2	36.10
Total non-current assets		**2,602.00**
Current assets		
Inventories		368.00
Financial assets		
(i) Investments		45.00
(ii) Trade Receivables		762.00
(iii) Cash and Cash Equivalents	3	59.00
(iv) Bank balances other than (iii) above		28.00
(v) Other financial assets		267.00
Total current assets		**1,529.00**
Total assets		**4,131.00**
EQUITY AND LIABILITIES		
Equity		
Equity Share Capital		295.00
Other equity		
Equity component of compound financial instruments		717.00

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Reserves and surplus		2,481.00
Total equity		**3,493.00**
Liabilities		
Non-current liabilities		
Financial Liabilities		
Borrowings	4	300.00
Total non-current liabilities		**300.00**
Current liabilities		
Financial Liabilities		
(i) Trade payables		302.00
Other current liabilities		36.00
Total current liabilities		**338.00**
Total liabilities		**638.00**
Total equity and liabilities		**4,131.00**

Notes to Accounts

1. Property, Plant and Equipment

Particulars	**Rs in Million**
PPE value as on 1st April, 2011	2,158.00
Add: Fair Value of Power Plant acquired	46.90
Total	2,204.90

2. Other Non-current Assets

Particulars	**Rs in Million**
Other non-current assets value as on 1st April, 2011	25.00
Add: Fair Value of Non-current assets acquired	11.10
Total	36.10

3. Cash and Cash equivalents

Particulars	**Rs in Million**
Cash and Cash equivalents as on 1st April, 2011	110

Less: Payment of Purchase consideration transferred	(51)
Total	59

4. Non-current Liabilities

Particulars	**Rs in Million**
Non-current Liabilities value as on 1st April, 2011	268
Add: Non-current liabilities assumed in acquisition	32
Total	300

(d) Subsequent Accounting: Ind AS 103 provides a measurement period window, wherein if all the required information is not available on the acquisition date, then entity can do price allocation on provisional basis. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as on the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. Any change i.e. increase or decrease in the net assets acquired due to new information available during the measurement period which existed on the acquisition date will be adjusted against goodwill.

Accordingly, in the financial statements for half year ending 30th September, 2011, Mini Limited will retrospectively adjusts the prior year information as follows:

(i) the carrying amount of PPE (including power plant) as of 1st April, 2011 is increased by Rs 8 million (i.e. Rs 54.90 million minus Rs 46.90 million). The adjustment is measured as the fair value adjustment at the acquisition date less the additional depreciation that would have been recognised if the asset's fair value at the acquisition date had been recognised from that date [(80,00,000/40) x (6/12) = 0.1 million]

(ii) the carrying amount of goodwill as of 1st April, 2011 is decreased by Rs 8 million; and

(iii) depreciation expense for the period ending 30th September, 2011 will increase by Rs 0.1 million

(iv) disclose in its financial statements of 1st April, 2011, that the initial accounting for the business combination has not been completed because the valuation of property, plant and equipment has not yet been received;

(v) disclose in its financial statements of 30th September, 2011, the amounts and explanation of the adjustments to the provisional values recognised during the current reporting period. Therefore, Mini Limited discloses that comparative information is adjusted retrospectively to increase the fair value of the item of property, plant and equipment at the acquisition date by Rs 8 million, offset by decrease in goodwill of Rs 8 million.

Journal Entries

	Particulars		Dr.	Cr.
(1)	PPE (Power Plant)	Dr.	Rs 8 Million	
	To Goodwill			Rs 8 Million
(2)	Depreciation	Dr.	Rs 0.1 Million	
	To Provision for Depreciation			Rs 0.1 Million

Question 6 (Practice Q.10)

On 1st April 2011, Pride Limited acquired 30% of the ordinary shares of Famous Limited for Rs 4,000 crores. Pride Limited accounts for its investment in Famous Limited using the equity method as prescribed under Ind AS 28. On 31st March 2012, Pride Limited recognized its share of the net asset changes of Famous Limited using equity method accounting as follows:

Share of profit	Rs 350 crore
Share of exchange difference in OCI	Rs 50 crore

Share of revaluation reserve of PPE in OCI	Rs 25 crore

The carrying amount of the investment in the associate on 31st March 2012 is therefore Rs 4,425 crore (4,000 + 350 + 50 + 25).
On 1st April 2012, Pride Limited acquired the remaining 70% of Famous Limited for cash Rs 12,500 crore.
The following additional information is relevant at that date:

Fair Value of 30% interest in Famous Limited as on 1st April 2012	Rs 4,500 crore
Fair Value of Net Identifiable Assets of Famous Limited as on 1st April 2012	Rs 15,000 crore

You are required to

(i) Determine the acquisition date for Pride Ltd.

(ii) Determine the gain on previously held interest in Pride Ltd. and suggest the accounting treatment on acquisition date as per Ind AS 103.

(iii) Compute the amount of goodwill arising on the acquisition of Famous Ltd.

(iv) Pass necessary journal entry on the acquisition date.

Answer

(i) Acquisition date for accounting of business combination is

The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree. In the given case, the acquisition date is 1st April, 2012 i.e. when Pride Ltd. acquired 100% holding of Famous Ltd.

(ii) Computation of gain on previously held interest

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. If the investment in an associate becomes a investment in a subsidiary, the entity shall account for its investment in accordance with Ind AS 103 and Ind AS 110.

Ind AS 103 provides that in a business combination achieved in stages, the acquirer is required to remeasure the previously held equity interest at its acquisition date fair value and recognise any gain or loss in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in the other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

The gain on previously held equity interest in Famous Ltd. is calculated as follows:

Fair value of 30% interest as on 1st April, 2012	Rs 4,500 crore
Carrying value of 30% investment as on 31st March, 2012	(Rs 4,425 crore)
Gain on previously held interest	Rs 75 crore
Unrealised gain previously recognised in OCI	Rs 50 crore
Total gain recognised in Profit and loss	Rs 125 crore

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(iii) Computation of goodwill

For 70% share	Rs 12,500 crore
For 30% share	Rs 4,500 crore
Total amount of purchase consideration	Rs 17,000 crore
Less: Fair value of net identifiable assets	(Rs 15,000 crore)
Goodwill	Rs 2,000 crore

(iv) Journal Entry on 1st April, 2012

		Rs in crore	
Net Identifiable Assets	Dr.	15,000	
Goodwill (W.N.1)	Dr.	2,000	
Foreign currency translation reserve	Dr.	50	
PPE revaluation reserve	Dr.	25	
To Cash			12,500
To Investment in Associate – Famous Ltd.			4,425
To Retained Earnings (W.N.)			25
To Gain on previously held interest recognised profit and loss (Refer point (ii) above)			125

Working Note:

The credit to retained earnings represents the reversal of the unrealised gain of Rs 25 crore in OCI related to the revaluation of PPE. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

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34. IND AS 110 : CONSOLIDATION - SUBSIDIARY

Question 1 (Practice Q.6)

A company, AB Ltd. holds investments in subsidiaries and associates. In its separate financial statements, AB Ltd. wants to elect to account its investments in subsidiaries at cost and the investments in associates as financial assets at fair value through profit or loss (FVTPL) in accordance with Ind AS 109, Financial Instruments.

Whether AB Limited can carry investments in subsidiaries at cost and investments in associates in accordance with Ind AS 109 in its separate financial statements?

Answer

Paragraph 10 of Ind AS 27, Separate Financial Statements inter-alia provides that, when an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109, Financial Instruments in its separate financial statements. Further, the entity shall apply the same accounting for each category of investments.

It may be noted that although the 'category' is used in number of Standards, it is not defined in any of the Ind AS. It seems that subsidiaries, associates and joint ventures would qualify as separate categories. Thus, the same accounting policies are applied for each category of investments - i.e. each of subsidiaries, associates and joint ventures. However, paragraph 10 of Ind AS 27 should not be read to mean that, in all circumstances, all investments in associates are one 'category' of investment and all investments in joint ventures or an associate are one 'category' of investment. These categories can be further divided into sub-categories provided the sub-category can be defined clearly and objectively and results in information that is relevant and reliable. For example, an investment entity parent can have investment entity subsidiary (at fair value through profit or loss) and non-investment entity subsidiary (whose main purpose is to provide services that relate to the investment entity's investment activities) as separate categories in its separate financial statements.

In the present case, investment in subsidiaries and associates are considered to be different categories of investments. Further, Ind AS 27 requires to account for the investment in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109 for each category of Investment. Thus, AB Limited can carry its investments in subsidiaries at cost and its investments in associates as financial assets in accordance with Ind AS 109 in its separate financial statements.

Question 2 (Practice Q.7)

PP Ltd., a non-investment entity, is the parent of Praja Ltd. within the meaning of Ind AS 110 'Consolidated Financial Statements'. The investment in Praja Ltd. was carried in the separate financial statements of PP Ltd. at fair value with changes in fair value recognised in the other comprehensive income. On 1st April, 2012, PP Ltd. qualifies as one that is an investment entity. Carrying amount of the investment on 1st April, 2012 was Rs 8,00,000. The fair value of its investment in Praja Ltd was Rs 10,00,000 on that date. PP Ltd had recognised in OCI an amount of Rs 1,00,000 as a previous fair value increase related to the investment in Praja Ltd.

How would PP Ltd account for the investment in Praja Ltd on the date of change of its classification/status as an investment entity, in its separate financial statements?

Answer

(i) As per paragraph 11B(b) of Ind AS 27, on the date of change, ie, 1st April, 2012, PP Ltd (the parent) becoming an investment entity, its investment in Praja Ltd (the subsidiary) shall be at fair value through profit and loss in accordance with Ind AS 109. Accordingly, the new carrying amount will be Rs 10,00,000.

(ii) The difference between the new carrying amount and the carrying amount of the investment on the date of change will be recognised in the profit and loss. Hence, PP Ltd will recognise an amount of Rs 2,00,000 (Rs 10,00,000 – Rs 8,00,000) in profit and loss as gain.

(iii) Any fair value adjustments previously recognised in OCI in respect of subsidiary ie Praja Ltd. shall be treated as if the investment entity had disposed off the subsidiary at the date of change in status as per para 11B(b) of Ind AS 27.

Further, as per para B5.7.1 of Ind AS 109, amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss within equity.

Therefore, the company shall not reclassify the fair value gains or losses to profit or loss on change in classification from FVTOCI to FVTPL. However, the company may transfer the fair value gains or losses from one component to the other within equity.

Moreover, Paragraph 11A(e) of Ind AS 107, requires disclosure of any transfers of the cumulative gain or loss within equity during the period and the reason for such transfers. Accordingly, PP Ltd. shall provide the disclosures if it transfers the cumulative gain or loss from one component to the other within equity.

Particulars	Rs
Carrying amount of investment in Praja Ltd [as per (i) above]	10,00,000
Amounts recognised in profit and loss relating to investment in Praja Ltd [as per (ii) above]	2,00,000

Question 3 (Practice Q.8)

Solar Limited has an 80% interest in its subsidiary, Mars Limited. Solar Limited holds a direct interest of 25% in Venus Limited. Mars Limited also holds a 30% interest in Venus Limited. The decisions concerning relevant activities of Venus Limited require a simple majority of votes. How should Solar Limited account for its investment in Venus Limited in its consolidated financial statements?

Answer

In the present case, Solar Limited controls Mars Limited (since it holds 80% of its voting rights). Consequently, it also controls the voting rights associated with 30% equity interest held by Mars Limited in Venus Limited. Solar Limited also has 25% direct equity interest and related voting power in Venus Limited. Thus, Solar Limited controls 55% (30% + 25%) voting power of Venus Limited. As the decisions concerning relevant activities of Venus Limited require a simple majority of votes. Solar Limited controls Venus Limited and should therefore consolidate it in accordance with Ind AS 110.

Although, Solar Limited controls Venus Limited, its entitlement to the subsidiary's economic benefits is determined on the basis of its actual ownership interest. For the purposes of the consolidated financial statements, Solar Limited's share in Venus Limited is determined as 49% [25% + (80% × 30%)]. As a result, 51% of profit or loss, other comprehensive income and net assets of Venus Limited shall be attributed to the non-controlling interests in the consolidated financial statements (this comprises 6% attributable to holders of non-controlling interests in Mars Limited [reflecting 20% interest of non-controlling shareholders of Mars Limited in 30% of Venus Limited] and 45% to holders of non-controlling interests in Venus Limited).

Question 4 (Practice Q.9)

Identify the type of joint arrangements in each of the following scenarios:

(i) X Ltd and Y Ltd, manufacturing similar type of mobile phones, form a joint arrangement to manufacture and sell mobile phones. Under the terms of the arrangement, both X Ltd and Y Ltd are to use their own assets to manufacture the mobile phones and both are responsible for liabilities related to their respective manufacture. The arrangement also lays down the distribution revenues from the sale of the mobile phones and expenses incurred thereof. X Ltd however has exclusive control over the marketing and distribution functions and does not require the consent of Y Ltd in this aspect. No separate entity is created for the arrangement.

(ii) Continuing with (i) above, what would be the classification of the joint arrangement if X Ltd and Y Ltd both jointly control all the relevant activities of the Joint arrangement including the marketing and the distribution functions?

(iii) What would be the classification of the joint arrangement if under the terms of the arrangement, a separate entity is created to manufacture the mobile phones.

(iv) Continuing with (iii) above, the joint arrangement is a means of manufacturing mobile phones on a common platform but the output of the joint arrangement is purchased by both X Ltd and Y Ltd in the ratio of 50:50 . The joint arrangement cannot sell output to third parties. The price of the output sold to X Ltd and Y Ltd is set by both the parties to the arrangement to cover the production costs and other administrative costs of the joint arrangement entity.

(v) Would your answer in (iv) above be different if X Ltd and Y Ltd sold their respective share of output to third parties?

(vi) Assume that in (iv) above, the contractual terms of the arrangement were modified so that the joint arrangement entity is not obliged to sell the output to X Ltd and Y Ltd but was able to sell the output to third parties.

Answer

For a joint arrangement to be either a joint operation or joint venture, it depends on whether the parties to the joint arrangement have rights to the assets and obligations for liabilities (will be a joint operation) OR whether the parties to the joint arrangement have rights to the net assets of the arrangement (will be joint venture).

(i) In order to fit into the definition of a joint arrangement, the parties to the joint arrangement should have joint control over the arrangement. In the given case, decisions relating to relevant activities, ie, marketing and distribution, are solely controlled by X Ltd and such decisions do not require the consent of Y Ltd. Hence, the joint control test is not satisfied in this arrangement and the arrangement does not fit into the definition of a joint arrangement in accordance with the Standard.

(ii) Where X Ltd and Y Ltd both jointly control all the relevant activities of the arrangement and since no separate entity is formed for the arrangement, the joint arrangement is in the nature of a joint operation.

(iii) Where under a joint arrangement, a separate vehicle is formed to give effect to the joint arrangement, then the joint arrangement can either be a joint operation or a joint venture.

Hence in the given case, if:

(a) The contractual terms of the joint arrangement, give both X Ltd and Y Ltd rights to the assets and obligations for the liabilities relating to the arrangement, and the rights to the corresponding revenues and obligations for the corresponding expenses, then the joint arrangement will be in the nature of a joint operation.

(b) The contractual terms of the joint arrangement, give both X Ltd and Y Ltd. rights to the net assets of the arrangement, then the joint arrangement will be in the nature of a joint venture.

(iv) Where the rights to assets and liabilities to obligations are not clear from the contractual arrangement, then other facts and circumstances also need to be considered to determine whether the joint arrangement is a joint operation or a joint venture.

When the provision of the activities of the joint venture is primarily to produce output and the output is available / distributed only to the parties to the joint arrangement in some pre-determined ratio, then this indicates that the parties have substantially all the economic benefits of the assets of the arrangement. The only source of cash flows to the joint arrangement is receipts from parties through their purchases of the output and the parties also have a liability to fund the settlement of liabili ties of the separate entity. Such an arrangement indicates that the joint arrangement is in the nature of a joint operation.

In the given case, the output of the joint arrangement is exclusively used by X Ltd. and Y Ltd. and the joint arrangement is not allowed to sell the output to outside parties. Hence, the joint arrangement between X Ltd. and Y Ltd. is in the nature of a joint operation.

(v) It makes no difference whether the output of the joint arrangement is exclusively for use by the parties to the joint arrangement or the parties to the arrangement sold their share of the output to third parties.

Hence, even if X Ltd. and Y Ltd. sold their respective share of output to third parties, the fact still remains that the joint arrangement cannot sell output directly to third parties. Hence, the joint arrangement will still be deemed to be in the nature of a joint operation.

(vi) Where the terms of the contractual arrangement enable the separate entity to sell the output to third parties, this would result in the separate entity assuming demand, inventory and credit risks. Such facts and circumstances would indicate that the arrangement is a joint venture.

Question 5 (Practice Q.10)

'High Speed Limited' manufactures and sells cars. The Company wants to foray into the two-wheeler business and therefore it acquires 30% interest in Quick Bikes Limited for Rs 5,00,000 as at 1st November, 2011 and an additional 25% stake as at 1st January, 2012 forRs 5,00,000 at its fair value.

Following is the Balance Sheet of Quick Bikes Limited as at 1st January, 2012:

Liabilities	Carrying value	Fair value		Assets	Carrying value	Fair value
Share capital	1,00,000			Plant and equipment	3,50,000	7,50,000

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Reserves	5,50,000			Investment in bonds	4,00,000	5,00,000
Trade payables	1,50,000	1,50,000		Trade Receivables	50,000	50,000
Total	8,00,000			Total	8,00,000	

Quick Bikes Limited sells the motorcycles under the brand name 'Super Start' which has a fair value of Rs 3,50,000 as at 1st January, 2012. This is a self- generated brand therefore Quick Bikes Limited has not recognized the brand in its books of accounts. Following is the separate balance sheet of High Speed Limited as at 1st January, 2012:

Liabilities	**Amount**	**Assets**	**Amount**
Share capital	5,00,000	Plant and equipment	13,50,000
Reserves	15,00,000	Investment in Quick Bike	10,00,000
Short term loans	4,00,000	Trade Receivables	80,000
Trade payables	3,00,000	Cash and bank balances	5,20,000
Other liabilities	2,50,000		________
Total	29,50,000	Total	29,50,000

In relation to the acquisition of Quick Bikes Limited, you are required to:

(i) Pass the necessary journal entries to give effect of business combination in accordance with Ind AS 103 as at acquisition date 1 st January, 2012. NCI is measured by the entity at fair value. Provide working notes, Ignore deferred tax implication; and

(ii) Prepare a consolidated balance sheet of High Speed Limited as at 1st January, 2012.

Answer

(i) **Journal Entry**

		Rs	Rs
Plant and Equipment	Dr.	7,50,000	
Investment in bonds	Dr.	5,00,000	
Trade Receivables	Dr.	50,000	
Brand	Dr.	3,50,000	
Goodwill (balancing figure)	Dr.	5,00,000	
To Investment in Quick Bikes			10,00,000
To Profit or loss A/c (W.N.1)			1,00,000
To Trade Payables			1,50,000
To NCI (W.N.3)			9,00,000

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(Being assets and liabilities acquired at fair value and previous investment considered at fair value on the acquisition date)		

Working Notes:

1. Calculation of fair value of shares on the acquisition date 1st January, 2012

25% Shares purchase on 1st January, 2012 (fair value)	Rs 5,00,000
30% Shares purchase on 1st November, 2011 at Rs 5,00,000	
Fair value = [(5,00,000 / 25%) x 30%]	Rs 6,00,000
Total consideration at fair value on acquisition date	Rs 11,00,000
Less: Cost of investment (5,00,000 + 5,00,000)	(Rs 10,00,000)
Gain recognised to Profit or Loss/OCI (as appropriate)	Rs 1,00,000

2. Computation of Net Identifiable Assets at fair value

	Rs
Plant and Equipment	7,50,000
Investment in bonds	5,00,000
Trade Receivables	50,000
Self-generated Brand	3,50,000
	16,50,000
Less: Trade Payables	(1,50,000)
Net Identifiable Assets at fair value	15,00,000

3. Measurement of Non-controlling Interest (on fair value basis)

Share of NCI (100- 30-25)	45%
Taking fair value of shares on 1st January, 2012 as a base [(11,00,000/ 55%) x 45%]	Rs9,00,000

(ii) Consolidated Balance Sheet of High Speed Limited as at 1 st January, 2012

	Note No.	Rs
Assets		
Non-current assets		
(a) Property, plant and equipment	1	21,00,000

(b) Intangible asset	2	8,50,000
(c) Investment in bonds		5,00,000
Current Assets		
(a) Financial assets		
(i) Trade receivables	3	1,30,000
(ii) Cash and cash equivalents	4	5,20,000
		41,00,000
Equity and Liabilities		
Equity		
(a) Equity share capital		5,00,000
(b) Other Equity	5	16,00,000
Non-controlling Interest (W.N.3)		9,00,000
Current Liabilities		
(a) Financial liabilities		
(i) Borrowings	6	4,00,000
(ii) Trade Payables	7	4,50,000
(b) Other Current Liabilities	8	2,50,000
		41,00,000

Notes to Accounts

S. No.		Rs	Rs
1.	Property, plant and equipment		
	High Speed Ltd.	13,50,000	
	Quick Bikes Ltd.	7,50,000	21,00,000
2.	Intangible asset		
	Goodwill	5,00,000	
	Brand value of Quick Bikes Ltd.	3,50,000	8,50,000
3.	Trade Receivables		
	High Speed Ltd.	80,000	

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	Quick Bikes Ltd.	50,000	1,30,000
4.	Cash and cash equivalents		
	Quick Bikes Ltd.		5,20,000
5.	Other Equity - Reserves		
	High Speed Ltd.	15,00,000	
	Add: Gain on investment in Quick Bikes Ltd.	1,00,000	16,00,000
6.	Borrowings		
	Short term loans of High Speed Ltd.		4,00,000
7.	Trade Payables		
	High Speed Ltd.	3,00,000	
	Quick Bikes Ltd.	1,50,000	4,50,000
8.	Other Current Liabilities		
	High Speed Ltd.		2,50,000

Question 6 (Practice Q.11)

Entity A owns all the share capital of Entity B and controls Entity B. On 1st April, 2012, Entity A acquired a building from Entity B, for Rs 600 lakhs, that the group plans to use as its new head office. Entity B had purchased the building from a third party on 1st April, 2011 for Rs 525 lakhs. At that time, the building was assessed to have a useful life of 21 years and a residual value of Nil. On 1st April, 2012, the carrying amount of the building was Rs 500 lakhs in Entity B's individual financial statements. The estimated remaining useful life of the building measured from 1st April, 2012 is 20 years and the residual value of the building is still Nil. The method of depreciation followed is straight-line.

Pass necessary Journal Entries for recording the above transactions in the books of Entity B, Entity A and the Group's general ledger.

Answer

Journal Entries in the books of Entity B

	Rs in lakhs	Rs in lakhs
1st April, 2011		
Building A/c (Property, plant and equipment) Dr.	525	
To Bank A/c		525
(To recognise the purchase of the building for cash)		
31st March, 2012		
Depreciation (Refer W.N.) Dr.	25	
To Building A/c (Property, plant and equipment)		25

(To recognise depreciation on building for its use in the year 201 2012)		
1st April, 2012		
Bank A/c Dr.	600	
To Building A/c (Property, plant and equipment)		500
To Profit on sale of Building		100
(To recognise the sale of the building for cash)		

Journal Entries in the books of Entity A

	Rs in lakhs	**Rs in lakhs**
1st April, 2012		
Building A/c (Property, plant and equipment) Dr.	600	
To Bank A/c		600
(To recognise the purchase of a building for cash from Entity B)		
31st March, 2013		
Depreciation A/c (Refer W.N.) Dr.	30	
To Building A/c (Property, plant and equipment)		30
(To recognise depreciation on building for its use in the year 2012-2013)		

Journal Entries in the books of Group

	Rs in lakhs	**Rs in lakhs**
31st March, 2013		
Profit on sale of Building Dr.	100	
To Building A/c (Property, plant and equipment)		100
(To eliminate the effects of the intragroup transaction)		
Building A/c (Property plant and equipment) Dr.	5	
To Depreciation A/c (W.N.)		5
(To eliminate the effects of the intragroup transaction)		

Working Note:

Computation of Depreciation and its Adjustment in the Group's Financial Statements

Particulars	In Individual financial statements of Entity B/Entity A Rs in lakhs	For adjustment in the books of Group Rs in lakhs
Cost of Building on 1st April, 2011 **for Entity B**	525	
Useful life	21 years	
Depreciation per year (Rs 525 lakhs / 21 years)	25	25
Cost of Building on 1st April, 2012 **for Entity A**	600	
Useful life	20 years	
Depreciation per year (Rs 600 lakhs / 20 years)	30	30
Reversal of depreciation in the books **of Group**		(5)

Question 7 (Practice Q.12)

Ishwar Ltd. holds investments in Vinayak Ltd. The draft balance sheets of two entities at 31st March, 2014 were as follows:

Particulars	Ishwar Ltd. Rs in '000s	Vinayak Ltd. Rs in '000s
Assets		
Non-current Assets		
Property, Plant and Equipment	26,20,000	18,50,000
Investment	21,15,000	NIL
Total non-current assets	47,35,000	18,50,000
Current Assets		
Inventories	6,00,000	3,75,000
Trade Receivables	4,50,000	3,30,000
Cash and Cash Equivalents	75,000	60,000
Total current assets	11,25,000	7,65,000
TOTAL ASSETS	**58,60,000**	**26,15,000**
Equity and Liabilities		
Equity		

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Share Capital (Rs 1 shares)	7,00,000	5,00,000
Retained Earnings	28,65,000	10,50,000
Other Components of Equity	12,50,000	50,000
Total Equity	48,15,000	16,00,000
Non-current Liabilities		
Provisions	6,250	NIL
Long-term Borrowings	4,13,750	4,50,000
Deferred Tax	2,25,000	1,40,000
Total Non-current Liabilities	6,45,000	5,90,000
Current Liabilities		
Trade and Other Payables	3,00,000	2,50,000
Short-term Borrowings	1,00,000	1,75,000
Total Current Liabilities	4,00,000	4,25,000
TOTAL EQUITY AND LIABILITIES	**58,60,000**	**26,15,000**

Additional Information:

Ishwar Ltd.'s investment in Vinayak Ltd.

On 1st April, 2011, Ishwar Ltd. acquired 400 million shares in Vinayak Ltd. by means of a share exchange of one share in Ishwar Ltd. for every two shares acquired in Vinayak Ltd. On 1st April, 2011, the market value of one share of Ishwar Ltd. was Rs 7.

Ishwar Ltd. appointed a professional firm for conducting due diligence for acquisition of Vinayak Ltd., the cost of which amounted to Rs 15 million. Ishwar Ltd. included these acquisition costs in the carrying amount of the investment in Vinayak Ltd. in the draft balance sheet of Ishwar Ltd. There has been no change to the carrying amount of this investment in Ishwar Ltd.'s own balance sheet since 1st April, 2011.

On 1st April, 2011, the individual financial statements of Vinayak Ltd. showed the following balances:

- Retained earnings Rs 750 million
- Other components of equity Rs 25 million

The directors of Ishwar Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of Vinayak Ltd. at 1st April, 2011. The following matters emerged:

- Property having a carrying amount of Rs 800 million (land component Rs 350 million, buildings component Rs 450 million) had an estimated fair value of Rs 1,000 million (land component Rs 400 million, buildings component Rs 600 million). The buildings component of the property had an estimated useful life of 30 years at 1st April, 2011.
- Plant and equipment having a carrying amount of Rs 600 million had an estimated fair value of Rs 700 million. The estimated remaining useful life of this plant at 1st April, 2011 was four years. None of this plant and equipment had been disposed of between 1st April, 2011 and 31st March, 2014.
- On 1st April, 2011, the notes to the financial statements of Vinayak Ltd. disclosed contingent liability. On 1st April, 2011, the fair value of this contingent liability was reliably measured at Rs 30 million. The contingency was resolved in the year ended

31st March, 2012 and no payments were required to be made by Vinayak Ltd. in respect of this contingent liability.

- The fair value adjustments have not been reflected in the individual financial statements of Vinayak Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

The directors of Ishwar Ltd. used the proportion of net assets method when measuring the non-controlling interest in Vinayak Ltd. in the consolidated balance sheet.

Impairment review of goodwill on acquisition of Vinayak Ltd.

No impairment of the goodwill on acquisition of Vinayak Ltd. was evident when the reviews were carried out on 31st March, 2012 and 2013. On 31st March, 2014, the directors of Ishwar Ltd. carried out a further review and concluded that the recoverable amount of the net assets of Vinayak Ltd. at that date was Rs 2,000 million. Vinayak Ltd. is regarded as a single cash generating unit for the purpose of measuring goodwill impairment.

Provision

On 1st April, 2013, Ishwar Ltd. completed the construction of a non-current asset with an estimated useful life of 20 years. The costs of construction were recognised in property, plant and equipment and depreciated appropriately. Ishwar Ltd. has a legal obligation to restore the site on which the non-current asset is located on 31st March, 2X43. The estimated cost of this restoration work, at 31st March, 2X43 prices, is Rs 125 million. The directors of Ishwar Ltd. have made a provision of Rs 6.25 million (1/20 x Rs 125 million) in the draft balance sheet at 31st March, 2014.

An appropriate annual discount rate to use in any relevant calculations is 6% and at this rate the present value of Rs 1 payable in 20 years is 31.2 paise.

Prepare the consolidated balance sheet of Ishwar Ltd. at 31st March, 2014. Consider deferred tax implications.

Answer

Consolidated Balance Sheet of Ishwar Ltd. at 31st March, 2014

Particulars	Rs in '000s
Assets	
Non-current Assets:	
Property, Plant and Equipment	
[(26,20,000 + 18,50,000) + {(2,00,000 (W.N.1) – 15,000 (W.N.1)) + (1,00,000 (W.N.1) – 75,000 (W.N.1)) + (39,000 – 1,950) (WN 7)}]	47,17,050
Investment (21,15,000 – 14,00,000 – 15,000)	7,00,000
Goodwill (W.N.2)	1,85,600
Total non-current assets	**56,02,650**
Current Assets:	
Inventories (6,00,000 + 3,75,000)	9,75,000
Trade Receivables (4,50,000 + 3,30,000)	7,80,000
Cash and Cash Equivalents (75,000 + 60,000)	1,35,000
Total current assets	**18,90,000**

TOTAL ASSETS	**74,92,650**
Equity and Liabilities	
Equity attributable to equity holders of the parent	
Share Capital	7,00,000
Retained Earnings (W.N.5)	30,31,960
Other Components of Equity (W.N.6)	12,70,000
	50,01,960
Non-controlling Interest (W.N.4)	3,53,600
Total equity	**53,55,560**
Non-current Liabilities	
Provisions (39,000 + 2,340 (W.N.7))	41,340
Long-term Borrowings (4,13,750 + 4,50,000)	8,63,750
Deferred Tax (W.N.8)	4,07,000
Total non-current liabilities	**13,12,090**
Current Liabilities	
Trade and Other Payables (3,00,000 + 2,50,000)	5,50,000
Short-term Borrowings (1,00,000 + 1,75,000)	2,75,000
Total Current Liabilities	**8,25,000**
TOTAL EQUITY AND LIABILITIES	**74,92,650**

Working Notes:

1. **Computation of Net Assets of Vinayak Ltd.**

	1st April, 2011 (Date of acquisition) Rs in '000s	**31st March, 2014 (Date of consolidation) Rs in '000s**
Share Capital	5,00,000	5,00,000
Retained Earnings:		
Per accounts of Vinayak Ltd.	7,50,000	10,50,000
Fair Value Adjustments:		

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Property (10,00,000 – 8,00,000)*	#2,00,000	$2,00,000
Extra depreciation due to Buildings appreciation* ((6,00,000 – 4,50,000) x 3/30)		$(15,000)
Plant and Equipment (7,00,000 – 6,00,000)*	#1,00,000	$1,00,000
Extra depreciation due to Plant and Equipment appreciation* (1,00,000 x ¾)		$(75,000)
Contingent Liability*	#(30,000)	$NIL
Other Components of Equity	25,000	50,000
Deferred Tax on Fair Value Adjustments*:		
Date of acquisition (20% x #2,70,000 (from above))	(54,000)	
Date of Consolidation (20% x $2,10,000 (from above))		(42,000)
Net Assets for Consolidation	14,91,000	17,68,000

The post-acquisition increase in Net Assets is Rs 2,77,000 (Rs 17,68,000 – Rs 14,91,000). Rs 25,000 of this increase is due to changes in Other Components of Equity and the remaining Rs 2,52,000 due to changes in retained earnings.

2. Computation of Goodwill on Consolidation

	Vinayak Ltd. Rs in '000s
Cost of Investment:	
Shares issued to acquire Vinayak Ltd. (4,00,000 x ½ x Rs 7)	14,00,000
Non-controlling Interests at the date of acquisition:	
Vinayak Ltd. – 20% x Rs 1,491,000 (from W.N.1)	2,98,200
Net Assets at the date of acquisition:	16,98,200
Vinayak Ltd. (W.N.1)	(14,91,000)
Goodwill before Impairment	2,07,200
Less: Impairment of Goodwill (refer W.N.3)	(21,600)
Goodwill reported in Consolidated Balance Sheet	1,85,600

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3. **Impairment of Goodwill on acquisition of Vinayak Ltd.**

	Vinayak Ltd. Rs in '000s
Net Assets of Vinayak Ltd. at 31st March, 2014 (W.N.1)	17,68,000
Grossed up Goodwill on acquisition (100/80 x Rs 2,07,200) (Refer Note 1 below)	2,59,000
	20,27,000
Recoverable amount of Vinayak Ltd. as a CGU	(20,00,000)
Therefore, gross impairment will be	27,000
Impairment attributed to Parent (refer Note 2 below)	21,600

Note 1: Grossing up of Goodwill

As per **Para C4 of Appendix C to Ind AS 36 Impairment of Assets** – If an entity measures non-controlling interests at its proportionate interest in the net identifiable assets of a subsidiary at the acquisition date, rather than at fair value, goodwill attributable to non-controlling interests is included in the recoverable amount of the related Cash Generating Unit but is not recognised in the parent's consolidated financial statements. As a consequence, an **entity shall gross up the carrying amount of goodwill allocated to the unit** to include the goodwill attributable to the non-controlling interest. This **adjusted carrying amount is then compared with the recoverable amount of the unit** to determine whether the cash-generating unit is impaired.

Note 2: Allocation of Impairment of Goodwill

Since the non-controlling interests of Vinayak Ltd. are measured at proportionate share of identifiable net assets of Vinayak Ltd., the goodwill computed is entirely attributable only to the parent of Vinayak Ltd. Accordingly, the impairment also would be attributed entirely to the parent of Vinayak Ltd., and not to the non- controlling interest.

4. **Computation of Non-controlling Interest (NCI)**

	Vinayak Ltd. Rs in '000s
NCI at the date of acquisition (W.N.2)	2,98,200
Share of post-acquisition increase in net assets (20% x Rs 2,77,000 (from W.N.1))	55,400
	3,53,600

5. **Computation of consolidated Retained Earnings**

	Rs in '000s
Balance as per accounts of Ishwar Ltd.	28,65,000
Adjustments:	
Acquisition costs	(15,000)

Restoration Provision (W.N.7)	1,960
Share of Vinayak Ltd.'s post-acquisition profits (80% x Rs 2,52,000 (W.N.1))	2,01,600
Impairment of Goodwill (W.N.3)	(21,600)
	30,31,960

6. Other Components of Equity

	Rs in '000s
Balance as per accounts of Ishwar Ltd.	12,50,000
Share of Vinayak Ltd.'s post-acquisition balance (80% x Rs 25,000 (W.N.1	
	20,000
	12,70,000

1. Computation of Restoration Provision

		Rs in '000s
Provision for Restoration originally required (Rs 1,25,000 x 0.312)		39,000
One year's unwinding of discount (Rs 39,000 x 6%)	A	(2,340)
One year's depreciation of capitalized cost (Rs 39,000 x 1/20)	B	(1,950)
Original provision incorrectly made	C	6,250
So retained earnings adjustment equals [C -A – B]		1,960

2. Computation of Deferred Tax

	Rs in '000s
Ishwar Ltd. + Vinayak Ltd.	3,65,000
Fair value adjustments in Vinayak Ltd. (from W.N.1)	42,000
	4,07,000

Question 8 (Practice Q.13)

Entities A and B establish a 50:50 joint operation in the form of a separate legal entity, Entity J, whereby each operator has a 50% ownership interest and takes 50% of the output.

On formation of the joint operation, Entity A contributes a property with fair value of Rs 110 lakhs and intangible asset with fair value of Rs 10 lakhs whereas Entity B contributes equipment with a fair value of Rs 120 lakhs.

The carrying amounts of the assets contributed by Entities A and B are Rs 100 lakhs and Rs 80 lakhs, respectively.

What will be the amount of any gain or loss to be recognised by Entity A and Entity B in its separate financial statements as well as consolidated financial statements?

Answer

Paragraph B34 of Ind AS 111 states that when an entity enters into a transaction with a joint operation in which it is a joint operator, such as a sale or contribution of assets, it is conducting the transaction with the other parties to the joint operation and, as such, the joint operator shall recognise gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation.

The amount of gain or loss to be recognised by Entity A in its separate financial statements as well as consolidated financial statements will be computed as below:

(All amounts are Rs in lakhs	
A's share of fair value of asset contributed by Entity B (50% x Rs 120 lakhs)	60
Less: Asset contributed by Entity A to the joint operation – carrying amount of proportion ceded to Entity B (50% x Rs 100 lakhs)	(50)
Gain to be recognised by Entity A	10

The gain can alternatively be calculated as:

Share acquired in fair value of net assets of joint operation (50% x Rs 240 lakhs)	120
Less: Carrying amount of asset contributed	(100)
Less: Unrealised portion of gain on asset contributed (50% × (Rs 120 lakhs – Rs 100 lakhs))	(10)
Gain to be recognised by Entity A	10

The amount of gain or loss to be recognised by Entity B in its separate financial statements as well as consolidated financial statements will be computed as below:

(All amounts are Rs in lakhs	
B's share of fair value of asset contributed by Entity A (50% x Rs 120 lakhs)	60
Less: Asset contributed by Entity B to the joint operation – carrying amount of proportion ceded to Entity A (50% x Rs 80 lakhs)	(40)
Gain to be recognised by Entity B	20

The gain can alternatively be calculated as:

Share acquired in fair value of net assets of joint operation (50% x Rs 240 lakhs)	120
Less: Carrying amount of asset contributed	(80)
Less: Unrealised portion of gain on asset contributed (50% × (Rs 120 lakhs – Rs 80 lakhs))	(20)
Gain to be recognised by Entity B	20

Question 9 (Practice Q.14)

On 1st April 2017, A Limited acquired 80% of the share capital of S Limited. On acquisition date the share capital and reserves of S Ltd. stood at Rs 5,00,000 andRs 1,25,000 respectively. A Limited paid initial cash consideration of Rs 10,00,000. Additionally, A Limited issued 2,00,000 equity shares with a nominal value of Rs 1 per share at current market value of Rs 1.80 per share.

It was also agreed that A Limited would pay a further sum of Rs 5,00,000 after three years. A Limited's cost of capital is 10%. The appropriate discount factor for Rs 1 @ 10% receivable at the end of

1st year: 0.91

2nd year: 0.83

3rd year: 0.75

The shares and deferred consideration have not yet been recorded by A limited. Below are the Balance Sheet of A Limited and S Limited as at 31st March, 2013.

	A Limited (Rs 000)	S Limited (Rs 000)
Non-current assets:		
Property, plant & equipment	5,500	1,500
Investment in S Limited at cost	1,000	
Current assets:		
Inventory	550	100
Receivables	400	200
Cash	200	50
	7,650	1,850
Equity:		
Share capital	2,000	500
Retained earnings	1,400	300
	3,400	800
Non-current liabilities	3,000	400
Current liabilities	1,250	650
	7,650	1,850

Further information:

(i) On the date of acquisition the fair values of S Limited's plant exceeded its book value by Rs 2,00,000. The plant had a remaining useful life of five years at this date;

(ii) The consolidated goodwill has been impaired by Rs 2,58,000; and

(iii) The A Limited Group, values the non-controlling interest using the fair value method. At the date of acquisition, the fair value of the 20 % non-controlling interest was Rs 3,80,000.

You are required to prepare Consolidated Balance Sheet of A Limited as at 31st March, 2019. (Notes to Account on Consolidated Balance Sheet is not required).

Answer

Consolidated Balance Sheet of A Ltd. and its subsidiary, S Ltd.

as at 31st March, 2013

Particulars		**Rs in 000s**
I.	**Assets**	
(1)	Non-current assets	
(i)	Property Plant & Equipment (W.N.4)	7,120.00
(ii)	Intangible asset – Goodwill (W.N.3)	1,032.00
(2)	Current Assets	
(i)	Inventories (550 + 100)	650.00
(ii)	Financial Assets	
(a)	Trade Receivables (400 + 200)	600.00
(b)	Cash & Cash equivalents (200 + 50)	250.00
Total Assets		**9,652.00**
II.	**Equity and Liabilities**	
(1)	Equity	
(i)	Equity Share Capital (2,000 + 200)	2,200.00
(ii)	Other Equity	
(a)	Retained Earnings (W.N.6)	1190.85
(b)	Securities Premium	160.00
(2)	Non-Controlling Interest (W.N.5)	347.40
(3)	Non-Current Liabilities (3,000 + 400)	3,400.00
(4)	Current Liabilities (W.N.8)	2.353.75
Total Equity & Liabilities		**9,652.00**

Notes:

1. Since the question required not to prepare Notes to Account, the column of Note to Accounts had not been drawn.
2. It is assumed that shares were issued during the year 2012-2013 and entries are yet to be made.

Working Notes:

1. Calculation of purchase consideration at the acquisition date i.e. 1st April, 2011

	Rs in 000s
Payment made by A Ltd. to S Ltd.	
Cash	1,000.00
Equity shares (2,00,000 shares x Rs 1.80)	360.00
Present value of deferred consideration (Rs 5,00,000 x 0.75)	375.00

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Total consideration	1,735.00

2. Calculation of net assets i.e. net worth at the acquisition date i.e. 1st April, 2011

	Rs in 000s
Share capital of S Ltd.	500.00
Reserves of S Ltd.	125.00
Fair value increase on Property, Plant and Equipment	200.00
Net worth on acquisition date	825.00

3. Calculation of Goodwill at the acquisition date i.e. 1st April, 2011 and 31st March, 2013

	Rs in 000s
Purchase consideration (W.N.1)	1,735.00
Non-controlling interest at fair value (as given in the question)	380.00
	2,115.00
Less: Net worth (W.N.2)	(825.00)
Goodwill as on 1st April 2011	1,290.00
Less: Impairment (as given in the question)	258.00
Goodwill as on 31st March 2013	1,032.00

4. Calculation of Property, Plant and Equipment as on 31st March 2013

			Rs in 000s
A Ltd.			5,500.00
S Ltd.		1,500.00	
Add: Net fair value gain not recorded yet	200.00		
Less: Depreciation [(200/5) x 2]	(80.00)	120.00	1,620.00
			7,120.00

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5. Calculation of Post-acquisition gain (after adjustment of impairment on goodwill) and value of NCI as on 31st March 2013.

		Rs in 000s	Rs in 000s
		NCI (20%)	A Ltd. (80%)
Acquisition date balance		380.00	Nil
Closing balance of Retained Earnings	300.00		
Less: Pre-acquisition balance	(125.00)		
Post-acquisition gain	175.00		
Less: Additional Depreciation on PPE [(200/5) x 2]	(80.00)		
Share in post-acquisition gain	95.00	19.00	76.00
Less: Impairment on goodwill	258.00	(51.60)	(206.40)
		347.40	(130.40)

6. Consolidated Retained Earnings as on 31st March 2013

	7. Rs in 00(
A Ltd.	1,400.00
Add: Share of post-acquisition loss of S Ltd. (W.N.5)	(130.40)
Less: Finance cost on deferred consideration (37.5 + 41.25) (W.N.7)	(78.75)
Retained Earnings as on 31st March 2013	1,190.85

7. Calculation of value of deferred consideration as on 31st March 2013

	Rs in 000s
Value of deferred consideration as on 1st April 2011 (W.N.1)	375.00
Add: Finance cost for the year 2011-2012 (375 x 10%)	37.50
	412.50
Add: Finance cost for the year 2012-2013 (412.50 x 10%)	41.25
Deferred consideration as on 31st March 2013	453.75

8. Calculation of current Liability as on 31st March 2013

	Rs in 000s
A Ltd.	1,250.00
S Ltd.	650.00
Deferred consideration as on 31st March 2013 (W.N.7)	453.75
Current Liability as on 31st March 2013	2,353.75

35. JOINT ARRANGEMENTS, JOINT VENTURES AND ASSOCIATES [IND AS 28, 111]

Question 1 (Practice Q.15)

P Limited and Q Limited enter into a contractual arrangement to buy a building that has 12 floors, which they will lease to other parties. P Limited and Q Limited are authorised to lease five floors each. P Limited and Q Limited can unilaterally make a ll decisions related to their respective floors and are entitled to all of the income from those floors. The remaining two floors will be jointly managed – all decisions concerning these two floors must be unanimously agreed to between P Limited and Q Limited who will share net profits or net losses in respect of these two floors equally, i.e. they both have the rights to the net assets of the arrangement. The leasing of property is determined to be the relevant activity.

Whether this arrangement is a joint operation or a joint venture?

Answer

Paragraphs 15-17 of Ind AS 111 state that a joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.

Further, a joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

Furthermore, an entity applies judgement when assessing whether a joint arrangement is a joint operation or a joint venture. An entity shall determine the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties in the contractual arrangement and, when relevant, other facts and circumstances.

In the given case, accounting by P Limited and Q Limited would be as follows:

(i) Five floors that P Limited controls

Five floors that are controlled by P Limited shall be accounted for by P Limited as investment property under Ind AS 40, Investment Property, which defines the term 'investment property' as property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

(ii) Five flo ors that Q Limited controls

Five floors that are controlled by Q Limited shall be accounted for by Q Limited as investment property under Ind AS 40.

(iii) Two floors that P Limited and Q Limited jointly control

For the two floors that are jointly controlled by P Limited and Q Limited, as per the contractual arrangement, both P Limited and Q Limited will share net profits or net losses equally i.e. they both have the rights to the net assets of the arrangement. Thus, the arrangement in respect of these two floors is a joint venture and shall be accounted for accordingly by P Limited and Q Limited.

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